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CASE NOTES

Bankruptcy Law—ENFORCEABILITY OF STATE ENVIRONMENTAL LAWS AGAINST BANKRUPT DEBTORS—*Ohio v. Kovacs* (In re *Kovacs*), 105 S. Ct. 705 (1985)

I. THE STATUTORY SCHEME

Under the United States Bankruptcy Code, a discharge in bankruptcy discharges the debtor from all debts that arose before bankruptcy, with certain exceptions.¹ Once a debtor files a bankruptcy petition, most proceedings already in progress against him are automatically stayed.² The automatic stay provision of the Bankruptcy Code contains exceptions, however, one of which provides that a state may act to enforce a judgment against a bankrupt debtor if it is a nonmoney judgment obtained in an enforcement action brought by the state under its police or regulatory power.³

Under these statutory provisions, a bankruptcy case may involve disputes as to whether a particular obligation is indeed a debt and whether such a debt is nondischargeable due to a statutory exception. Another issue of concern in a bankruptcy case is whether court proceedings already in progress against the debtor will be

1. 11 U.S.C. § 727(b) (1982) provides:

Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

2. *Id.* § 362 provides in pertinent part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of—

. . . .

(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. *Id.* § 362(b) provides in pertinent part:

The filing of a petition under section 301, 302, or 303 of this title . . . does not operate as a stay—

. . . .

(5) . . . 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.

frozen due to the Code's automatic stay provision or will be allowed to continue to final judgment under a statutory exception.

These questions are of particular significance when the person filing for bankruptcy is the chief executive officer of a large corporate entity whose business entails hazardous waste disposal and whose "debt" involves compliance with important environmental laws in the course of operating his business. Such a case recently came before the United States Supreme Court in *Ohio v. Kovacs*.⁴ This Note analyzes the implications of that decision.

II. HISTORY OF THE CASE

A. *Kovacs I*

William Kovacs was one of two chief executive officers of Chem-Dyne Corporation, which was engaged with other entities in the business of industrial waste disposal in Ohio. The State of Ohio sued Kovacs individually and as an officer of the defendant corporation for violating state environmental protection laws. That suit was filed in state court. Ohio alleged that Kovacs had polluted public waters, caused fish kills, and maintained a nuisance. Kovacs signed a Stipulation and Judgment Entry which enjoined all defendants from causing further pollution, forbade bringing additional industrial wastes onto the site, and required the defendants to clean up the premises and pay \$75,000 to Ohio's Department of Natural Resources.⁵ Ohio moved to appoint a receiver of Kovacs' nonexempt property and assets upon the defendants' failure to comply with the judgment rendered by the state court. This motion was granted. The receiver had authority to take control of the Chem-Dyne site, collect any sums of money due to Kovacs individ-

4. *Ohio v. Kovacs (In re Kovacs)*, 29 Bankr. 816 (Bankr. S.D. Ohio 1982). The *Kovacs* case concerns Kovacs' individual obligation under the affirmative injunction issued against him. Two appeals arose from the *Kovacs* case, and each will be discussed separately. The first appeal from the decision of the bankruptcy court was taken to determine whether an automatic stay of the state's attempt to garnish Kovacs' wages to secure payment of his obligation was proper. *Ohio v. Kovacs (In re Kovacs)*, 29 Bankr. 816 (Bankr. S.D. Ohio 1982), *aff'd*, 681 F.2d 454 (6th Cir. 1982), *vacated and remanded*, 459 U.S. 1167 (1983), *appeal dismissed*, 755 F.2d 484 (6th Cir. 1985). This series of opinions is hereinafter referred to as *Kovacs I*.

The second appeal dealt with dischargeability in bankruptcy of Kovacs' obligation to the state. *Ohio v. Kovacs (In re Kovacs)*, 29 Bankr. 816 (Bankr. S.D. Ohio 1982), *aff'd*, 717 F.2d 984 (6th Cir. 1983), *aff'd*, 105 S. Ct. 705 (1985). This series of opinions is hereinafter referred to as *Kovacs II*.

