CAVEAT LENDER: THE *MIDLANTIC* DECISION AND ITS PROGENY

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I. INTRODUCTION

On January 27, 1986, the United States Supreme Court declared, pursuant to section 554 of the Bankruptcy Code,[1] that a trustee in bankruptcy could not abandon an estate's concededly burdensome property without spending estate assets to correct immediate and identifiable environmental problems.[2] Although one of the issues certified by the Supreme Court involved a secured creditor's claim of an unconstitutional taking of collateral, the Court limited its decision to whether the trustee's power to abandon property under section 554 was impliedly conditioned upon compliance with environmental regulations.[3]

By affirming two lower court opinions, this decision may have a resounding effect on financial institutions in our environmentally sensitive society. In *New York v. Quanta Resources Corp. (In re Quanta Resources Corp.)*[4] and in a companion case brought by New Jersey Department of Environmental Protection (NJDEP),[5] the Court of Appeals for the Third Circuit held that a trustee administering the liquidation of an estate must bring the

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[1] 11 U.S.C. § 554 (1982) *amended by* 11 U.S.C. § 554 (Supp. II 1984). Subsection (a) of the 1982 statute stated that:

> After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate.

11 U.S.C. § 554(a) (1982). The 1984 amendment merely added the term "and benefit" after "value" in § 554(a). *See* 11 U.S.C. § 554(a) (Supp. II 1984).

[2] Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 507 (1986). The case involved the presence of environmentally hazardous waste oil on the bankrupt's property. *Id.* at 497.

[3] *Id.* at 496.

[4] 739 F.2d 912 (3d Cir. 1984), *aff'd sub nom.* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986).

[5] *In re* Quanta Resources Corp., 739 F.2d 927 (3d Cir. 1984) [hereinafter *NJDEP*], *aff'd sub nom.* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986).

property into compliance with health and safety regulations prior to abandonment.[6] In both cases the court of appeals denied the trustee permission to abandon certain hazardous, albeit worthless, property and ordered the trustee to expend estate funds to safeguard the environment. Although the money used for the environmental cleanup had been earmarked for private creditors, as a result of these holdings, the creditors recovered nothing. The court of appeals concluded that this outcome was not violative of the taking clause of the fifth amendment.[7]

In order to address the issue of a trustee's abandonment power under 11 U.S.C. § 554(a), as well as the constitutionality of taking property without just compensation, the United States Supreme Court granted certiorari in both cases.[8] The Court's resolution of these issues has had a direct bearing on the degree of risk that members of the financial community are willing to incur when making loans to companies whose operations are potentially hazardous to the environment.

This article will discuss the history of the Quanta Resources Corporation, its bankruptcy proceedings and trace the path by which the dispute reached the Supreme Court. The analysis will then focus upon the arguments of the three primary parties implicated in the *Quanta* cases: the bankruptcy trustee, the state environmental groups and Midlantic National Bank, Quanta's secured creditor. Finally, the article will analyze the Supreme Court opinion in light of subsequent decisions which have attempted to apply the *Midlantic* holding in varying factual circumstances.

II. HISTORICAL BACKGROUND

Quanta Resources Corporation (Quanta) was formed as a Delaware corporation in March of 1980 and shortly thereafter acquired a waste oil treatment facility from Hudson Oil Refining Corporation in Long Island City, New York.[9] In July of 1980, Quanta entered into an agreement to acquire Edgewater Terminal, Inc. and its lease which authorized the operation of a waste

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[6] New York v. Quanta Resources Corp., 739 F.2d at 921-23; *NJDEP*, 739 F.2d at 928-29.

[7] New York v. Quanta Resources Corp., 739 F.2d at 922 n.11.

[8] 469 U.S. 1207 (1985). The two cases were consolidated at the Supreme Court level. *See supra* notes 4-5.

[9] Brief for Petitioner Midlantic National Bank at 6, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986) (No. 84-801) [hereinafter Midlantic Brief].

oil recovery business in Edgewater, New Jersey.[10] Pursuant to this agreement, the NJDEP issued a temporary operating authorization, allowing Quanta to operate the Edgewater facility.[11] On June 3, 1981 Midlantic National Bank provided Quanta with a $600,000 working capital loan secured by various items of Quanta's Edgewater property, including the waste oil inventory.[12] The New York property was not involved since it was already heavily mortgaged. Shortly after Quanta received the Midlantic loan, the NJDEP discovered that a considerable amount of waste oil stored at both the New York and New Jersey sites was contaminated with unlawful concentrations of polychlorinated biphenyls (PCBs).[13] Quanta ceased operations at the two facilities.[14]

Quanta took immediate steps to remove the contaminated oil from each of the facilities.[15] Despite locating out-of-state incineration facilities where the contaminated oil could be properly consumed, the parties could not reach an agreement for the loading and movement of the contaminated oil in New Jersey.[16] As a result, on October 6, 1981, Quanta filed a voluntary petition for reorganization under chapter eleven of the Bankruptcy Code, and continued negotiations with the NJDEP for removal of the contaminated waste oil from New Jersey.[17] When the parties could not reach an agreement, Quanta converted the chapter eleven petition to a chapter seven liquidation proceeding on No-

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10 Petition of Midlantic National Bank for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit at 3, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 469 U.S. 1207 (1985) (No. 84-801) [hereinafter Petition of Midlantic].

