THE 'INSOLVENT POLLUTER STILL PAYS' PRINCIPLE?

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Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht **(NVRII)** / Netherlands Association for Comparative and International Insolvency Law **(NACIIL)**

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How to deal with environmental claims in insolvency? Although the question as to the ranking of environmental claims has been one of the more controversial issues in Dutch insolvency law in recent years, there are many other and perhaps bigger questions: Could something like successor liability under Dutch law apply to environmental claims in case of pre-packs? Does it matter whether a claim is based on private law or public Law? Is it possible for companies to obtain discharge regarding environmental liabilities if they go through a restructuring proceeding?

Dutch restructuring law has been inspired by the US Chapter 11 (and the UK Scheme of Arrangement). US (case) law is moving away from allowing discharge under Chapter 11 of environmental liabilities. How can one balance the interests of the creditors with those of the environment, or is the environment just another creditor? These questions and a variety of answers are explored from a US, European, Swedish and Dutch perspective, highlighting various solutions and inspiring to move forward in this new field.

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Preface

The central theme of the annual meeting of NACIIL 2024 was 'Insolvent Polluter Still Pays Principle?'.[1] Somehow, the two widely discussed themes of environmental interests on the one hand and reorganisation procedures on the other, had not yet really connected under Dutch law, even though Supreme Court case law on the ranking of public environmental claims in liquidation procedures[2] did spark fierce debate. Analyses of how these rules on ranking of claims are to be transposed from liquidation procedures to reorganisation procedures and pre-packs was largely lacking in the Netherlands.

The lack of both case law and in depth legal and policy analyses in the Netherlands, provided the reasons for NACIIL to seek legal scholars from jurisdictions that have further developed their thinking on environmental claims around insolvency and restructuring. The NACIIL is honoured that Michael Ohlrogge (NYU, USA) and Jonatan Schytzer (Uppsala University, Sweden) accepted our invitation to write and present a report (pre-advies). We are also very grateful to Marc Noldus & Daniella Strik (Linklaters, Amsterdam) as well as Aart Jonkers & Rolef de Weijs (UvA, Amsterdam) to devote their time and dedicate their inspiration to write two reports from a Dutch perspective for the NACIIL. We believe the reports provide a solid point of departure for future legal and policy analyses on how insolvency law should deal with environmental liabilities. The reports provide a clear overview, and inspiring starting point for further development of this field.

We are grateful to Rabobank as our host in 2024, with Bas van Weert as chair. We also want to thank all participants for their very active contributions. A report of the annual meeting has been prepared by Inge Bakker (Radboud Universiteit, Nijmegen) and is published as, 'The 'Insolvent Polluter Still Pays' Principle? – Een verslag van de jaarvergadering van de NVRII', *TvI* 2024.

We also want to thank professor Edward Morrison (Columbia Law School, USA). It was his off the cuff remark and reference to the research of Ohlrogge that provided the initial inspiration for this year's theme, when he said: "Recent research has shown that non-dischargeability of environmental liabilities has led to cleaner rivers in the US."

Board of the NACIIL, Amsterdam 2024

1 The annual meeting was held on June 10, 2024 in Utrecht and was hosted by Rabobank Netherlands.

2 See Dutch Supreme Court 4 June 2021, ECLI:NL:HR:2021:833 (Ridderkerkse Taxicentrale), *TvI* 2022/10, annotation G.A.J. Boekraad.

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What If Polluters Cannot Pay?

The Swedish Mining Bankruptcies – Problems and Proposals

Jonatan Schytzer[*]

1. Introduction

Over the last two decades, Sweden has suffered from a number of large mining businesses going bankrupt. An example is the Blaiken mine, where Scanmining, in 2000, got a permit to mine zinc, lead, and gold. Six years later, the mining started. The company was declared bankrupt after just sixteen months. Lappland Goldminers bought the mine but did not even manage to begin mining before it was declared bankrupt. The companies have left behind large open pits and thousands of tonnes of mine waste with no plan to deal with it. Instead, water has continued to flow through the mine area, leaking high levels of zinc into a nearby lake – causing severe environmental damage. The Blaiken mine is, unfortunately, not a one-of-a-kind case. According to the Swedish Environmental Protection Agency, as many as 324 contaminated mining sites in Sweden are classified as "very high or high risk" to human health and the environment.[1]

There is an extensive set of regulations on mining, both on the EU and national level. Operators of mines shall take measures necessary to prevent environmental damage. If damage nevertheless occurs, operators are obliged to remedy it according to the Swedish Environmental Act,[2] which, in part, is an implementation of the Environmental Liability Directive.[3] The directive and the European Union's environmental policy are based on the principle that the polluter should pay.[4] However, in the vast majority of cases, such as Blaiken, there is no money left in the businesses to mitigate environmental harm and remedy environmental damage. The polluter cannot pay, which short-circuits the environmental liability system. You could say that the environment has gone bankrupt.

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1 See SOU [Swedish Government Official Reports] 2018:59 pp. 85–89; Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017a), Förslag till strategi för hantering av gruvavfall, NV-03195-16, SGU-311-888/2016, p. 44 and pp. 84–85; "Här är gruvorna som förorenar Sverige", DN.se 2022-06-12 (last accessed 15 June 2024).

2 See Chapter 2 § 8 and Chapter 10 Environmental Act (in Swe: miljöbalk (1998:808)).

3 Full title: Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage.

4 See Art. 191 Treaty on the Functioning of the European Union.

This article aims to explore and propose solutions that ensure that the polluter can pay, even if it goes bankrupt. We will use the Swedish mining industry and its regulation, which is mainly based on EU law, as a case study. We will start by providing an environmental background to identify typical environmental actions that require funding to prevent environmental hazards and to remediate the environment in case a mining company goes bankrupt. In this section, we will also delve into the polluter pays principle to explore how the polluter can, in principle, pay, even if it goes bankrupt. Then, we will explore solutions, focusing on priority, insurance, and security. While doing that, we will dip into Norwegian, Canadian, and American regulations as well as recommendations from the World Bank and Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Developments (IGF).[5]

2. Environmental Background

2.1 Introductory Remarks

In Sweden, three parallel environmental liability regimes are in place to ensure that polluted sites are remedied. First and foremost, an operator of a mine must have a permit to start mining. The mining permit sets out how the mine should be operated to avoid and mitigate environmental damage and how the mining site should be remedied when it closes. Second, there is the liability mentioned above for environmental damages. Third, there are rules on environmentally hazardous activities that apply to, inter alia, storing extractive waste. We will explore the second and third liability regimes further in the section on priority. This section will focus on the permits, particularly how they are a tool for regulating how water and extractive waste should be managed. It will illustrate what kind of funding needs to be in place if a mining company goes bankrupt. This is deemed as a sufficient background to discuss solutions.

2.2 Permit, Water, and Extractive Waste

Let us start with water. It is fundamental to mining in several ways, but the use of water creates significant environmental hazards. Water must be pumped out of open pits and shafts to carry out the mining operations. Water is also used in the enrichment process, which pollutes it. Afterwards, the water is purified in sedimentation ponds. However, there is a risk that these ponds will be flooded, especially at high water flows, which

5 IGF is an intergovernmental organisation that brings together over 75 countries and its goal, among other things, is to promote a sustainable mining industry.

occur during snowmelt in spring and when autumn rain falls. When flooding occurs, water must be released into adjacent streams, rivers, and lakes. To mitigate the risks of polluted water being released into nearby water courses, the mining company needs to control the water levels in ponds, open pits, and shafts, which is done, for example, by pumping. Furthermore, the water quality needs to be tested continuously to ensure that the water released from the ponds is up to environmental standards.[6]

The permit regulates the maximum levels of, for example, sulphate that the released water can contain, under the forms of flooding that can occur (or rather what measures must be taken to avoid flooding) and how continuous dam safety work must be maintained. The requirements follow from the Environmental Act and suppliant ordinances,[7] which, in part, are an implementation of the EU Water Framework Directive,[8] and the Directive Setting Environmental Quality Standards in the Field of Water Policy.[9] Operating these systems is vital to avoid environmental damage but also expensive. In the *Blaiken* case, the costs exceeded €100,000 per month.[10]

Let us move on to extractive waste. In 2020 alone, the Swedish mining industry generated nearly 120 million tonnes of extractive waste, which was over 75% of the total waste produced in Sweden that year.[11] The extractive waste mainly consists of blasted grey rock, and the environmental hazards of the waste depend on the type of ore being mined. Sulphide ores, from which gold, silver, copper, lead, and zinc can be extracted, can cause severe environmental damage. In these cases, the remediation aims to avoid oxidation and weathering, which occurs if the ore comes into contact with water and oxygen.[12]

Post-processing of mining waste can be done in different ways. The Geological Survey of Sweden[13] recommends covering the extractive waste with a two-meter layer of

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6 See for example "Varför vi pumpar ut vatten", kaunisiron.se (last accessed 15 June 2024); "Med vatten och dammar i fokus", lkab.com (last accessed 15 June 2024); Swemin (2021), Gruvbranschens riktlinjer för dammsäkerhet, GruvRIDAS.