5. *Kovacs II*, 29 Bankr. at 817.

ually, and to effect the cleanup of the site.⁶

A few months later, Kovacs filed a personal petition in bankruptcy under chapter 11 of the Bankruptcy Act.⁷ That petition was converted by the court to a chapter 7 liquidation petition.⁸ Ohio then filed a motion with the state court for a hearing to determine Kovacs' employment status and income. In response, Kovacs filed a motion with the bankruptcy court seeking a stay of the state court proceedings⁹ under the automatic stay provision of the Code. The bankruptcy court held that the state's action was an attempt to enforce a money judgment and that the action would therefore be stayed.¹⁰ The court reasoned that Ohio's attempt to secure information about Kovacs' income was actually an effort to collect money from Kovacs and was therefore an attempt to enforce a money judgment. According to the court, "there is no difference in substance between efforts to collect money from a debtor by securing a court order, and efforts to enforce a money judgment against him."¹¹

The Court of Appeals for the Sixth Circuit affirmed the conclusion of the bankruptcy court and the district court that "the state of Ohio in its state court proceedings was seeking what in essence amounted to a money judgment against Kovacs, which was properly subject to the automatic stay."¹² The United States Supreme

6. *Kovacs I*, 681 F.2d at 455. The state court order provided in part:

It is further ordered that Mr. Jack Zettler be appointed receiver of all property or assets, wherever situated, whether real or personal, tangible or intangible, and all interests, whether legal or equitable, in property or assets, of William Kovacs, except to the extent of any property exempt from the control of a receiver by operation of law;

. . . .

The receiver shall have power and authority to receive and collect any and all sums of money due or owing to the defendant business entities or defendant Kovacs in any manner, whether the same are now due or shall hereafter become due and payable

. . . .

It is further ordered . . . that each of the business entities and defendant Kovacs, and all officers, agents, and employees of the Defendant business entities and defendant Kovacs be enjoined and ordered to cooperate fully with the receiver in the performance of such duties or the exercise of such powers.

Id.

7. *Id.*

8. *Id.* Chapter 11 of the Bankruptcy Code governs reorganization proceedings. Chapter 7 of the Code governs liquidation proceedings.

9. *Id.*

10. *Id.*

11. *Id.* at 456 (quoting bankruptcy court's unpublished opinion).

12. *Id.* at 456. The court of appeals noted that "the state court's order appointing a

Court subsequently granted certiorari, vacated the judgment of the court of appeals, and remanded the case to that court to consider whether the dispute over the stay was moot.¹³

B. *Kovacs II*

The State of Ohio meanwhile had sought a declaration from the bankruptcy court that Kovacs' obligation under the state court order to clean up the Chem-Dyne site was not dischargeable in bankruptcy because it was not a "debt" as defined in the Code, but rather was an obligation which arose from a violation of law.¹⁴ The bankruptcy court ruled against the state.¹⁵ In January 1985, the Supreme Court ruled on this issue, unanimously affirming the Sixth Circuit Court of Appeals, which had affirmed the district court and the bankruptcy court.¹⁶

The Bankruptcy Code defines a "debt" as a liability on a claim.¹⁷ A "claim" is defined in section 101(4)(B) as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment"¹⁸ Ohio had argued that Kovacs' obligation to it was not a debt—and therefore not dischargeable in bankruptcy—because the state did not have a claim against Kovacs. The Supreme Court disagreed and reasoned that the state did indeed have a claim against Kovacs because it had a "right to an equitable remedy . . . and that the right has been reduced to judgment in the form of an injunction ordering the cleanup."¹⁹ The

receiver also ordered that Kovacs turn over all his non-exempt assets to the receiver, and authorized the receiver to collect any sums of money that would become payable to Kovacs in the future." The court felt that "[t]here is very little in substance to distinguish that order and a money judgment."

13. *Kovacs I*, 459 U.S. 1167 (1983). On remand, the Sixth Circuit took no action, waiting instead for the final adjudication of the dischargeability issue. 755 F.2d 484 (6th Cir. 1985). That issue is addressed in *Kovacs II*, 105 S. Ct. 705 (1985), *aff'g* 717 F.2d 984 (6th Cir. 1983). The Supreme Court's decision allowing the debt to be discharged in bankruptcy led the circuit court to dismiss the appeal. Since the debt was discharged in bankruptcy, the question as to whether the automatic stay provision applied became moot. 755 F.2d at 484.

14. 29 Bankr. at 817.

15. *Id.* at 819.

16. 105 S. Ct. at 705.

17. 11 U.S.C. § 101(11) (1982).

18. *Id.* § 101(4). "Claim" is defined as:

(A) [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) [a] right to an equitable remedy for breach of performance if such breach gives rise to a right to payment

19. 105 S. Ct. at 708.

