EMPOWERING STATES TO SET THE PRIORITY OF ENVIRONMENTAL CLAIMS IN BANKRUPTCY

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The bankruptcy code allows individuals and companies to receive a fresh start through a discharge of debts. When entering into business relationships, creditors are able to factor the risk of the debtor defaulting and discharging the debts. However, unlike debts to specific creditors, the cost of environmental damage is externalized onto all of society. Credit scores are not designed to address environmental impact and creditors are not directly impacted by such externalizations; therefore, the credit structure does not motivate individuals or companies to avoid risk of environmental damage. Because environmental concerns vary from state to state and the bankruptcy code primarily operates by changing outcomes under state law, states should be responsible for setting standards of liability for environmental damage (or risk of damage) under the bankruptcy code.

If states are given the opportunity to set the priority at which environmental claims are paid, they could either leave the structure as is and spread the cost to all of society or assign higher priority to claims that have a particular impact on the state's ecosystem. For example, Florida may set a higher claim priority for the storage of chemicals that have been shown to harm organisms in marshlands, whereas Oklahoma, being relatively free of marshland, may be willing to shoulder a greater degree of risk in the storage of the same chemicals.

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I. INTRODUCTION

The bankruptcy code allows individuals and companies to receive a fresh start through a discharge of debts. When entering into business relationships, creditors are able to factor the risk of the debtor defaulting and discharging the debts. Such assessment is commonly done through the assignment of a credit score.[1] In the United States, scores are assigned predominantly through three companies – Equifax, Experian, and TransUnion.[2] Credit scores operate differently for individuals and businesses, but they are both indicators of the likelihood of the individual or company repaying its debts.

Unlike debts to specific creditors, the cost of environmental damage is externalized onto all of society in the cases of air and water pollution, and it is externalized onto those who did not consent to the risk in cases of fire.[3] Credit scores are not designed to address environmental impact and creditors are not directly impacted by such externalizations; therefore, the credit structure does not motivate individuals or companies to avoid risk of environmental damage. Businesses are also aware that if they take a risk and liability does arise, they can discharge some or all liability in a bankruptcy.[4] Because environmental concerns vary from state to state, and the bankruptcy code primarily operates by changing outcomes under state law, states should be responsible for setting standards of liability for environmental damage (or risk of damage) under the bankruptcy code.

If states are given the opportunity to set the priority at which environmental claims are paid, they could either leave the structure as is, spreading the cost to all of society, or alternatively assign higher priority to claims that have a particular impact on a state's ecosystem. For example, Florida may set a higher claim priority for the storage of chemicals that have been shown to harm organisms in marshlands, whereas Oklahoma, being relatively free of marshland, may be willing to shoulder a greater degree of risk in the storage of the same chemicals.

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1. FICO INC., http://www.fico.com/en/Company/Pages/about.aspx (last visited Mar. 3, 2014) (most credit scores are given as FICO scores).

2. *Id.*

3. Laura Petersen, *Global Economy Must Tally Environmental Costs -- Report*, N.Y. TIMES (Oct. 20, 2010), http://www.nytimes.com/gwire/2010/10/20/20greenwire-global-economy-must-tally-environmental-costs--4664.html.

4. 11 U.S.C. § 727 (2012) (section authorizing the discharge of debts).

II. INTRODUCTION TO APPLICABLE BANKRUPTCY LAW

As a constitutionally enumerated power, the federal government has the sole authority to set bankruptcy laws.[5] However, because property law is traditionally set on the state level, the bankruptcy code acts as a mechanism to change rights and obligations that are otherwise a function of state law.[6] There are two general types of bankruptcies: liquidation (Chapter 7) and restructuring (including Chapters 11 and 13).[7] In a Chapter 7 bankruptcy, the assets of the debtor are used to pay a portion of the debts.[8] The remaining debts, subject to certain exceptions, are discharged.[9] The discharge gives the debtor a fresh start without the debt they previously acquired. Under Chapters 11 and 13, the debtor must have a payment plan approved by the court.[10] After making payments for a defined period, the debtor's remaining debt is discharged.[11]

When the debtor filing bankruptcy is an individual, they get to keep certain property called exemptions.[12] States may set their own exemption rules[13] and may deny access to exemptions for specified behavior.[14] Otherwise, the bankruptcy code defines the available exemptions.[15] Property that is not covered as an exemption goes into the bankruptcy estate[16], which is managed by a trustee and used to pay the debts owed.[17]

When filing bankruptcy, the debtor must list all creditors whom he or she owes.[18] Creditors may then file claims against the

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5. U.S. CONST. art. I, § 8.

