UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

9832.8

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OFFICE OF ENFORCEMENT AND COMPLIANCE MONITORING

MEMORANDUM

SUBJECT: Revised Hazardous Waste Bankruptcy Guidance

FROM: Richard H. Mays
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TO: Regional Counsels, Regions I-X

The Agency's recent experience in CERCLA and RCRA bankruptcy actions has identified the need for updated and revised guidance on the scope of EPA's enforcement actions against bankrupt parties. This memorandum is intended to update the May 24, 1984 guidance "CERCLA Enforcement Against Bankrupt Parties" and the guidelines on bankruptcy contained in the Cost Recovery Handbook "Procedures for Documenting Costs for CERCLA §107 Actions," January 30, 1985. The memorandum defines specific criteria for evaluating the merits of a potential bankruptcy referral; elaborates on the policy regarding settlement with bankrupt parties; reviews the recent judicial decisions in the areas of the automatic stay, abandonment, discharge, and claims of administrative expenses; and briefly describes new enforcement theories which have been asserted by the Agency in recent pleadings.

BANKRUPTCY REFERRALS 9832.8

EPA has referred 22 hazardous substance cases to the Department of Justice for filing in bankruptcy actions. After several years of litigation only two of these cases have resulted in recovery of funds from the debtor. The current docket of bankruptcy cases has consumed a disproportionate amount of attorney resources based on the expected recovery of funds to the Agency.

Additional scrutiny will be used in evaluating future referrals from the Regions which include bankruptcy claims. In all referrals regarding bankrupt parties, the Regions should include a justification for filing in the bankruptcy action. The referral justification should be based on at least one of the following five criteria:

1. EPA is likely to recover at least $5,000 by filing a simple proof of claim as a general unsecured creditor

Filing a proof of claim is a relatively simple and straightforward matter which may be appropriate when the Agency has a claim as a general unsecured creditor, for example in cases where the Agency has completed a response action before the bankruptcy is filed. Where there appears to be sufficient assets in the debtor's estate 1/ for a small distribution to the

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1/ Determining the extent of the assets in the estate can be based on the schedule of assets set out in the bankruptcy petition, the extent of assets and claims published following the initial meeting of creditors, the court's bankruptcy docket and periodic filings available through the court clerk.

government on an unsecured claim, the trustee, debtor, or other creditors may well not undertake the trouble and expense to challenge a claim that does not otherwise threaten the estate. The chances of such an objection are particularly small where EPA's claim is liquidated and CERCLA liability is clear 2/. As a general rule, a proof of claim should be filed in cases where EPA does not anticipate that an objection will be raised by the creditors or the estate and where the filing of a proof of claim will lead to a recovery of at least $5,000 3/. In these cases, the Region should prepare an abbreviated referral package containing the proof of claim, supporting affidavits and cost documentation and a brief description of the assets in the debtor's estate.

2. EPA is likely to recover at least $20,000 of response costs through a more complex bankruptcy filing

As a general rule, prospective referrals of complex bankruptcy actions (such as a request for an administrative expense priority) that may lead to recovery of less than $20,000 are discouraged.

2/ Under Section 502(a) of the Bankruptcy Act a claim is deemed allowed unless objected to. Thus, filing a proof of claim, by itself, will often not lead to the type of extensive litigation that has characterized many of the Agency's bankruptcy cases so far.

3/ If costly obstacles or significant challenges at some point do in fact loom over EPA's proof of claim, the Agency can always withdraw its claim as a matter of right prior to the filing of an objection (Bankruptcy Rule 3006). Even after the filing of an objection to the proof of claim, EPA can withdraw its claim, subject to court approval. As long as the claim was filed in good faith, a court will be unlikely to deny the withdrawal of a claim where the government indicates that it is not in its best interests to pursue the claim.

Assuming a recovery of $20,000 or more, the Region should set out the extent of the assets in the debtor's estate, the number and extent of other claims, the status of other creditors (i.e., secured or unsecured), and the theories of recovery which will be asserted in the bankruptcy litigation. The Region should also evaluate the merits of EPA's claims, including the ability of the Agency to prove its CERCLA §107 claims based on available cost documentation.

