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Continuing Regulatory Obligations Under New Jersey's Environmental Cleanup Responsibility Act: Are they Preempted by the Bankruptcy Code

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CONTINUING REGULATORY OBLIGATIONS UNDER NEW JERSEY'S ENVIRONMENTAL CLEANUP RESPONSIBILITY ACT: ARE THEY PREEMPTED BY THE BANKRUPTCY CODE?

I. Introduction

During the 1980's environmental awareness was growing rapidly. The economic successes of this period allowed many state legislatures to pass stringent environmental laws without much difficulty. New Jersey was one of the first states to do this when they passed the Environmental Cleanup Responsibility Act[1] ("ECRA" or "Act"). ECRA is one of the most innovative environmental laws in the nation. Its purpose is to provide for the expeditious and safe cleanup of any hazardous waste sites at the time of their closure, sale, or other transfer.[2] A significant factor contributing to the characterization of ECRA as "landmark legislation"[3] is the attempt by New Jersey's Legislature to eliminate the potential of evading cleanup responsibility through the Federal Bankruptcy Code[4] ("Code"). The inclusion of this provision in ECRA has elevated the Act above the "superlien" laws of various states.[5] ECRA has attempted to create an obligation which has "super-priority" and which cannot be discharged in bankruptcy under any circumstances.

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1. N.J. STAT. ANN. §§ 13:1K-6 to -14 (West 1991), P.L. 1983 c.330. The regulations that correspond to this Act are N.J. ADMIN. CODE tit. 7, §§ 26B-1.1 to 26B-14.1 (1989). *See generally* Wendy E. Wagner, *Liability for Hazardous Waste Cleanup: An Examination of New Jersey's Approach*, 13 HARV. ENVTL. L. REV. 245 (1989) (a general overview of hazardous waste law in New Jersey).

2. N.J. STAT. ANN. § 13:1K-7 (West 1991).

3. Jeffrey T. Cox, *Industrial Property Transactions and Hazardous Waste Cleanup in America: An Analysis of State Innovations*, 15 U. DAYTON L. REV. 471, 472 (1990).

4. N.J. STAT. ANN. § 13:1K-12 (West 1991). This section is titled "Obligations imposed by act not affected by bankruptcy proceedings and constitute continuing regulatory obligations imposed by state." It provides that "No obligations imposed by this act shall constitute a lien or claim which may be limited or discharged in a bankruptcy proceeding. All obligations imposed by this act shall constitute continuing regulatory obligations imposed by the State."

5. A "superlien" law is one "which would make environmental cleanup debts superior to secured claims." Norman I. Silber, *Cleaning Up In Bankruptcy: Curbing Abuse of the Federal Bankruptcy Code by Industrial Polluters*, 85 COLUM. L. REV. 870, 890 (1985). *See* MASS. GEN. LAWS ANN. ch. 21E, §§ 1 to 13 (West 1991); N.H. REV. STAT. ANN. ch. 147-B §§ 1 to 11 (1990). *See generally* Beth Anne Smith, *State "Superlien" Statutes: An Attempt to Resolve the Conflict Between the Bankruptcy Code and Environmental Law*, 59 TEMP. L. Q. 981 (1986).

The recent economic slowdown has directly resulted in an increase in bankruptcy filings.[6] An additional feature of the current recessionary times is a frustration with environmental laws and the potentially enormous amounts of money involved in complying with these laws. As the number of New Jersey industries facing bankruptcy has grown, ECRA has become the object of heightened interest. This interest has focused on the "super-priority" provision in the Act. This provision is in direct conflict with the Code and has been controversial since the Act became law.[7] However, this conflict was recently ameliorated by a Bankruptcy Court in New Jersey.[8]

On September 6, 1991, the United States Bankruptcy Court for the District of New Jersey entered a decision in *In re Torwico Electronics, Inc.*,[9] which held that section 13:1K-12 of the act [10] is unconstitutional because it violates the Supremacy Clause of the Constitution.[11] The Bankruptcy Court found that the provision in ECRA which attempts to prevent environmental liability from being discharged in bankruptcy conflicts with the Code and is therefore preempted pursuant to the Supremacy Clause. This decision is of great importance to the future strength of ECRA. If the decision is adopted by New Jersey State Courts, it could eliminate ECRA's status as a "super-priority" statute.

This Comment will discuss the ramifications and merits of *In re Torwico*. This will be done in several contexts. First, the operation of ECRA will be briefly discussed. Second, three important cases in this area of the law will be analyzed: *Ohio v. Kovacs*,[12] *Penn Terra Ltd. v. Department of Environmental Resources*,[13] and

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6. In 1991, personal bankruptcy filings increased by 22 percent from 1990. Businesses with liabilities of greater than one million dollars filed for bankruptcy protection at the rate of 398 per month in 1991. The average for the first three months of 1992 increased to 413 per month. Richard Burke, *There's No Slowdown in Bankruptcy; Personal Filing Wave to Continue*, HOUS. CHRON., May 3, 1992, at G4.