6. Butner v. United States, 440 U.S. 48, 54 (1979).

7. 11 U.S.C. §§ 701-84 (2012) (Ch. 7); 11 U.S.C. §§ 1101-74 (2012) (Ch. 11); 11 U.S.C. §§ 1301-30 (2012) (Ch. 13).

8. 11 U.S.C. § 726 (2012).

9. 11 U.S.C. § 727 (2012).

10. 11 U.S.C. §§ 1121-29 (2012) (addressing the debtor plan for a Ch. 11 filing); 11 U.S.C. §§ 1321-30 (2012) (addressing the plan in a Ch. 13 filing).

11. 11 U.S.C. § 1141(c) (2012) (stating that all property addressed in the plan is "free and clear" of claims); 11 U.S.C. § 1328 (2012) (addressing discharge under a Chapter 13).

12. 11 U.S.C. § 522 (2012).

13. 11 U.S.C. § 522(b)(2) (2012); CAL CODE OF CIV. P. §§ 703-704 (California opted out of the exemption scheme under the federal code and created the two exemption schemes under these sections).

14. *See* Law v. Siegel, 134 S. Ct. 1188, 1197 (2014) (stating "the exemption's scope is determined by state law, which may provide that certain types of debtor misconduct warrant denial of the exemption").

15. 11 U.S.C. § 522(d) (2012).

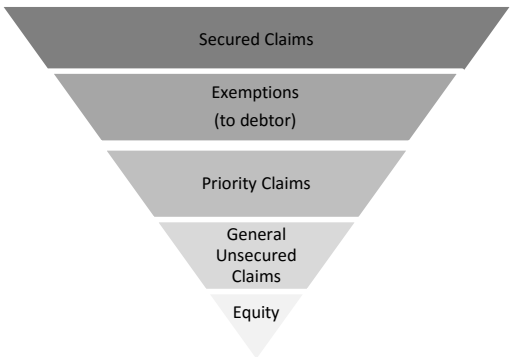
16. 11 U.S.C. § 541 (2012).

17. 11 U.S.C. § 704 (2012).

18. BANKRUPTCY SCHEDULE D: SECURED CLAIMS; SCHEDULE E: UNSECURED PRIORITY CLAIMS; SCHEDULE F: UNSECURED NON PRIORITY CLAIMS (i.e. general unsecured claims),

bankruptcy estate to receive payment for the debt owed.[19] Debts may include not only money but also performance obligations[20] and the risk of future debt due to liability – including environmental liabilities.[21] In the cases of performance obligations and liability, the court can assign a value to the obligation, estimate the future liability, or create a trust to address future claims.[22] This estimate will then be turned into a claim and paid in accordance with the bankruptcy code.[23] Therefore, subject to some statutorily defined exceptions, all remaining debt, obligations, and liability is discharged at the end of the bankruptcy.[24]

Claims are divided into four general categories and are paid in accordance with the category they belong.[25] The "absolute priority" rule states that all claims of a category must be paid in full before any category of a lower priority.[26] The categories from highest to lowest priority are: secured claims, exemptions (not technically a claim category but exemptions are paid to the debtor before lower claims categories), priority claims, general unsecured claims, and equity.



http://www.uscourts.gov/FormsAndFees/Forms/BankruptcyForms.aspx (last visited Jan. 8, 2016).

19. 11 U.S.C. § 501 (2012).

20. BANKRUPTCY SCHEDULE G: EXECUTORY CONTRACTS AND UNPAID LEASES, http://www.uscourts.gov/forms/individual-debtors/schedule-g-executory-contracts-and-unexpired-leases-individuals (last visited Jan. 8, 2016).

21. In Re Piper Aircraft, 362 F.3d 736, 737 (11th Cir. 2004) (court order creating an irrevocable trust to satisfy all current and future claims).

22. *Id.*

23. 11 U.S.C. § 507(a) (2012) (establishing the order in which claims priority claims are paid. Secured claims are secured by collateral and all other claims for debt are general unsecured claims).