11 *Midlantic*, 474 U.S. at 497.

12 *Id.*

13 *Id.* At the time of the bankruptcy filing, the inventory at the Edgewater facility included approximately 3.5 to 5.0 million gallons of waste oil, of which approximately 400,000 gallons were contaminated with PCBs. *See id.* The inventory at the Long Island City facility included approximately 500,000 gallons of waste oil, of which approximately 70,000 gallons were contaminated with PCBs. *See* Response in Opposition to Petition of Midlantic National Bank for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit at 2-3, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 469 U.S. 1207 (1985) [hereinafter NJDEP Response Brief].

14 *Midlantic*, 474 U.S. at 497. The temporary operating authorization under which Quanta operated the waste oil recovery business in Edgewater prohibited storing PCBs at this facility. Thus, at NJDEP's request, Quanta ceased operations at the New Jersey site on July 2, 1981. Midlantic Brief, *supra* note 9, at 7.

15 Petition of Midlantic, *supra* note 10, at 4.

16 *See* NJDEP Response Brief, *supra* note 13, at 2.

17 Midlantic Brief, *supra* note 9, at 7.

vember 12, 1981.[18]

A. New York

From the onset of the bankruptcy proceedings, the trustee was required to maintain, at a cost in excess of $1,100 per week, twenty-four hour guard service at the deteriorating New York facility.[19] Unable to sell the virtually worthless property at this site and desirous to rid the estate of the security expense, the trustee issued a notice of proposed abandonment to Quanta's creditors.[20] In response to this notice, the State and City of New York filed objections with the bankruptcy court maintaining that the trustee's abandonment of the Long Island City facility would effectively place the burden of the cleanup on the State and City.[21]

On June 22, 1982 the bankruptcy court ruled that the trustee could abandon the facility and denied New York's motion to designate governmental cleanup funds as a first lien on the property.[22] New York appealed this holding to the United States District Court for the District of New Jersey. In a memorandum opinion, the Honorable Frederick B. Lacey affirmed the decision of the bankruptcy court.[23] On appeal, the Court of Appeals for the Third Circuit reversed the decision of the district court and held that the trustee would violate state environmental laws if he were permitted to abandon the PCB laden oil at the Long Island City facility.[24] It left to the bankruptcy court the issue of whether the monies the state and city expended on cleanup were entitled to administrative expense priority.[25]

B. New Jersey

Prior to the bankruptcy filing, the NJDEP issued an adminis-

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18 *NJDEP*, 739 F.2d at 928. On that same day, Thomas J. O'Neill was designated as the Quanta trustee. Petition of Midlantic, *supra* note 10, at 4.

19 Brief for Petitioner Thomas J. O'Neill, Trustee at 5, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986) [hereinafter Brief for Trustee].

20 *Id.*

21 New York v. O'Neill (*In re* Quanta Resources Corp.), 55 Bankr. 696 (D.N.J. 1983) (mem.), *rev'd sub nom.* New York v. Quanta Resources Corp., 739 F.2d 912 (3d Cir. 1984), *aff'd. sub nom.* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986).

22 *O'Neill*, 55 Bankr. at 699.

23 *Id.* By the time the appeal was heard, the State and City of New York had expended $2.5 million cleaning up the Long Island City site. *Id.* at 697.

24 New York v. Quanta Resources Corp., 739 F.2d at 913.

25 *Id.* at 922-23.

trative order requiring Quanta to cleanup all hazardous materials at the Edgewater site.[26] Since executing this directive would have exhausted all the assets of the debtor's estate, the trustee, after taking control of Quanta's property, notified the NJDEP and its creditors of his intention to abandon the contaminated waste oil and leasehold interest of the estate at the facility.[27] On May 20, 1983, the bankruptcy court granted the trustee authority to proceed with the proposed abandonment.[28] Since the abandonment issue raised in the New Jersey case was already pending before the Third Circuit in the companion New York action, the NJDEP, with consent of the other parties, filed a notice of appeal directly with the Third Circuit Court of Appeals.[29]

On appeal, the NJDEP argued that the trustee could not abandon the burdensome property because of the statutorily-imposed duty to cleanup the environmental contamination at the New Jersey site.[30] Relying on its decision in the New York case, the Court of Appeals for the Third Circuit held that allowing abandonment would be in derogation of state environmental laws and remanded the case to the bankruptcy court for further action.[31]

C. *Supreme Court Decision*

The United States Supreme Court granted the trustee's petition for certiorari and consolidated the New York and New Jersey actions.[32] The trustee contended that section 554 placed no restrictions on his power to abandon property burdensome to the estate or of inconsequential value.[33] Respondents NJDEP and

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[26] *NJDEP*, 739 F.2d 927, 928 (1984), *aff'd sub nom.* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986).