7. *See, e.g., In re* Borne Chemicals Co., Inc., 54 B.R. 126 (Bankr. D. N.J. 1984).

8. The conflict referred to here is the conflict with the purposes of the Bankruptcy Code. The purpose of liquidation (Chapter 7) is "the expeditious reduction of the debtor's property to money, for equitable distribution to creditors." Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494, 508 (1985). The purpose of reorganization (Chapter 11) is "to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." National Labor Relations Board v. Bildisco, 465 U.S. 513, 528 (1983).

9. 131 B.R. 561 (Bankr. D. N.J. 1991).

10. N.J. STAT. ANN. § 13:1K-12 (West 1991).

11. U.S. CONST. art. VI, cl. 2. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land."

12. 469 U.S 274 (1984).

13. 733 F.2d 267 (3rd Cir. 1984).

In re Borne Chemical Co., Inc.[14] Finally, the *Torwico* decision will be discussed and analyzed. A discussion of the Federal Bankruptcy Code as it relates to state environmental laws generally and ECRA specifically will be included throughout.

II. Environmental Cleanup Responsibility Act

A. Operation

ECRA went into effect on December 31, 1983.[15] The Act was a product of a proposal drafted by the New Jersey Department of Environmental Protection.[16] The initial purpose of this proposal was to require cleanup of industrial sites by present owners or operators prior to the closure of the facility.[17] The Act ultimately goes far beyond this initial proposal.

ECRA is invoked whenever an industrial establishment is "closing, terminating or transferring operations."[18] The initial inquiry is to determine whether a facility is an industrial establishment. The Act defines industrial establishment as:

> any place of business engaged in operations which involve the generation, manufacture, refining, transportation, treatment, storage, handling, or disposal of hazardous substances or wastes on-site, above or below ground, having a Standard Industrial Classification number within 22-39 inclusive, 46-49 inclusive, 51 or 76 . . . ."[19]

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14. 54 B.R. 126 (Bankr. D. N.J. 1984).

15. N.J. STAT. ANN. §§ 13 1K-6 to -14 (West 1991). *See also* Gregory Battista, *The Environmental Cleanup Responsibility Act (ECRA): New Accountability for Industrial Landowner's in New Jersey*, 8 SETON HALL LEGISL. J. 331, 340 (1985).

16. *Id.* at 336.

17. *Id.*

18. N.J. STAT. ANN. § 13:1K-8(b) (West 1991).

19. N.J. STAT. ANN. § 13:1K-8(f) (West 1991).

The STANDARD INDUSTRIAL CLASSIFICATION MANUAL is published by the United States Government Printing Office, Washington, D.C. It classifies industries for the purpose of gathering data. The industries which are identified in the statute are numbers: 22 (textile mill products); 23 (apparel and other finished products made from fabrics and similar materials); 24 (lumber and wood products except furniture); 25 (furniture and fixtures); 26 (paper and allied products); 27 (printing, publishing and allied industries); 28 (chemicals and allied products); 29 (petroleum refining and related industries); 30 (rubber and miscellaneous plastic products); 31 (leather and leather products); 32 (stone, clay, glass and concrete products); 33 (primary metal industries); 34 (fabricated metal products, except machinery and transportation equipment); 35 (machinery except electrical); 36 (electrical and electronic machinery, equipment, and supplies); 37 (transportation equipment); 38 (measuring, analyzing, and controlling instruments; photographic, medical, and optical goods; watches and clocks); 39 (miscellaneous manufacturing

ECRA then makes specific exclusions for facilities subject to the closure requirements of the Solid Waste Management Act,[20] the Major Hazardous Waste Facilities Siting Act,[21] or the Solid Waste Disposal Act.[22] ECRA also excludes establishments engaged in the production or distribution of agricultural goods.[23] This definition is extremely broad and in practical application includes virtually every industrial establishment in New Jersey.

The second, and perhaps more important inquiry, revolves around identifying what exactly triggers ECRA. "Closing, terminating or transferring operations" is defined in the Act as:

> the cessation of all operations which involve the generation, manufacture, refining, transportation, treatment, storage, handling or disposal of hazardous substances and wastes, or any other transaction or proceeding through which an industrial establishment becomes nonoperational for health or safety reasons or undergoes change in ownership, except for corporate reorganization not substantially affecting the ownership of the industrial establishment, including but not limited to sale of stock in the form of a statutory merger or consolidation, sale of the controlling shares of the assets, the conveyance of the real property, dissolution of corporate identity, financial reorganization and initiation of bankruptcy proceedings.[24]

This definition is lengthy and rather confusing. However, the regulations provide extensive assistance in clarifying this definition.[25] Bankruptcy proceedings are explicitly included in several places in both the regulations and the Act as a closure,

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industries); 46 (pipelines, except natural gas); 47 (transportation services); 48 (communication); 49 (electric, gas and sanitary services); 51 (wholesale trade-nondurable goods); 76 (miscellaneous repair services). The STANDARD INDUSTRIAL CLASSIFICATION MANUAL (1979).