24. 11 U.S.C. § 1141(c) (2012) (stating that all property addressed in the plan is "free and clear" of claims); 11 U.S.C. § 1328 (2012) (addressing discharge under a Chapter 13).

25. 11 U.S.C. § 506 (2012) (secured claims); 11 U.S.C. § 507 (2012) (priority claims).

26. Northwest Bank Worthington v. Ahlers, 485 U.S. 197, 197 (1988) (absolute priority rule refers to Chapter 11 but for the purposes of this analysis the same principle applies in Chapter 7 and Chapter 13).

Secured claims are those which are guaranteed by collateral that covers the amount of the claim.[27] Priority claims are set by the bankruptcy code, and the code specifies the order in which these claims are to be paid within the priority category.[28] Administrative priority claims, which include trustee's fees, are paid before most other priority claims.[29] In Chapter 11, administrative priority claims are significant because they must be paid at the beginning of the bankruptcy or it will be dismissed or transferred to Chapter 7 liquidation.[30] The assumption is a business incapable of paying administrative priority claims is not capable of restructuring, and the assets should be liquidated before the company loses more money.[31] Although there are many priority claims[32], for the purpose of this paper we will refer to all non-administrative priority claims as general priority claims.

Non-monetary obligations are generally also dischargeable in bankruptcy.[33] Contractual obligations to perform or refrain from action can be listed as a claim, and the court may set a monetary value for the claim.[34] The obligation then becomes a general unsecured claim and is discharged at the end of the bankruptcy.[35] However, the Sixth and Seventh Circuits have different approaches to dealing with injunctions.[36] This difference may ultimately be settled by the U.S. Supreme Court setting a standard interpretation of the law nationally. A standard interpretation may allow injunctions to be used as a means of enforcing compliance with environmental regulations – even through the bankruptcy process. This is important because a contractual duty to act, that is meant to prevent environmental

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27. *Secured Claims*, BLACK'S LAW DICTIONARY (6th ed. 1990).

28. 11 U.S.C. § 507(a) (2012).

29. 11 U.S.C. § 507(a)(1)(C) (2012); 11 U.S.C. § 507(a)(2) (2012).

30. John D. Penn, Viewpoint/Daily Bankruptcy Review (Aug. 2005).

31. If a company cannot pay the highest level claims, they will not have money to pay the lower level claims or restructure.

32. *See* 11 U.S.C. § 507 (2012).

33. *See generally* Matthew S. Smith, *Breach of Pre-petition Contract Claims May be Subject to "Core" Jurisdiction*, THE NAT'L L. REV. (May 31, 2010), http://www.natlawreview.com/article/breach-pre-petition-contract-claims-may-be-subject-to-core-jurisdiction (discussing "core" jurisdiction, demonstrating how breaching a contract can lead to a claim in bankruptcy).

34. *Id.*

35. 11 U.S.C. § 727 (2012).

36. *Compare* United States v. Whizco, Inc., 841 F.2d 147 (6th Cir. 1988) (holding that an injunction to clean up environmental damage *was* dischargeable), *with* United States v. Apex Oil Co., 579 F.3d 734 (7th Cir. 2009) (holding that an injunction to clean up a contaminated property was *not* dischargeable).

harm, may now be discharged as an unsecured claim. Additionally, under most circumstances, the bankruptcy estate will not pay anything on the unsecured environmental claim.

III. ABILITY TO ABANDON PROPERTY UNDER THE CODE

In June of 2009, General Motors Company filed for Chapter 11 bankruptcy.[37] General Motors (GM) had several "toxic assets" that were costing the company, and to deal with this problem GM split itself into two entities.[38] At the time of the split, GM had 127 properties considered "environmentally distressed."[39] The failed General Motors Corporation changed its name to Motors Liquidation Company (MLC) and took on the toxic assets, while GM started over as General Motors Company.[40] MLC is not a true profit making entity but exists for the purpose of paying claims against GM. MLC does not expect the company to have any value for shareholders after claims are paid.[41] GM was required to allocate funds to MLC to settle claims because the bankruptcy code requires creditors in a Chapter 11 be paid at least what they would have received in a Chapter 7.[42] However, MLC has not been able to maintain the properties abandoned to it.[43] In fact, within two years of GM's filing, the federal government dedicated over $800 million to clean abandoned GM sites.[44]

GM abandoned 89 manufacturing facilities across 14 states to MLC.[45] Because the U.S. Attorney General's Office claims 59 of the properties are contaminated,[46] MLC settled claims against

37. In Re Motors Liquidation Co., 430 B.R. 65 (Bankr. S.D.N.Y. 2010).

38. *Id.*; MOTORS LIQUIDATION COMPANY: GENERAL UNSECURED CREDITORS TRUST, https://www.mlcguctrust.com/Page.aspx?Name=Home (last visited Jan. 8, 2016).