[27] Brief for Trustee, *supra* note 19, at 5.

[28] *NJDEP*, 739 F.2d at 928.

[29] *Id.* The appeal was filed under 28 U.S.C. § 1293(b) (1982) which provides:

> Notwithstanding section 1482 of this title, a court of appeals shall have jurisdiction of an appeal from a final judgment, order, or decree of an appellate panel created under section 160 or a District court of the United States or from a final judgment, order, or decree of a bankruptcy court of the United States if the parties to such appeal agree to a direct appeal to the court of appeals.

28 U.S.C. § 1293(b) (1982).

[30] *NJDEP*, 739 F.2d at 928.

[31] *Id.* at 928-29.

[32] Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 469 U.S. 1207 (1985).

[33] Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 498 n.2 (1986).

New York, on the other hand, asserted that they had the authority to require a trustee in bankruptcy to assume the responsibility of safeguarding the environment against the dangers posed by the bankrupt's estate.[34] Lastly, petitioner Midlantic National Bank maintained that imposing cleanup duties on the trustee would consume all of the funds otherwise available to secured and unsecured creditors, thus constituting a taking of private property without just compensation in violation of the fifth amendment.[35]

Justice Powell, writing for a five member majority, declared that the trustee's abandonment power under section 554 was conditioned upon compliance with local laws designed to protect the public health and welfare.[36] The Court noted that "[b]efore the 1978 revisions to the Bankruptcy Code, the trustee's abandonment power had been limited by a judicially developed doctrine intended to protect legitimate state or federal interests."[37] Thus, Justice Powell reasoned that when Congress enacted section 554, it presumably included the established judicially developed rule.[38] The Court also found that Congress did not intend section 554 to preempt the state laws referred to in section 959(b) of the Bankruptcy Code.[39] That section obligates a trustee to observe the requirements of all relevant state laws while controlling and operating the property in question.[40] The

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[34] Brief of Respondents State of New York and City of New York at 7-34, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986) (No. 84-801); Brief of Respondent New Jersey Department of Environmental Protection at 11-43, Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986) (No. 84-801) [hereinafter NJDEP Brief].

[35] Midlantic Brief, *supra* note 9, at 11-15.

[36] *Midlantic*, 474 U.S. at 506-07.

[37] *Id.* at 500.

[38] *Id.* at 501. There is no legislative history to § 554. The Court noted that other courts recognized this judicially developed rule. *See* Ottenheimer v. Whitaker, 198 F.2d 289 (4th Cir. 1952) (trustee not permitted to abandon barges obstructing harbor traffic); *In re* Chicago Rapid Transit Co., 129 F.2d 1 (7th Cir. 1942) (conditions imposed before abandonment permitted), *cert. denied sub nom.* Chicago Junction R.R. v. Sprague, 317 U.S. 683 (1942). The Court further noted that one bankruptcy decision recognized this rule. *See In re* Lewis Jones, Inc., 1 Bankr. Ct. Dec. (CRR) 277 (E.D. Pa. 1974) (trustee required to spend estate funds to seal manholes). In his dissent, Justice Rehnquist found these decisions "particularly unpersuasive." *Midlantic*, 474 U.S. at 507-12 (Rehnquist, J., dissenting).

[39] *Midlantic*, 474 U.S. at 505 (quoting 28 U.S.C. § 959(b) (1982)).

[40] Section 959(b) provides in pertinent part:

> Except as otherwise provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager

Court concluded that:

> Congress did not intend for § 554(a) to pre-empt all state and local laws. The Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety. Accordingly, without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself, we hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards.[41]

In a footnote to the holding and probably in response to the stinging dissent of Justice Rehnquist, the Court noted that the exception it created to section 554 was a narrow one.[42] Justice Powell further stated that "[i]t does not encompass a speculative or indeterminant future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm."[43] As illustrated by the cases which have interpreted and purportedly followed the *Midlantic* rationale, that footnote has provided a fertile field for judicial imagination.