20. N.J. STAT. ANN. §§ 13:1E-1 to -48. (West 1991); P.L. 1970, c. 39.

21. N.J. STAT. ANN. §§ 13:1E-49 to -91. (West 1991); P.L. 1981, c. 279.

22. 42 U.S.C. §§ 6901 to 6992(i) (1988 & Supp. II 1990).

23. N.J. STAT. ANN. § 13:1K-8(f) (West 1991).

24. N.J. STAT. ANN. § 13:1K-8(b) (West 1991).

25. N.J. ADMIN. CODE tit. 7, § 26B-1.3 (1989). This section is titled "Definitions." "(4) Termination of a leasehold interest at an industrial establishment by the owner or operator of the industrial establishment unless the lease is renewed by the same tenant without a disruption in operations." Closure termination or transfer of operations also includes "(5) financial reorganization and liquidation in bankruptcy or insolvency proceedings."

termination, or transfer of operations.[26] Thus, the regulations suggest that the situations which trigger ECRA are to be interpreted broadly.

Once it is established to whom ECRA applies and when ECRA applies, an analysis of the impact of ECRA must be undertaken.[27] Section 13:1K-9 of the Act provides that notification by an industrial establishment that is planning to close, terminate, or transfer operations, must be given to the New Jersey Department of Environmental Protection ("DEP") within "five days subsequent to public release, of its decision to close operations" or "within five days of the execution of an agreement of sale or any option to purchase."[28] In the case of closure, the owner or operator must provide either a declaration of compliance or a cleanup plan within sixty days after public closure.[29] In the event of sale or transfer, the declaration or cleanup plan must be submitted sixty days prior to the transfer of title.[30] To encourage compliance with the Act, section 13:1K-13 provides that failure to comply with the Act will result in strict liability to the owner or operator for any and all cleanup costs.[31]

The real strength of ECRA, which sets it apart from similar laws, is the "super-priority" provision.[32] This provision has created extensive controversy. It explicitly attempts to evade the Code by characterizing obligations under the Act as liens or claims which may not be "limited or discharged in a bankruptcy proceeding."[33] Furthermore, because the Code specifically stays actions involving liens or claims,[34] the Act labels obligations created under it as "regulatory obligations."[35] Thus, the owner or operator of an industrial establishment in New Jersey which may have some hazardous waste problems cannot take refuge by

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26. *Id. See also* N.J. ADMIN. CODE tit. 7, § 26B-1.5(b)(7) (1991) ("bankruptcy proceedings under Chapters 7, 11, or 13 of the Federal Bankruptcy Act" are included).

27. For purposes of this comment most of the details of analyzing the impact of ECRA will be left out in favor of a cursory outline of the process. The author of this comment does not recommend using only the procedures outlined here when working on an ECRA related matter. Instead, the regulations should be utilized extensively.

28. N.J. STAT. ANN. § 13:1k-9(a)(1) and (b)(1) (West 1991).

29. N.J. STAT. ANN. § 13:1K-9(a)(2) (West 1991).

30. N.J. STAT. ANN. § 13:1K-9(b)(2) (West 1991). In addition, ECRA requires a surety bond to be posted whenever a cleanup plan is required.

31. N.J. STAT. ANN. § 13:1K-13 (West 1991).

32. *See supra* note 4.

33. N.J. STAT. ANN. § 13:1K-12 (West 1991).

34. 11 U.S.C. § 362(a) (1988 & Supp. II 1990).

35. N.J. STAT. ANN. § 13:1K-12 (West 1991).

attempting to reorganize under the Code. ECRA provides that its obligations are not dischargeable in bankruptcy and as such, effectively attempts to avoid the mandates of Congress.

B. Ohio v. Kovacs; Penn Terra Ltd. v. Department of Environmental Resources; In re Borne Chemical Co., Inc.

ECRA is relatively short-lived at this point and is still evolving. Consequently, there is not a large amount of case law involving the Act. Most of the cases which have been published are in the context of bankruptcy. In addition to cases directly involving ECRA, there are several important cases under other state environmental laws which have had a direct impact on the Act. This comment will consider in detail three cases prior to *In re Torwico* which are important both to ECRA and the analysis of the *Torwico* case. These limited decisions are not representative of the entire field of interaction between state environmental laws and the Code.[36] However, they do provide an appropriate basis for analysis of the preemption issue.