Court rejected the notion that a claim could only arise from breach of an ordinary commercial contract and not from breach of a statutory obligation.²⁰ It also rejected the state's alternative contention that even if the state had a right to an equitable remedy, it was not entitled to a "right to payment." The Court noted that the state had specifically requested information regarding Kovacs' income and that the state's counsel had at oral argument "conceded that after the receiver was appointed, the only performance sought from Kovacs was the payment of money."²¹ The Supreme Court affirmed the court of appeals' conclusion that "the cleanup order had been converted into an obligation to pay money, an obligation that was dischargeable in bankruptcy."²²

III. PROBLEMS PRESENTED BY THE *Kovacs* CASES

A. *Preemption of State Environmental Laws Through Application of the Bankruptcy Code's Automatic Stay Provision*

The preemption doctrine is derived from the supremacy clause of the United States Constitution and provides that federal law shall have superiority over state law if the two are in conflict.²³ The underlying rationale of the preemption doctrine is that the supremacy clause invalidates state laws that "interfere with, or are contrary to laws of Congress."²⁴ The general rule established by case law, however, is that preemption is not favored in the absence of an unavoidable conflict between state and federal law, or unless Congress has explicitly provided for federal supremacy in a particular area of legislation.²⁵

Bankruptcy law is a federal creature, passed by Congress and codified in title 11 of the United States Code.²⁶ The purpose of the

20. *Id.* The Court examined the statutory definition of a claim, *see supra* note 18, and concluded that there is no requirement that a right to performance arise from a contractual obligation. It made no sense to the Court for Ohio to admit that Kovacs' obligation to pay \$75,000 was a dischargeable debt, but to contend that the cleanup order was not, since each order was to remedy an alleged breach of Ohio law.

21. *Id.* at 709 & n.9. The Court also referred to the bankruptcy court's observation that if Ohio were successful, it would be able to levy on Kovacs' wages.

22. *Id.* at 711. Once the receiver was in control of the site, it was apparent to the Court that Ohio did not expect Kovacs to clean up the premises; rather, Ohio expected a money payment as reimbursement for costs incurred by the state.

23. U.S. CONST. art. VI, cl. 2.

24. *Gibbons v. Odgen*, 22 U.S. (9 Wheat.) 1, 211 (1824).

25. *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311 (1981); *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).

26. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11

Bankruptcy Code is twofold: to give debtors a fresh start²⁷ and relief from harassing creditors,²⁸ as well as to protect the interests of creditors by administering the estates of debtors in a fair and orderly manner.²⁹

States, on the other hand, exercise their police power to regulate the environment for the protection of the public's health and safety.³⁰ These two regulatory schemes—federal bankruptcy law and Ohio's exercise of its police power to enforce its environmental laws—came into conflict in *Kovacs*.

If a state action involving the enforcement of state law against a bankrupt debtor is stayed pursuant to the bankruptcy proceeding, the state law is effectively preempted by federal bankruptcy law.³¹ A state's attempt "to rectify harmful environmental hazards . . . [is an] obvious exercise of the State's power to protect the health, safety, and welfare of the public"³² These important public interests protected by state law "should not be overridden by federal legislation unless they are inconsistent with explicit congressional intent."³³ Therefore, it is necessary to look to the legislative history of the sections of the Bankruptcy Code pertinent to *Kovacs* to ascertain whether Congress intended to preempt state environmental regulations.

Certain actions already pending will *not* be automatically stayed when a debtor files a bankruptcy petition. The purpose of the exception to the automatic stay provision relevant in *Kovacs*³⁴ is explained in the legislative history of that section of the Code: "[W]here a governmental unit is suing a debtor to prevent or stop violation of . . . environmental protection . . . or similar police or

U.S.C. §§ 101-151, 326 and scattered sections of 28 U.S.C. (1982)), amended by Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333.

27. *Fallick v. Kehr*, 369 F.2d 899, 904 (2d Cir. 1966).

28. *Kovacs I*, 681 F. 2d at 456.

29. *Gochenour v. George & Francis Ball Foundation*, 35 F.Supp. 508, 518 (S.D. Ind. 1940), *aff'd*, 117 F.2d 259 (7th Cir.), *cert. denied*, 313 U.S. 566 (1941).

30. *Penn Terra Ltd. v. Department of Env'tl. Resources*, 733 F.2d 267 (3d Cir. 1984). In *Penn Terra*, the State of Pennsylvania enjoined a coal surface mining company from causing further harm to the environment and ordered it to restore the area already damaged. The court, in holding that the state was acting within its police or regulatory power to protect an important public interest, noted that the states' police power "embodies the main bulwark of protection by which they carry out their responsibilities to the People; its abrogation is therefore a serious matter." *Id.* at 273.