3. The bankruptcy action has significant deterrence value

Under this justification, the Regions should establish that the bankrupt party may be seeking to avoid liability for Superfund cleanup through an unlawful declaration of insolvency. The referral should include a discussion of the past financial practices of the potential defendant and any indication of misrepresentation or fraudulent transfer of funds. A bankruptcy case may also be an appropriate candidate for referral if the case is made highly visible to the regulated community and will serve as a deterrent to other defendants who may contemplate using the bankruptcy courts as an obvious shield from potential Superfund liability to the government 4/. In these cases, the

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4/ The government has been successful in dismissing bankruptcy actions where the government was able to show under Rule 707(a) or 305(a) that the dismissal was in the public interest. In In re Commercial Oil (No. 85-01951 Bankr. N.D. Ohio) the Bankruptcy Court under rule 707(a) dismissed the petition in bankruptcy citing In re Charles George Land Reclamation Trust, 30 B.R. 918 (Bankr. C.D. Mass. 1983) which involved a sham bankruptcy filing in an attempt to avoid Superfund liability.

Region should attempt to estimate the extent to which the costs of litigation may be recoverable.

4. Equitable treatment of all responsible parties

In some circumstances the Region may wish to refer a case against a bankrupt party in the interest of equity and fair treatment of all parties. For example, it may be appropriate to pursue the bankrupt owner or operator of a facility who contributed significantly to the creation of the hazard, particularly in connection with a settlement with other viable responsible parties. In most cases, the Region should not consider a referral against bankrupt generators or transporters unless the case meets the criteria set out in justifications 1 or 2.

5. Favorable precedent or tactical litigation considerations

In rare cases there may be an overriding interest in pursuing a bankrupt party for the purposes of obtaining an important and favorable precedent 5/ or where there are tactical litigation issues relating to other actions in which the Agency is involved 6/.

5/ There may be cases where even though the potential recovery is small, there is good opportunity to develop the law in the area of environmental bankruptcy litigation. Moreover, cases where the Agency's claim is small may present the best factual situations for developing our legal arguments. For example, courts may be more willing to grant an administrative expense priority when the size of EPA's claim is small and will not keep other administrative claims from being paid.

6/ For example, filing a proof of claim may be a useful mechanism to insure that the United States receives copies of relevant pleadings filed in the bankruptcy and has access to participate in whatever discovery is conducted in the bankruptcy proceeding.

MULTIPLE CLAIMS

In several cases, the Regions have referred bankruptcy cases which address one claim against a debtor, but which do not mention other, sometimes unrelated, potential claims that may involve the same debtor. For example, referrals for the recovery of funds spent in an immediate removal may also have potential claims for CERCLA remedial action or RCRA corrective action. There can be conflicts in how the Agency would want to proceed on the various claims. Accordingly, it is essential that the full extent of all potential EPA claims against a debtor be disclosed to the Department of Justice before any formal action is taken in the bankruptcy. All litigation reports prepared by the Regions for bankruptcy cases should summarize all known and potential claims that EPA may have against the debtor.

SETTLEMENT WITH BANKRUPT PARTIES UNDER CERCLA

The Agency's settlement policy 7/ states that it may be appropriate for the Regions to enter into negotiations with bankrupt PRPs even though an offer may not represent a substantial portion of the costs of cleanup. The policy further states that the Regions should avoid becoming involved in bankruptcy proceedings

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7/ "Interim Hazardous Waste Settlement Policy" Vol. 50, No. 24 Federal Register (February 5, 1985) 5034-5044. See discussion at II. Management Guidelines for Negotiation, claims in bankruptcy Id. at 5036.

if there is little likelihood of recovery, and should recognize the risks of negotiating without creditor status. In general, the Regions have been given broad authority to settle with bankrupt parties.