1. Ohio v. Kovacs[37]

Ohio v. Kovacs is a landmark case involving the interaction of state environmental law and the Code.[38] This case arose pursuant to a stipulation and judgment entered against Kovacs as the chief executive officer and stockholder of an industrial and hazardous waste site. This stipulation and judgment, among other things, affirmatively enjoined Kovacs, requiring him to clean-up the property. When he failed to do this, Ohio appointed a receiver. Shortly thereafter, Kovacs filed a petition under Chapter 11 of the Code for personal reorganization.[39] This was later converted to a Chapter 7 petition for liquidation.[40] Ohio then sought a declaration

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36. Another major area of interest in this context surrounds the ability created by the Code to abandon burdensome property. Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986) is the leading case on abandonment. *See also* John E. Theuman, *Right and Power of Trustee in Bankruptcy or Debtor in Possession to Abandon, Under 11 U.S.C.S. § 554(a), Property Which is "Burdensome" Because of Existence of Environmental Conditions Requiring Cleanup-Midlantic and its Progeny*, 103 A.L.R.FED. 72 (1991).

37. 469 U.S. 274 (1984).

38. *See generally* Arlene Elgart Mirsky et al., *The Interface Between Bankruptcy and Environmental Laws*, 46 BUS. LAW. 626 (1991) (excellent analysis of state and federal environmental laws and their conflict with the Code); Ellen E. Sward, *Resolving Conflicts Between Bankruptcy Law and the State Police Power*, 1987 WIS. L. REV. 403 (1987) (discusses the conflict among state environmental laws and the Code).

39. 11 U.S.C. §§ 1101 to 1174 (1988). Chapter 11 deals with reorganization.

40. 11 U.S.C. §§ 701 to 766 (1988 & Supp. II 1990). Chapter 7 deals with liquidation.

from the Bankruptcy Court that the affirmative obligation created by the stipulation was not dischargeable in bankruptcy.[41] The Bankruptcy Court ruled against Ohio.[42] This decision was affirmed by the District Court and later by the Court of Appeals for the Sixth Circuit.[43] The Supreme Court granted certiorari and affirmed the decision against Ohio.[44]

Ohio argued that the obligation to clean the site was neither a debt nor a liability on a claim as these are defined in the Code.[45] The Supreme Court, in a unanimous decision written by Justice White, acknowledged the Congressional intent that "claim" be broadly construed. Holding the obligation imposed by Ohio to be a claim under the Code definition,[46] Justice White wrote "it makes little sense to assert that because the cleanup order was entered to remedy a statutory violation, it cannot likewise constitute a claim for bankruptcy purposes."[47] Thus, the Court found that this injunction was in fact a money judgment. Therefore, as a money judgement, Kovacs could discharge "the affirmative duty to clean up the site and the duty to pay money to that end."[48]

Kovacs is an important precedent which has not yet been tested again at the Supreme Court level. The scope of the case must be kept in perspective. It was a Chapter 7 bankruptcy proceeding involving the dischargeability of an obligation

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41. 469 U.S. at 276-77.

42. *In re* Kovacs, 29 B.R. 86 (Bankr. S. D. Ohio 1982).

43. *In re* Kovacs, 717 F.2d 984 (6th Cir. 1983).

44. 469 U.S. 274 (1984).

45. 11 U.S.C. § 101(11) (Supp. II 1990) defines "debt" as a "liability on a claim." 11 U.S.C. § 101(5) (Supp. II 1990) defines "claim" as:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated or 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 an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

46. The Court cited 11 U.S.C. § 101(5)(B) as the provision which included the obligation imposed by Ohio. 469 U.S. at 280.

47. 469 U.S. at 279.

48. *Id.* at 285.

where a receiver has been appointed. These narrow factual circumstances have been utilized to distinguish the decision.[49]

2. *Penn Terra Ltd. v. Department of Environmental Resources*[50]

The Third Circuit of the United States Court of Appeals held in *Penn Terra* that an action to "compel Penn Terra to remedy environmental hazards was properly brought as an equitable action to prevent future harm, and did not constitute an action to enforce a money judgment."[51] The effect of this holding was to allow the Commonwealth of Pennsylvania Department of Environmental Resources ("DER") to circumvent application of the Code's automatic stay provisions.[52] This case,

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49. *See, e.g., In re* Stevens, 68 B.R. 774 (Bankr. D. Me. 1987); *In re* Hemingway Transport, Inc., 73 B.R. 494 (Bankr. D. Mass. 1987) (both cases distinguish *Kovacs* because they involve a cleanup done by the state, with the attempt to then retrieve the costs from the assets of the estate). These cases make logical distinctions which have merit, because they do not involve an attempt by the state to force the debtor to spend money, but instead seek distribution from the assets of the estate.

50. 733 F.2d 267 (3rd Cir. 1984).

51. 733 F.2d at 278.