31. 11 U.S.C. § 362(d) (1982).

32. *Penn Terra*, 733 F. 2d at 274.

33. *New York v. Quanta Resources Corp (In re Quanta Resources Corp.)*, 739 F.2d 912, 918 (3d Cir. 1984).

34. *See supra* notes 2 & 3.

regulatory laws, . . . the action or proceeding is *not* stayed under the automatic stay."³⁵

Paragraph (5) of that same subsection, however, creates an exception to the exception, providing that an action by a governmental unit to enforce a *money judgment* will be stayed even if the action represents an effort by the government to enforce its police or regulatory powers.³⁶ The legislative history of paragraph (5) explains that this section permits the entry and enforcement by a state of an *injunction* against a debtor and permits the *entry* of a money judgment, but it does not permit the *enforcement* of a money judgment.³⁷ The legislative history offers this rationale for the distinction drawn between the enforceability of an injunction and of a money judgment:

Since the assets of the debtor are in the possession and control of the bankruptcy court, and since they constitute a fund out of which all creditors are entitled to share, enforcement by a governmental unit of a money judgment would give it preferential treatment to the detriment of all other creditors.³⁸

Congressional intent is explicit. If, in the course of enforcing its environmental laws, a state is seeking to enforce a money judgment against a bankrupt debtor, federal bankruptcy law preempts state law and the state action is automatically stayed. If, on the other hand, a state is attempting to enforce an injunction against a bankrupt debtor, that action is allowed to proceed and is not preempted by federal law. The question then becomes whether the nature of the state's action is truly injunctive or is a disguised attempt to enforce a money judgment. The distinction is not always clear, especially if the state court's order is in the *form* of an injunction, yet entails an expenditure of money.

A recent case in the Court of Appeals for the Third Circuit, *Penn Terra Ltd. v. Department of Environmental Resources*,³⁹ dealt with this problem. The facts of *Penn Terra* were similar to

35. S. REP. No. 989, 95th Cong., 2d Sess. 52, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5838 (emphasis added) [hereinafter cited as SENATE REPORT].

36. See *supra* note 3.

37. The legislative history of 11 U.S.C. § 362(b)(5) (1982) explains:

Paragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not extend to permit enforcement of a money judgment.

SENATE REPORT, *supra* note 35, at 52.

38. SENATE REPORT, *supra* note 35, at 52.

39. 733 F. 2d at 267.

those of *Kovacs*. Penn Terra Limited operated coal surface mines in Pennsylvania. The State Department of Environmental Resources (DER) cited Penn Terra for numerous violations of state environmental protection laws. The DER and Penn Terra then entered into a consent order, with Penn Terra agreeing to remedy the situation. Upon Penn Terra's noncompliance with the state order and its subsequent filing of a chapter 7 bankruptcy petition, the state obtained an injunction against Penn Terra to correct violations of the state's environmental laws and to enforce the terms of the consent order.⁴⁰ In bankruptcy court, Penn Terra asserted that the automatic stay provision of the Code requires that the state's injunction be stayed.⁴¹ The court of appeals disagreed and reasoned that even though the injunction required the expenditure of money in order for Penn Terra to comply, the injunction was not the equivalent of a money judgment.⁴² The court held that the state's action would not be stayed and the injunction against Penn Terra was therefore enforceable.⁴³ The court noted that "the very nature of injunctive relief is that it addresses injuries which may not be compensated by money,"⁴⁴ but that "it is not unusual for a defendant in equity to expend money in order to obey or perform the act mandated by the injunction."⁴⁵

Case law is unsettled as to when a court order which entails the expenditure of money is or is not a money judgment. The Fifth Circuit has held the automatic stay provision inapplicable in a Na-

40. *Id.* at 270. The court ordered Penn Terra to: (1) complete all backfilling and final grading, (2) submit updated erosion and sedimentation plans, (3) seal a deep mine opening, (4) submit a plan for the removal of top strata over a gas line, (5) effectuate plans for erosion and sedimentation control, and (6) complete top soil spreading, mulching, and seeding, all within a certain time limit. *Id.* at 270 n.3.

41. *Id.* at 270. Penn Terra contended that the state proceeding violated the automatic stay provision of the Bankruptcy Code because the action was to enforce a money judgment.

