Ohio v. Kovacs: Financial Freedom for Bankrupt Polluters

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NOTES

OHIO V. KOVACS: FINANCIAL FREEDOM FOR BANKRUPT POLLUTERS

I. INTRODUCTION

The bankruptcy courts and United States courts of appeals have encountered severe conflicts between the operation of the current Bankruptcy Code (the Code) and state and federal enforcement of environmental regulations. When a debtor files for bankruptcy under the Code, the debtor's assets are distributed pro rata to the creditors and the debtor discharges the remaining debts. The Code does not discriminate between government and private claimholders. Therefore, if a state or federal environmental protection agency holds a "claim" against a bankrupt debtor, such as a legal obligation to clean a hazardous waste site, the debtor can also discharge such a "claim" in bankruptcy. Once the claim is discharged, the government can no longer require the debtor to clean up the waste site.

The conflict between environmental and bankruptcy policies is illustrated by the Supreme Court's decision in Ohio v. Kovacs. In Kovacs, the debtor was a hazardous waste site operator who entered into a consent decree with the state of Ohio. As part of the settlement, the operator agreed to clean a waste site that he owned. Not long after the settlement, however, the operator petitioned for bankruptcy. Ohio intervened in the bankruptcy proceeding to argue that Kovacs's cleanup obligation, so long as it had not been converted into an obligation to pay money to the state, could not be discharged in bankruptcy. The bankruptcy court, and ultimately the Supreme Court, rejected the state's argument and held that Kovacs's obligation could be discharged.

2. See generally In re Quanta Resources, 739 F.2d 927 (3d Cir. 1984), cert granted sub nom. O'Neill v. City of New York, 105 S. Ct. 1168 (1985) (disallowing bankruptcy trustee from abandoning hazardous waste site, and compelling debtor's estate to bear the costs of cleanup); Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267 (3d Cir. 1984) (state stayed from collecting compensation from bankrupt debtor who is liable for environmental damages).
6. Id. at 708. Ohio argued that Kovacs's obligation to pay the costs of cleanup was not a claim as defined by 11 U.S.C. § 101(4), and was therefore not dischargeable under 11 U.S.C. § 727(b).
The Supreme Court's decision in *Kovacs* may undermine government efforts to correct environmental hazards. If the bankruptcy courts and federal courts of appeals interpret the *Kovacs* decision broadly, and discharge all environmental cleanup obligations held by debtors that are reducible to cash remedies, the state and federal governments will have to bear the entire cost of cleaning up waste sites. This will result in more environmental contamination. This Note illustrates, through the *Kovacs* decision, how the Bankruptcy Code interferes with state and federal environmental protection efforts. Federal bankruptcy policy commands that a debtor's assets be preserved so that they may be distributed among all creditors without unfair preference. State and federal environmental policies, meanwhile, strive to preserve natural resources and correct damage caused by environmental polluters. In *Kovacs*, the Supreme Court faced a choice between these policies and decided that the debtor's interests should prevail.

II. BACKGROUND: THE LEGAL CONFLICT BETWEEN ENVIRONMENTAL PROTECTION AND BANKRUPTCY

A. Bankruptcy Claims under the Code: Section 101(4)(B)

Prior to 1978, bankruptcy law in the United States was governed by the Bankruptcy Act of 1898 (the Act). Under the Act, a creditor was required to prove to the court that it actually had a claim against a bankrupt before the court would allow the creditor to enter the bankruptcy adjudication. Section 63 of the Act listed nine categories of debts that could be proved and allowed against a bankrupt's estate. This narrow and exclusive list closed off large classes of potential claims from consideration in bankruptcy proceedings. Creditors that were excluded from bankruptcy proceedings by the old Act could not share in the distribution of assets from the debtor's estate. Following the bankruptcy proceedings, creditors who were excluded from the bankruptcy action could assert their claims against the bankrupt debtor in separate actions.

Congress replaced the old Act with the current Code in 1978 to simplify the bankruptcy process for debtors. The Code was designed to give the

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8. Id. § 17(a).
9. Id. § 63 (listing debts that can be discharged).
12. Id.
debtor a “fresh start” after bankruptcy. A major reform in the Code was the elimination of the requirement that a claim be provable before it could be discharged in bankruptcy. This reform expanded the number and variety of claims that could be discharged in a bankruptcy proceeding. The Code also contains provisions that preserve the estate’s value during bankruptcy proceedings and that facilitate the distribution of assets in an orderly and equitable fashion. Each of these reforms helped to simplify the bankruptcy process and benefited debtors by freeing them from a myriad of post-bankruptcy claims.

Much adjudication over the types of claims that can be discharged in bankruptcy has centered on what constitutes a “claim” under the Code. While claims are commonly discharged in bankruptcy, “nonclaims” are not. Also, the value of all claims must be determined by the court to assess each creditor’s pro rata share from the estate. Section 101(4) of the Bankruptcy Code defines a claim as follows:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, legal, equitable, secured or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives 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.

Under this definition, the Code contemplates that all legal obligations, no matter how remote or contingent, will be handled in the bankruptcy proceeding. Thus, if a legal obligation fits within the definition of section 101(4), that obligation may be discharged.

The definition of a claim under section 101(4)(B) is composed of three elements: “equitable remedy,” “breach of performance,” and “right to payment.” While none of these terms are defined by the Code, the case