When a Region elects to settle with a bankrupt party the following five options should be considered:

1. Confession of Judgment

In United States v. Metate Asbestos Corp. et al., No. 83-309-GLO-RMB (Order of July 12, 1985) the court approved the entry of a consent decree and civil judgment against certain of the defendants in bankruptcy for $7,085,000. The order granted judgment jointly and severally in the District Court proceeding in settlement of claims against the bankrupt parties. In this case, due to the extremely limited assets of the bankrupt individuals, it is doubtful that the United States will recover a substantial portion of the $7 million. This form of settlement (i.e., a confession of liability and judgment) is only encouraged in a Chapter 11 reorganization action where a specific provision for enforcement of the judgment is set out in the confirmed plan of reorganization. 8/

8/ Unless otherwise provided for in the plan of reorganization, the confirmation of the plan discharges the debtor from all debts arising before the date of confirmation, 11 U.S.C. §1141(d)(1). In addition, 11 U.S.C. §524(a) provides that a discharge voids judgments on discharged debts and enjoins any legal action to collect such debts from the debtor or the property of the debtor.

2. Written agreement with trustee and other creditors regarding satisfaction of claim with appropriate reservations

It is also possible for the Agency to enter into an agreement with the trustee for the debtor regarding a future payment of funds upon dissolution of the estate. For example, in one case in the Northern District of Florida the Agency is contemplating entering into a stipulation with the trustee and the mortgage holder on the contaminated property. As a condition of settlement, EPA will agree to release the debtor from liability and allow the cleaned up property to be sold or leased. EPA and the mortgage holder would split the proceeds from the sale or lease of the property thereby recovering a substantial portion of the Agency's cleanup costs.

In a second case, in the Eastern District of North Carolina, the Agency is considering entering into a similar arrangement. The debtor-in-possession has submitted a liquidation plan of reorganization in which the debtor agrees to retain title to the contaminated property during the EPA cleanup. When the cleanup is completed, the debtor will sell the property. The proceeds will go first to cover administrative expenses involved in the sale and then to EPA for reimbursement of response costs. EPA has requested that language be included in the plan which protects the right of EPA to recover against the debtor's insurance companies.

3. Agreement with trustee regarding pro rata distribution of assets

Pending a final accounting, EPA may agree with the trustee to a pro-rata payment of our claim in bankruptcy. In In re Crystal Chemical Company, No. 81-02901-HB-4 (Bankr. S.D. Texas), EPA entered into a stipulation with the trustee for a pro rata payment of cleanup costs after liquidation. The stipulation was reached after a four day presentation of evidence to the bankruptcy court where EPA was seeking an immediate payment of funds for the ongoing cleanup.

4. Settlements contained in the reorganization plan

A Chapter 11 reorganization plan is a type of settlement document. Reorganization plans can be used to set forth various settlement-type provisions that are in the Agency's interest. For example, in In re Thomas Solvent Co., NK 84-00843 (Bankr. W.D. Mich.), the Second Amended Plan of Reorganization, which was confirmed by the court, included, at the government's insistance, provisions relating to preserving claims against liability insurers and provisions relating to restrictions on transfer of contaminated property. Other appropriate provisions in such plans might be provisions on access to property and retention of records. The Agency should insist on this type of provision in cases where a plan cannot be confirmed without our concurrence.

5. Settlement with other creditors.

In some cases, other creditors will be a party to a settlement between FPA and the debtor. For example, in In re Thomas Solvent Co., NK 84-00843 (Bankr. W.D. Mich.), there is approximately $350,000 available for distribution to creditors. The significant creditors are EPA, the State of Michigan and two residents groups with health claims. EPA, the State and the two groups have filed multi-million dollar claims. We are presently finalizing a settlement among these creditors and the debtor which will provide for the distribution of the $350,000. One primary benefit of such a settlement is that it avoids the need for time consuming and expensive litigation in bankruptcy court among creditors damaged by the same activities, and will allow us to devote our full resources to pursuing a cost recovery action against other responsible parties.

There are numerous other options for settlement, and for documentation of settlement, with a bankrupt party, including those used to resolve non-bankruptcy proceedings under CERCLA. Although Headquarters will be flexible in reviewing these settlements, it is important that the Regions consult with Headquarters and the Department of Justice before entering into final negotiations with a bankrupt party. An abbreviated referral of the bankruptcy settlement agreement is acceptable.