39. PHILIP L. HINERMAN, *Helping Bankruptcy Clients Discharge Their Environmental Responsibilities*, *in* MANAGING ENVIRONMENTAL LIABILITIES IN BANKRUPTCY 40 (Aspatore ed., 2010).

40. *Id.*

41. *Id.*

42. *See* 11 U.S.C. § 1325(a)(4) (2012) (best interest test for ch. 13 means creditors will get at least what they would in a ch. 7 liquidation); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 211 (1988) (holding that reorganizations under ch. 12 are not less accessible than under ch. 11).

43. David Shepardson, *Abandoned GM Plants Get Cleanup, Feds Devote $836M to Recycle Sites*, DETROIT NEWS, May 19, 2010, at A1.

44. *Id.*

45. U.S. ENVTL. PROTECTION AGENCY, CASE SUMMARY: 2010 MLC (GENERAL MOTORS) BANKRUPTCY SETTLEMENT (2010), http://www.epa.gov/enforcement/case-summary-2010-mlc-general-motors-bankruptcy-settlement.

46. Tiffany Kary, *GM Estate Seeks Approval of Environmental Agreement*, BLOOMBERG (Oct. 20, 2010), www.bloomberg.com/news/2010-10-20/gm-s-bankruptcy-estate-seeks-approval-of-773-million-environmental-accord.html.

the 89 properties filed under the Comprehensive Environmental Response, Compensation and Liability Act[47] (CERCLA), the Resource Conservation and Recovery Act (RCRA)[48], and The Clean Air Act[49] (CCA).[50] The $773 million settlement created the largest environmental trust in US history.[51]

The ability to strip liability to another entity is a powerful tool for businesses to effectively abandon property that otherwise no one would take. The abandonment plays an important role in helping debtors to restructure but, as with GM, can be at odds with environmental concerns.

IV. FUTURE CONSIDERATIONS FOR THE BANKRUPTCY CODE

The old standard in the Sixth Circuit is *United States v. Whizco, Inc.* (*Whizco*).[52] In *Whizco*, the United States brought an action to force *Whizco* to reclaim an abandoned coal mine.[53] Under federal statute and permit regulations, companies were required to reclaim surface area disrupted through mining.[54] *Whizco* abandoned the property and filed for Chapter 11, but the bankruptcy was converted to a Chapter 7.[55] To determine if the obligation was discharged in bankruptcy, the court looked to the definition of claim under 11 U.S.C. § 727(b) as 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 a right to an equitable remedy for breach of performance if such breach gives *rise to a right of payment*. . . ".[56] The defendant in the case, Lueking, was the vice president and sole shareholder of Whizco.[57] He testified that he was 63 and surrendered his equipment and mining property in the bankruptcy, factors making performance

47. 42 U.S.C. § 9601 (2012).
48. *Id.*
49. 42 U.S.C. § 7671 (2012).
50. CASE SUMMARY: 2010 MLC, *supra* note 45.
51. WHITE HOUSE OFFICE OF THE PRESS SECRETARY, FACT SHEET: ENVIRONMENTAL LIABILITIES SETTLEMENT WITH GM, (Oct. 20, 2010), https://www.whitehouse.gov/the-press-office/2010/10/20/fact-sheet-environmental-liabilities-settlement-with-gm; U.S. ENVTL. PROTECTION AGENCY, CASE SUMMARY: 2010 MLC, *supra* note 45.
52. *Whizco*, 841 F.2d at 147.
53. *Id.*
54. *Id.* at 148.
55. *Whizco*, 841 F.2d at 148.
56. *Id.* at 148-49; 11 U.S.C. §101(4) (2012) (emphasis added).
57. *Whizco*, 841 F.2d at 147-48.

difficult.[58] The court found that Lueking was not capable of meeting his obligation without spending money because he could not personally conduct the required rehabilitation of the land and did not own title or hold lease to the land.[59] As a result, the court held that the obligation was a valid claim to the extent that it would cost him to comply and was discharged, but that if he could comply with any part of the injunction without incurring monetary costs, the non-monetary portion of the obligation is non-dischargeable.[60]