In dissent, Justice Rehnquist raised the issue with which later courts would have to grapple. In doing so, he stated that:

> The Court of Appeals, as I read its opinions in these cases, apparently would require the trustee to expend all of Quanta's available assets to cleanup the sites. But barring abandonment and forcing a cleanup would effectively place respondents' interest in protecting the public fisc ahead of the claims of other creditors.[44]

The majority in *Midlantic* found support for its position from its previous holding in *Ohio v. Kovacs*.[45] In *Kovacs*, the Court stated in dicta, that persons in possession of a contaminated site, including a bankruptcy trustee, must comply with state environmental laws.[46]

> according to the requirements of the valid laws of the State in which such property is situated . . . .

28 U.S.C. § 959(b) (1982).

41 *Midlantic*, 474 U.S. at 506-07 (footnote omitted).

42 *Id.* at 507 n.9.

43 *Id.*

44 *Id.* at 516-17 (Rehnquist, J., dissenting) (footnote omitted).

45 *Id.* at 502 (citing Ohio v. Kovacs, 469 U.S. 274 (1985)).

46 Ohio v. Kovacs, 469 U.S. 274, 285 (1985).

The Court, however, never determined how compliance could be accomplished if estate assets were insufficient for that purpose.

In *Kovacs*, the State of Ohio obtained an injunction from an Ohio State court to compel the operator of a hazardous waste disposal site to institute cleanup procedures, refrain from further contamination, and pay a specified amount of damages to the State.[47] When Kovacs, the operator of the facility, made no attempt to comply with the dictates of the injunction, the state court appointed a receiver to oversee the disposition of the property.[48] Kovacs began to comply with the injunction.[49] Before the cleanup was completed, however, he filed for bankruptcy.[50] Ohio sought a declaration that Kovacs' obligation to comply with the terms of the injunction was not a dischargeable debt under the Bankruptcy Code.[51] The Supreme Court affirmed the conclusion of the Court of Appeals for the Sixth Circuit and held "that the cleanup order had been converted into an obligation to pay money, an obligation that was dischargeable in bankruptcy."[52]

Addressing the concern that the decision would impose severe financial burdens on the states, Justice O'Connor, in her concurrence in *Kovacs*, noted that the states had recourse against the bankrupt's assets.[53] She explained that because Congress had left the determination of the priority of interests in the debtor's property to state law, a state could protect itself by according priority to its claim against the bankrupt.[54] A state could thus safeguard "its interest in the enforcement of its environmental laws by giving cleanup judgments the status of statutory liens or secured claims."[55]

A general flaw in the Supreme Court's analysis in *Midlantic* is that it failed to embrace many equitable factors implicated by the controversy. The Court did not consider the total value of Quanta's estate, the estimated cost of cleanup or the claims of creditors. A thorough examination would have revealed that the bankrupt's

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47 *Id.* at 276.

48 *Id.*

49 *Id.*

50 *Id.*

51 *Id.* at 276-77. *See* 11 U.S.C. § 523 (Supp. V 1987) (describing discharge exceptions).

52 *Kovacs*, 469 U.S. at 283 (footnote omitted).

53 *Id.* at 285 (O'Connor, J., concurring).

54 *Id.* at 286 (O'Connor, J., concurring).

55 *Id.* New Jersey has enacted such a law. *See* N.J. STAT. ANN. § 58:10-23.11(f) (West Supp. 1988). This new law would have enabled the NJDEP in *Midlantic* to claim a first priority claim and lien paramount to all other claims and liens had the NJDEP expended any funds to clean up the Edgewater site.

property had a forced sale value of $428,000, the cost of cleanup was considerably more than $2.5 million, and Midlantic alone had a secured lien of over $643,000. Thus, disallowing abandonment would prevent creditors from recouping any of their money while only marginally benefiting the public. Moreover, the creditors who would be burdened with the costs of cleanup were in no way responsible for the environmental violations. Yet the Supreme Court opinion, which did not directly address these issues, is certainly broad enough to effectuate this result in future cases.

III. SUBSEQUENT DECISIONS

The impact of the *Midlantic* decision has had far ranging effects. The essence of the decision is that only in bankruptcy situations which pose an immediate and grave threat to the environment will a trustee's abandonment power be subjugated to environmental regulations. An analysis of subsequent decisions indicates, however, that the *Midlantic* rationale has been twisted to suit the facts of particular cases, often with inconsistent results.

The cases which have followed *Midlantic* fall into a number of categories. Some have allowed abandonment in the face of environmental problems by distinguishing *Midlantic*. Other cases allow environmental cleanup costs as an administrative expense with priority status. Still others have considered the effect of the automatic stay of governmental actions to enforce pre-petition and post-petition cleanup orders. Finally, a few cases have addressed the issue raised by Justice Rehnquist regarding which entity is responsible for the cleanup. Depending on the factual situation presented, lower courts have found either solace in or perplexion with the *Midlantic* decision and have reached results which attempt to balance the equities of a particular case. Moreover, a number of cases address the realities of the matter by considering the assets available and the cost of environmental cleanup.