42. *Id.* at 275. The court explained that an essential element of a money judgment is a sum certain, a definite designation of the amount which the defendant owes the plaintiff. Since Pennsylvania's injunction was brought in equity to compel performance of certain remedial acts by Penn Terra, and did not seek or direct any payment, it was not an effort to enforce a money judgment.

43. *Id.* at 278-79.

44. *Id.* at 277. The court considered it unlikely that an action which seeks to prevent future harmful conduct will materialize into an action for a money judgment. According to the court's reasoning, if a remedy compensates for past wrongful acts, it is more likely to manifest itself as a money judgment because a sum certain is calculable for injuries suffered in the past but not for injuries not yet suffered. This reasoning, however, fails to take into account an action which seeks to prevent future harm as well as to remedy past injuries.

45. *Penn Terra*, 733 F.2d 267, 276 (3d Cir. 1984) (quoting *United States v. Price*, 688 F.2d 204, 212 (3d Cir. 1982)).

tional Labor Relations Board case involving an order to reinstate employees with back pay.⁴⁶ The court noted that its decision permitted the *entry* of judgment for injunctive relief and back pay, but expressly withheld opinion as to whether an action to *enforce* a judgment for back pay would be automatically stayed.⁴⁷ The First Circuit has held, however, that the automatic stay provision does not preclude enforcement of a back pay order of the NLRB.⁴⁸

The court of appeals in *Penn Terra* pointed out that the distinction made in the Code between the entry of a money judgment and the subsequent attempt to enforce that judgment is based on the policy against allowing a creditor to seize property of the debtor in order to enforce a judgment. "It is this seizure of a defendant-debtor's property, to satisfy the judgment obtained by a plaintiff-creditor, which is proscribed by subsection 362(b)(5)."⁴⁹

In *Kovacs I*, Ohio law was preempted through the application of the Bankruptcy Code's automatic stay provision. Not only did the conditions of the injunction require Kovacs to expend money, but the state-appointed receiver also retained authority over the property site and over Kovacs' nonexempt assets even after he had filed a bankruptcy petition.⁵⁰ At that point the state's action, although in the form of an injunction, constituted seizure of Kovacs' property and an attempt to levy on his wages.⁵¹

In *Kovacs II*⁵² the Supreme Court distinguished *Penn Terra*, on which the State of Ohio had relied, on the basis that no receiver had been appointed in *Penn Terra*.⁵³ The Supreme Court apparently agrees with the *Penn Terra* court, that once a debtor files a bankruptcy petition, seizure of the debtor's property by a creditor is prohibited. The Court took a dim view of the fact that Kovacs was required to turn over all nonexempt assets to the state-ap-

46. NLRB v. Evans Plumbing Co., 639 F.2d 291 (5th Cir. 1981).

47. *Id.* at 293.

48. Ahrens Aircraft, Inc. v. NLRB, 703 F.2d 23 (1st Cir. 1983).

49. 733 F.2d at 275.

50. 105 S. Ct. at 709.

51. BLACK'S LAW DICTIONARY 705 (5th ed. 1979) defines "injunction" as "[a] prohibitive, equitable remedy issued or granted by a court at the suit of a party complainant, directed to a party defendant in the action, . . . forbidding the latter to do some act, . . . such act being unjust and inequitable, injurious to plaintiff . . ."

"Equitable relief" is defined as "[t]hat species of relief sought in a court with equity powers as, for example, in the case of one seeking an injunction or specific performance instead of money damages." *Id.* at 484.

52. 29 Bankr. 816 (Bankr. S.D. Ohio 1982), *aff'd*, 717 F. 2d 984 (6th Cir. 1983), *aff'd*, 105 S. Ct. 705 (1985).

53. 105 S. Ct. at 711 n.11.

pointed receiver.⁵⁴ The Court also noted that the receiver was authorized to collect any money owed to Kovacs, and that Ohio "sought discovery with respect to [Kovacs'] earnings . . . for the purpose of levying upon his wages,"⁵⁵ a technique which is applied in the enforcement of money judgments. The Court emphasized that "[a]s the case comes to us . . . Kovacs has been dispossessed and the State seeks to enforce his cleanup obligation by a money judgment."⁵⁶ Once Kovacs' cleanup obligation under the injunction became an obligation to pay money, it also became dischargeable upon his filing a bankruptcy petition.⁵⁷

Thus, on the facts of the *Kovacs* cases, and in similar circumstances when a state or other governmental unit controls property of a debtor after he has filed a petition in bankruptcy, not only will preemption of state law be proper, but the debtor's prebankruptcy obligation may also be found to be dischargeable.