JUDICIAL DEVELOPMENTS

Since the May 24, 1984 guidance was issued regarding CERCLA enforcement againt bankrupt parties, there has been an increase in judicial activity in the area of environmental bankruptcy actions, particularly in cases involving hazardous waste sites. In addition to several significant District Court and Appellate Court decisions, the Supreme Court has issued two significant rulings in this area in Ohio v. Kovacs, 105 S. Ct. 705 (1985), and Midlantic National Bank v. New Jersey Department of Environmental Protection, 54 U.S.L.W. 4138 (U.S. Jan. 27, 1986) ("Quanta Resources").

1. Automatic Stays

Several courts have adopted the Agency's interpretation that the automatic stay provision of section 362 of the Bankruptcy Code does not apply to actions taken by a governmental unit to prevent environmental harm. In Penn Terra Ltd. v. Department of Environmental Resources, 733 F.2d 267, 274 (3d Cir. 1984), the court held that actions taken to "rectify harmful environmental hazards" were an obvious exercise of the State's authority under the police power and therefore were exempt from the automatic stay. The Supreme Court, in a footnote to the Kovacs decision, suggested that Penn Terra may be applicable to hazardous waste cleanup actions, 105 S.Ct. 705, 718, n. 11.

A recent CERCLA decision regarding the Film Recovery site in Illinois was also favorable to the Agency on the issue of the automatic stay, United States v. B.R. MacKay & Sons Inc.,

et al., No. 85-C-6925 (N.D. Ill. Jan. 17, 1986). In the McKay decision the court held that CERCLA cost recovery actions fall squarely within the governmental enforcement exception to the automatic stay. Id. at 7.

Other recent decisions indicate a split of authority on the issue of whether the automatic stay applies to enforcement actions brought pursuant to CERCLA. In United States v. ILCO, 48 B.R. 1016 (N.D. Ala. 1985), EPA asserted claims pursuant to RCRA §3008, CWA §§301 and 309, and CERCLA §106. The Court's decision in the ILCO case stated clearly that the CERCLA §106 claims were exempt from the automatic stay because the government's complaint, which sought a court order compelling ILCO to remedy environmental harm, constituted an equitable action to prevent future harm, rather than an action to enforce a money judgment. Recognizing that the debtor would have to expend funds in order to satisfy the requested mandatory relief, the Court indicated that compliance with environmental laws is of greater importance than the rights of the creditors. The ILCO decision cites Penn Terra, 733 F.2d 277 and Kovacs in support. See also, In the Matter of Hildeman Indus., Inc. (Bankr. N.D. N.J. Dec. 17, 1984) (dioxin sampling taken pursuant to an administrative order falls within the enforcement of the police or regulatory powers of a governmental unit). But see, In re Thomas Solvent Co., Bankr.

L. Rep. (CCC) ¶70,111 (Bankr. W.D. Mich. 1984) (automatic stay held applicable to Michigan's attempt to enforce a pre-bankruptcy cleanup injunction).

Enforcement actions brought pursuant to the Resource Conservation and Recovery Act and its applicable regulations have also been found to be exempt from the automatic stay in most of the recent decisions. The Bankruptcy Court in In re Wheeling Pittsburg Steel Corp., et al., v. United States Environmental Protection Agency and Ralph W. Siskind, No. 85-793 (PGH) No. 85-0236 (Bankr. W.D. Penn. Oct. 31, 1985), granted the United States' motion to dismiss the complaint to enforce the automatic stay. In that decision, the court held that the United States can: 1) proceed to enforce RCRA; 2) seek to determine the existence of any violations of RCRA; 3) seek to rectify those violations; and 4) seek the entry of a money judgment on any penalties assessed (but cannot seek to enforce such judgment without an order from the court).