52. The automatic stay provision is located at 11 U.S.C. § 362 (1988 & Supp. II 1990). Section (a) provides that a voluntary or involuntary petition under either Chapter 7 or Chapter 11 operates as an automatic stay, which applies to all entities, of:

> (1) the commencement or continuation...of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over the property of the estate;
> (4) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title . .

11 U.S.C. § 362(b) provides exceptions to the automatic stay:

> (4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;
> (5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power.

although it was decided prior to *Kovacs*,[53] is important because it is in conflict with *Kovacs*.

The lawsuit arose pursuant to certain environmental violations by Penn Terra Limited ("Penn Terra"), a company engaged in the surface mining of coal. The DER entered into a consent agreement with Penn Terra and its president on November 9, 1981. This agreement established a cleanup and compliance program.[54] Penn Terra had not complied with this consent agreement when it filed a Chapter 7 Petition for Bankruptcy.[55] DER then sought and obtained an injunction requiring Penn Terra to complete the compliance program established under the consent agreement. Penn Terra then filed a Petition for Contempt in the bankruptcy court, claiming that the injunction violated the automatic stay provisions of the Code. The Bankruptcy Court agreed, and found that the actions by DER were "actions to enforce a money judgment, which do not fall within the exception to [section] 362(a)."[56] Thus, the bankruptcy court enjoined DER from enforcing the injunction they had obtained.[57]

On appeal to the Third Circuit, the court reversed. The court engaged in a general discussion about preemption of state laws by federal statutes not being favored and the fact that there was no explicit indication of preemption by the Code over the regulation of the environment by states.[58] The court then moved on to what it considered to be the central issue: whether the injunction held by DER was in effect a money judgment. The court determined that the injunction held here clearly was not in any way a money judgment. Central to the court's analysis was "whether plaintiff seeks compensation for past damages or prevention of future harm."[59] In the court's opinion, the injunction held by DER "was meant to prevent future harm to, and to restore, the environment."[60] The court concluded that the injunction was a remedy for a sum uncertain related to prevention of future harm. As such, it was not a money judgment. Thus, the injunction was not subject to the automatic stay provisions of the Code.

There are several questionable aspects of this decision. First, it is tenuously distinguished from the Sixth Circuit decision in *In re Kovacs*. In a footnote, the court distinguishes *In re Kovacs* because it did not involve the automatic stay provision of

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53. *See infra* note 99.

54. 733 F.2d at 269.

55. *See supra* note 40.

56. 733 F.2d at 270. *See also supra* note 52.

57. 733 F.2d at 270.

58. *Id.* at 272-73.

59. *Id.* at 278.

60. *Id.*

the Code.[61] However, *In re Kovacs* involved strikingly similar facts, a point which the *Penn Terra* court seems to ignore. The court also ignores the broad definition of money judgment which the Sixth Circuit adopts, and which is later adopted by the Supreme Court. Second, the *Penn Terra* court places much emphasis on the "prevention of future harm," as distinguished from compensation for past damages.[62] It then characterizes the injunction as one to "restore" the environment.[63] In order for a restoration to be required, it is only logical that there must have been some damage in the first place. The conclusion therefore is that the *Penn Terra* court's analysis of this issue is of questionable merit.

Without a thorough analysis of the *Penn Terra* decision, it is sufficient to characterize it as an important, although arguably erroneous, decision regarding the interaction of the Code and state environmental laws.

3. In re Borne Chemical Co., Inc.[64]

An early bankruptcy case which involved the constitutionality of ECRA broadly is *In re Borne Chemical Co., Inc.*[65] This case arose pursuant to a sale of real property under a plan of Chapter 11 reorganization in bankruptcy.[66] The DEP objected to the sale because the properties were not in compliance with ECRA. Borne Chemical Co., Inc. ("Borne") sought an order declaring that it did not have to comply with the Act because ECRA was preempted by the Code.[67] The court denied this argument.

In reaching the conclusion that ECRA was not preempted by the Code, the Bankruptcy Court went through an extensive analysis of the preemption issue. The constitutional grounds for preemption arise under the Supremacy Clause.[68] The court

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61. *Id.* at 277 n.11. "[S]ince different sections of the Bankruptcy Code are at issue which involve different policies and considerations, we are not prepared to declare that our decision is in conflict with *Kovacs II*." *Id.* (emphasis original). *Kovacs II* is *In re Kovacs*, 717 F.2d 984 (6th Cir. 1983).

62. *See supra* text accompanying note 59.

63. *See supra* text accompanying note 60.

64. 54 B.R. 126 (Bankr. D. N.J. 1984).

65. *Id.*

66. *See supra* note 39.

67. 54 B.R. at 128. Borne also argued that ECRA did not apply because the contract of sale arose prior to the Act becoming law. However, this argument was declined because the interim regulations provided that if the sale is not completed by December 31, 1983, the Act applies. *Id.* at 129.