B. Ability of a State to Collect a Fine or Monetary Penalty from a Bankrupt Debtor

Under section 727(b) of the Bankruptcy Code,⁵⁸ a debtor is discharged from all debts that arose before bankruptcy, with certain exceptions. Section 523(a)⁵⁹ excepts from discharge a fine or penalty payable to a governmental unit which is not compensation for actual pecuniary loss.⁶⁰

As noted by the Supreme Court in *Kovacs II*,⁶¹ Ohio had neither imposed a fine on Kovacs nor claimed that his obligation under the injunction was nondischargeable due to an exception under section 523.⁶² Rather, the state submitted that Kovacs' obligation was non-

54. *Id.* at 710. The Court observed that Ohio, by requiring Kovacs to turn over all non-exempt assets to the receiver, actually removed Kovacs from authority over the site and divested him of assets possibly useful to the cleanup of the property.

55. 29 Bankr. at 818, quoted in 105 S. Ct. at 709, 710 n.9.

56. 105 S. Ct. at 712.

57. *Id.*

58. See *supra* note 1.

59. 11 U.S.C. § 523 (1982) provides in pertinent part:

(a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—

. . . .

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty

60. *Id.*

61. 105 S. Ct. at 705.

62. *Id.* at 708.

dischargeable because it was not a debt within the meaning of section 101, since the state had no "claim" against Kovacs as defined in that section.⁶³

The state argued that Kovacs' noncompliance with the injunction did not give rise to a claim within the statutory definition because Kovacs' failure to comply with the order was a violation of law and not a breach of an ordinary contract.⁶⁴ The Court thought this was a strained interpretation of the statute,⁶⁵ and rightly so, as the statutory language does not even imply that a claim may arise only from the breach of a contractual arrangement. One court has held that all legal obligations of the debtor, no matter how remote or contingent, will be dealt with in a bankruptcy case.⁶⁶ Congress carefully mandated a broad definition of claim.⁶⁷ In a futile attempt to save its injunction from falling within the statutory definition of a claim, Ohio also contended it was not entitled to a "right to payment" upon Kovacs' breach of performance (his non-compliance with the injunction).⁶⁸ In light of remarks of the state's counsel at oral argument that "the only performance sought from Kovacs was the payment of money,"⁶⁹ and since the state had requested information about Kovacs' earnings,⁷⁰ the Court was not persuaded by the state's argument and held that Kovacs' obligation to clean up the Chem-Dyne site had been converted into an obligation to pay money; Kovacs' obligation was therefore a debt and was dischargeable in bankruptcy.⁷¹

In light of the feebleness of Ohio's argument that it was not entitled to a money payment from Kovacs, and that Kovacs' obligation to the state was therefore not a debt and not dischargeable, one

63. *Id.*

64. *Kovacs II*, 29 Bankr. at 819. Ohio had also argued that Kovacs' noncompliance with the injunction was a contempt of court, not a breach of performance.

65. 105 S. Ct. at 709. The Court noted that Congress specifically created certain exceptions from discharge for certain claims, including those involving fines, penalties, embezzlement, and larceny, but that Ohio did not contend that its claim fell within one of those exceptions. *Id.* at 709 n.5.

66. *Iowa v. Thomas (In re Thomas)*, 12 Bankr. 432, 433 (Bankr. S.D. Iowa 1981).

67. 105 S. Ct. at 709 & n.3.

68. *Id.* at 709.

69. *Id.* at 710 (quoting transcript of oral argument 19-20).

70. 717 F.2d at 987. Not only had Ohio requested a hearing to determine Kovacs' income, but freely admitted in its brief that the reason it had done so was to develop "a factual record which might provide a basis for requiring part of Kovacs' income 'to be applied to the unfinished task of the receivership,' i.e., removal of the drums of chemical waste from the site." *Id.* In view of the record before it, the Supreme Court had no choice but to affirm the court of appeals and conclude that Ohio sought a money payment from Kovacs.