16. See, e.g., id. § 362 (bankruptcy proceedings automatically stay legal actions by creditors against debtors); id. § 507 (estimating six levels of priority claims); id. § 547 (empowering bankruptcy trustee to invalidate certain pre-bankruptcy transfers).
17. See id. § 523 (exceptions to discharge); id. § 524 (effect of discharge); id. § 727(b) (scope of discharge in Chapter Seven); id. § 1141(d) (scope of discharge after confirmation of Chapter Eleven plan); id. § 1328 (discharge under Chapter Thirteen plan).
18. See id. § 726 (order of distribution); id. § 1129(a)(7) (condition to confirmation of Chapter Eleven plan is that those with claims accept the plan or receive at least liquidation value); id. § 1325 (confirmation of chapter 13 plan).
19. Id. § 101(4).
law and legislative history related to this section are useful guides for evaluating the proper scope of a claim. For example, in the recent case of *In re O.P.M. Leasing Services, Inc.*, the Bankruptcy Court for the Southern District of New York decided that a breach of a service contract by a contractor against a state was a "claim" under the Code. In *In re O.P.M.*, the state of West Virginia leased computer equipment from O.P.M. Leasing Services. O.P.M. subsequently filed a Chapter Eleven reorganization bankruptcy, and the company's trustee refused to honor the service contract with the state. The court held that the trustee's rejection of the service contract was a breach of that contract and a corresponding breach of performance under section 101(4)(B). The court also found that when the state moved during the bankruptcy adjudications to relinquish its right to service in exchange for an abatement of the lease payments on the computer equipment, the state converted its contractual right to damages into a right to equitable relief. The court reasoned that the state's motion to set a reduced fee for the continued use of the computer equipment was a claim under section 101(4)(B). The claim was therefore held to be dischargeable in bankruptcy.

In another case, *In re All Media Properties, Inc.*, the Bankruptcy Court for the Southern District of Texas decided that two involuntary Chapter

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22. 21 Bankr. 993, 998 (Bankr. S.D.N.Y. 1982).
23. Id. at 998.
24. Id. at 1003. See also 11 U.S.C. § 365(g) (1982 & Supp. 1984) (listing instances in which rejection of executory contract or unexpired lease constitutes a breach).
25. 21 Bankr. at 1003. A "breach of performance," in the traditional sense, implies failure to act or fulfill an obligation. If the Code drafters had intended the term "breach of performance" to have a more narrow interpretation, the term "breach of contract" could have easily been used; Congress has limited other sections of the Code by use of contract language. See, e.g., 11 U.S.C. § 365(a) (1982 & Supp. 1984) ("trustee . . . may assume or reject an executory contract or lease of the debtor"). Also, a "breach of duty" is too broad to be equated with a "breach of performance." A "breach of duty" could theoretically give rise to every equitable remedy. It therefore appears that Congress used "breach of performance" to limit the range of equitable remedies that fall within section 101(4)(B).
26. 21 Bankr. at 1003.
27. Id. "Equitable remedy" is not defined in the Code. Some commentators have argued that the terms in section 101(4)(B), including "equitable remedy," should be given a uniform meaning regardless of the various state definitions. See, e.g., Matthews, supra note 10, at 223 n. 10. In order to define "equitable remedy" uniformly, the term should be analyzed within the scope of section 101(4) as a whole. Therefore, since the Code provides for monetary remedies through rights to payment in § 101(4)(A), "equitable remedy" should be limited to nonpayment remedies. Defining "equitable remedy" as any nonpayment remedy does not interfere with Congress' purpose in enacting the Code and does not undermine the concept of "claims" as used in the Code. Thus, a breach of performance that could result in a nonpayment remedy, as determined by state law, is an equitable remedy for purposes of bankruptcy law. See Matthews, supra note 10, at 351-53.
28. 21 Bankr. at 1003.
29. Id. at 998.
30. 5 Bankr. 126 (Bankr. S.D. Tex. 1980).
Eleven petitions were properly brought by creditors under the Code where the creditors were owed money as a substitute for a specific performance judgment. The case was decided on the ground that the creditors had claims, and therefore standing, to file the petitions against All Media. The creditors were originally entitled to specific performance from All Media after it failed to perform under trade agreements with the creditors. Under Texas law, specific performance is an equitable remedy, and a party entitled to specific performance may recover money damages in lieu of specific performance. Although the petitioning creditors were not originally owed a cash payment by All Media, Texas law gave them a contingent right to cash payment and thereby converted their interest into a claim for money damages. The All Media court held that if a creditor is entitled to an equitable remedy that can be converted into a right to payment, the creditor has a claim under section 101(4)(B).

The All Media court's decision was based on its definition of the term "right to payment." The court held that a "right to payment" was more than just the tender of money for a debt, and that it also included the delivery of other value to the creditor. The court interpreted the term "right to payment" in its broadest possible scope. An equitable remedy for breach of performance that gives rise to a right to payment of money or other value under the All Media approach is, therefore, also a claim under section 101(4)(B).

The legislative history of section 101(4)(B) does not preclude the All Media court's interpretation of the right to payment. A joint legislative statement by Representative Don Edwards and Senator Dennis DeConcini illustrates that section 101(4)(B) was intended to allow the liquidation or estimation of contingent rights of payment to be discharged in bankruptcy. The statement

31. Id.
33. Id. at 126. A "right to payment" in section 101(4)(B) can be interpreted in two ways. First, a right to payment could be interpreted to exist when there is a claim for equitable relief unless a suit for money damages for the breach would not be permitted. The second interpretation, which would diminish dramatically the scope of section 101(4)(B) claims, allows as claims only those rights for equitable relief that could be compensated adequately by an award of money. A claim for nominal damages would therefore not be within the scope of subsection 101(4)(B). See Matthews, supra note 10, at 342.
34. All Media, 5 Bankr. at 137.

Much confusion centers around how section 101(4)(B) should be applied. If the Code section is read in conjunction with the legislative history, a right to an equitable remedy will be a claim only if it gives rise to an "alternative right to payment." See, e.g., H.R. Rep. No. 595, 95th Cong., 2d Sess. 308-14, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5963, 6271-77; S. Rep. No. 989, 95th Cong., 2d Sess. 21-22, 24, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5787, 5707-08, 5710. A broad interpretation of section 101(4)(B) under this "alternative
implies that an equitable remedy for section 101(4)(B) must be a legally authorized alternative to a right to payment. Nevertheless, Congress left the language of the Code broad enough to include all equitable remedies that are alternative, additional, or supplemental to the right to payment. Thus, the legislative history does not preclude the expansive interpretation given the right to payment by the All Media court. So long as the claim is within the broad category of claims as defined by section 101(4), the claim is subject to discharge.