A. Allow Abandonment

The case of *In re Franklin Signal Corp.*[56] required the United States Bankruptcy Court for the District of Minnesota to confront precisely the dilemma identified by Justice Rehnquist in his *Midlantic* dissent. In that case, the debtor manufactured burglar

[56] 65 Bankr. 268 (Bankr. D. Minn. 1986).

alarm systems at a leased facility in Wisconsin.[57] Prior to the filing of its chapter eleven petition, the debtor produced fourteen drums of waste containing at least one chemical considered hazardous under Wisconsin law.[58]

Most of the assets of the estate (including the drums), were subject to liens exceeding $268,000.[59] The bankruptcy court had previously approved the sale of certain assets subject to the bank's lien and subsequently ordered that the proceeds be paid over to the bank.[60] Following this sale, the estate consisted of nearly $10,000 in cash, the drums of contaminated waste and two uncollectible notes.[61] In addition to creditor claims, there were at least $17,000 in administrative expenses, and the cost to remove the hazardous waste was estimated at $20,000.[62]

The court approved the trustee's application to abandon the fourteen drums of hazardous waste.[63] In so doing, the court strictly interpreted *Midlantic*, indicating that the Supreme Court's decision was obviously based upon the fact that the trustee in *Midlantic* took no action at all to safeguard the public from the great danger created by the two processing facilities.[64] By contrast, the trustee in *Franklin* had conducted an investigation to determine what hazardous substances were present in the drums and informed the appropriate state agencies of the presence of those hazardous substances.[65] The court interpreted the *Midlantic* decision to require courts to ask whether the trustee carried out an investigation to determine what hazardous substances burden the property and whether the trustee notified the appropriate state agency of the intention to abandon.[66] The court noted that a case-by-case approach provides a more realistic solu-

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57 *Id.* at 269.

58 *Id.* The Wisconsin Department of Natural Resources was apprised of the problem. *Id.* at 269 n.1. No party has attempted to dispose of the hazardous substances contained in the drums. *Id.* The court noted that "[t]he logical inference of the state's inaction is that the drums do not pose any imminent threat to the public." *Id.*

59 *Id.*

60 *Id.* at 269.

61 *Id.* at 269-70.

62 *Id.* at 270.

63 *Id.* at 273.

64 *Id.* at 271. The *Franklin* court reasoned: "I believe the Supreme Court intended only to place limits on a trustee's power of abandonment by holding that the bankruptcy court cannot authorize the abandonment of property in contravention of state law *unless* conditions are formulated that will adequately protect the public health and safety." *Id.* (emphasis in original).

65 *Id.* at 273.

66 *Id.*

tion to the underlying problems posed by *Midlantic* as opposed to a strict reading that would bar any abandonment.[67] The court also noted that the storage of the fourteen drums did not pose an imminent danger to the public health and that the estate did not have the requisite funds to carry out the cleanup costs.[68]

In a complex factual setting, an Oklahoma bankruptcy court allowed abandonment despite the presence of arguably the controlling principle in *Midlantic*. In *In re Oklahoma Refining Co.*,[69] the owner of a refinery filed a chapter eleven petition.[70] The court subsequently appointed a trustee.[71] Because of environmental concerns, the Oklahoma state agencies compelled the trustee to terminate operations.[72] Like the *Midlantic* situation, the existing environmental problems at the refinery were the result of many years of crude oil refining at the site.[73]

When operations ceased, there were $40 million in secured claims and $8 million in unsecured claims against the estate.[74] The estate was estimated to have approximately $4 million in assets.[75] The trustee worked with state agencies, employing a consulting firm to effectuate an environmental investigation of the site and carried out certain cleanup steps costing $275,000.[76] Although there was no additional generation of contaminants following the appointment of the trustee, the environmental agencies found hazardous substances in the ground which could cause pollution at some indeterminate time in the future.[77] The bankruptcy court found that cleanup costs would be at least $2.5 million and that the site would require thirty years of monitoring.[78] As a result of the secured creditors' refusal to consent to the appropriation of their cash collateral for the cleanup, the trustee had no other assets at his disposal.[79]

The Oklahoma state agencies argued that all assets in the hands of the trustee should be used for cleanup costs before they

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67 *Id.*
68 *Id.*
69 63 Bankr. 562 (Bankr. W.D. Okla. 1986).
70 *Id.* at 562. The debtor's refinery was in operation since 1919. *Id.*
71 *Id.*
72 *Id.* at 562-63.
73 *Id.* at 563.
74 *Id.*
75 *Id.* Moreover, all of the estate's funds were cash collateral. *See id.*
76 *Id.* at 563-64.
77 *Id.* at 563.
78 *Id.* at 564.
79 *Id.*

were distributed to the secured claimants.[80] Bankruptcy Judge Bohanon addressed the issue and found the following:

> The trustee thus finds himself confronted with a formidable dilemma. On one hand he has no funds which are not cash collateral but, under a strict reading of *Midlantic*, could be required to comply with state laws and regulations which is impossible because of § 363(c)(2). We do not believe the Supreme Court intended to place bankruptcy trustees in such a predicament but rather that *Midlantic* requires the bankruptcy court, in determining whether to permit abandonment, [to] take state environmental laws and regulations into consideration.[81]

He then concluded:

> To require strict compliance with State environmental laws under the facts of this case could create a bankruptcy case in perpetuity and fetter the estate to a situation without resolve. This trustee, with consent of the secured creditors, has done what is reasonable under the circumstances. To preempt the administration of this estate would derogate the spirit and purpose of the bankruptcy laws requiring prompt and effectual administration within a limited time period. The Oklahoma laws regarding environmental protection are not unreasonable but juxtaposed to the Bankruptcy Code cannot be reconciled to satisfy the strict compliance sought by the State agencies.[82]

Similarly, the Fourth Circuit permitted abandonment in *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*.[83] In *Borden*, the debtor filed a voluntary petition under chapter eleven of the Bankruptcy Code and then attempted to sell one of its assets, a fertilizer plant located in Illinois.[84] Unable to locate a buyer, the debtor moved to abandon the property.[85] In permitting abandonment, the bankruptcy court declared that although the plant violated certain state environmental laws, it did not pose an imminent danger to the public.[86] The court also noted that the debtor had no unencum-

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80 *Id.* at 564-65. This, incidentally, was the NJDEP's position in *Midlantic*, but the Supreme Court never reached that issue. *See* NJDEP Brief, *supra* note 34, at 11-43.

81 *In re Okla.*, 63 Bankr. at 565 (citation omitted).

82 *Id.* at 565-66 (citation omitted).

83 856 F.2d 12 (4th Cir. 1988).

84 *Id.* at 13-14

85 *Id.* Wells-Fargo Bank, the debtor's principal secured lender, agreed to provide post-petition financing. *Id.* When Smith-Douglass moved for abandonment, Wells-Fargo supported its application. *Id.* at 14.

86 *Id.* at 14-15.

bered assets with which to finance a cleanup.[87] On appeal, the district court affirmed the bankruptcy court's decision.[88]

In affirming the lower court's ruling, the Fourth Circuit determined that its holding was consistent with the *Midlantic* decision.[89] The court reasoned that under *Midlantic* a court may allow abandonment when an environmental hazard consists only of an " 'indeterminant future violation.' "[90] Additionally, the court noted that the financial condition of the debtor was extremely relevant.[91] Finding that the debtor had no unencumbered assets and that the Illinois plant did not pose a serious threat to the public safety, the court permitted abandonment.[92] Thus, despite the *Midlantic* Court's holding to the contrary, insufficient estate assets, together with at least an investigation and identification of the environmental problem, will provide a basis to permit abandonment without compliance with either state law or cleanup orders.

B. Cleanup Costs As An Administrative Expense

Another approach flowing from the *Midlantic* rationale is to afford administrative priority for costs incurred by state environmental agencies or parties other than the debtor who have undertaken a cleanup effort. There is increasing case law supporting this allowance of cleanup costs as an administrative expense.[93] In *Juniper Development Group v. Kahn (In re Hemingway Transportation)*[94] the chapter seven trustee moved to dismiss a complaint which sought equitable rescission of a contract to purchase property from the debtor because of subsequently discovered environmental problems on the land.[95] The bankruptcy court denied the trustee's application and held that the purchaser's expenses were an administrative expense because the property was an asset of the estate at the time the environmental

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87 *Id.* at 15.

88 *Id.* The district court, contrary to the bankruptcy court, found that the financial condition of the debtor was irrelevant in deciding whether to allow abandonment. *Id.*

89 *See id.*

90 *See id.* (quoting Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 507 n.9 (1986)).

91 *Id.* at 17.

92 *Id.*

93 *See, e.g.*, Juniper Dev. Group v. Kahn (*In re* Hemingway Transp.), 73 Bankr. 494 (Bankr. D. Mass. 1987); Walsh v. West Virginia (*In re* Security Gas & Oil, Inc.), 70 Bankr. 786 (Bankr. N.D. Cal. 1987).

94 73 Bankr. 494 (Bankr. D. Mass. 1987).