This case sets the precedent in the Sixth Circuit that injunctions for environmental obligations are not necessarily dischargeable but no requirement can be made to expend funds. Thus, if funds were already set aside through other statutory means prior to bankruptcy, an injunction may be able to force the debtor to use those funds and administer the clean up themselves–provided they are capable. Such a fund base would need to be separate from the estate because there is rarely enough in the estate to cover claims.[61] However, an insurance policy or other asset statutorily secured to cover claims as a requirement of licensing environmentally hazardous activities may suffice. At present, states are waiting for the Supreme Court to weigh in on the issue because any varying interpretation of the court may drastically alter the effectiveness of a statute relying on the precedent of *Whizco.*

A more recent decision from the Seventh Circuit is *U.S. v. Apex Oil Company* (*Apex*).[62] Prior to this case, bankruptcy attorneys would tell clients they could "sanitize" property by receiving a discharge of environmental liability from the bankruptcy court, but this case brought less certainty.[63] In *Apex*, the Seventh Circuit held that an injunction not falling within the definition of a claim under the bankruptcy code could not be discharged in a Chapter 11, even if there is a monetary cost attached to complying with the injunction.[64]

In *Apex,* the debtor and new property owner were required by RCRA[65] to clean a site where millions of gallons of oil were contaminating ground water and releasing fumes.[66] As in *Whizco*, the debtor (and in this case the successor to the property) was not

58. *Whizco*, 841 F.2d at 149.
59. *Id.* at 150.
60. *Id.* at 150-51.
61. MARK JICKLING, CONG. RES. SERV., RS22058, BANKRUPTCY REFORM: THE MEANS TEST, (2005).
62. *Apex*, 579 F.3d at 734.
63. HINERMAN, *supra* note 39, at 41.
64. *Apex*, 579 F.3d at 738.
65. 42 U.S.C. §§ 6901, 6973 (2012).
66. *Apex*, 579 F.3d at 735.

capable of correcting the environmental issue on its own without incurring expenses. The court reasoned that because RCRA did not allow for monetary relief in place of the injunction, the claim was not an equitable remedy that gives rise to a right of payment under the bankruptcy code.[67]

The implication of this interpretation is states could create causes of action in equity without allowing monetary damages for environmental harm and prevent the discharge in bankruptcy. A significant drawback is more businesses would be incapable of restructuring and forced into Chapter 7 if they had to carry the entire debt. Additionally, if a business is liquidated, it is incapable of making additional profits to pay a greater percentage of claims, including environmental claims. This is in addition to the costs to society from loss of employment and lost tax revenue. Also, if the liability passes to subsequent owners, potential owners who would invest in some correction of the harm will not take the land for fear of adopting full liability. As a result, the law will prevent restoration that would otherwise take place.

Whizco and *Apex* are not controlling law outside their circuits, and the Supreme Court declined to hear the appeal of *Apex*, making the adoption of one of these standards on the national level unlikely in the near future. The adoption of either interpretation of the code will not directly alter any of the proposals to empower states in processing or regulating environmental concerns in bankruptcy assessed in the proceeding pages. However, the Court's decision would be important in allowing states to proactively decide if environmental causes of action on the state level should be in law, equity, or equity with a monetary alternative. It would also be important for policy makers in understanding possible legal and policy implications of those choices.

A. Solution Through the Existing Code: Setting of Exemptions

Under the existing code, states may opt out of the federal exemption scheme and set their own exemptions. California already has two exemption schemes.[68] The dual structure allows debtors to choose between using home equity as their primary exemption or using cash reserves.[69] A state could set a second (third in the case of

67. *Id*. at 736.

68. CAL. CIV. PROC. CODE § 703 (2012) (allowing less of an exemption for home equity compared to §704, but allowing a greater exemption for other assets); CAL. CIV. PROC. CODE § 704 (2015) (allowing a greater exemption for equity in a home).