B. The Effect of Bankruptcy on Environmental Law Enforcement

Under the current Code, bankruptcy law has begun to interfere with environmental law enforcement. For example, in the area of hazardous waste disposal, since compliance with environmental regulations is costly, some polluters have used bankruptcy to escape liability under environmental laws. Courts have recently faced the problem of whether bankrupt polluters can discharge their liability for producing hazardous waste dumps. This issue

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remedies" concept would treat any equitable remedy as a claim so long as it gives rise to any alternative right to a payment of money or value, even if the payment is not compensatory.

If the "alternative remedies" concept is rejected, a right to an equitable remedy would be a claim even if it were an additional remedy rather than an alternative one. Rejection of the "alternative remedies" concept would significantly enlarge the scope of section 101(4)(B). Virtually any right to an equitable remedy that gave rise to any right to payment, whether the right was supplemental, additional, or alternative, would be a valid "claim."

36. The "alternative remedies" concept is not part of the Code. The concept appears at 124 CONG. REC. 32,393 (1978) (statement of Rep. Edwards). Comments by the Senate sponsor of the bill, Senator Dennis DeConcini, explained the definition and offered an example of a section 101(4)(B) claim:

Section 101(4)(B) represents a modification of the House-passed bill to include the definition of claim as a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. This 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. For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment, in the event performance is refused; in that event, the creditor entitled to specific performance would have a 'claim' for purposes of a proceeding under title 11.

124 CONG. REC. 33,992 (1978) (statement of Sen DeConcini).

37. A minimum of $13.5 billion will be needed over the next five years to clean up abandoned hazardous waste sites under a reauthorized Superfund law, according to a coalition of citizen, labor, health, and environmental groups. 15 ENV'T REP. (BNA) 1663 (Feb. 15, 1985). President Reagan has proposed to more than triple the Superfund, increasing it to $5.3 billion over the next five years. Congress has estimated that the money necessary to clean up abandoned hazardous waste sites over the next five years is between $7.5 and $10.1 billion. 15 ENV'T REP. (BNA) 1787-88 (Mar. 1, 1985).

involves the conflicting government interests of environmental protection and the preservation of bankrupt estates. In these recent cases, bankruptcy interests have prevailed over the enforcement of environmental laws.

The conflict between bankruptcy and environmental law stems principally from the automatic stay provision in the current Code. This provision, section 362, stays all legal proceedings against the debtor while a petition for liquidation or reorganization is pending. Section 362 was adopted to control the distribution of a debtor's assets, and particularly, to assure that the distribution among creditors would be fair. Section 362 freezes the debtor's assets, preventing disbursement of the debtor's assets until the court orders an equitable distribution among the creditors. Ordinarily, a creditor who claims an interest in the property of the debtor's estate is prevented from recovering an interest in the property until the stay is lifted.

Section 362(b)(4) exempts the enforcement of police or regulatory powers from the stay. Generally, under the Code, a government agency can file a suit against a debtor and order the debtor to clean up an environmental hazard for which it is liable. If an environmental protection agency seeks only to abate an existing violation, for instance, an injunction may be ordered.

Cir. 1985) (order to compel debtor to correct environmental damage not subject to the automatic stay); In re Borne Chemical Co., No. 80-00495 (Bankr. D.N.J. 1984) (cleanup of hazardous waste site is bankruptcy trustee's obligation, since it is part of the sale of an estate's real estate holdings); In re T.P. Long Chemical Co., Inc., No. 581-906 (Bankr. N.D. Ohio, Jan. 1984) (considering EPA cleanup expenditures as an administrative expense of the estate is appropriate).

40. The legislative history of the Code emphasizes the importance of the automatic stay provision to the scheme of the Code:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment plan or reorganization plan or simply to be relieved of the financial pressure that drove him into bankruptcy.


The automatic stay was developed in 1973 by the Advisory Committee on Bankruptcy Rules. The Advisory Committee's initial purpose for seeking enactment of the automatic stay provision was to remedy the inequities that persecute debtors who seek to reorganize their financial affairs. Business debtors were often so concerned with staying in business that they lost track of the lawsuits pending against them in various courts around the country. The automatic stay was adopted to allow debtors to order their financial affairs. Address by Norman Nachman, Member of the Advisory Committee on Bankruptcy Rules, Judicial Conference of the United States, 1973 to present, in Chicago (March 12, 1985).

41. The debtor's filing of a bankruptcy petition automatically stays the commencement or continuation of any proceeding against the debtor to recover a pre-petition claim, to enforce a pre-petition judgment, to obtain possession of property, to create, perfect, or enforce a lien, or to effect the set off of a pre-petition debt. 11 U.S.C. § 362(a) (1982 & Supp. 1984).
42. Id. § 362.
43. Id.
44. Section 362(b)(4) excepts from the stay enforcement of police or regulatory powers of a governmental unit. Id. 362(b)(4).
against the debtor without violating the automatic stay provision.\textsuperscript{45} Also, government agencies generally will not be stayed from enforcing prior judgments that order specific performance or some other equitable remedy.\textsuperscript{46}

Nevertheless, a government action to obtain money damages from a debtor to correct an environmental hazard is stayed by the Code.\textsuperscript{47} Section 362(b)(5) precludes any government action to enforce a compensatory money judgment against a bankrupt debtor. A government agency may not seek the actual payment of money from the debtor to finance the cleanup of an environmental hazard. Under the principle that damages are generally awarded to compensate a party for injury already suffered, the government is stayed under the Code from seeking contribution from a bankrupt polluter to clean up a hazardous waste dump.

Although the automatic stay provision can preclude state government action against a bankrupt polluter, this section was not intended by Congress to preempt enforcement of state environmental law. Sections 362(b)(4) and (5), when read together, logically imply that state governments generally retain their authority to enforce laws against bankrupt debtors.\textsuperscript{48} Despite this logical inference, application of section 362(b)(5) hampers government efforts to impose liability on polluters. A government agency that seeks to enforce environmental laws against a debtor may be barred by the Code from seeking money damages. If a government agency is unable to enforce a judgment against the debtor because of the stay, the agency must stand in line with all of the other creditors. Unless the state receives priority under some provision of the Code,\textsuperscript{49} the agency can at best expect a nominal payment.