7 See, for example, Chapter 2, Chapter 5, Chapter 11 §§ 24–26, Chapter 22 § 25, and Chapter 26 §§ 19–19a of the Environmental Act; Ordinance on Dam Safety (in Swe: förordning (2014:214) om dammsäkerhet); Ordinance on Extractive Waste (in Swe: förordning (2013:319) om utvinningsavfall); Ordinance on Operators' Self-Checks (in Swe: Förordning (1998:901) om verksamhetsutövares egenkontroll).

8 Full title: Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy.

9 Full title: Directive 2008/105/EC of the European Parliament and of the Council of 16 December 2008 on environmental quality standards in the field of water policy.

10 See SOU 2018:59 p. 87.

11 See "Uppkommet avfall", scb.se (last accessed 15 June 2024).

12 See SOU 2018:59 pp. 45–53; Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017b), Kartläggning av kostnader för hantering av gruvavfall och för efterbehandling av gruvverksamhet, NV-03195-16, SGU-311-888/2016, pp. 10–13 and pp. 14–18; Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017a), supra note 1, pp. 90–101 and pp. 102–112.

13 The Geological Survey of Sweden (in Swe: Sveriges geologiska undersökning) is the government authority responsible for issues relating to bedrock, soil, and groundwater in Sweden.

moraine. The cost has varied greatly, depending on whether the correct type of moraine was available nearby, ranging from €2,50 per square meter to €25. €2,50 may seem low, but the post-processing costs exceeded €2 million in that case.[14]

Every operator needs a waste management plan to obtain a permit. The plan must state how the extraction waste will be handled and how the rehabilitation will take place. It must also contain a plan for closure, including rehabilitation, after-closure procedures, and monitoring, as prescribed in Chapter 22, § 1 of the Environmental Act and the Ordinance on Extractive Waste. These, in turn, are an implementation of the Extractive Waste Directive.

The environmental hazards associated with water use and the management of extractive waste highlight the need for both short-term and long-term measures to prevent environmental hazards and remediate the environment. The holder of the permit is responsible for taking these actions. If these actions are not carried out, the supervisory authority can issue injunctions and necessary prohibitions to ensure compliance with the permit, as stipulated in Chapter 26 § 9 of the Environmental Act. The authority can also execute a decision at the permit holder's expense, according to Chapter 26 § 17 of the same act. This transposes the actions into monetary claims. But what if the permit holder goes bankrupt? Who should pay, then? Let us delve into the polluter pays principle to answer that question and to further explore the normative basis of environmental claims.

2.3 The Polluter Pays Principle

The polluter pays principle can be traced back to the work of the English economist A. C. Pigou. Pigou was active in the early twentieth century when Britain had undergone unparalleled industrial growth over the previous sixty years, increasing the country's gross domestic product substantially. But industrialisation had also destroyed parts of the British idyll: industries and coal mines had marred deep valleys and high hills in shades of green. It was a theme that Pigou took up in his texts. He pointed out that the market did not consider these "disservices"[15] (later called externalities) in pricing. If, for example, manufacturer A were to sell an item produced in one of her factories to B, A did not have to take responsibility when someone other than A and B was affected by this transaction, such as a neighbour and his living environment. In this way, the prosperity of the individual industrial owner benefited at the expense of the neighbour's and, in the end, society's prosperity. Pigou found that the market had failed in that respect

14 See SOU 2018:59 pp. 45–53; Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017b), supra note 12, pp. 45–63.

15 See Pigou, A. C. (1912), Wealth and Welfare, p. 158.

and that the government had to intervene. He argued that this problem could be solved through taxes. The externalities could be *internalised* in the business through taxes.[16]

Environmental lawyers later picked up the idea, and the polluter pays principle builds on the notion of internalisation. However, the primary vehicle for internalisation has not been taxes but environmental standards and liability regimes for environmental damages. For example, suppose a factory that produces goods discharges dirty water into a river. In that case, the cost of taking care of the externalities should, according to the principle, be internalised in the business. Otherwise, the product's price will not reflect the actual manufacturing cost, and the seller and buyer may prosper at the expense of the environment. The principle that the polluter should pay is thus a *cost allocation norm*, which has its basis in Pigou's thinking.[17]

Given this background, the question raised earlier – should the polluter pay even if it goes bankrupt – can be rephrased and specified as follows: should the internalisation of costs also occur in the event of the polluter's bankruptcy?

In contrast, society generally tolerates companies taking business risks that can lead to bankruptcy in the future; a credit provider, such as a bank, bases its business on managing and pricing such risks. The credit provider's business is based on assuming a specific proportion of the risk that the debtor's business will not develop as planned.

If we return to the *Blaiken* case, the bankruptcies were caused by overestimating profitability, underestimating environmental consequences, and problems with ore beneficiation.[18] These are standard business risks, and in a market economy, we tolerate that these risks, in part, are carried by, inter alia, a credit provider. In a sense, they are externalised to the credit provider. However, a claim to a credit provider is not fully comparable to an environmental claim. According to the polluter pays principle, the internalisation of environmental costs should be complete. Hence, it is unacceptable that some business risks are externalised, resulting in unfulfilled environmental claims.

There are risks involved in setting up a mining company. The mining sector suffers from volatile commodity prices. For example, during the last decade, the cost of zinc has varied between €1,400 and €4,000 per tonne,[19] which makes it hard to start and

16 See Pigou, A. C. (1912), supra note 15, pp. 7–8; Pigou, A. C. (1932), The Economics of Welfare, 4th ed., pp. 172–203. See also Kumekawa, I. (2017), The First Serious Optimist, A.C. Pigou and the Birth of Welfare Economics, pp. 74–78; Collard, D. (2011), Generations of Economists, pp. 20–21; Aslanbeigui, N. & Oakes, G. (2015), Arthur Cecil Pigou, pp. 70–72.

17 See for example De Sadeleer, N. (2020), Environmental Principles, From Political Slogans to Legal Rules, 2nd ed., pp. 31–33, pp. 42–46, and pp. 62–80; Bugge, H. C. (2009), The polluter pays principle: dilemmas of justice in national and international contexts, Ebbesson, J. & Okowa, P. (Eds.), Environmental law and justice in context, pp. 411–422; Beyerlin, U. & Marauhn, T. (2011), International Environmental Law, pp. 58–59.

18 See SOU 2018:59 pp. 86–87.

19 "Commodity Prices", indexmundi.com (last accessed 15 June 2024).

operate a profitable mining business in the long term. If these risks were to materialise, as in the *Blaiken* case, the polluter would not bear the costs of, for example, remedying the open pits and the mine waste – contrary to the notion of internalisation, which the polluter pays principle builds on.

The fundamentals of the principle support that the polluter should also pay in case of bankruptcy, or rather that the internalisation of costs should also occur in case of the polluter's bankruptcy. Next, we will explore different ways to enable this. We also need to keep in mind that short-term and long-term actions need to be taken to avoid environmental hazards and to be able to remediate the environment. Therefore, short-term and long-term funding must be in place so the environment does not go bankrupt.

