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Environmental Law - In Re Jensen: Determining When a Bankruptcy Claim Arises in the Context of Environmental Liability

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ENVIRONMENTAL LAW

SUMMARY

IN RE JENSEN: DETERMINING WHEN A BANKRUPTCY CLAIM ARISES IN THE CONTEXT OF ENVIRONMENTAL LIABILITY

I. INTRODUCTION

In *In re Jensen*,[1] the Bankruptcy Appellate Panel of the Ninth Circuit (Appellate Panel) held the State of California's claim against a bankrupt corporation for hazardous waste cleanup costs under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)[2] and the Hazardous Substance Account Act (HSA)[3] arose prior to the time when the bankruptcy petition was filed.[4] Thus, the State's

1. *In re* Jensen, 127 B.R. 27 (Bankr. 9th Cir. 1991) (per Ashland, J.; the other panel members were Meyers, J., and Ollason, J.).

2. Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (codified as amended at 42 U.S.C. §§ 9601-9657 (1988)). This is the federal "Superfund" statute which provides agencies with a procedure for cleanup cost recovery from those parties responsible for hazardous waste contamination.

3. Hazardous Substance Account Act (codified as amended at CAL. HEALTH & SAFETY CODE §§ 25300-25395 (West 1992)). Also known as the "State Superfund," this statute provides state agencies with a procedure for cleanup cost recovery from those parties responsible for hazardous waste contamination.

4. *Jensen*, 127 B.R. at 32. The Appellate Panel followed the district court's holding in *In re* Chateaugay Corp., 112 B.R. 513 (Bankr. S.D.N.Y. 1990), *aff'd sub nom.*, United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997 (2d Cir. 1991), that a bankruptcy claim arises when a prepetition triggering event occurs, such as the release or

claim was discharged pursuant to section 727 of the Bankruptcy Reform Act (Bankruptcy Code).[5] The court reasoned that the debtor's conduct, here the discharge of hazardous wastes, dictated when the State's claim arose.[6]

II. FACTS

The Jensens wholly-owned and operated Jensen Lumber Company (JLC), a lumber treatment facility, which dipped logs in fungicide tanks.[7] On February 2, 1984, the Jensens received a letter from the California Regional Water Quality Control Board stating that a hazardous waste problem existed at the site.[8] The Jensens subsequently filed for bankruptcy under Chapter 7 of the Bankruptcy Code on February 13, 1984.[9]

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threatened release of hazardous waste, and was, therefore, dischargeable in this case. The court reasoned this result sustains the fresh start goal of bankruptcy and discourages manipulation of the bankruptcy process. *Id.* at 33.

5. Bankruptcy Reform Act of 1978 (codified as amended at 11 U.S.C. §§ 101-1330 (1988)). Section 727 lists the circumstances when a court can grant an individual debtor a discharge from creditors' claims.

6. *Jensen*, 127 B.R. at 32 (citing *In re* Chateaugay Corp., 112 B.R. 513, 522 (Bankr. S.D.N.Y. 1990)), *aff'd sub nom.*, United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997 (2d Cir. 1991).

7. *In re* Jensen, 127 B.R. 27, 28 (Bankr. 9th Cir. 1991). The lumber was treated by dipping the logs into a fungicide solution containing pentachlorophenol. *In re* Jensen, 114 B.R. 700, 701 (Bankr. E.D. Cal. 1990). The fungicide solution was held in an aboveground, six foot by six foot by twenty foot, cinder block tank. *Id.*

8. *Jensen*, 127 B.R. at 28.

9. *Id.* The following is a partial excerpt of the appendix to the appellate decision which contained a chronology of events.