\textsuperscript{45} The legislative history of the Code reflects the following interpretation of the automatic stay provision:

Section 362(b)(4) indicates that the stay under section 362(a)(1) does not apply to affect the commencement or continuation of an action or proceeding by a governmental unit to enforce the governmental unit’s police or regulatory power. This section is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect pecuniary interests in property of the debtor or property of the estate.


\textsuperscript{47} See, e.g., \textit{id.} at 278-79.

\textsuperscript{48} Sections 362(b)(4) and (5), when read together, imply that Congress preserved the states’s rights to enforce their laws, except those requiring the payment of money. See \textit{Penn Terra Ltd. v. Department of Envtl. Resources}, 733 F.2d 267, 273 (3d Cir. 1984).

\textsuperscript{49} See, e.g., \textit{In re T.P. Long Chemical Co.}, No. 581-906 (Bankr. N.D. Ohio Jan. 1984) (waste removal effort an obligation of the estate and entitled to administrative expense priority);
on its claim. While the goals of the Code might be satisfied by this result, state and federal governments are left with unfulfilled and costly cleanup obligations.

In *Penn Terra Ltd. v. Department of Environmental Resources,* the United States Court of Appeals for the Third Circuit determined that the Pennsylvania Department of Environmental Resources (DER) could enforce an injunction against a debtor to abate an environmental nuisance. Before Penn Terra filed for bankruptcy, it entered into a consent decree with the state in which the company agreed to correct its violations of Pennsylvania’s pollution laws. After Penn Terra filed a Chapter Seven bankruptcy petition, the DER sued the company in state court to enforce compliance with the consent decree. Penn Terra, in turn, filed a Petition for Contempt in the bankruptcy court against the DER arguing that the DER’s action violated the automatic stay provision.

The court of appeals held that the DER’s action to enforce the injunction was exempt from the automatic stay provision. The court reasoned that enforcement of the injunction was an exercise of regulatory power, which fell under the section 362(b)(4) exception to the automatic stay. The court also interpreted section 362(b)(5) of the Code as expanding the exception in section 362(b)(4) to cover both the entry and enforcement of an injunction. The state court’s injunction was allowed to be enforced because its purpose was to protect the public health and safety by preventing future harm to the environment.

The Code permits enforcement of an equitable injunction against a debtor even if the debtor must expend funds from the estate to comply with the decree. In *United States v. Price,* the Court of Appeals for the Third Circuit held that a debtor could be ordered to conduct a diagnostic environmental study of its property—an equitable order—at the debtor’s own expense. The court held that such an order is consistent with the Code so long as the act ordered by the injunction is prospective and not compensatory.

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50. 733 F.2d 267 (3d Cir. 1984).
51. Id. at 278-79. Penn Terra had been ordered to reclaim surface mines, to implement soil erosion and sedimentation plans, to seal a deep mine, and to remove a strata stored over a gas line. *In re Penn Terra Ltd.,* 24 Bankr. 427, 430 (Bankr. W.D. Pa. 1982).
52. *Penn Terra,* 733 F.2d at 278-79.
54. *Penn Terra,* 733 F.2d at 272.
55. Id. at 273-73.
56. 688 F.2d 204 (3d Cir. 1982).
57. Id. at 212. "Injunctions, which by their terms compel expenditures of money, may similarly be permissible forms of equitable relief."
58. Id; see also *Penn Terra,* 733 F.2d at 276-77.
In part to resolve the conflict between bankruptcy law and environmental protection, Congress passed the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) in 1980. CERCLA created a civil cause of action for the mismanagement of hazardous waste, and established the Superfund to finance the cleanup of oil, toxic substances, and hazardous waste spills. CERCLA and the Superfund were intended to provide funds to clean up hazardous waste sites that were either abandoned by unknown parties or owned by insolvent parties. Unfortunately, the program has met with little success. To receive Superfund money, a state must agree to pay ten percent of the costs of any remedial action, must assure that disposal facilities are available, and must agree to administer remedial measures. Since these requirements have proved to be beyond the fiscal means of most states, only a few states have received the funds. As a result, cleanup efforts have been delayed indefinitely.

Polluting companies should theoretically finance the cleanup of environmental hazards themselves. The Code, however, has in practice shielded bankrupt companies from accountability. To hold a debtor financially liable for the correction of environmental law violations, the cleanup judgment must be fully satisfied before the polluter has an opportunity to file for bankruptcy and discharge the liability. If cleanup judgments were exempted


60. See, e.g., 42 U.S.C. § 9606 (abatement actions); id. § 9607 (liability); id. § 9611 (uses of fund).


64. Id. at 388.

65. Section 523(a) of the Bankruptcy Code lists ten debts that are not dischargeable under section 727. Section 523(a)(6) excepts from discharge a debt that is for "willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6) (1982 & Supp. 1984). The outcome of the Kovacs case might have been decided differently had Ohio sought to exclude the cleanup obligation from discharge by alleging that
from discharge as a rule, however, it would thwart one of the fundamental goals of the Code; the debtors would remain liable for satisfaction of pre-bankruptcy cleanup judgments and would not be afforded the "fresh start" that they legitimately sought under the Code. In the face of vague legislative standards, courts must make sensitive decisions as to whether environmental or bankruptcy interests will prevail in a particular case.

III. THE SUPREME COURT'S TREATMENT OF ENVIRONMENTAL LAW CLAIMS UNDER THE CODE: OHIO v. KOVACS

The Kovacs case began in the late 1970's with the entry of a consent decree between the state of Ohio and the Chem-Dyne Corporation [Chem-Dyne]. Chem-Dyne hauled, stored, disposed, and recycled industrial and hazardous waste at a facility in Hamilton, Ohio. The state of Ohio filed suit in 1977 against William Lee Kovacs, the chief executive officer of Chem-Dyne, as well as Chem-Dyne and other corporate entities owned by Kovacs. The complaint alleged that the Chem-Dyne plant caused water pollution and created a public nuisance, in violation of the environmental laws and regulations of Ohio. On July 18, 1979, Kovacs and the state settled their disputes. The settlement, decreed in a Stipulation and Judgment Entry, stated that the defendants were not liable under any of Ohio's environmental laws. The Judgment Entry nevertheless ordered Kovacs and the other defendants to abate pollution at the Chem-Dyne site, to remove the waste stored on the site, and to pay $75,000 to Ohio's Division of Wildlife as compensation for fish that had died as a result of the pollution.