3. Direct and Indirect Priority

3.1 Introductory Remarks

In the previous section, it was established that there are extensive regulations on mining operations in Sweden, which, in significant part, are based on EU law. According to these regulations, numerous measures must be taken to mitigate environmental harm. The supervisory authority can transpose these measures into monetary claims if necessary measures are not taken. In this section, we will examine priority as a solution to ensure that the polluter can pay, even if it goes bankrupt. We will distinguish between direct priority and indirect priority. The latter is achieved by making the bankruptcy estate (or the equivalence of) responsible. An indirect priority raises the question of whether the bankruptcy estate can abandon (disclaim, renounce) the property and, thus, avoid responsibility.

Before exploring these questions, another preliminary question must be addressed: is priority in line with the polluter pays principle? When priority is given to environmental claims, they get priority *over* other creditors' claims. Questions of priority deal with how to allocate the assets of the operator. In that sense, giving priority to environmental claims is not about making the polluter pay but rather about making the polluter's *creditors* pay. However, this is an interpretation of the polluter pays principle based on the principle's wording. We must consider that the principle is based on the idea that the costs of polluting the environment should be internalised within the business. Therefore, a better question is whether these costs are in any way internalised by giving priority to environmental requirements. This is a question we will delve into in this section.

In many ways, questions of priority can be questions of which interest one wants to promote. In that way, they are highly normative questions.[20] To illustrate that environmental claims receive different priority in different legal orders and to explore various solutions to if and when priority should be given to environmental claims, we will look into other legal orders besides Sweden. Norway, Canada, and the US were chosen because they provide different solutions. As will become apparent, Norway is on one (extreme) side of the spectrum, and recent developments in Canada have placed it on the other (far) side. In addition, case law from the Supreme Court of the United States (SCOTUS) gives further nuances. That environmental claims receive different kinds of priority is also illustrated by the two reports of this meeting giving a Dutch perspective on these matters – Jonkers & de Weijs, "Preventing Environmental Bail Outs" and Noldus & Strik, "The ESG Factor in Dutch Insolvency and Restructurings" – and is supported by the literature.[21]

This comparative study will provide a platform for discussing whether priority should be given to environmental claims. The discussion will entail the question of whether priority is a way of internalising costs and its effects on lending for these types of businesses. Whether priority has a preventive effect will also be considered.

3.2 Sweden

According to the Swedish Rights of Priority Act,[22] environmental claims do not receive priority. However, environmental claims are often given *in*direct priority in Sweden. The bankruptcy estate may be liable for environmental claims. Before the proceeds of the debtor's assets are distributed to the creditors, debts the bankruptcy estate has incurred (as well as other administrative expenses) are to be paid, as stated in Chapter 11 § 1 of the Swedish Bankruptcy Act.[23] However, secured creditors are generally unaffected by

20 Cf. Omar, P. (2010), Disclaiming Onerous Property in Insolvency: A Comparative Study, International Insolvency Review, p. 63; Linna, T. (2017), The Environmental Liabilities of a Bankruptcy Estate, International Insolvency Review, pp. 56–58; Ehmke, D. & Vaccari, E. (2024), Environmental Liabilities in Insolvency, Ghio, E. & Vaccari, E. (Eds.), The Perpetual Renewal of European Insolvency Law, pp. 29–33, highlighting the normative and political aspects of providing priority directly or indirectly to environmental claims (including the power of the trustee to disclaim onerous property, thereby avoiding indirect priority).

21 See, for example, INSOL International (2024), Environmental Claims and Liabilities in Insolvency and Restructuring, comparing 22 jurisdictions regarding the treatment of environmental claims. See also Omar, P. (2010), supra note 20, pp. 41–64, comparing UK, Australia, France, Malaysia, Singapore, and South Africa; Linna, T. (2017), supra note 20, pp. 40–59, comparing Norway, Finland, and Sweden; Ehmke, D. & Vaccari, E. (2024), supra note 20, pp. 29–42, comparing Germany, England, the US, Canada, New Zealand, and Scotland.

22 In Swe: förmånsrättslag (1970:979).

23 In Swe: konkurslag (1987:672).

debts to the estate, and the trustee's remuneration is paid before other debts to the estate are fulfilled.[24] Still, environmental claims are given indirect priority if the bankruptcy estate becomes liable (over preferential rights and unsecured creditors). This is quite controversial, especially among bankruptcy scholars and practitioners. We will get to that discussion later in this section, but first, we will dig into when the estate becomes responsible.

As mentioned previously, in this context, three liability regimes are relevant. First, we have the liability for remediation measures under a permit. This liability regime is not relevant in this section because, even if the debtor was a permit holder, the bankruptcy estate does not automatically become liable under the permit.[25] Second, there is the liability for environmental damages according to Chapter 10 of the Swedish Environmental Act, which, as mentioned in the beginning, is, in part, an implementation of the Environmental Liability Directive. According to case law, the bankruptcy estate can become liable if it continues to run the debtor's activities and thereby contributes to the pollution (hereafter: "cases of continued operations").

Third, we have rules on environmentally hazardous activities that apply, among other things, to storing waste, including extractive waste. These rules are found in Chapter 9 of the Environmental Act, and the liability is based on the prevention principle. According to case law, in these cases, the bankruptcy estate becomes liable if it stores something – often in the form of harmful material – and controls it, and that something can give rise to pollution (hereafter: "cases of storing"). It should be added that it is sufficient for the estate to store what used to be the debtor's hazardous material to become liable in these situations. Today, the Supreme Court of Land and Environment of Sweden (MÖD) decides these cases, which probably has influenced the case law since the outcomes are primarily determined and are explained by environmental legal norms, principles, and arguments. Let us study some case law to determine when the estate becomes liable.

We can begin with the "cases of storing". In these instances, environmental damage has not yet occurred, but hazardous substances are stored, and there is a risk that these substances will spread to the environment. In a case decided in 1998 (KN B 14/98), the debtor had stored waste oil in tin barrels on his property. The debtor was declared bankrupt, and the Environmental Protection Agency issued an injunction against the bankruptcy estate to remove and take care of the oil. The court found that the debtor had stored and controlled the oil, and after the commencement of the bankruptcy proceedings, the estate stored and controlled the oil. Therefore, the court found that the estate was responsible for the hazardous waste.

24 See Chapter 14 §§ 2 and 18 Swedish Bankruptcy Act.
25 Cf. MÖD 2013:36.

Case law has since confirmed this ruling and established the boundaries for this liability.[26] The decisive factor is whether or not the debtor controlled and stored the material when the bankruptcy proceedings commenced. If, for example, the asset is stored on a property that the debtor rented, and the rental contract had expired before the proceedings, the estate is not liable (MÖD 2008:13).

Let us move on to "cases of continued operations". In these instances, environmental damage has occurred, the debtor has caused the damage, and the question is whether the estate also should be held liable. As an example, we can look at a case the Supreme Court of Land and Environment of Sweden decided in 2013, namely MÖD 2013:36. The case concerned the above-mentioned Blaiken mine. In this case, the debtor had conducted mining operations. However, the estate did not continue operations by continuing to mine ore. The estate had only ensured that certain parts of the water cleaning system were active and that self-monitoring tests were carried out. The bankruptcy practitioner intended to sell the mining company. The question was if these actions were sufficient for the estate to have continued the operations and to become liable for the environmental damage, including the damage caused by the debtor.

The Supreme Court of Land and Environment of Sweden found that mining included measures for operation and maintenance, such as storage and handling of extraction waste, operation of the water cleaning system as well as sedimentation ponds, and self-monitoring. According to the court, the mining operation should be seen as an integrated whole that includes all these parts. The court also established that the mining operation as a whole had caused environmental damage by spreading polluted water into the surroundings. In accordance with this reasoning, the court found that the estate was liable for the environmental damage. Conclusively, continued operations do not mean continued operations with the intent of the bankruptcy practitioner to carry on the debtor's business. Continued operations are measured by whether the action taken by the trustee contributes to the environmental damage.