68. *See supra* note 11.

pointed to a two step process for determining preemption questions.[69] This analysis involves "first ascertaining the construction of the two statutes and then determining the constitutional question whether they are in conflict."[70] The construction analysis necessarily involves determining the intended purpose of the statutes. "Notwithstanding a legitimate state purpose, a state statute is superseded if it has the effect of interfering with the objections underlying the federal law."[71] Applying this analysis, the court held that "federal bankruptcy legislation is not pervasive as to preclude enforcement of state laws on the same subject."[72]

Expanding on its reasoning, the *Borne* court pointed to two purposes of the Code. The first purpose is to facilitate " a fair and equitable distribution of the nonexempt property of a bankrupt person to and among his [or her] creditors.'"[73] The second purpose of the Code is "to give debtors a fresh start.'"[74] The court then established the purpose of ECRA as "a rational and orderly way of minimizing potential risks associated with the generation, handling, storage, and disposal of hazardous substances."[75] From this the court concluded that the Code and ECRA have completely different purposes, and therefore, New Jersey did not create "priorities in conflict with those embodied in the Bankruptcy Code."[76]

Borne then petitioned the Bankruptcy Court for reconsideration, claiming that compliance with both ECRA and the Code was a physical impossibility.[77] However, the court maintained the integrity of its earlier decision, and found that "impossibility does not exist in the instant case."[78] Thus, ECRA survived its first constitutional challenge.

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69. This analysis was established in Perez v. Campbell, 402 U.S. 637 (1971).

70. 402 U.S. 637, 644 (1971).

71. 54 B.R. at 130 (citing Perez v. Campbell, 402 U.S. at 650-52).

72. *Id.* at 130.

73. 54 B.R. at 131 (quoting 4 COLLIER ON BANKRUPTCY ¶ 67.01 at 15 (14th ed. 1976)).

74. 54 B.R. at 131 (quoting *In re* Vasko, 6 B.R. 317, 322 (Bankr. N. D. Ohio 1980)).

75. 54 B.R. at 131.

76. *Id.*

77. The opinion of the Bankruptcy Court on reconsideration is also contained in 54 B.R. 126.

78. 54 B.R. at 134.

4. Summary

The above cases represent only a few of the many decisions in this area of the law. However, they illustrate the confusion and uncertainty in this area. Furthermore, they illustrate the subtle distinguishing factors the courts will use to make decisions in this area of the law. *Kovacs* laid down the rule that compliance with obligations which essentially require the expenditure of money are money judgments and therefore dischargeable in bankruptcy. *Penn Terra*, which was decided prior to *Kovacs*, took a narrow view of money judgment and found that none existed under the facts of the case. Finally, *In re Borne Chemicals Co., Inc.* found that ECRA was not preempted by the Code. However, *In re Torwico* has disagreed with *Borne* and *Penn Terra* and has aligned the Bankruptcy Court and the law with the *Kovacs* decision.

II. *In re Torwico Electronics, Inc.*[79]

In re Torwico Electronics, Inc. ("*Torwico*") is the focus of this comment. The case holds section 13:1K-12 of the Act to be unconstitutional. In doing so, it follows and expands upon the guidance provided by the Supreme Court in *Kovacs*. Additionally, the Court recognizes the economic hardship that the ECRA "super-priority" provision imposes upon financially struggling companies.[80]

This case arose under a Chapter 11 Bankruptcy proceeding.[81] Torwico Electronics, Inc. ("Torwico") had leased, but never owned, certain property where it conducted the business of manufacturing electronic transformers.[82] In 1985, the lease terminated and Torwico moved to another location. Torwico had not had possession or control of the property since this time. Shortly thereafter, Torwico entered into an agreement with the landlord to share certain costs related to ECRA, but maintained a dispute about a seepage pit located on the property.[83] The seepage pit has created extensive groundwater contamination.

Torwico filed for reorganization under Chapter 11 of the Code in 1989, and scheduled the Attorney General of New Jersey as an unsecured creditor holding a

79. 131 B.R. 561 (Bankr. D. N.J. 1991).

80. Judge Stripp points out the economic considerations in a footnote. 131 B.R. at 576 n.18.

81. *See supra* note 39.

82. 131 B.R. at 562.

83. *Id.* at 562.

disputed claim.[84] Torwico then sought a declaratory judgment that any obligation under ECRA was an unsecured claim.[85] The DEP sought a declaratory judgment that the obligations were not claims. The Bankruptcy Court heard the issue as a core proceeding[86] on a motion and cross-motion for summary judgment.[87]

In its opinion, the Bankruptcy Court thoroughly explores the obligations recognized by the Code. All obligations requiring payment of money fall within five categories under the Code.[88] These include secured claims,[89] administrative expenses,[90] priority claims,[91] unsecured claims,[92] and equity interests.[93] From this, the *Torwico* court makes two important conclusions. First, that "the Bankruptcy Code recognizes no other categories."[94] The second conclusion is that in the event of a dispute about an obligation, "the first phase of the analysis must be to determine the

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84. *Id.* at 563. The Attorney General and the DEP claim that they were never notified to file a proof of claim. Torwico alleged that they mailed this notice. The court held that Torwico had proof of mailing and this was enough. Therefore, the disputed claim of the DEP is time-barred. *Id.* at 572-73. However, because ECRA provides that the obligation sought to be imposed is not actually a "claim," the court was required to undertake further analysis, which is the subject of this comment.