Kovacs ultimately failed to comply with the Judgment Entry. In response, the state sought appointment of a receiver to take charge of the Chem-Dyne site and to execute Kovacs's end of the settlement. The court granted the state's request and gave the receiver authority to carry out the obligations imposed upon Kovacs by the Judgment Entry. Kovacs was thereby required

Kovacs's dumping of the waste was a willful and malicious act.

Section 523(a)(7) excepts from discharge any debt that is for a "fine, penalty or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." Id. § 523(a)(7). If, for instance, the EPA had imposed a fine on Kovacs for violating environmental laws, that fine would have been excepted from discharge by section 523(a)(7) so long as it was not a compensatory payment for past damages.


67. The hazard that was the subject of the Judgment Entry was not completely abated at the time the case was brought before the Supreme Court. Although tanks and drums of waste that were on the surface of the site had been removed pursuant to action under CERCLA, not all the tasks required by the Judgment Entry had been fulfilled. One of Kovacs's "removal" techniques was to pour liquids on the ground and to let them soak into the soil. Muchnicki, The Bankruptcy Issue in Environmental Cleanup Cases, HAZARDOUS WASTE REP., Nov. 1984, at 4-5.

68. The order directed the receiver to take "complete and exclusive control, possession and custody of all assets and property" of the defendants, including Kovacs, and to use such assets to order compliance with the Judgment Entry of July 18, 1979. In re Kovacs, 681 F.2d 454, 455 (6th Cir. 1982).
to turn over all of his nonexempt assets and was dispossessed of the Chem-Dyne site. Before the state was able to progress with the cleanup, however, Kovacs filed a personal petition for reorganization under Chapter Eleven, and later Chapter Seven, of the Bankruptcy Code. On September 2, 1980, Kovacs was adjudicated as bankrupt.

In an effort to apply part of Kovacs’s post-bankruptcy income to the receiver’s unfinished tasks, the state filed a motion to discover Kovacs’s income and assets. On October 20, 1980, the state filed a complaint in bankruptcy court asserting that Kovacs’s obligation to remove all waste stored at the Chem-Dyne site was not subject to discharge under the Code. The state argued that the obligations imposed on Kovacs in the Judgment Entry were not “claims” or “debts” as defined by the Code, and that only obligations which involve debts or claims can be discharged in bankruptcy.

The bankruptcy court, the United States District Court for the Southern District of Ohio, and the United States Court of Appeals for the Sixth Circuit concluded that the state was seeking a money judgment that could be discharged in bankruptcy. The United States Supreme Court affirmed the Sixth Circuit’s holding.

Justice White, writing for a unanimous Court, found that section 101(4)(B) applied to the state’s purported claim against Kovacs. Most of Justice White’s opinion analyzed and defined the terms of that section. The Court found that Ohio had a right to an equitable remedy against Kovacs under state law. The Court also found that the state’s claim was converted to a judgment in the form of an injunction that ordered the cleanup. Consequently, Kovacs’s failure to comply with the cleanup order constituted a breach of performance with respect to the injunction that gave rise to a “claim” by the state under the Code. The cleanup order against Kovacs was entered to remedy Kovacs’s statutory violation. The state conceded that the decree entered against Kovacs ordering him to compensate the state for the injured wildlife was a claim for bankruptcy purposes. The Court therefore concluded that the cleanup order against Kovacs was compensatory and that

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71. In re Kovacs, 681 F.2d 454, 455 (6th Cir 1982).
73. Ohio v. Kovacs, 717 F.2d 984, 987 (6th Cir. 1983).
74. Id.
75. Kovacs, 105 S. Ct. at 707.
76. Id.
77. Id. at 708-09.
Kovacs's failure to comply with each order constituted a breach of performance within the scope of section 101(4)(B). 78

To support this finding, the Court showed that Congress intended to give the term "claim" a broad definition. 79 The Court also analyzed the phrase "right to payment." The Code defines a "claim" in section 101(4)(B) as an equitable remedy for breach of performance that gives rise to a right to payment under the Code. 80 The Court found that the drafters of the Code intended for an equitable judgment that gives rise to an alternative right to payment to be held as a claim for bankruptcy purposes. 81

Accordingly, the Court found that the cleanup order against Kovacs was a money judgment that gave rise to an alternative right to payment. The contingent right to payment constituted a claim against the debtor's estate. The Court's opinion relied heavily on the fact that Kovacs had been dispossessed of the Chem-Dyne site by the state-appointed receiver. The Court found that because Kovacs was not in possession of the property, he could not clean up the site. Kovacs was consequently held liable only for damages. 82 Moreover, the state's insistent pursuit of damages against Kovacs, as an alternative to specific performance, converted the cleanup duty to a judgment for damages. The Court concluded that this money judgment could be discharged in bankruptcy.

Justice O'Connor concurred with the Court in a separate opinion. Justice O'Connor addressed Ohio's argument that if damages under an injunction to correct environmental hazards were dischargeable in bankruptcy, then states would be unable to finance the enforcement of environmental laws. 83 Justice O'Connor responded that the Court's holding helped preserve the right of states as creditors to seek and receive a fair portion of a debtor's assets upon distribution. Had Ohio's cleanup order not been found to be a "claim" under the Code, the state might have been precluded from recovering any money owed by Kovacs under the cleanup order. 84 Justice O'Connor

78. Id. at 708-09. For a court to determine what actions constitute a "breach of performance" under section 101(4)(B), it must identify the unfulfilled obligation and determine the basis upon which that obligation is owed. If the obligation is one which was imposed by a contract or implied by law, then failure to fulfill the obligation is a breach of performance in the context of section 101(4)(B).