To conclude, the estate becomes liable in cases of continued operations and in cases of storing. Furthermore, according to case law, the estate cannot disclaim (or, with another term, abandon) property to avoid this responsibility.[27]

Bankruptcy practitioners and scholars have heavily criticised this state of play. They have argued that the estate should not "inherit" the debtor's liability because it circumvents the Priority Act and conflicts with the equal treatment of the creditors.[28] It is also said to conflict with the purpose of the bankruptcy estate being able to enter into new

26 See, for example, MÖD 2005:29, MÖD 2008:13, and MÖD 2008:14.

27 See MÖD 2015:19.

28 See, for example, Pfannenstill, M. (1992), Konkursbos m fl ansvar för annans miljöfarliga verksamhet, Juridisk tidskrift 1992/93, pp. 116–117; Möller, M. (1999), Konkurs och miljöansvar, Insolvensrättsligt forum 1999, pp. 104–113; Håstad, T. (1999), Konkurs och miljöansvar, Insolvensrättsligt forum 1999, pp. 120–122.

agreements and give priority to the counterparty.[29] The purpose is to enable the bankruptcy trustee to get deliveries on credit.[30] It is to facilitate and promote a beneficial and prompt winding up of the estate that indirect priority is given to these claims,[31] not to give certain claims priority. Theoretically, making the bankruptcy estate liable can also result in the estate becoming insolvent and having to be declared bankrupt.[32] However, it is unheard of that the Environmental Protection Agency actually forced a bankruptcy estate to declare itself bankrupt.

It is evident from these lines of argument that bankruptcy scholars and practitioners primarily see the purpose of bankruptcy as favouring the creditor's best interest within the boundaries determined by bankruptcy law and the Rights of Priority Act. Accordingly, environmental claims should not be given priority.

The main answer from environmental lawyers to these arguments has been that the bankruptcy estate becomes responsible on the same terms as every other operator and that the Environmental Act makes no exception for bankruptcy estates.[33] This highlights that the estate's liability is determined by the environmental law system and how the estate matches the liability rules in that system.

Nevertheless, making the bankruptcy estate liable, in practice, prioritises these environmental claims, as seen from a bankruptcy law perspective. And providing indirect priority is the only way courts can develop new types of priority. Providing indirect priority to environmental claims has long been an established part of case law, at least for the last forty years,[34] so the legislator has had the opportunity to abolish this priority for a long time. Therefore, the idea that this kind of priority conflicts with the bankruptcy law system and the equal treatment of creditors is not a particularly strong argument; we must consider both case law and the Rights of Priority Act when establishing which claims receive priority.

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29 See, for example, Pfannenstill, M. (1992), supra note 28, pp. 116–117; Möller, M. (1999), supra note 28, pp. 104–113; Håstad, T. (1999), supra note 28, pp. 120–122.

30 See, for example, Möller, M. (1988), Konkurs och kontrakt, Om konkursboets inträde i gäldenärens avtal, pp. 74–77; Håstad, T. (1996), Sakrätt, Avseende lös egendom, 6th ed., p. 398; Schytzer, J. (2020), Fordrans uppkomst inom insolvensrätten, pp. 340–349. See also UNCITRAL (2004), Legislative Guide on Insolvency Law, paras. 94–98, on the importance of post-financing, and paras. 101–102, on priority to post-financing.

31 See Chapter 7 § 8 Bankruptcy Act.

32 See, for example, Pfannenstill, M. (1992), supra note 28, p. 110; Sandberg, S.-I. (1998), Konkursbo har ansvar för att miljöfarligt avfall tas om hand, Advokaten nr 8, p. 7; Lindskog in his addendum to NJA 2009 p. 41.

33 See, for example, SOU 1993:78 pp. 147–148; Darpö, J. (2007), Förvaringsfallen, JP Miljönet, p. 7; Naturvårdsverket (2012), Efterbehandlingsansvar, En vägledning om miljöbalkens regler och rättslig praxis, Rapport 6501, p. 33.

34 See ministry decision of 26 February 1981, 1619/80; ministry decision of 12 August 1982, 1458/82. See also KN B [koncessionsnämnden] 109/91; KN B 128/91; KN B 79/92; KN B 215/92; KN B 250/92; KN B 159/93; KN B 14/98.

The practical problems of giving priority to environmental claims should not be exaggerated either. Claims against the bankruptcy estate have lower priority than the trustee's fees, according to Chapter 14 § 2 of the Swedish Bankruptcy Act. Therefore, indirect priority to environmental claims does not disincentivise trustees to accept bankruptcies involving environmental claims. Furthermore, providing indirect priority to environmental claims does not legally hinder the trustee from obtaining new credit with the same type of priority as environmental claims and thereby achieve the continued operations of the business to, for example, sell the business as a going concern or, in other ways, enable higher dividends to creditors.

A practical problem arises when there are insufficient assets in the estate to fulfil the claims against the estate, making the indirect priority useless. However, priority for environmental claims is only a default position. If the trustee can show the Environmental Protection Agency that in order to continue the operations, there is a need for new funding, and continued operations of the estate will enable the agency to get an improved recovery, there is nothing that can stop the agency from waiving that priority to new funding. In that sense, priority should be considered as a bargaining tool and a de facto priority. Still, with direct priority rather than indirect priority, these practical problems would not occur at all.

Categorising the estate's liability as a priority question also highlights that the state of play in Sweden is not optimal from an environmental point of view. It is sufficient to store something to become liable, but it is not sufficient to become liable for environmental damage for simply being in possession of a property that is environmentally damaged. Instead, the estate must have contributed to the pollution to become liable in "cases of continued operations".

However, the liability in "cases of continued operations" gives trustees skewed incentives with regard to environmental considerations: if the trustee in a "case of continued operations" estimates that the potential liability exceeds the amount s/he can sell the asset for, the trustee should not ensure that, for example, parts of the water cleaning system are active and that self-monitoring tests are carried out. The trustee shall only take measures that promote a beneficial and prompt winding up of the estate, according to Chapter 7 § 8 of the Bankruptcy Act, if the law explicitly does not state that the trustee shall take certain action.[35] Furthermore, the case law results in the estate becoming liable in cases where the regulation is based on the prevention principle but not when the rules are based on the polluter pays principle. The severity of the environmental damage or the risk of environmental damage has nothing to do with the liability and the associated priority.

Moreover, for priority to work as a means to enable the polluter to pay even if it goes bankrupt, it depends on whether the estate has sufficient assets to fulfil these

35 See NJA 2015 p. 132.

environmental claims. In the *Blaiken* case, there were nowhere near enough assets in the estate to cover the remediation costs.[36] Priority is not a suitable and robust solution for long-term actions to remediate the environment when a mining company goes bankrupt.

3.3 Norway

Norwegian bankruptcy law bears many similarities with Swedish bankruptcy law, which can be explained by the fact that the substantive parts of bankruptcy law were reformed in a Nordic collaboration during the 1960s and 1970s.[37] As in Sweden, environmental claims have no direct priority in Norway. However, environmental claims can get indirect priority in Norwegian bankruptcy proceedings if the bankruptcy estate becomes liable, as stipulated in Chapter 9 § 2 of the Norwegian Creditors Security Act.[38] However, Norwegian bankruptcy law differs in the sense that there is a rule on abandonment in the Norwegian Bankruptcy Act,[39] namely in § 117b, which enables the trustee to abandon property that is of no financial interest to the estate.

When the abandonment rule was introduced into the Norwegian Bankruptcy Act, it was discussed whether an abandonment resulted in the bankruptcy estate avoiding liability under the Norwegian Pollution Act.[40] Three different types of cases have been distinguished in the preparatory work and the literature, which can clarify the bankruptcy estate's liability. Let us take a closer look at these cases to establish the meaning of the abandonment rule and, with that, the bankruptcy estate's liability for environmental claims.