85. 131 B.R. at 562. Torwico further argued that since they were unsecured claims, they were time barred. *See supra* note 74.

86. 28 U.S.C. § 157(b) (1988).

87. 131 B.R. at 562.

88. *Id.* at 564.

89. 11 U.S.C. § 506(a) (1988). "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff."

90. 11 U.S.C. § 503(b) (1988). This section includes the actual and necessary costs and expenses of preserving the estate, attorney and accountant expenses, and trustee expenses.

91. 11 U.S.C. § 507 (1988 & Supp. II 1990). This section establishes the order of priority beyond secured claims, with administrative expenses at the top of the list, followed by various unsecured claims.

92. *See* 11 U.S.C. § 507 (1988 & Supp. II 1990).

93. 11 U.S.C. § 101(16) (Supp. II 1990). "Equity security" is defined as:

> (A) share in a corporation, whether or not transferable or denominated 'stock,' or similar security;
> (B) interest of a limited partnership; or
> (C) warrant or right, other than a right to convert, to purchase, sell, or subscribe to a share, security, or interest of a kind specified in subparagraph (A) or (B) of this paragraph.

94. 131 B.R. at 565 (emphasis original).

category to which the obligation belongs."[95] The court then moves to the discussion of its determination that the DEP holds an unsecured claim.

The DEP argues that under section 13:1K-12 of the Act, the obligations here sought to be imposed on Torwico are regulatory obligations not dischargeable in bankruptcy. To assist in making their determination, the court looks to the Code definition of "claim" and "debt."[96] Citing recent Supreme Court cases which interpret "claim" and "debt" consistently with the *Kovacs* interpretation, the *Torwico* court turns to *Kovacs*.[97] After an extensive analysis of the case and its reasoning, the court determines that *Kovacs* held that "where a debtor in bankruptcy cannot clean up environmental contamination himself or itself without paying money, the obligation to clean up pursuant to an injunction is a debt which is dischargeable in bankruptcy."[98]

This analysis of *Kovacs* is crucial to the decision in *Torwico*. By overlooking the receivership issue, which is what the DEP had consistently used to distinguish *Kovacs*, the court opened the door for the broader application which *Kovacs* deserves. Furthermore, the *Torwico* court removes the blinders which many courts like to wear and looks at the reality of the situation. An injunction requiring cleanup inevitably requires the expenditure of money. Thus, an injunction is a dischargeable debt. The *Penn Terra* court failed to see that an injunction is a dischargeable debt, and therefore, the *Torwico* court distinguishes the *Penn Terra* decision.

The initial distinguishing factor cited is that *Penn Terra* was decided prior to *Kovacs*.[99] *Kovacs* responds to *Penn Terra* and distinguishes it because in *Penn Terra* the state was not seeking money. The DEP attempts to distinguish *Penn Terra* by arguing that where a receiver has been appointed, the cleanup obligation is unsecured. Where no receiver has been appointed, the obligation would have a higher priority.[100] According to the *Torwico* court, any attempt to distinguish *Penn*

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95. *Id.* (emphasis original).

96. *See supra* note 45.

97. The court cites Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552 (1990). The proposition for which this is cited is that "the plain meaning of right to payment' is nothing more nor less than an enforceable obligation, regardless of the objectives the state seeks to serve in imposing the obligation." *Id.* at 559. Also cited is Johnson v. Home State Bank, 111 S.Ct. 2150 (1991), which reaffirms *Davenport*. The *Torwico* court commented that the result of this decision was that "the fact that the defendant could still look to the debtor's real property as a source of payment meant that the defendant still had a claim' against the debtor." 131 B.R. at 565-66.

98. 131 B.R. at 566-67.

99. Penn Terra Ltd. v. DER, 733 F.2d 267 (3rd Cir. 1984) was decided on April 30, 1984. Ohio v. Kovacs, 469 U.S. 274 (1984) was decided on October 10, 1984.

100. 131 B.R. at 570.

Terra because there was no receiver appointed "has no sound basis in law or logic."[101] The court then looks to the definition of "money judgment." In the opinion of the *Torwico* court, "money judgment" is defined in *Kovacs* broadly as a cleanup order that requires a debtor to spend money.[102] "Money judgment" was defined much more narrowly in *Penn Terra* as a "judgment that the defendant shall pay a sum of money to the plaintiff."[103] The Bankruptcy Court seizes this distinction and concludes that *Kovacs* utilizes the proper definition.