12/2/83 - JLC filed voluntary petition under Chapter 11.
1/25/84 - Albert Wellman, engineer for the Board, inspected the JLC site.
2/2/84 - The Jensens received a letter from Wellman stating a potential hazardous waste problem existed at the site.
2/10/84 - The Jensens' attorney informed Wellman by letter that JLC had filed a Chapter 11 petition, virtually certain to be converted to Chapter 7, and that JLC had no available funds for site cleanup.
2/13/84 - The Jensens filed a joint voluntary petition in bankruptcy under Chapter 7. The schedule of liabilities filed did not include any costs for potential site cleanup.
2/24/84 - First notice of creditors' meeting in the Jensens' individual bankruptcy.
3/84 - The Board requested assistance from the Department of Health Services.
3/20/84 - JLC's Chapter 11 case converted to Chapter 7.
7/16/84 - The Jensens were released from all dischargeable debts in their personal Chapter 7 case.
2/20/85 - The Jensens' personal bankruptcy closed with no assets being distributed to creditors.
3/18/87 - JLC Chapter 7 case was closed.
Jensen, 127 B.R. at 33-34.

The California Department of Health Services (DHS) became involved in March, 1984.[10] After expending funds for hazardous waste cleanup, DHS sought indemnification from the Jensens.[11]

Eventually, the Jensens filed an adversary proceeding to determine whether the DHS claim was prepetition and therefore discharged.[12] The bankruptcy court granted the DHS motion for summary judgment and denied the Jensen's motion for summary judgment.[13] The Jensens appealed.[14]

III. THE COURT'S ANALYSIS

The court specifically limited its review to the issue of when DHS's claim arose for purposes of bankruptcy.[15] In addition, the court expressly stated that its decision did not address the issue of whether the environmental claim was exempted from discharge.[16]

A. Broad Interpretation of 11 U.S.C. § 101(4) Defining Claim

The court set the groundwork for its analysis by evaluating the scope of the definition of "claim."[17] This analysis employed a broad interpretation of claim, defined by 11 U.S.C. § 101(4).[18]

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10. *Id.* at 28.
11. *Id.*
12. *Id.*
13. *Jensen*, 127 B.R. at 28.
14. *Id.*
15. *In re* Jensen, 127 B.R. 27, 29 (Bankr. 9th Cir. 1991).
16. *Id.* The court noted DHS did not contend that its claim was excepted from discharge, rather the claim arose postpetition and was, therefore, not discharged. *Id.*
17. *Id.*
18. 11 U.S.C. § 101(4) (1988). Section 101(4) defines claim as follows:

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

Jensen, 127 B.R. at 29.

After the court determined that the use of a broad interpretation was the most appropriate,[19] it was confronted with the additional issue of interpreting just how broad this definition should be.[20]

B. Supreme Court Precedents

The Ninth Circuit cited two recent United States Supreme Court decisions: *Ohio v. Kovacs*[21] and *Midlantic National Bank v. New Jersey Department of Environmental Protection*,[22] involving environmental issues in the context of bankruptcy.[23] In *Kovacs* the Court held that the State of Ohio's injunction to clean up hazardous waste was a claim and, therefore, dischargeable in bankruptcy.[24] In *Midlantic National Bank*, the Court held that state environmental laws could require a bankruptcy trustee to clean up the debtor's contaminated property.[25] However, neither *Kovacs* nor *Midlantic National Bank* were followed because they failed to address when bankruptcy claims

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19. *Jensen*, 127 B.R. at 29. The Appellate Panel relied on congressional proceedings to support its use of this particular interpretation of claim. Congress commented:

> The effect of the definition is a significant departure from present law . . . . By this broadest possible definition and by use of the term throughout the title 11 . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

S. Rep. No. 989, 95th Cong., 2d Sess. 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5807-08.

20. *Jensen*, 127 B.R. at 29.

21. Ohio v. Kovacs, 469 U.S. 274, 276 (1985). In Ohio v. Kovacs, the State of Ohio filed an injunction requiring the debtor to clean up hazardous waste on the debtor's property. After the debtor filed for bankruptcy, the State sought a declaration that the debtor's obligation under the injunction was not dischargeable. *Id.* at 277. The State argued the injunction did not constitute a "debt" or "liability on a claim" as defined in the Bankruptcy Code and was thus not dischargeable. *Id.* The United States Supreme Court disagreed, finding the State wanted the equivalent of a monetary payment which was within the definition of a claim. *Id.* Consequently, the debtor's environmental obligation was dischargeable in bankruptcy. *Id.* at 282.

22. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986). The Court narrowed a bankruptcy trustee's powers in order to force a cleanup of hazardous waste. The Supreme Court determined that a trustee in bankruptcy could not abandon property in contravention of a state statute or regulation reasonably designed to protect public health and safety, such as state environmental laws. *Id.* at 506-07.

23. *Jensen*, 127 B.R. at 29.

24. *Kovacs*, 469 U.S. at 283.

25. *Midlantic*, 474 U.S. at 507.

arose.[26]

C. Origination of Claims

Because the respective Supreme Court decisions offered no guidance, the court turned to other authority to determine when bankruptcy claims originated.[27] This authority provided that bankruptcy claims may arise: (1) with the right to payment, (2) upon the establishment of the relationship between creditor and debtor, or (3) based upon the debtor's conduct.[28]

1. *Claim Arises With the Right to Payment*

The bankruptcy court held that the claim arose with the right to payment, that is, after cleanup costs were incurred.[29] The court's reasoning was as follows: section 101(4) of the Bankruptcy Code specifically required a right to payment before a cognizable claim originated,[30] and the right to payment under CERCLA or HSA did not arise until cleanup costs were incurred.[31] Thus, the court concluded that until cleanup costs were incurred, no right to payment and no cognizable bankruptcy claim existed.[32]

In *In re Frenville*,[33] the Third Circuit adopted this theory. The *Frenville* court, concluding that the Bankruptcy Code did not clearly define when a right to payment arose, applied state law.[34] The appropriate state law declared a right to payment arose upon payment of the judgment flowing from the act.[35] The Third Circuit concluded that the creditor's claim arose postpeti-

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26. *Jensen*, 127 B.R. at 30.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Jensen*, 127 B.R. at 30.
31. *Id.*
32. *Id.*
33. *In re* Frenville, 744 F.2d 332 (3rd Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985). A creditor appealed a district court order holding the creditor's indemnity action against the Chapter 7 debtor was barred by the automatic stay provision of the Bankruptcy Code. *Id.* at 332.
34. *Id.* at 337.
35. *Id.*

tion and was not discharged by the debtor's bankruptcy.[36]

The Appellate Panel did not follow *Frenville*.[37] The court justified its departure by noting that *Frenville* had been criticized for confusing a right to payment for federal bankruptcy purposes with the accrual of a cause of action for state law purposes.[38] In addition, the court stated the definition of claim under section 101(4) included contingent and unmatured rights to payment.[39]

If a bankruptcy claim arose based on a statutory right to payment, the Appellate Panel believed the bankruptcy process would be manipulated.[40] The court reasoned that utilizing a statutory right to payment to trigger recognition of a bankruptcy claim would contravene the goal of the Bankruptcy Code to provide a "fresh start" for the debtor.[41]

DHS argued that a private cause of action does not arise under CERCLA until cleanup costs are incurred.[42] The bankruptcy court and DHS cited *Levin Metals Corp. v. Parr-Richmond Terminal Co.*[43] and *Bulk Distribution Centers, Inc. v. Monsanto Co.*[44] in support of this proposition.[45] However, the court's opinion discounted these cases as being inapposite and distinguishable.[46] Similarly, the court concluded that *In re Hem-*

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36. *Id.*

37. *Jensen*, 127 B.R. at 31.

38. *Id.* at 30 (citing *In re* A.H. Robins Co., 63 B.R. 986, 992 (Bankr. E.D. Va. 1986)).

39. *Jensen*, 127 B.R. at 31.

40. *Id.* The court postulated that a creditor, aware of a debtor's precarious financial situation, would delay expenditures in anticipation of the debtor's bankruptcy, thereby preventing discharge of the creditor's claims. *Id.*

41. *Id.* The court justified this policy of providing a "fresh start" for the debtor by turning to a recent Supreme Court decision. Grogan v. Garner, 498 U.S. 279 (1991).

42. *Jensen*, 127 B.R. at 31.

43. Levin Metals Corp. v. Parr-Richmond Terminal Co., 799 F.2d 1312, 1316 (9th Cir. 1986). The Ninth Circuit found that private causes of action under CERCLA did not arise until cleanup costs were incurred.