The first case occurs when the pollution takes place before the bankruptcy commencement, and the environmental authority remedies the property before the commencement, thereby obtaining a recourse claim against the debtor in accordance with §§ 74 and 76 of the Norwegian Pollution Act. According to the preparatory work of the Norwegian Bankruptcy Act, this recourse claim is a bankruptcy claim, and the bankruptcy estate is not responsible for it.[41]

If, instead, the pollution occurred after the commencement of the bankruptcy proceedings through the activities of the bankruptcy estate (for example, by continuing the operation of the business and thereby causing the pollution), the preparatory work

36 See MÖD 2013:36; "Här är gruvorna som förorenar Sverige", dn.se (last accessed 15 June 2024).
37 See, for example, SOU 1970:75 p. 3; Betænkning [Danish bill] 1971:606 pp. 5–6; NOU [Norwegian Government Official Reports] 1972:20 p. 2.
38 In No: Lov nr 59 av 8. juni 1984 om fordringshavernes dekningsrett.
39 In No: Lov nr 58 av 8. juni 1984 om gjeldsforhandling og konkurs.
40 In No: Lov nr 6 av 13. mars 1981 om vern mot forurensninger og om avfall.
41 See Ot.prp. [Norwegian bill] nr. 26 (1998-99) p. 116. See also Falkanger, T. (2001), Konkurs og realisasjon av sterkt beheftede eiendeler, Lov og Rett, nr. 3, p. 176.

states that the bankruptcy estate is responsible for the remediation. The bankruptcy estate cannot avoid this responsibility by abandoning the contaminated property.[42]

The more problematic case occurs when the pollution took place before the bankruptcy proceedings commenced, and the property is included in the bankruptcy estate. The question has then been raised whether the bankruptcy estate can avoid liability by abandoning the property. The Norwegian preparatory works take no position on this issue.[43] However, scholars who have commented on the issue have stated that the estate should be able to free itself from liability by abandoning the property precisely in a situation like this.[44] Further support for this position can be found in how the legislator justified the abandonment rule, particularly in contrast to how it valued other interests. The purpose was said to be to limit the responsibility for the bankruptcy estate, which in turn would benefit the interests of creditors. It was noted that abandonment could have negative consequences for other interests, such as when a property is heavily polluted. The legislator, therefore, considered whether an exception to the abandonment rule should be introduced, but it was believed that in such cases, it would have meant that the estate would have been, indirectly, liable for the remediation of the property. The legislator did not want to impose such a liability on the estate because bankruptcy proceedings were primarily carried out in the interests of the creditors.[45]

Conclusively, the estate can abandon the property and thereby avoid environmental liability when the debtor polluted the property before the commencement of bankruptcy. This is in line with the preparatory works view that bankruptcy proceedings are conducted, first and foremost, in the interest of the creditors. Indirectly, the legislator then also takes the view that environmental claims are comparable to any other (unsecured) claim. However, even in a legal order, such as the Norwegian one, that puts the best interests of the creditors first, the estate becomes liable if it causes pollution by continuing operations.

3.4 Canada

In contrast to Norway, environmental claims receive direct and indirect priority in Canada. According to the Bankruptcy and Insolvency Act (BIA) § 14.06(7),[46] claims for the costs of remedying any environmental condition or environmental damage are secured

42 See Ot.prp. nr. 26 (1998-99) pp. 115–116. See also Falkanger, T. (2001), supra note 41, p. 176.

43 See Ot.prp. nr. 26 (1998-99) p. 116; NOU 1993:16 p. 70.

44 See Wiker, H. & Ro, K. (2003), Konkursloven, Kommentarutgave, p. 433; Løvold, V. I. (2015), Brækhus' Omsetning og kreditt 1, Tvangsfullbyrdelse, gjeldsforhandling og konkurs, pp. 70–71; Andenæs, M. H. (2009), Konkurs, 3rd ed., p. 41.

45 See NOU 1993:16 pp. 67–70. See also Ot.prp. nr. 26 (1998-99) p. 108.

46 Bankruptcy and Insolvency Act, RSC 1985, c B-3.

by a security interest on the real property of the debtor affected by the environmental condition. The security interest also applies to any other real property of the debtor that is contiguous with that real property and related to the activity that caused the environmental condition or environmental damage. Thus, environmental claims get *direct* priority, a super-priority status over any other claim, right, charge or security against the property.[47]

The leading case in Canada regarding indirect priority is *Redwater*. The Supreme Court of Canada (SCC) decided it in 2019, and it covers many different questions, such as division of powers and federal paramountcy. In this section, we will focus on the question of priority for environmental claims.[48]

The background to the case was that Redwater Energy Corporation, an oil and gas producer, had experienced financial problems and subsequently went bankrupt. Redwater had extensive assets: 84 oil and gas wells, seven facilities, and 36 oil and gas pipelines. Nineteen of the wells and facilities remained productive and had a positive value. However, due to environmental requirements, most of the remaining 72 wells and facilities had a negative value.

The Alberta Energy Regulator (the provincial environmental protection agency) ordered the trustee to clean up the contaminated areas (but not beyond the assets remaining in the Redwater estate). The regulator's position was that the trustee was legally obligated to fulfil environmental obligations for all licensed assets before distributing any funds to creditors.[49] The trustee's position, on the other hand, was that it had only taken possession and control of the most productive wells, facilities, and pipelines, abandoned the other assets (with a negative value), and, therefore, had no obligation to fulfil any regulatory requirements associated with the abandoned/renounced assets.

Let us start with the question of whether the trustee could abandon the assets and, thereby, not be liable for the cleanup order. The basis for abandonment is found in § 14.06(4) BIA. However, in the *Redwater* case, the SCC found that this rule could only be used to relieve the bankruptcy trustee *from personal liability*. SCC supported the conclusion on the wording of the rule, a systematic reading of the BIA, and the preparatory works. The legislator justified the introduction of § 14.06(4) by not wanting to

47 See Wood, R. J. (2015), Bankruptcy and Insolvency Law, 2nd ed., p. 154.

48 For further analysis of the case, see Wood, R. J. (2019), Environmental Obligations in Insolvency Proceedings, Canadian Business Law Journal, 62, no. 2, pp. 211–230; Butler, R. (2019), Understanding Redwater, Banking & Finance Law Review, Volume 34, pp. 461–474; Lund, A. (2021), Elaborate Imaginings: Rethinking Environmental Obligations in Canadian Insolvency Law, University of Toronto Law Journal, Vol. 71, no. 3, pp. 301–337; Coordes, L. N. (2021), Reviewing Redwater: An Analysis of the U.S. and Canadian Approaches to Environmental Obligations in Bankruptcy, papers.ssrn.com (last accessed 15 June 2024), pp. 1–18.

49 The legal basis for the order was found in the provincial acts governing oil and gas extraction in Alberta. According to these acts, bankruptcy trustees are included in the definition of who is responsible for, among other things, post-processing. See §§ 134 (b(vi)) and 240 (3) Environmental Protection and Enhancement Act; § 1(1)(cc) Oil and Gas Conservation Act; § 1(1)(n) Pipeline Act.

discourage trustees from undertaking assignments in which environmental liabilities could exist. The aim, therefore, had not been to limit the trustee's liability in using the estate's assets. Redwater clarifies that abandonment only prevents the trustee from becoming personally liable. If we compare this abandonment rule with the Norwegian one, we can notice that abandonment rules can have different effects and aims.

We can now move on to the question of whether the trustee was responsible insofar as to use the bankrupt estate's assets to satisfy the remediation claims. It is equivalent to the estate becoming liable in Sweden. The main question in this regard was if the claims were so-called "provable claims". According to § 121 BIA, provable claims include, as a main rule, all debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt. Provable claims are stayed during the bankruptcy proceedings and are fulfilled according to the rules on priority, which follow from inter alia §§ 69, 121, 135, 136, 141, and 178 BIA. If the orders the regulator put forward against the trustee were provable claims, the trustee would not have had to fulfil these before distributing any funds to creditors.