Similarly, on appeal to the U.S. District Court for the Western District of Texas from the Bankruptcy Court, in In the Matter of Commonwealth Oil Refining Co., Inc., Offical Committee of Unsecured Creditors and the Indentured Trustee v. United States Environmental Protection Agency, No. SA 85-CA-2045 (W.D. Texas, Nov. 5, 1985), the court held that an EPA enforcement action to require a debtor to comply with RCRA's Part B requirements was an exercise of the Agency's regulatory power.

and thus excepted from the automatic stay under 11 U.S.C. §362(b)(4). The court stated that the expense which the debtor will incur to comply with environmental laws does not convert into an enforcement of a money judgment which would be automatically stayed, slip op. at 3. See also, United States v. ILCO, 48 B.F. 1016, 1021, 1024 (N.D. Ala. 1985); In re Bayonne Barrel and Drum Co., Inc., No. 82-04747, slip op. at 1 (D. N.J. July 17, 1984). But see, In re Professional Sales Corp., 48 B.R. 651 (Bankr. N.D. Ill. 1985), rev'd 56 B.R. 753 (N.D. Ill. 1985).

There is also some authority to suggest that the collection of a civil administrative fine or penalty is an exercise of the government's regulatory power, and therefore is exempt from the automatic stay provisions, United States v. Energy International Inc., 19 BR 1020, (S.D. Ohio, 1981).

2. Abandonment

In Midlantic National Bank v. New Jersey Dept. of Environmental Protection, ("Quanta Resources") 54 U.S.L.W. 4138 (Jan. 27, 1986), the Supreme Court held 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." The Court qualified this holding by stating that this exception to the abandonment power would not apply if the state statute did not address an "imminent and identifiable harm" or if the violations alleged were "speculative or indeterminate future" events. Id. at n.9. The Court left

open the question of whether trustees must comply with health and safety laws no matter how "onerous" their provisions. However, the Court did give some clue when it described security fencing, drainage and diking repairs, sealing deteriorating tanks, and removing explosive agents as "relatively minor steps." Id at n.3.

Prior to the Supreme Court's ruling, abandonment decisions in the lower courts were mixed. Compare, In re T.P.Long Chemical Inc., No. 581-906 (Bankr. N.D. Ohio, Jan. 31, 1985) (the trustee was denied permission to use abandonment to avoid CERCLA liabilities) with, Catamount Dyers, 13 B.C.D. 321 (Bankr. D. Vt. 1985) (abandonment of contaminated property allowed); In re Union Scrap Iron and Metal, 13 B.C.D. 29 (Bankr. D. Minn., 1985 (same)).

3. Discharge

The Supreme Court recently addressed the issue of whether a bankruptcy discharge relieves the debtor from fulfilling environmental duties that may have arisen prior to filing the petition in bankruptcy. In Ohio v. Kovacs, 105 S. Ct. 705 (1985) the Court stated that a pre-petition injunction for cleanup of the Chem Dyne hazardous waste site is a dischargeable debt where the debtor had been dispossessed of the property and hence the State was seeking nothing more than payment of money for the cleanup. However, the Kovacs decision noted that an affirmative injunction not to bring waste to a site (which would not involve an expenditure of money) was not a dischargeable debt. The Agency has taken the position that the Kovacs ruling

should be applied only to those sites where the debtor is no longer in possession or control of the contaminated property. An equally narrow interpretation can be made of the decision in In re Robinson, No. 84-404-BK-J-GP (Bankr. M.D. Fla. Feb. 4, 1985), rev'd. (A pre-petition injunction to restore marshland which the debtor had illegally excavated was also held to be dischargeable even though the debtor was not dispossessed, because the restoration project would have required an expenditure of money and was not an affirmative injunction. In contrast, EPA enforcement actions or cleanup compliance orders could be characterized as an affirmative injunction).

4. Recovery of Response Costs - Administrative Expenses

The Agency has successfully argued that the EPA's response costs are necessary to preserve the estate of the debtor and should be accorded the priority allowed for administrative expenses, In re T.P. Long Chemical Inc., No. 581-906 (Bankr. N.D. Ohio, Jan. 31, 1985). In the T.P. Long case, the Court held that the estate was a liable party under CERCLA §107 and that the CERCLA liabilities of the estate were entitled to priority treatment as an administrative expense. Kovacs 105 S.Ct. at 711-712.