69. CAL. CIV. PROC. CODE §§ 703-04 (2012).

California) exemption scheme that is for those who seek a discharge for environmental damage or release from liability for potential damage. By lowering the individual exemption limit, the scheme would create a greater cost for actions harming the environment and could dissuade individuals from harmful actions they might otherwise take. For example, if a farmer decided to install a small gas tank on his property for his equipment, he might purchase an old cheap tank, knowing that any cleanup liability from a leaky tank could be discharged in bankruptcy. If the exemption scheme would require him to forfeit an additional $20,000 in assets, that same individual might be motivated to purchase a safer tank. However, there are two significant problems with this approach.

The first problem is exemptions are only applicable for individuals,[70] so the scheme would not deter businesses other than sole proprietorships.[71] Businesses provide larger scale environmental risks than most individuals. Therefore, such a solution will have limited effect.

The second problem is the individual would have to be aware of the bankruptcy process, know such an exemption scheme existed, and factor the risks of bankruptcy into his or her decision. The fact individuals rarely diversify the locations of their funds in bank accounts between multiple banks demonstrates people do not generally prepare for the periods of financial hardship warranting bankruptcy.[72] Similarly, sole proprietorships generally have less access to expertise than other types of businesses.[73] Therefore, sole proprietorships will not likely be more informed than the average person about the disincentives to creating environmental harm.

An additional exemption scheme will lead to a larger payout in some environmental claims, because more assets will be included in the bankruptcy estate in cases with environmental liability. However, most cases are zero-asset cases, where the debtor's assets are less than their exemptions and no money is paid to creditors.[74] Lowering the exemption amount will decrease the number of zero-asset cases, but lowering the exemption too far will negate the bankruptcy code's goal of allowing debtors enough assets to start over.

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70. *Id.*

71. JOHN E. MOYE, THE LAW OF BUSINESS ORGANIZATIONS 14 (6th ed. 2005).

72. *See* Jacob McElwee, *Don't Sell Property to Avoid Bankruptcy*, NAT'L BANKR. F. (Mar. 8, 2014), http://www.natlbankruptcy.com/dont-sell-your-birthright-for-a-bowl-of-soup/: The use of multiple banks decreases the debtor's risk of losing all cash assets if a bank freezes the debtor's accounts to use the funds to offset a debt.

73. *See* Susan Coleman, *Sources of Capital for Small Family-Owned Businesses* 12 FAM. BUS. REV. 73 (1999) (sole proprietorships are limited in funding, so it is harder for them to hire experts and experienced employees).

74. JICKLING, *supra* note 61, at 1

Although this solution is limited, it can be accomplished on the state level. However, there are more comprehensive solutions that require congressional amendment of the code.

B. Solutions Requiring Amendment of the Existing Code

The success of the American economy has been widely attributed to policies fostering risk-taking and entrepreneurial spirit.[75] The bankruptcy code, in allowing businesses to restructure and discharge debts, encourages a degree of risk-taking.[76] Because the absolute priority rule requires higher-level claims to be paid in full before lower-level claims, setting environmental claims as administrative-level[77] or priority claims increases the risks to creditors who would have lower-level claims, resulting in a positive and a negative consequence.

The positive consequence to increasing the priority of environmental claims is that creditors will be less likely to do business with companies incurring environmental liabilities, or they will charge higher credit rates to compensate for the increased risk. The additional costs will cut into profit margins and motivate businesses to avoid environmental liabilities. The negative consequence is businesses finding themselves with an unforeseeable or unavoidable environmental liability may be harmed by the higher rates creditors will charge to the extent they will need to file a bankruptcy they could otherwise avoid. This not only harms the business directly (and thereby the local economy), but the business may also have been able to correct the environmental damage if they were able to continue operating without the bankruptcy. A balance must be struck between the needs to protect the environment and the goal of allowing companies to take reasonable risks.

Setting environmental liabilities at the equivalent level as administrative claims would meet the environmental goals at the expense of business goals. Environmentally, it would be ideal

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75. *See, e.g.*, Maryann P. Feldman, *The Entrepreneurial Event Revisited: Firm Formation in a Regional Context*, 10 INDUS. & CORP. CHANGE 861 (2001), http://maryann feldman.web.unc.edu/files/2011/11/Entrepreneurial-Event-Revisited_2001.pdf.

76. Nathalie Martin, *U.S. Bankruptcy Laws Encourage Risk-Taking and Entrepreneurship*, 11 EJOURNAL USA: ECON. PERSP. 13 (2006), http://photos.state.gov/ libraries/amgov/30145/publications-english/EJ-entrepreneurship-0106.pdf.