However, by aligning with and expanding on *Kovacs*, the court creates a conflict between ECRA and the purpose of the Code. This conflict is resolved by holding section 13:1K-12 of the Act unconstitutional. This holding, without explicitly overruling *In re Borne Chemical Co., Inc.*, is clearly contrary to that decision.[104]

To reach the conclusion that section 13:1K-12 is unconstitutional, the court utilizes the two step test under *Perez* for analysis of Supremacy Clause issues.[105] The purpose of section 13:1K-12 is characterized by the court as being "to further the express requirement of financial security for clean up obligations by stating that a bankruptcy proceeding shall not discharge, limit or effect an obligation imposed by ECRA."[106] Conversely, the purposes of the Code are "to give debtors a fresh start and to provide for an orderly and equitable distribution of their assets among creditors."[107] From this, the court is able to conclude that "by attempting to dictate that cleanup obligations triggered by ECRA do not fall within those definitions (Code definitions of claim, lien and debt), and hence are not affected by bankruptcy, N.J.S.A § 13:1K-12 plainly has both the purpose and effect of interfering with the Bankruptcy Code provisions in question."[108]

Although the Code does not explicitly provide that it preempts all state law, there must be a line drawn where the Code and the state law in question are in conflict. Section 13:1K-12 suffers from such a conflict. Interestingly, in an opinion

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101. *Id.*

102. *Id.*

103. 733 F.2d at 275.

104. In a footnote, *Borne* is distinguished because it was a general comparison of ECRA with the Code. 131 B.R. at 575, n.16. *Borne*, without specifically acknowledging it, did address section § 13:1K-12. However, the *Borne* court did so in the context of ECRA in general, and was unable to find any direct conflict.

105. *See supra* notes 69-76 and accompanying text.

106. 131 B.R. at 574.

107. *Id. Compare supra* notes 73-74 and accompanying text.

108. 131 B.R. at 575. The court makes an important remark in a footnote that the "regulatory obligation" which ECRA attempts to create may also fall within the Code definition of lien in § 101(37). *Id.* at 575 n.15.

entered on the same date as *Torwico*, the Bankruptcy Court seems to erode the *Torwico* decision by saying that once a sale of estate property free and clear of liens has been approved by the court, ECRA cannot come in and block the sale.[109] This indicates that ECRA can still operate to hamper Bankruptcy proceedings prior to court approval of sales, and also that ECRA would block court approval of sales. However, the court later cures any discrepancy by holding that the clause in section 13:1K-8 which triggers ECRA when a petition in bankruptcy is filed is unconstitutional under the Supremacy Clause.[110] Thus, this Bankruptcy Court has clearly established its position of utilizing preemption to limit the reach of ECRA.

The opinion of the court in *Torwico* is very clear, emphatic, and well reasoned. *Kovacs* is interpreted broadly, which is consistent with the Congressional intent of a broad interpretation of the Code in favor of the debtor. *Penn Terra* is conversely given the narrow interpretation it deserves, in light of the fact that it was decided prior to *Kovacs* and that the obligation sought to be imposed in *Penn Terra*, in the opinion of the Third Circuit, did not require the expenditure of money. Finally, in holding section 13:1K-12 unconstitutional, the court recognizes the practical effect and purpose of both ECRA and the Code. *In re Borne Chemicals Co., Inc.* overlooked these practical purposes. It is not possible under ECRA to receive an adequate treatment in bankruptcy while complying with ECRA. The *Torwico* court recognized this and finally ameliorated the problem.

III. Conclusion

The *Torwico* decision must be kept in the proper perspective. It is a Bankruptcy Court decision. The precedential value is therefore limited.[111] However, this case provides ample support and solid analysis for the preemption argument to be made in the state courts. While ECRA is a powerful tool for the state, the *Torwico* court makes it clear that characterizing an obligation requiring the expenditure of money to effectuate an environmental cleanup as a "regulatory obligation" in order to circumvent the Code may go too far, especially in light of the current state of the economy. Until the Code is revised to accommodate a new obligation recognizing environmental responsibility, it establishes a hopeless conflict with state environmental laws such as ECRA and a convenient escape for those in violation of ECRA.

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109. *In re* Heldor Industries, Inc., 131 B.R. 578, 585 (Bankr. D. N.J. 1991).

110. *Id.* at 587.

111. In *In re Great Northern Forest Products, Inc.*, 135 B.R. 46 (Bankr. W. D. Mich. 1991), the Bankruptcy Court applied ECRA to a Chapter 7 liquidation. The court cited the *Torwico* decision with approval and held that "the filing of a bankruptcy petition by the Debtor did not trigger liability pursuant to ECRA." *Id.* at 58.