71. *Kovacs II*, 105 S. Ct. at 712.

wonders why Ohio did not impose a fine on Kovacs for violating its environmental protection laws. Although the Supreme Court, court of appeals, and bankruptcy court all implied that they were confused as to why the state failed to do so,⁷² the answer may lie in the section of the Code which excepts fines from dischargeability.⁷³ That section provides that a fine imposed against an individual debtor by a governmental unit is dischargeable if it is "compensation for actual pecuniary loss"⁷⁴ To the extent that a fine imposed by Ohio against Kovacs constituted reimbursement for expenses the state incurred in cleaning up the waste site, it is possible that such a fine would have been characterized as "compensation for actual pecuniary loss," and therefore dischargeable.⁷⁵

In re Tauscher,⁷⁶ a bankruptcy court decision, is a leading case concerning the imposition of a civil penalty on a bankrupt debtor. In that case, the United States Secretary of Labor assessed a money penalty against a bankrupt debtor for violating the child labor provisions of the federal Fair Labor Standards Act. The court held that since the penalty fell under the statutory exception to dischargeability contained in section 523(a)(7) of the Code, the assessment would be permitted.⁷⁷ Actual enforcement of the penalty through a money judgment was not allowed as long as the automatic stay was in effect, due to its provision that entry of a money judgment against a bankrupt debtor is permitted but enforcement is not.⁷⁸

This apparently is the catch-22 in which Ohio found itself. After Kovacs had filed a bankruptcy petition, a civil fine or money penalty imposed against him would be unenforceable while the automatic stay was in effect, and may even have been dischargeable. Due to the urgency of the situation created by Kovacs' continuing violation of important environmental protection laws, Ohio attempted to maintain the receiver's access to and control over the property site and Kovacs' assets.

72. See *Kovacs II*, 105 S. Ct. at 711; 717 F.2d at 988; 29 Bankr. at 817.

73. 11 U.S.C. § 523(a)(7) (1982).

74. *Id.*

75. See Comprehensive Environmental Response, Compensation & Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2781 (codified at 42 U.S.C. § 9607 (1982)). This "superfund" legislation imposes liability upon owners of hazardous waste facilities to affected states and the federal government. The liability is extended to all costs incurred either in the removal of the hazardous substances or in remedial action.

76. *Marshall v. Tauscher (In re Tauscher)*, 7 Bankr. 918 (Bankr. E.D. Wisc. 1981).

77. *Id.* at 920.

78. *Id.*

Imposition by Ohio of either civil or criminal penalties against Kovacs undoubtedly would have changed the outcome. Although a civil fine would have been subject to the automatic stay, the state could have requested judicial relief pursuant to section 362(d) of the Code.⁷⁹ If a civil fine were declared dischargeable as reimbursement to the state for actual pecuniary loss,⁸⁰ a criminal contempt action by Ohio against Kovacs for failure to perform his obligation under the injunction would not be stayed. Nor would a criminal fine have been dischargeable had one been imposed.⁸¹

C. Issues Not Decided

A number of issues the Supreme Court did *not* decide in *Kovacs II* were emphasized in the opinion and are important. The Court distinguished between the negative and affirmative aspects of the injunction. It specifically did not address whether the prohibition against bringing more toxic wastes onto the premises and causing further pollution was dischargeable; however, the affirmative obligation imposed on Kovacs to clean up the site by paying money directly to the state *was* held to be dischargeable.⁸² The Court also withheld opinion as to the legal consequences had a receiver not been appointed by the state prior to bankruptcy and the usual procedure in chapter 7 bankruptcy cases had been followed instead, that is, had a bankruptcy trustee been appointed by the bankruptcy court with authority to administer the assets of the debtor's estate.⁸³

79. 11 U.S.C. § 362(d) (1982) provides:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

- (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
- (2) with respect to a stay of an act against property, if—
 - (A) the debtor does not have an equity in such property; and
 - (B) such property is not necessary to an effective reorganization.

80. *Id.* § 523(a).

81. A criminal proceeding against a debtor is not subject to the automatic stay provision. *Id.* § 362(b) (1982) provides in part: "The filing of a petition under section 301 . . . of this title . . . does not operate as a stay—(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor . . ." See also 105 S. Ct. at 711.

82. 105 S. Ct. at 712. By demanding that Kovacs pay money directly to it, the state tainted the affirmative aspect of the injunction to such a degree that the obligation became dischargeable.