44. Bulk Distribution Centers, Inc. v. Monsanto Co., 589 F. Supp. 1437, 1450-52 (S.D. Fla. 1984). District court found that private causes of action under CERCLA did not arise until cleanup costs were incurred.

45. *Jensen*, 127 B.R. at 31.

46. *Id.* The court concluded reliance on these cases was misplaced because the cases did not involve bankruptcy or when a bankruptcy claim arose. *Id.* Rather, the cases only determined that a private action under CERCLA could not be commenced prior to incurrence of cleanup costs. *Id.*

ingway Transport, Inc.[47] and *In re Wall Tube & Metal Products Co.*,[48] cases which held that cleanup costs were entitled to administrative expense priority, were inapplicable as well. The Appellate Panel concluded that the bankruptcy court's reliance on these cases was misplaced because neither case mentioned the definition of a claim under section 101(4) nor addressed when a bankruptcy claim arose.[49]

2. *Claim Arises Upon the Establishment of the Relationship Between the Debtor and the Creditor*

DHS alternatively contended that claims originate at the earliest point of a relationship between the debtor and the creditor.[50] DHS asserted that because its staff did not become involved until after the Jensens filed for individual bankruptcy, its claims would be postpetition and not dischargeable.[51] The court rejected this view and concluded the analysis used in *Edge*,[52] cited by DHS, actually followed the view that the claim arose

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47. *In re* Hemingway Transport, Inc., 73 B.R. 494 (Bankr. D. Ma. 1987). In *Hemingway*, the plaintiff purchased property from the bankruptcy trustee, property which later was found to be contaminated with hazardous waste. The plaintiff was forced to clean up the waste and sought indemnification from the estate, asserting administrative priority for its claim. *Id.* at 504. The court held plaintiff's claims were entitled to administrative priority because of the negligence of the trustee. *Id.* at 504-05.

48. *In re* Wall Tube & Metal Products Co., 831 F.2d 118 (6th Cir. 1987). The *Wall* court held Tennessee's response costs, incurred at debtor's hazardous waste site, were allowable as administrative expenses. *Id.* at 124.

49. *Jensen*, 127 B.R. at 31. The court found *Hemingway* distinguishable because the case only dealt with administrative priority claims. *Id.* Furthermore, the court justified this distinction because the bankruptcy court's decision relied on equitable considerations. *Id.* Specifically, the bankruptcy court frowned upon the debtor's attempt to transfer its liability or potential liability under state or federal environmental laws. *Hemingway*, 73 B.R. at 505.

The Appellate Panel determined that *Wall* was also inapposite for failing to mention section 101(4) or the origination of a bankruptcy claim. *Jensen*, 127 B.R. at 31.

50. *Jensen*, 127 B.R. at 31.

51. *Id.*

52. *In re* Edge, 60 B.R. 690 (Bankr. M.D. Tenn. 1986), involved the prepetition negligence of two debtor dentists. The plaintiff sought a declaration that her claim arose upon discovery of the injury, which was postpetition, and was, therefore, not subject to the automatic stay. *Id.* at 690. The bankruptcy court held the plaintiff's claim arose at the time the negligence occurred and allowed the plaintiff to share in the distribution of the debtors' prepetition assets. *Id.* at 699.

However, the Appellate Panel construed the results of *Edge* differently than DHS. The court inferred the claim arose at the time of the dentists' negligent conduct, which coincided with the relationship between the debtor-dentists and creditor-plaintiff. *Jensen*, 127 B.R. at 32.

based upon the debtor's conduct.[53]

3. *Claim Arises Based Upon the Debtor's Conduct*

The Appellate Panel adopted the theory that a bankruptcy claim originated with conduct, by the debtor, leading to a cause of action.[54] The court discussed *In re Johns-Manville Corp.*[55] and *In re A.H. Robins Co.*,[56] cases frequently cited in support of this theory.