79. Id. at 709.


81. Kovacs, 105 S. Ct. at 709.

82. In re Kovacs, 717 F.2d 984, 987-88 (6th Cir. 1983).


84. Id. (O'Connor, J., concurring). Justice O'Connor stated that a corporate Chapter Seven debtor charged with an obligation similar to Kovacs's would be unable to make any post-bankruptcy payments in compliance with the obligation. In a corporate Chapter Seven liquidation, all that remains after distribution of the corporation's assets is a corporate shell—a fictitious entity with no assets, capital, or future. Thus, if a state is precluded from asserting a claim of noncompliance against a corporate debtor's estate, the state will be unable to receive even a pro rata distribution of the debtor's assets. As a result, the state will be left with the obligation to clean up the site without any assistance from the corporate debtor or its estate.
also concluded that the Court's holding did not prevent states from enforcing cleanup orders. To the contrary, it assures states the opportunity to participate in the distribution of a debtor's assets.

Justice O'Connor offered an additional reason why the Court's holding was not hostile to state enforcement of environmental laws. Under the Code, Congress left the property rights of creditors in the assets of a debtor's estate to be determined under state law. The classification of a state's interest as either a lien on property, a perfected security interest, or an unsecured claim is also determined by state law. The state's claim to the assets of the debtor's estate, relative to other creditors, can therefore be advanced by a state statutory right of priority for cleanup funds. According to Justice O'Connor, states can obtain full compliance with cleanup orders under state law by giving the cleanup judgments the status of statutory liens or secured claims.

IV. ANALYSIS AND CRITICISM OF THE KOVACS DECISION

The Kovacs Court analyzed the breadth of the term "claim" under the Code. Ohio sought to prove that Chem-Dyne's obligation to clean a waste dump was not a "claim" within the meaning of the Code, and therefore could not be discharged in bankruptcy. Because a debt is a liability on a claim for bankruptcy purposes, the court focused on the definition and scope of a "claim." The Court, however, did not explain why it focused on section 101(4)(B), rather than section 101(4)(A). Section 101(4)(A) defines a "claim" as virtually any right to payment. The Court implied that Kovacs's obligation to clean up the Chem-Dyne site was a judgment for damages; as such, it might logically have been treated under section 101(4)(A). Despite this possibility, the Court did not classify Ohio's right to payment as a claim under section 101(4)(A). Instead, the Court viewed the state's underlying right to equitable relief as controlling the definition of the state's interest. The Court applied section 101(4)(B) to the case because Kovacs's obligation

85. Id. (O'Connor, J., concurring). See also Butner v. United States, 440 U.S. 48, 54 (1979) (observing Congressional preference to allow state law to govern).
86. Kovacs, 105 S. Ct. at 712 (O'Connor, J., concurring).
89. Id. at 708 (O'Connor, J., concurring).
90. Id. at 707-08 (O'Connor, J., concurring).
91. Id. at 705 (O'Connor, J., concurring).
93. The Court did not disturb the court of appeal's judgment that Kovacs's cleanup duty had been reduced to a monetary obligation. Kovacs, 105 S. Ct. at 710.
94. See id. at 710. "The State had the right to an equitable remedy under Ohio law, and that right has been reduced to a judgment in the form of an injunction ordering the cleanup."
to clean up the Chem-Dyne site was developed in the consent decree as an equitable remedy.

As defined by section 101(4)(B), a "claim" must begin as a right to an "equitable remedy" that results in a "breach of performance" and ends in a "right to payment." The Kovacs Court found that Ohio had a right to an equitable remedy from Kovacs under state law that satisfied the first element under section 101(4)(B). The second element, a "breach of performance," was defined by the court to include any violation of a judicial order. Since Kovacs was obliged to clean up the Chem-Dyne site under a judicial order, his failure to comply with the cleanup order was a breach of performance under section 101(4)(B).

The third element of a claim under 101(4)(B), a "right to payment," was considered by the Court to include a fine that is ordered by a court to substitute for specific performance under a judicial order. The state unsuccessfully argued that Kovacs's breach of his obligation, because it was a violation of a state statute, did not constitute a "right to payment" within the meaning of section 101(4)(B). The Kovacs Court rejected Ohio's argument and held that the obligation owed by Kovacs was a right to payment that was contingent upon Kovacs's failure to perform.

The Supreme Court determined that Congress intended for contingent remedies—those in which the liable party could satisfy its obligation with either a payment or specific performance—to be counted as "breaches of payment" under section 101(4)(B). Based on its examination of the legislative history, the Court concluded that Kovacs's breach of performance created the state's contingent right to payment. Because Kovacs's dispossession of the Chem-Dyne site prohibited him from specifically performing the cleanup, he was ordered to pay the costs of the cleanup. The Kovacs Court reasoned that the cleanup obligation was "converted" into an obligation to pay money.

96. Kovacs, 105 S. Ct. at 708.
98. Kovacs, 105 S. Ct. at 708-09. Ohio contended that the cleanup order was entered to remedy a statutory violation, and was therefore not a claim for bankruptcy purposes. The Court rejected the state's argument because it was inconsistent with Ohio's admission that Kovacs's obligation to pay a $75,000 fine to the state was a debt dischargeable in bankruptcy. Since both the cleanup order and the fine were entered to remedy a statutory violation, neither one could survive the bankruptcy discharge. Id.
99. See supra note 36.
100. Kovacs, 105 S. Ct. at 711. Ohio steadfastly pursued the payment of money to defray cleanup costs. At oral argument before the Court, state counsel conceded that after the receiver was appointed, the only performance sought from Kovacs was the payment of the money. Transcript of the Oral Argument at 19-20; Kovacs, 105 S. Ct. at 710-11.
The Kovacs decision validated a joint statement of Representative Don Edwards and Senator Dennis DeConcini that a judgment for specific performance that includes an alternative right to payment when performance is refused is a claim that can be discharged in bankruptcy.\textsuperscript{101} Ohio's claim was discharged in Kovacs's bankruptcy proceeding because the Supreme Court found that Kovacs's obligation to pay Ohio the costs of cleaning up the Chem-Dyne site was a claim under section 101(4)(B).\textsuperscript{102} Once the Kovacs Court decided that the Judgment Entry against Kovacs created a right to payment for the state, the discharge of Kovacs's claim was inevitable. Kovacs had been dispossessed of the authority to clean up the Chem-Dyne site and Ohio sought to enforce his cleanup obligation by a money judgment.\textsuperscript{103} Since the money judgment was found to be a claim within the meaning of the Code, Kovacs obligation to pay the costs of cleaning the Chem-Dyne site was properly discharged.