95 *Id.* at 496. The trustee also sought monetary damages. *Id.*

cleanup expenses were incurred.[96]

By definition, in order to be entitled to administrative priority, the expenses must be costs necessary to preserve an estate.[97] The United States Court of Appeals for the Third Circuit, in a case decided before *Midlantic*, held that cleanup costs incurred pursuant to an administrative order would merely constitute an unsecured claim not entitled to priority.[98] Following *Midlantic*, however, courts have given such costs administrative priority.

For instance, the United States District Court for the District of Maine decided that the cost of a post-petition cleanup of a pre-petition environmental hazard constituted a first priority administrative expense.[99] The court found that the *Midlantic* decision altered the criteria for determining administrative expenses.[100] Further, the court concluded that since the trustee was obligated to comply with environmental laws regulating hazardous waste, the estate was liable for the costs that the Maine Department of Environmental Protection incurred in removing the waste as a first priority administrative expense.[101] Similarly, the court in *In re Pierce Coal and Construction, Inc.*,[102] found that costs incurred in the reclaiming of a mining area destroyed by the debtor-in-possession were entitled to administrative priority in order to protect the public safety.[103] In so finding, the court viewed *Midlantic* in the following light:

> The United States Supreme Court has indicated in its decision that where imminent and identifiable harm is present, the priorities of the Bankruptcy Code may be subservient to the environmental laws designed to protect the public safety. It is reasonable to expect that under a given set of circumstances, the necessary costs of protecting the public health or safety from imminent and identifiable harm may be elevated to administrative priority and, perhaps, even to a type of secured priority.[104]

Consistent with this reasoning, the court in *In re Peerless Plating*

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96 *Id.* at 505.

97 11 U.S.C. § 503(b)(1)(A) (1982).

98 *See* Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985).

99 *In re* Stevens, 68 Bankr. 774, 780 (Bankr. D. Me. 1987).

100 *Id.* at 780-81.

101 *Id.*

102 65 Bankr. 521 (Bankr. N.D. W. Va. 1986).

103 *Id.* at 531. The court found that evidence of an identifiable harm did not exist. *Id.*

104 *Id.*

Co.,[105] approved federal Environmental Protection Agency (EPA) cleanup costs as an administrative expense based on the determination that the bankruptcy trustee was the site owner.[106] Significantly, the court did not view the total depletion of estate assets for the environmental cleanup costs sufficiently detrimental to other creditors to disallow the claim.[107] The court reasoned that *Midlantic* must be read liberally, so that "[t]he fact that one claimant or creditor receives the lion's share does not render that claim onerous."[108]

C. *Automatic Stay*

In a different context, debtors often attempt to stop governmental efforts to compel cleanup. In one pre-*Midlantic* decision, *Penn Terra Ltd. v. Department of Environmental Resources*,[109] the Court of Appeals for the Third Circuit held that the automatic stay does not apply to actions by governmental agencies pursuant to its police and regulatory power.[110] In a later case citing *Midlantic*, the court in *United States v. F.E. Gregory & Sons, Inc.*,[111] also refused to issue a stay which required reclamation work at an abandoned mine site.[112] In so doing, the court dismissed the debtor's argument that it could simply abandon the site, and stated that "[t]he argument is now foreclosed by a recent decision of the Supreme Court, *Midlantic National Bank v. New Jersey Department of Environmental Protection*. The Court held that a trustee may not abandon property in contravention of state environmental statutes and regulations."[113]

The Fifth Circuit provided a much more interesting discussion of that issue in *In re Commonwealth Oil Refining Co.*[114] Again, the question concerned whether the automatic stay prohibited the federal government from enforcing an action to bring the debtor into compliance with state and federal environmental

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105 70 Bankr. 943 (Bankr. W.D. Mich. 1987).

106 *Id.* at 948-49.

107 *Id.* at 947.

108 *Id. See also In re* Wall Tube & Metal Prods. Co., 831 F.2d 118 (6th Cir. 1987) (state's response cost recoverable as administrative expense); *In re* Stevens, 68 Bankr. 774 (Bankr. D. Me. 1987) (state agency entitled to costs for cleanup as administrative expense); *In re* Mowbray Eng'g Co., 67 Bankr. 34 (Bankr. M.D. Ala. 1986) (state's cost for decontamination recoverable as an administrative expense).

109 733 F.2d 267 (3d Cir. 1984).

110 *Id.* at 273.

111 58 Bankr. 590 (W.D. Pa. 1986).

112 *Id.* at 592.