In this matter, the SCC built its decision on a test from previous case law, namely *Newfoundland and Labrador v. AbitibiBowater Inc*.[50] In *AbitibiBowater*, the SCC stated that for a claim to constitute a provable claim, three requirements must be met:

> "First, there must be a debt, a liability or an obligation to a *creditor*. Second, the debt, liability or obligation must be incurred *before the debtor becomes bankrupt*. Third, it must be possible to attach a *monetary value* to the debt, liability or obligation."[51]

The main question about this test in *Redwater* was if the regulator was a creditor. Regarding the concept of creditor, the SCC in *Redwater* established that a party is not a creditor as soon as it has a claim against the debtor because, in that case, this part of the test would have no meaning. The SCC instead considered whether or not the regulator had a financial interest:

> "[I]n seeking to enforce Redwater's end-of-life obligations, the Regulator is acting in a *bona fide* regulatory capacity and does not stand to benefit financially. The Regulator's ultimate goal is to have the environmental work actually performed, for the benefit of third-party landowners and the public at large."[52]

50 *Newfoundland and Labrador v. AbitibiBowater Inc*., 2012 SCC 67.
51 Ibid., at para. 26.
52 *Orphan Well Association v. Grant Thornton Ltd*, 2019 SCC 5, at para. 128.

> "The end-of-life obligations the Regulator seeks to enforce against Redwater are public duties. […] These public duties are owed, not to a creditor, but, rather, to fellow citizens, and are therefore outside the scope of 'provable claims.'"[53]

The regulator's interest in the fulfilment of the order was not a financial interest, similar to ordinary creditors' interest. Put another way, the regulator's relationship with Redwater, and later the trustee, was not a normal debtor-creditor relationship. The order was instead issued in the public interest. For this reason, the regulator did not act as a creditor under the *AbitibiBowater* test. Therefore, the claim was not a provable claim, and the supervisory authority could enforce it against the bankruptcy trustee (who had to fulfil the claim with the assets of the estate).

Considering that it was sufficient that the regulator was not a creditor according to the *AbitibiBowater* test, regulators will be able to have obligations carried out by trustees before distribution to the creditors takes place in the bankruptcy.[54] This is subject to the condition that provincial standards provide for the trustee to be liable. However, if the regulator has acted prior to the commencement of the proceedings, the regulator will be seen as a creditor.[55]

Redwater illustrates that there is a stratification between different claims and liabilities in Canadian bankruptcy law. Public duties that consist of a regulator clearly representing a public interest (which is not financial) are *not* treated on the same footing as claims that are of a financial nature in a bankruptcy. If we compare this with the order of things in Norway, the bankruptcy proceedings in Canada are not primarily carried out in the best interests of the (unsecured) creditors in these cases because if they were, the trustee would have been able to abandon the polluted wells and facilities.

The Canadian legal scholar Anna Lund has written several articles on these issues. She has problematised precisely the fact that those in bankruptcy law would otherwise like to convert all liabilities into obligations:

> "The prescription, from those who are concerned about non-economic liabilities, has been to find a way to quantify the obligations. But perhaps there is a

53 Ibid., at para. 135.

54 See Wood, R. J. (2019), supra note 48, pp. 221–230, who states that in certain cases some secured creditors could get priority over environmental liabilities, regardless of *Orphan Well*. See also INSOL International (2024), supra note 21, pp. 51–52, on how appellate courts have interpreted the *Redwater* case.

55 See Wood, R. J. (2019), supra note 48, pp. 224–225. See also Doelle, M. (2019), Reflections on Orphan Well Association v Grant Thornton Ltd, 2019 SCC 5, blogs.dal.ca (last accessed 15 June 2024); Stewart, H. (2021), Drilling to the Bottom of the Orphan Well Problem: Suggestions for Better Regulatory Framework for Preventing and Remediating Orphaned Oil Well in British Columbia, Appeal: Review of Current Law and Law Reform, Vol. 26, pp. 93–94; Unger, J. (2020), Clean Slate, Contaminated Land, The "untidy intersection" of Insolvency and the Polluter Pays Principle and Recommended reforms to the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, p. 29.

> different way forward that would involve resisting this rush to quantification, as part of a bigger move toward resisting the omnipresence of financialized thinking. This resistance would be grounded in the understanding that not only is it difficult to come up with a number that accurately reflects the value we place on a healthy environment, but our efforts to monetize environmental entities also 'ends up cheapening and belittling them.'"[56]

Converting environmental liabilities into monetary claims will typically mean that they are deemed unsecured claims in bankruptcy, which Lund refers to as cheapening and belittling environmental liabilities. The SCC's decision in *Redwater* represents another way in which environmental claims are not converted into monetary claims in a way that corresponds to "cases of storing" under Swedish law.

However, *Redwater* has been criticised for not creating the necessary clarity on the question of which claims get priority. For example, it has been stated that it is unclear which environmental liabilities will constitute public claims. The Canadian legal scholar Roderick J. Wood has put forward that it would be better if the environmental-related claims were given priority over all other creditors (including secured ones) because it would create clarity and *internalise* all costs associated with the business to the debtor and those who financed the business.[57] According to Wood, this would result in lenders increasing their interest rates and possibly changing their lending to reflect the increased risk.[58] Others have also pointed out that the ruling in *Redwater* probably will make borrowing money more expensive for the oil and gas industry.[59]

The reasoning in Canadian literature highlights that priority is a way to internalise the costs of business risk and, therefore, indirectly, the costs of remediation, even if the polluter goes bankrupt. If environmental claims are given priority over other claims, creditors will likely adapt and make it more expensive for businesses, such as mining companies, to receive credit, thereby indirectly internalising the costs of pollution to the business.

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56 Lund, A. (2021), supra note 48, p. 333.

57 See Wood, R. J. (2019), supra note 48, p. 221 and pp. 227–229.

58 See Wood, R. J. (2019), supra note 48, p. 221 and pp. 227–229.

59 See Buckingham, J., Paplawski, E. & Gaston, M. (2019), Supreme Court of Canada Decision in Redwater, Early Implications, osler.com (last accessed 15 June 2024); Coordes, L.N. (2021), supra note 48, p. 1 and p. 9.

3.5 US

Environmental claims are not entitled to direct priority under the Bankruptcy Code (BC).[60] However, the United States Environmental Protection Agency (EPA) is granted a type of priority lien under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).[61] The lien ensures payment for the cleanup, or the cleanup of the environmentally damaged property itself, provided that the debtor owns the property. This is stipulated in § 9607(l) CERCLA. The priority lien takes precedence over unsecured creditors and creditors whose liens on the property arose after EPA's lien. However, it does not take priority over previously granted liens on the relevant property. Nevertheless, some examples of state laws provide for so-called super-priority to these claims, which means that these claims take precedence even over previously granted liens.[62]

Environmental claims can also get indirect priority in the US. The regulation works in a similar way to the regulation in Swedish bankruptcy law, since environmental claims can become "administrative expenses", which corresponds to the bankruptcy estate becoming liable under Swedish law. In US law, administrative expenses are fulfilled after certain secured creditors have been paid, and, thus, these expenses receive a high priority.[63] Administrative expenses consist, among other things, of fees to trustees and claims against the estate. A difference compared to the Swedish regulation is that if there are insufficient assets to fund these costs, trustee fees do not have priority over other administrative expenses. Instead, these costs have equal rights.[64]

The conditions under which the bankruptcy estate becomes liable are regulated in the Bankruptcy Code. Administrative expenses are "actual, necessary costs and expenses of preserving the estate".[65] However, there are times when this requirement has not been strictly enforced according to the wording of the rule. An example of

60 The Bankruptcy Code is found in title 11 the United States Code (U.S.C.). See 11 U.S.C. § 507, for the priority rules in BC.

61 CERCLA is found in title 42 the U.S.C.

62 See Nash, J. R. (2002), Environmental Superliens and the Problem of Mortgage-Backed Securitization, Washington and Lee Law Review, 59(1), pp. 145–157; Koks, M. J. & Million, T. (2009), Environmental Issues in Bankruptcy, Texas Environmental Law Journal, 40 (Issues 1–3), pp. 68–69; Schenk, S. (2013), Environmental Burdens in Bankruptcy Floodwaters, The Urban Lawyer, Vol. 45, No. 2, pp. 467–470, for summaries of the regulations.