Justice O'Connor's concurrence addressed Ohio's concern that enforcement of the Code in some settings would shield bankrupt companies from the cost of cleaning environmental hazards.\textsuperscript{104} The concurring opinion is a theoretical justification for the Court's holding. The Supreme Court was called upon to decide whether the Code relieved debtors of the duty to abate continuing threats to public health and safety. The Kovacs opinion determined that a state that cannot obtain sufficient reimbursement for cleanup costs from the debtor must bear the costs of cleanup itself. The majority of the Supreme Court in Kovacs was unwilling to confront directly the conflict between federal bankruptcy law and state environmental law enforcement efforts. Justice O'Connor, to her credit, explained how state environmental protection efforts could be continued in spite of the Code.

\textsuperscript{101} See supra note 36.
\textsuperscript{102} \textit{11 U.S.C. § 727(b)} (1982 & Supp. 1984). The Court emphasized that its decision did not shield Kovacs from prosecution for his violations of state environmental laws. The decision also did not shield Kovacs from criminal contempt proceedings for not performing his obligations under the Judgment Entry. In addition, the monetary penalties imposed on Kovacs before he filed for bankruptcy were not dischargeable. \textit{Kovacs}, 105 S. Ct. at 711.
\textsuperscript{103} \textit{Kovacs}, 105 S. Ct. at 710-11.
\textsuperscript{104} Justice O'Connor suggested two reasons why the Kovacs holding was not hostile to state environmental protection efforts. First, states were free to give cleanup judgments the status of statutory liens or secured claims, thereby protecting the state's interest in the enforcement of environmental laws. \textit{Id.} at 712.

Second, the Court's holding preserved the state's authority to seek compensation from liable bankrupt corporations. A corporate debtor ordinarily transfers its property to a trustee for distribution among creditors. The corporation then usually dissolves under state law, leaving no post-bankruptcy earnings for the state to use to fulfill a cleanup order. The Kovacs decision nevertheless allows states to secure needed funds from liable debtors since the state retains a claim to pre-bankruptcy assets against the trustee. \textit{Id.} On this latter point, the Court agreed to review two decisions concerning the cleanup duties of a trustee for a bankrupt company. See \textit{In re Quanta Resources Corp.}, 739 F.2d 912 (3d Cir. 1984); \textit{In re Quanta Resources Corp.}, 739 F.2d 927 (3d Cir. 1984), \textit{cert. granted and cases consolidated sub nom. O'Neill v. City of New York}, 105 S. Ct. 1168 (1985).
By ignoring the legal conflict presented by the case, the majority understated the impact that its decision will have on state environmental protection efforts. The Kovacs decision will undermine state efforts to finance costly environmental cleanups. Thus, the Supreme Court left unresolved the conflict between federal bankruptcy policy and state environmental law enforcement.

V. IMPACT OF THE KOVACS DECISION

The Kovacs decision will significantly affect future state enforcement of environmental laws. When the Supreme Court discharged Kovacs from his obligation to pay for the cleanup costs associated with the Chem-Dyne site, the Court opened the door for other insolvent debtors to similarly seek a discharge of their cleanup obligations. The Kovacs decision will encourage other courts faced with the same conflict to ignore environmental concerns and to apply the Code strictly against state environmental protection agencies. Kovacs thereby erodes state enforcement efforts that arguably conflict with the Code.

Although Kovacs may impede some state environmental cleanup efforts, the decision does not exempt debtors from all environmental liability. For instance, in future litigation the Kovacs decision can be limited to its specific facts. That is, the controversy must involve an insolvent debtor who was dispossessed of the contaminated property, and the state must have "converted" the cleanup obligation into an obligation to pay money. A state that seeks to impose liability on bankrupt property owners for the cleanup of environmental hazards should seek specific performance of the cleanup obligations, and should neither dispossess the debtor of the property nor convert the cleanup obligation into an obligation to pay money. Such state efforts create legal duties that are not claims under the Code and may not be discharged in bankruptcy.

While Kovacs can be limited to its facts, the decision remains a loose cannon on the bankruptcy deck. After Kovacs, bankruptcy courts can discharge a debtor's obligation to pay the costs of cleaning a hazardous waste site even if the debtor created the hazard. Justice O'Connor suggested alternatives to Ohio's enforcement strategy that may circumvent the problems created by Kovacs. Nonetheless, a state that fails to recover the cleanup costs associated with the cleanup order entered against a debtor prior to the debtor's discharge will be unable to recover the costs from the debtor's

105. See supra notes 83-88, 104 and accompanying text.

106. There are various ways by which a state can recover some of the costs associated with cleaning up a hazardous waste site. See, e.g., Ohio v. Kovacs, 105 S. Ct. 705, 712 (1985) (O'Connor, J., concurring) (judgment orders may be given the status of statutory liens or secured claims); In re Quanta Resources Corp., 739 F.2d 912 (3d Cir. 1984) (Code does not permit debtors to abandon property in contravention of state and local environmental protection laws), cert. granted sub nom. O'Neill v. City of New York, 105 S. Ct. 1168 (1985); In re T.P. Long Chemical Co., No. 581-906 (Bankr. N.D. Ohio Jan. 1984) (state can seek reimbursement of cleanup costs as an administrative expense from debtor's estate).
post-bankruptcy income or assets.\textsuperscript{107} In such a situation, the state has no recourse against the bankrupt debtor and must either write off the cleanup costs or seek reimbursement from another responsible party.\textsuperscript{108}

The experience with the Superfund shows that states are either unable or unwilling to finance cleanup efforts by themselves.\textsuperscript{109} Although the federal Superfund pays for ninety percent of the remedial measures required to clean up and manage waste sites,\textsuperscript{110} states are responsible for the remaining ten percent.\textsuperscript{111} When the costs of cleanups run into the billions of dollars, the state's ten percent share becomes quite substantial.