The Supreme Court's decision in Midlantic Bank may be read to support the holding in T.P. Long that CERCLA liabilities of the estate are administrative expenses. Although the Court attempted to reserve the administrative expenses question, the

implication of the Court's holding that trustees must comply with health and safety laws is that such compliance is an "actual, necessary cost and expense of preserving the estate." 11 U.S.C. §503(b)(1)(A). See also, In the Matter of Thomas Solvent Co., No. NK-84-00843 (Bankr. N.D. Mich, Jan. 2, 1986) (court order requiring construction of a fence on contaminated property owned by the debtor stated that cost of construction is an administrative expense pursuant to §503(b) of the Bankruptcy Code); In re Geuder Paesche & Frey Co., (Bankr. E.D. Wisc.) (cleanup costs are administrative expenses); In re Laurinberg Oil Co., Inc., No. B-84-00011 (M.D. N.C. Sept. 14, 1984) (expenses incurred to abate violations of state water pollution laws are administrative expenses); but see, Southern Railway Co. v. Johnson Bronze Co., 758 F.2d 137 (3d Cir. 1985) (in the absence of fraud, purchaser of property from the debtor does not have claims against the bankrupt's estate for the costs of cleaning up the site); In re Charles A. Stevens, 53 BR 783 (Bankr. D.C. Maine, Oct. 9, 1985) (costs for investigation of waste oil contamination were found not to be an administrative expense and constitute only a general, unsecured claim against the debtor's estate); and In re Wall Tube and Metal Products Co., No. 3-84-00278 (Bankr. E.D. Tenn. Jan. 17, 1986), appeal pending (environmental response costs incurred by the State of Tennessee did not constitute administrative expenses).

An important First Circuit decision which may have applicability in the recovery of CERCLA penalties from bankrupt parties

is the case In re Charlesbank Laundry, Inc., 755 F.2d 200 (1st. Cir. 1985), which held that a State fine assessed for violation of a preliminary injunction is properly an administrative expense.

Governments have also been successful in recovering cleanup costs through property liens. In In re Berg Chemical Co., Inc., Case No. 82-B-12052 (Bankr. S.D. N.Y. July 9, 1984), the City was granted a superpriority lien against the property to clean up chemical wastes. But see, In re Charles A. Stevens 53 BR 783 (Bankr. D.C. Maine Oct. 9, 1985) (the State's pre-bankruptcy investigation costs did not give rise to a lien against the property).

5. Federal Lien

The proposed CERCLA reauthorization legislation establishes a federal lien on property belonging to persons otherwise liable for costs and damages under CERCLA. (Amendments to CERCLA §107). The Senate bill provides that the lien is not valid against the purchaser, holder of security interest, or judgment creditor until notice of lien is filed in the State where the property is located. The House bill provides that the Agency's lien would be subject to the rights of purchasers, judgment lien creditors, or holders of security interests under State law until notice of lien is filed. The House version also establishes a maritime lien applicable to vessels.

ENFORCEMENT THEORIES

There have been several new enforcement theories developed by the EPA Regional Offices, the Department of Justice and the Office of Enforcement and Compliance Monitoring in the area of environmental enforcement against bankrupt parties. Two of these legal theories may be particularly useful in the cases involving insolvent hazardous waste handlers.

1. Withdrawal of Reference to District Court

In deciding whether a bankruptcy court is the appropriate forum there are two issues which are relevant: whether the proceeding is a core proceeding under Section 157(b) and, if so, whether Section 157(d) applies.

The bankruptcy courts have the authority to render final decisions on all core proceedings listed under the bankruptcy code. However, both core and non-core proceedings, such as factual determinations of liability for environmental damages, may be referred to the federal district court. Pursuant to 11 U.S.C. §157(d) the district court is required to withdraw a matter from bankruptcy court when its resolution will involve consideration of the bankruptcy code and other federal statutes regulating organizations or activities affecting interstate commerce.

In United States v. ILCO, Inc., 48 Bankr. Rep. 1016 (N.D. Ala., 1985), the district court held that Section 157(d) applied to, and required withdrawal from the bankruptcy court of, claims asserted by EPA under CERCLA and other environmental statutes.