63 See 11 U.S.C. §§ 507(a)(2) and 725. According to 11 U.S.C. § 507(a)(1), certain exceptions are made for e.g. domestic support, if the debtor is a natural person. See also Tabb, C. J. (2020), Law of Bankruptcy, 5th ed., p. 667; Lubben, S. J. (2022), American Business Bankruptcy, A Primer, 2nd ed., pp. 45–48; Gelber, L. V., Kim, S., Schulte, R. & Schulte, Z. (2011), The Intersection of Environmental and Bankruptcy Laws, Schnapf, L. P. (Ed.), Environmental Issues in Business Transactions, pp. 358–359.

64 See 11 U.S.C. § 726(b).

65 See 11 U.S.C. § 503(b)(1)(A).

this is the case of *Reading Co v. Brown*, which the Supreme Court of the United States (SCOTUS) decided in 1968.[66]

Reading Co v. Brown concerned a restructuring case under a predecessor to the current Chapter 11. After the commencement of the proceedings, the debtor's workers had negligently caused an injury, and the question was whether this should be given administrative priority. SCOTUS found that was the case. The court noted that creditors usually benefit from the debtor (or estate) continuing operations during the proceedings. According to SCOTUS, the creditors should, therefore, also bear the risks that come with this activity: "'actual and necessary costs' should include costs ordinarily incident to the operation of a business, and not be limited to costs without which rehabilitation would be impossible".[67]

Seen in this context, it is, therefore, possible for the estate to incur costs even though it does not strictly contribute to the estate. The state of play in this regard is similar to the one in Norway, where the estate cannot abandon property and thereby avoid responsibility if the estate itself caused environmental damage. However, there is no court case from SCOTUS specifically regarding environmental-related liabilities caused by the debtor *pre*-bankruptcy and whether these can become administrative expenses.[68] Instead, a case from the Court of Appeals for the Sixth Circuit, an appellate court in the US covering Kentucky, Michigan, Ohio, and Tennessee, can be used as an example of when the estate has become liable, namely the case of *In re Wall Tube*, which was decided in 1987.[69]

In the case of *In re Wall Tube*, a debtor had been declared bankrupt, and certain environmentally hazardous waste was on the debtor's property. The environmental agency tried to get both the debtor to take care of the waste before the bankruptcy and the trustee to take care of the waste during the bankruptcy. The agency then removed the waste. The question was whether the costs should be entitled to administrative priority.

The court considered this issue in two stages. The court first noted that 28 U.S.C. § 959(b), a federal regulation, provides that a trustee in bankruptcy must, with respect to property in his possession, follow the laws of the state where the property is located. In light of this rule, the court found that the trustee had to obey the environmental laws that applied in the state. The second question was whether that meant that the costs would be considered administrative expenses. In this part, the court noted that the

66 391 U.S. 471 (1968).

67 Ibid., p. 483.

68 See Gelber, L. V., Kim, S., Schulte, R. & Schulte, Z. (2011), supra note 63, pp. 358–361; Tabb, C. J. (2020), note 57, pp. 692–693; Koks, M. J. & Million, T. (2009), supra note 62, pp. 55–56; Shelby, P. M. (2020), Environmental Claims in Bankruptcy, Annual Institute on Mineral Law, 67, pp. 96–100, with further references.

69 See *In re Wall Tube*, 831 F.2d 118 (6th circuit 1987).

SCOTUS in *Reading v. Brown* extended liability to include negligence in causing damages and that, in this case, the environmentally hazardous waste was a danger to public health and safety. Based on this, the court found that the claim was an administrative expense, even though it was not strictly speaking a cost that benefited the estate.

However, there is other case law from appellate courts in which courts have found that environmental claims caused by the debtor *pre*-bankruptcy are not entitled to administrative priority.[70] These cases can probably be explained by the absence of danger to the public's health and safety.[71] This particular requirement relates to and can be understood in relation to the conditions under which the bankruptcy estate may abandon certain property. This topic will be discussed now.

In bankruptcy proceedings, the administrator can abandon property if the property lacks value for the estate, according to 11 U.S.C § 544(a). The estate abandons the property to the debtor. If the property is mortgaged and there is no surplus value, abandonment can instead be made to the mortgagee.[72] The general rule seems clear: the estate can abandon property. Heavily contaminated properties should, therefore, be abandoned according to the wording of the BC. However, SCOTUS has, in a case from 1986, added further nuances on how we should understand the abandonment rule.

Midlantic National Bank v. New Jersey Department of Environmental Protection[73] involved Quanta Resources, which was a company that handled and processed waste oil. Quanta's properties were heavily contaminated. The company stored, among other things, large amounts of oil containing PCB, a highly carcinogenic chemical compound. The oil was stored in barrels and containers, and some of them were leaking. As Quanta did not have the financial ability to comply with the environmental regulations and clean up its properties, the company had to be declared bankrupt. In the bankruptcy, the trustee tried to abandon the properties. However, the environmental authorities objected and stated that an abandonment would conflict with environmental regulations. The authorities argued that there was a tacit exception to the abandonment rule, which meant that it did not apply in this situation and that the trustee under 28 U.S.C. § 959(b) had to comply with environmental regulations.

A minority of four justices found that the abandonment rule was absolute, and an abandonment relieved the estate of liability in this case. However, the majority concluded that abandonment was not possible in this situation, and the reasons for this are of particular interest here. The majority noted that there was a general abandon-

70 Case law seems to be inconsistent. See and cf. Gelber, L. V., Kim, S., Schulte, R. & Schulte, Z. (2011), supra note 63, pp. 358–361; Tabb, C. J. (2020), supra note 63, pp. 692–693; Koks, M. J. & Million, T. (2009), supra note 62, pp. 55–56; Shelby, P. M. (2020), supra note 68, pp. 96–100, with further references.

71 See Brookener, J. S. (1995), Environmental Claims in Bankruptcy: An Overview, Banking Law Journal, 112(2), p. 147; Gelber, L. V., Kim, S., Schulte, R. & Schulte, Z. (2011), supra note 63, p. 362, who put forward this aspect.

72 Tabb, C. J. (2020), supra note 63, pp. 442–443.

73 474 U.S. 494 (1986).

ment rule even before the enactment of BC. However, that abandonment rule had an exception, the purpose of which was to protect legitimate federal and state interests. Although such an exception had not been expressly introduced in the BC, the majority stated that there were other elements in the BC in which environmental interest was considered. The majority concluded:

> "[…] we hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."[74]

Creditors' interest in dividends must, therefore, yield when it conflicts with the public's health and safety. That is what the SCOTUS majority concluded. In a footnote, the majority clarified when the exception to the abandonment rule is applicable. It stated:

> "The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm."[75]

The exception, therefore, only applies if an imminent and identifiable danger exists. At least, that is how the court case has been interpreted. Within the doctrine and in courts, attempts have been made to clarify in which situations this exception applies, but we do not need that fine-graininess of how American law is adapted to our purposes.[76]

To summarise, American law does contain an abandonment rule that apparently gives the trustee an opportunity to abandon unprofitable assets, but the rule does not apply to certain situations. SCOTUS has made exceptions for when there is an imminent and identifiable danger to the public's health and safety. In these situations, the estate cannot abandon the property and thereby avoid responsibility. The exception to the abandonment rule can be understood against what applies when the estate becomes responsible for administrative expenses. The estate becomes liable for environmental claims caused by the debtor *pre*-bankruptcy under *re Wall Tube* precisely in order to protect the health and safety of the public.[77]

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74 Ibid., p. 507.

75 Ibid., footnote 9.

76 For further reading see Koks, M. J. & Million, T. (2009), supra note 62, pp. 59–62; Tabb, C. J. (2020), supra note 63, pp. 444–445; Mamutse, B. & Fogleman, V. (2013), Environmental claims and insolvent companies: the contrasting approaches of the United Kingdom and the United States. British Journal of American Legal Studies, 2(2), pp. 607–608; Brookener, J. S. (1995), supra note 71, pp. 152–154.