The federal Superfund itself may also be affected by the \textit{Kovacs} decision.\textsuperscript{112} The Superfund is subsidized by excise taxes on crude oil, imported petroleum

\textsuperscript{107} Section 727(b) discharges the debtor of all debts, except those listed in section 523, that arose before the date of the order for relief. In a voluntary Chapter Seven or Chapter Eleven proceeding, the date of the petition is the date of the order for relief. 11 U.S.C. 727(b) (1982 & Supp. 1984).

\textsuperscript{108} The EPA reports that between November, 1980 and December 1983, $7.2 million was returned to the federal Superfund through cost recovery suits prosecuted by state or federal government entities against responsible parties. The federal Superfund has also recovered $332 million in out-of-court settlements from parties responsible for abandoned hazardous waste sites. The remainder of the $918 million obligated by the EPA for Superfund program work will probably not be recovered. 15 \textsc{Env't Rep.} (BNA) 1531 (Jan. 25, 1985).

\textsuperscript{109} 15 \textsc{Env't Rep.} (BNA) 2137-38 (Apr. 5, 1985) (states have not paid statutory share of cleanup costs).


\textsuperscript{112} Although the Superfund receives money from taxes on petroleum, chemical, and other products, the fund relies most heavily on reimbursement from responsible parties. The EPA is charged with dispensing the Superfund money and is also responsible for seeking reimbursement. The EPA is often forced to seek reimbursement through legal proceedings, and sometimes those proceedings are in bankruptcy court. The EPA is presently involved in 17 reimbursement cases in bankruptcy court. Interview with Roger Grimes, Assistant Chief Counsel of the Environmental Protection Agency, in Chicago, Illinois (Feb. 21, 1985).

Eighty-seven percent of the current Superfund's $1.6 billion is derived from a tax on 42 chemical ingredients and on crude oil. The remaining 13% comes from general revenues. President Reagan's proposal would eliminate general revenues as a source of income for the fund, and would levy a new tax on hazardous waste storage, treatment, and disposal facilities. Senator Robert Stafford, Chairman of the Senate Environment and Public Works Committee, has expressed a willingness to accept President Reagan's funding proposal, but he appears unwilling to compromise on the amount of funds necessary for cleanup. Representative James J. Florio, sponsor of the $10.1 billion Superfund bill that passed the House in the 98th Congress, stated that the Administration's funding proposal was inadequate. Representative Florio noted that the House last year rejected a tax on waste because it was "unpredictable and uncertain." 15 \textsc{Env't Rep.} (BNA) 1787-88 (Mar. 1, 1985).
products, and certain basic industrial chemicals. The Superfund is used to finance immediate measures to remove hazardous substances from the environment. Under current law, the Superfund's expenses can eventually be charged to the responsible parties, who are strictly liable without proof of negligence. If parties that are liable to the Superfund can file for bankruptcy before the EPA is able to recover expenses from them, the Superfund will have to absorb the entire expense of the cleanup. The Superfund was not created by Congress to be a fund to finance all necessary cleanup operations around the country. Rather, it was intended that the Superfund serve as a limited, temporary source of funds for emergency cleanups and as a back-up for the few cases in which the responsible parties were either insolvent or unidentified. Neither the states nor the Superfund can continue to bear the costs of hazardous waste site cleanups. Thousands of sites, however, are in need of such cleanup. The Kovacs decision does not provide for this threat to the nation's environment.

V. CONCLUSION

The Kovacs decision elevated debtors' interests over the public and government interest in arresting environmental damage. The decision allows a debtor to escape liability for the mishandling of hazardous waste by filing for bankruptcy. The filing of a petition for bankruptcy freezes all of the debtor's assets and stays proceedings against the debtor. The Kovacs decision

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113. There is also a 12.5% contribution from other general funds. R. Zener, Guide to Federal Environmental Law 365 (1981).

114. 46 U.S.C. § 9607 (1982). Of the $1.554 billion appropriated from the fund by Congress in the last four years to carry out the Superfund law, $918 million has been used by the EPA to fund emergency and long-term site cleanups. According to the EPA, $332 million has been recovered as a result of out-of-court settlements among state and federal government entities and parties responsible for the sites. 15 Env't Rep. (BNA) 1531 (Jan. 25, 1985).

115. According to Lee M. Thomas, Administrator of the Environmental Protection Agency, the EPA "will go after every dollar" it spends cleaning up Superfund hazardous waste sites. Thomas predicted that in fiscal year 1985 the EPA would reach cleanup settlement agreements totaling three times the amount reached in fiscal 1984 ($145 million). 15 Env't Rep. (BNA) 1765 (Feb. 22, 1985).


117. The official list of sites eligible for CERCLA cleanups now contains 538 sites; 244 additional sites were proposed for listing in October 1984. The assets of the Superfund ($1.6 billion for five years) will not finance the cleanup of the numerous hazardous waste sites throughout the country. As of October 31, 1984, long term cleanups were being conducted at 134 sites on the National Priorities list of sites eligible for Superfund cleanups. About 65 of those cleanups are being carried out by the EPA and the states, while 70 others are being conducted by responsible parties under enforcement orders. The EPA has estimated that there are close to 22,000 potentially hazardous sites which should be included in the long term remedial cleanup program. Of the 22,000 sites, the EPA has made "preliminary assessments" of 11,662 sites, and has investigated 4,365 sites for possible inclusion on the National Priorities List. 15 Env't Rep. (BNA) 1531 (Jan. 25, 1985).
has the effect of shifting the cost of environmental cleanups from the violaters to the public. This result is unfair and untenable in light of the central goals of tort law: to hold negligent parties liable for injuries caused by their carelessness, and to compensate the injured parties.

The Kovacs Court arrived at its conclusion because the Code is designed to prevent any party who looks like a creditor, even a state government, from collecting against a debtor adversely to other creditors. Justice O'Connor modified this rigid approach to the Code by suggesting that states can amend their statutes to make themselves secured creditors in environmental cases. This method would narrow the conflict between bankruptcy and environmental law, and would ensure steady financing for pollution cleanup efforts through secured damage awards.

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