One bankruptcy court has applied this theory to environmental claims. The bankruptcy court, in *In re Chateaugay Corp. (LTV)*,[57] examined the language of CERCLA requiring a release or threatened release of a hazardous substance before liability can be established. The *LTV* court held so long as a prepetition triggering event has occurred, then the claim is dischargeable, regardless of when the claim for relief may be ripe for adjudication.[58]

The Appellate Panel adopted the reasoning applied in *LTV*.[59] In doing so, the court rejected the DHS argument that *LTV* was distinguishable because the *LTV* parties had an extensive relationship prior to the bankruptcy filing.[60] The rationale for adopting this view was based upon the bankruptcy goal of providing a fresh start to the debtor and discouraging the ma-

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53. *Jensen*, 127 B.R. at 32.

54. *Id.*

55. *In re* Johns-Manville Corp., 57 B.R. 680 (Bankr. S.D.N.Y. 1986). In *In re* Johns-Manville, creditors sought relief from the stay so they could pursue the claims in state court. The bankruptcy court denied them relief because the court held that the claim arose at the time of sale of defective goods which occurred prepetition. *Id.* at 690.

56. *In re* A.H. Robins Co., 63 B.R. 986 (Bankr. E.D. Va. 1986). *In re* A.H. Robins Co. involved a Dalkon Shield claimant who had been inserted with the shield prepetition but perceived no injury until postpetition. The *A.H. Robins* court rejected the reasoning in *Frenville* and found the definition of claim in *Edge* overly broad for purposes of achieving Bankruptcy Code goals. *Id.* at 993. Using the theory from *Johns-Manville*, that a claim arises at the time when the acts giving rise to the alleged liability were performed, the *A.H. Robins* court held the claim arose at the time the shield was inserted. *Id.*

57. *See supra* note 4 and accompanying text.

58. *Jensen*, 127 B.R. at 32 (citing *In re* Chateaugay, 112 B.R. 552).

59. *Id.* at 33.

60. *Id.* The court called DHS's argument unpersuasive and further stated it overlooked the plain holding that a claim arose for purposes of discharge upon the actual or threatened release of hazardous waste by the debtor. *Id.*

nipulation of the bankruptcy process.[61]

D. Environmental Policy Considerations May Not Control the Bankruptcy Code in the Absence of Clear Legislative Intent

The court refused to consider the bankruptcy court's and DHS's contention that environmental cleanup claims deserved higher priority in bankruptcy proceedings because of public policy considerations.[62] The Appellate Panel noted, "[c]ourts are not free to formulate their own rules of super or sub-priorities within a specifically enumerated class."[63] The court maintained that preference to particular claims would only be accorded in the presence of clear legislative intent.[64]

IV. CONCLUSION

In *In re Jensen*,[65] the Bankruptcy Appellate Panel of the Ninth Circuit held the State of California's claim against a bankrupt corporation for hazardous waste cleanup costs under CERCLA and the HSA arose prior to the time when the bankruptcy petition was filed. Thus, the State's claim was discharged pursuant to section 727 of the Bankruptcy Reform Act.[66] The Appellate Panel concluded that hazardous waste cleanup claims arose when conduct causing contamination first occurred.[67]

Consequently, environmental cleanup claims would almost always arise prepetition, for bankruptcy purposes, and generally would be dischargeable. As a practical matter, the court's hold-

61. *Id.*

62. *Jensen*, 127 B.R. at 33.

63. *Id.* (citing *In re* Dant & Russell, Inc., 853 F.2d 700 (9th Cir. 1988)). *Dant* involved whether private claims against the debtor under CERCLA would be given administrative expense priority. *Dant*, 853 F.2d at 700. The Ninth Circuit established a policy against giving preference to particular claims. *Id.* at 709. Even though *Dant* did not address the timing of a claim, the Appellate Panel noted the *Dant* court discouraged giving preference to particular claims. *Jensen*, 127 B.R. at 33.

64. *Id.* The *Dant* court expressed its objection to preferential treatment holding that "[a]lthough [the creditor] asserts that public policy considerations entitle its claims for cleanup costs to administrative expense priority, we acknowledge that Congress alone fixes priorities." *Dant*, 853 F.2d at 709.

65. *In re* Jensen, 127 B.R. 27 (Bankr. 9th Cir. 1991).

66. *Id.* at 33.

67. *Id.*

ing may insulate debtor's responsible for hazardous waste contamination from CERCLA liability.

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