83. *Id.* at 711 & n.12. The Court observed that had a bankruptcy trustee been appointed to administer the assets of Kovacs' estate, the Chem-Dyne site would have been valued and

The Court also suggested available recourses for states in their attempts to enforce environmental protection laws violated by bankrupt debtors:

First, we do not suggest that Kovacs' discharge will shield him from prosecution for having violated the environmental laws of Ohio or for criminal contempt for not performing his obligations under the injunction prior to bankruptcy. Second, had a fine or monetary penalty for violation of state law been imposed on Kovacs prior to bankruptcy, § 523(a)(7) forecloses any suggestion that his obligation to pay the fine or penalty would be discharged in bankruptcy.⁸⁴

IV. IMPLICATIONS OF KOVACS II

The Supreme Court specifically noted that its holding was based on the particular facts surrounding the *Kovacs* dispute.⁸⁵ Thus, the implications of *Kovacs* may not be as far-reaching as they first appear. What is clear from the decision is that Ohio dug its own grave by maintaining the receiver's control over the property site after Kovacs filed for bankruptcy, and by requiring Kovacs to pay money directly to the state. Ohio's failure to impose a nondischargeable criminal penalty against Kovacs for violation of the cleanup order also proved a mistake.⁸⁶ If the state had not appointed a receiver to take control of the premises, and thereby had not "dispossessed" Kovacs, it is debatable whether the Court would have allowed the injunction to stand in its entirety. The affirmative aspect of the injunction, i.e., the requirement that Kovacs pay money directly to the state for the cleanup costs, would still have been unenforceable,⁸⁷ but if the injunction had merely required Kovacs to clean up the site *without* requiring direct payment to the state it may have been enforceable.

The *Penn Terra*⁸⁸ case supports this contention. On facts similar to those in the *Kovacs* cases, (except that there was no state-ap-

either sold, in which case the proceeds would have gone to pay for the cleanup, or abandoned to its prior owner who would be responsible for complying with state environmental laws. The Court made it clear that whoever was in possession of the site would be required to comply with state laws.

84. 105 S. Ct. at 711.

85. See *supra* notes 82-83 and accompanying text; see also 105 S. Ct. at 711, 712.

86. See *supra* notes 59, 81 and accompanying text.

87. See *supra* note 82.

88. 733 F.2d 267 (3d Cir. 1984).

pointed receiver and no requirement that a money payment be made directly to the state), the state's injunction was held to be enforceable even though the debtor had to expend money in order to comply. The fact that the Supreme Court discussed the *Penn Terra* holding in *Kovacs II*⁸⁹ without overruling it suggests that a state will more likely prevail if it enjoins the defendant-debtor, but allows the bankruptcy court to appoint a trustee to manage the debtor's assets. The state may then have the option, depending on the particular circumstances, of imposing either civil or criminal penalties against the debtor. If an action assessing or enforcing such penalties is stayed, the state may request relief from the stay. The bankruptcy court will look to the nature of the state's interest in the debtor's property in making its decision as to whether the stay should be granted.⁹⁰ As Justice O'Connor observed in her concurring opinion, the classification of a state's interest in a debtor's property determines the priority of a state's claim, and this classification is controlled by state law.⁹¹

Justice O'Connor also noted that a state will not want to deny, as the State of Ohio did, that it has a claim against the debtor. This is especially true where the debtor is a corporation rather than an individual. After a corporation files a bankruptcy petition, it usually dissolves and there are no postbankruptcy earnings. "The State's only recourse in such a situation may well be its 'claim' to the prebankruptcy assets."⁹²

Although the Supreme Court specifically limited the holding of *Kovacs* to its particular facts, the case may prove useful as a guide to states in their attempts to enforce environmental protection laws against recalcitrant polluters who seek shelter in the Bankruptcy Code.⁹³

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89. 105 S. Ct. at 711 n.11.

90. 11 U.S.C. § 362(d) (1982); see *supra* note 79. Relief from a stay will be granted for a "lack of adequate protection of an interest in property of such party" seeking relief.

91. 105 S. Ct. at 712 (O'Connor, J., concurring).

92. *Id.*; see also Baird & Jackson, *Kovacs and Toxic Wastes in Bankruptcy*, 36 STAN. L. REV. 1199 (1984).

93. See Hoffman, *Environmental Protection and Bankruptcy Rehabilitation: Toward a Better Compromise*, 11 ECOLOGY L.Q. 671, 677-82 (1984), discussing *GAF Corp. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 26 Bankr. 405 (Bankr. S.D.N.Y. 1983); see also Comment, *Will Financially Sound Corporate Debtors Succeed in Using Chapter 11 of the Bankruptcy Code as a Shield Against Massive Tort Liability?*, 56 TEMP L.Q. 539, 544-49 (1983).