The court found that CERCLA and the other environmental statutes relied on were "clearly...rooted in the commerce clause and are the type of laws Congress had in mind when it enacted the mandatory withdrawal provision." Id. at 1021. The court in ILCO clearly stated that withdrawal was only appropriate if the resolution of the claim required substantial and material consideration of CERCLA; not that the CERCLA issues were "merely incidental" for resolution of the matter. See also, briefs filed by the government in In re Johns Manville Corp., No. 85-6828(A) (S.D. N.Y. Dec. 30, 1985).

Seeking withdrawal from the bankruptcy court to the district court will allow the Agency a more favorable forum which is experienced in hearing complex issues of fact, and will allow the Agency to obtain a judgment enforceable in the bankruptcy court.

2. Discharge of Debts

All pre-petition debts are automatically dismissed when the debtor is granted a discharge in bankruptcy, 11 U.S.C. §727(b), 11 U.S.C. §502, 11 U.S.C. §1141(d)(1)(A). The definition of a pre-petition debt includes any action where a claim or where a potential claim existed before the debtor filed for bankruptcy (i.e, where a creditor could have sued or could have filed a proof of claim). Discharges are available in individual bankruptcies (§727(b)) and in Chapter 11 reorganizations (§1141(d)(1)(A). They are not available in corporate or

partnership Chapter 7 proceedings, or in Chapter 11 liquidations (§1141(d)(3). This raises three questions for the Agency: 1) what type of bankruptcy proceeding is involved? 2) when did the debt arise? and 3) is the debt subject to discharge?

First, if the Agency did not incur response costs at a site prior to the bankruptcy filing, the Agency may wish to argue that the debt (or potential debt) did not arise until after commencement of the bankruptcy action. The Agency may then preserve its right to pursue an action against the party after discharge. However, a discharge in a Chapter 11 proceeding may be read broadly to include all claims that arose pre-confirmation, §1141(d). The issue of the proper treatment of post-petition, pre-confirmation claims is currently being litigated by the Agency in the action against Johns Manville at the Iron Horse Park site in North Billerica, Massachusetts, In re Johns Manville No. 85-6828(A) (S.D. N.Y. Dec. 30, 1985).

It may be advantageous in a Chapter 7 liquidation case for the Agency to argue that the CERCLA cost-recovery claim "arose" pre-petition, when the environmental harm first occurred or was discovered, even though response costs were not incurred until after the petition. This is due to the fact that the debtor does not survive the bankruptcy and therefore recovery during liquidation of the estate, as a pre-petition creditor, is EPA's only chance for recovery.

Second, if the debtor is an individual, or corporation or partnership under Chapter 11 Reorganization, the Agency may wish to take the position that even if the debt is a pre-petition

debt, EPA's claim is not subject to discharge because it falls under one of the stated exceptions to discharge set out in 11 U.S.C. §523(a). The exceptions that would be applicable are those which apply to fines or penalties payable to and for the benefit of a governmental unit, 11 U.S.C. §523(a)(7), or for willful or malicious injury to property, 11 U.S.C. §523(a)(6). In cases of misrepresentation by the debtor, the discharge can also be blocked by: proof that the debtor made fraudulent statements regarding its financial condition; failure by the debtor to produce books and records; or failure by the debtor to explain losses, 11 U.S.C. §523(a).

CONCLUSION

Future CERCLA bankruptcy referrals will be carefully reviewed by Headquarters to determine if the action merits referral to the Department of Justice under the five criteria set out in this guidance. Settlement with bankrupt responsible parties is encouraged and, consistent with the Agency's current settlement policy, the Region is given greater flexibility and authority to settle claims against bankrupt parties. Recent judicial decisions and enforcement theories developed by EPA and the Department of Justice will strengthen the Agency's legal position in those cases where the Agency has decided to pursue an enforcement action against a bankrupt party.

IMPLEMENTATION

This guidance updates the procedures contained in the existing bankruptcy and cost recovery policies. All future hazardous waste bankruptcy referrels and settlements should follow this guidance. If you have any questions concerning these procedures please contact Heidi Hughes of my office (FTS 382-2845).

cc: F. Henry Habicht II
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