77. The claim would not be administrative in the sense that it is for administration of the estate, but it would be set at a higher level than priority claims. True administrative claims would need to be paid in full prior to environmental claims or the trustee would lack the funds necessary to administer the estate.

because businesses cannot receive approval on a restructuring plan unless they are able to pay all administrative costs up front. The idea is businesses that cannot pay the administrative claims are not likely to succeed in restructuring and should be liquidated to ensure the maximum pay out on claims. Knowing an environmental liability a business could not pay would block a business's ability to restructure under a Chapter 11 would be significant incentive not to take on such a risk.[78] Creditors will also demand businesses abstain from such risks because they would not be paid until the environmental claim is paid in full. The fact the claim will be paid in full before regular business debts is the best attribute of this plan. Creditors have the opportunity to assess risks and enter into agreements with the knowledge of those risks. The man who lives downhill from the farmer who installed the gas tank did not have the same opportunity, so his claim (or that of society in the case of air or water pollution) should be paid before creditors voluntarily taking risks. This is a value judgment upon which the analysis is based. It must also be recognized that this judgment is not embodied in the current code. For example, a secured creditor holding a claim from a loan agreement may have priority over the judgment lien of a victim of some tort claims.[79]

As demonstrated in the policies underlying a Chapter 11, businesses in operation may be able to pay a larger share of claims than those liquidated.[80] Setting environmental claims as administrative without other changes to the code is not ideal. However, setting claims as priority will increase the pressure on businesses from those who would be general unsecured creditors and will likely not receive anything in a bankruptcy. This will also ensure a larger portion of environmental claims will be paid than if the debt fell in the general unsecured category. This approach will be beneficial for business, but it may not be strong enough to effectively dissuade harmful activity.

In order to effectively target regional environmental concerns, the bankruptcy code should be amended to empower states to statutorily enumerate environmental claims at the level of administrative claims, while additionally allowing these claims to be exempt from the rule requiring all administrative claims to be paid prior to Chapter 11 reorganization. This will cause creditors to pressure businesses not to take unnecessary environmental risks, while allowing businesses to continue operating if doing so will lead

78. 11 U.S.C. § 507 (2012).

79. *Id.*

80. *See* Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1 (1989) (discussing business discretion and loss allocation).

to greater payment on claims. This would also allow states to tailor the applicable environmental liabilities to the state's concerns and business interests. Individual state legislatures can also address changing business and environmental concerns more quickly than the 535-member U.S. Congress is capable. Should the provision have a more substantial effect on business than is desired (which is negative in terms of government income and employment), states may reduce the number of environmental liabilities at the level of administrative claims or choose not to avail themselves of the opportunity.

V. CONCLUSION

In certain contexts, the interests of the bankruptcy code and of environmental protection are opposed. The bankruptcy code seeks to give debtors a fresh start by wiping away their debts and leaving them with enough assets to succeed. When a debt is created by harm to the environment or a condition that threatens harm to the environment, the discharge of the debt has negative environmental consequences. To ensure that the environment and debtors are both protected a balance between the two interests must be struck.

Although the bankruptcy code primarily works by changing outcomes under pre-existing state law, the code itself is entirely federal. However, the code grants states the ability to set their own exemptions, and nothing prevents Congress from allowing states to set certain claims at a higher status. Allowing states the power to increase the priority of specific claims allows states to prioritize based on which environmental risk factors are of greatest concern and the ability to act and notify businesses of what types of liabilities to avoid. The exemption schedule could be used under the current code to accomplish the same goal with individuals, but, other than sole-proprietorships, companies would not be affected. Also, individuals are less likely to be informed about the law, and such a scheme may have little effect in regards to incentives not to cause environmental harm – even if it does increase the amount of claims paid.

Allowing states to set environmental claims at the level of administrative claims should cause creditors of general unsecured claims to be wary of entering into a creditor-debtor relationship and may also motivate companies to avoid environmental liability. However, it is important environmental claims not be subject to the rule under Chapter 11, that all administrative claims be paid before a plan can be confirmed. Otherwise, businesses able to

restructure and potentially pay the entire claim will be forced into liquidation – ultimately hurting the business and the ability to repair environmental damage. Allowing states to set claims as administrative level claims would meet the objectives of allowing a fresh start for debtors and decrease environmental damage through pressure from general unsecured creditors, while ensuring a higher percentage of environmental claims will be paid.