113 *Id.*

114 805 F.2d 1175 (5th Cir. 1986), *cert. denied sub nom.* 107 S. Ct. 3228 (1987).

laws.[115] Rejecting the debtor's contention that the enforcement action was tantamount to a money judgment stayed by section 362 of the Bankruptcy Code, the court observed that "in contemporary times, almost everything costs something."[116] The court reasoned that simply because an injunction will require the debtor to expend funds does not make it an action to enforce a money judgment.[117]

Taken to their logical conclusions, *Commonwealth*, *Penn Terra*, and *F.E. Gregory* are authority for the proposition that an appropriate state environmental cleanup order requiring the expenditure of all of the debtor's assets, regardless of the claims of secured and unsecured creditors, is not stayed by section 362. This was precisely the result in *In re Peerless Plating Co.*,[118] where the EPA incurred considerable expenses in performing environmental cleanup work at a site of the debtor's former operations.[119] In approving the EPA's application to compel the debtor to pay cleanup expenses, the court noted that any discussion regarding abandonment, administrative expenses, and the duty of an estate to cleanup hazardous wastes must start with the *Midlantic* requirement that the trustee comply with all environmental[120] obligations.[121] The court made this determination despite its recognition that the trustee's compliance with CERCLA could deplete the estate entirely.[122]

Consistent with this rationale, a district court reached a similar conclusion in the recent case of *United States v. Mattiace Industries, Inc.*[123] In *Mattiace*, the EPA brought an action to recover cleanup costs under the Superfund statute.[124] The court held that such cleanup expenses were exempt from the automatic stay provision of section 362 because Superfund was not enacted for

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115 *In re Commonwealth*, 805 F.2d at 1182.

116 *Id.* at 1186 (quoting Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 277-78 (3d Cir. 1984)).

117 *Id.* (quoting Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 277-78 (3d Cir. 1984)).

118 70 Bankr. 943 (Bankr. W.D. Mich. 1987).

119 *Id.* at 945.

120 The environmental cleanup at issue concerned the debtor's obligations pursuant to the Comprehensive Environmental, Response, Compensation & Liability Act (CERCLA). *See* 42 U.S.C. §§ 9601-9675 (Supp. IV 1986) (federal statute providing for removal of hazardous waste).

121 *In re Peerless*, 70 Bankr. at 946.

122 *Id.*

123 73 Bankr. 816 (E.D.N.Y. 1987).

124 *Id.* at 816. The EPA sought recovery of cleanup costs under 42 U.S.C. §§ 9604(a), (c), 9606(a), (b), 9607(a), (c) (Supp. IV 1986).

financial reasons, but to protect the public's health, safety and welfare.[125] The court observed that enforcement of regulatory statutes, despite requiring expenditures of estate (and therefore creditor) assets, is not stayed under section 362.[126]

The practical effect of an environmental cleanup order on the ability of a debtor to bring a chapter seven case to a conclusion is exemplified by *Ohio v. Commercial Oil Service, Inc. (In re Commercial Oil Service, Inc.)*.[127] In a unique twist, the trustee of a chapter seven debtor sought to dismiss the bankruptcy petition.[128] The trustee made this application after the court denied his motion to stay a pending state court action to compel the debtor to comply with the state's environmental protection laws.[129] Rather than impose the burden of the cleanup on the trustee, the court dismissed the chapter seven petition.[130] The court noted that *Midlantic* obligated the trustee to cleanup the site, by explaining that "[t]he Supreme Court in its recent decisions has clearly stated that the Trustee has an affirmative duty to make the hazardous waste site comply with state laws."[131] The court also recognized that since the trustee was not familiar with hazardous waste disposal, and since both federal and state authorities have more expertise, they were in a much better position to take control of the site and remove the waste.[132]

IV. CONCLUSION

Needless to say, these decisions do not lend comfort to financial institutions or other lenders to businesses which are subject to comprehensive state and federal environmental laws. It is apparent that when the trustee in bankruptcy attempts to identify the environmental problems, notify the appropriate parties and take steps to prevent imminent danger, lower courts will permit

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125 *Mattiace*, 73 Bankr. at 819.

126 *Id.* at 818. Similar results are found in pre-*Midlantic* cases. *See, e.g.*, United States v. ILCO, Inc. (*In re* Ilco, Inc.), 48 Bankr. 1016 (Bankr. N.D. Ala. 1985); *In re* Canarico Quarries, Inc., 466 F. Supp. 1333 (D.P.R. 1979). *But see* Thomas Solvent Co. v. Kelley (*In re* Thomas Solvent Co.), 44 Bankr. 83 (Bankr. W.D. Mich. 1984) (enforcing an automatic stay on the condition that the case be converted to a chapter seven proceeding).

127 58 Bankr. 311 (Bankr. N.D. Ohio 1986).

128 *Id.* at 312.

129 *Id.*

130 *Id.* at 316-18.

131 *Id.* at 317 (citing Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986); Ohio v. Kovacs, 469 U.S. 274 (1985)).

132 *Id.* at 317.

abandonment and leave environmental compliance to others. The *Midlantic* decision, however, can also be read to allow state environmental laws to take precedence over all other interests.