77 See also Brookener, J. S. (1995), supra note 71, p. 147.

3.6 Priority or Not?

3.6.1 Summary of and Conclusions from the Comparative Study

This article aims to explore and propose solutions that ensure that the polluter can pay, even if it goes bankrupt. A whole palette of solutions has manifested itself in the studies of if and when environmental claims get priority in Sweden, Norway, Canada, and the US. The state of play in Sweden illustrates a system in which the estate's liability is determined by the environmental law system and how the estate matches the liability rules in that system. When and if indirect priority is provided is not optimal from an environmental or bankruptcy law point of view, and it gives the trustee skewed incentives. This shows that the question of priority needs a comprehensive approach.

Furthermore, Swedish bankruptcy practitioners' and scholars' critiques of the estate's liability show that direct priority is preferable to indirect priority. Otherwise, the bankruptcy system might not work as intended. In some cases, at least, the trustee's ability to continue the operations of the business will be dependent on the Environmental Protection Agency being willing to discuss, understand, and accept the matter instead of the trustee's professional assessment of whether a measure will promote a beneficial and prompt winding up of the estate.[78]

In contrast to Sweden, the Norwegian legislator has taken a comprehensive approach to the question of priority for environmental claims. The legislator's view is that bankruptcy proceedings are conducted, first and foremost, in the interest of the creditors. Indirectly, the legislator also takes the view that environmental claims are comparable to any other (unsecured) claim. In line with that, the estate can abandon the property to avoid environmental liability when the debtor has polluted the property before the commencement of the bankruptcy proceedings. However, even in Norway, the estate becomes liable if it causes pollution by continuing operations.

Regarding priority for environmental claims, Norwegian bankruptcy law is clearly on the one side of the spectrum compared to Canadian bankruptcy law, which is on the other side. The abandonment rule in the BIA only protects the trustee from personal liability, and environmental claims receive both direct and indirect priority. The *Redwater* case illustrates that priority to environmental claims is a way to internalise the costs of business risks because it likely increases the costs of lending for the polluters when lenders take greater risks due to lower priority than environmental claims. However, the critique from bankruptcy scholars illustrates that *Redwater* does not give the necessary clarity.

Compared to Norway and Canada, the US is somewhere in the middle of the spectrum regarding indirect priority. The estate cannot abandon property and thereby

78 Cf. Chapter 7 § 8 Bankruptcy Act, which states, regarding the trustee's general duties, that the trustee shall take all measures to promote a beneficial and prompt winding-up of the estate.

avoid responsibility for environmental claims when there is an imminent and identifiable danger to the public's health and safety. Regarding direct priority, the situation differs at the federal and state levels. The EPA is granted liens, but these do not get super-priority. However, some states provide liens to environmental protection agencies that do get super-priority.

Before discussing if and when priority should be given to environmental claims, two additional aspects need to be considered in more detail: whether priority can have preventive functions, and the effects priority will have on lending.

3.6.2 Prevention

Besides internalising the costs associated with the business risk, providing priority can have other positive effects. We can look at Michael Ohlrogge's research to find out how. He has studied how a change of priority to environmental claims affected the actions of operators and creditors. The change resulted from a case, *United States v. Apex Oil Co.* from 2009, decided by the Seventh Circuit, an appellate court in the US covering Illinois, Indiana, and Wisconsin.[79] The decision meant that certain environmental cleanup claims could no longer be discharged in a restructuring. In practice, it gave these claims priority. The change is considerable since environmental claims are usually substantial in these cases. In *Apex Oil*, the liability amounted to $150 million. Giving such claims priority when they could previously be written off has had significant consequences for other creditors.

In his research, Ohlrogge demonstrates that credit providers to environmentally hazardous activities within the Seventh Circuit's jurisdiction changed their behaviour after *Apex Oil*. By studying public security filings, he found that credit providers were very much aware of this change in practice and took action. After *Apex Oil*, the loan agreements include covenants on how companies should manage and prevent these environmental damages. Covenants also grant credit providers the right to let environmental engineering firms make on-site inspections.[80]

According to Ohlrogge, these loan agreements promote a shift in how operators handle hazardous chemicals. Through empirical studies of companies affected by the change in priority, he found that operators in this region have reduced their emissions of environmentally hazardous chemicals by 12 to 30%. Additionally, these companies now more frequently use other specialised companies to handle the chemicals – a practice considered safer for the environment.[81]

Ohlrogge's research regards the US. However, if we assume that Swedish credit providers are active similar to the American providers in Ohlrogge's research, prioritising

79 See *United States v. Apex Oil Co.*, 579 F.3d 734 (Seventh Circuit 2009).

80 See Ohlrogge, M. (2023), Bankruptcy Claim Dischargeability and Public Externalities: Evidence from a Natural Experiment, papers.ssrn.com (last accessed 15 June 2024), pp. 1–4, p. 11, pp. 22–24, and pp. 24–34.

81 See Ohlrogge, M. (2023), supra note 79, pp. 1–4, pp. 16–24, and pp. 34–35.

environmental claims should have a preventive effect.[82] Furthermore, there are legal obligations for certain credit providers to be active. According to, for example, Chapter 8 § 1 of the Act on Banking and Financing Operations,[83] a credit provider has an obligation to conduct a credit check, which includes considering the value of any collateral.

In this context, it is also worth noting that mining operators can often minimise the accumulation of environmental responsibilities at any given time. A report from the Swedish Environmental Protection Agency and the Geological Survey of Sweden emphasises the importance of taking a holistic view of mining activities over time and space. What may be most efficient during the operations can increase the cost of remediation afterwards, if mine waste is not continuously and optimally managed. For example, the use of landfills over large areas may be cheaper during production, due to lower transportation costs. However, that strategy will likely increase the cost of remediation since a larger area needs to be covered by moraine.[84]

Giving priority to environmental claims can thus have positive effects. As the experiences from Canada teach us, it can also internalise the costs of the polluter going bankrupt by increasing the costs of financing the business.[85]

3.6.3 Negative Effects on Lending?

Obviously, there are also negative effects in providing environmental claims priority. The assets in the estate are limited. Providing priority to one creditor is prioritising one creditor over others. If priority were given to environmental claims over secured creditors, as in Canada, that would result in prioritising the environment over credit providers. However, as the discussion from Canada tells us, creditors will likely compensate for the increase in risk. The literature also supports that credit providers adapt to increases in risks.[86] Therefore, prioritising environmental claims should not be thought of as

82 This has previously been assumed in the Swedish literature without the empirical support that Ohlrogge provides, see Darpö, J. (2000), Verksamhetsutövare, markägare och konkursbon i miljöbalken, Svensk juristtidning, pp. 503–505; Möller, M. (1999), supra note 28, pp. 118–120; Håstad, T. (1999), supra note 28, pp. 121–122.

83 In Swe: lag (2004:297) om bank- och finansieringsrörelse. See also Chapter 4 § 4 Finansinspektionens föreskrifter och allmänna råd om hantering av kreditrisker i kreditinstitut och värdepappersbolag, FFFS 2018:16.

84 See Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017b), supra note 12, p. 54.

85 See also, for example, Armour, J. H. (2000), Who pays when polluters go bust, Law Quarterly Review, 116, p. 203; Mackie, C. & Fogleman, V. (2016), Self-insuring environmental liabilities: a residual risk-bearer's perspective, Journal of Corporate Law Studies, Vol. 16, No. 2, p. 322.

86 In corporate finance literature, the dominant theory on how the company should finance itself is the Modigliani & Miller theorem. In short, their conclusion is that the capital structure does not matter for a company's value. One of the reasons for this is that if the company finances itself through secured credit, other creditors will adapt and price their increased risk. See Modigliani, F. & Miller, M. H. (1958), The Cost of Capital, Corporation Finance and the Theory of Investment, The American Economic Review, Vol. 48, No. 3, especially pp. 267–271. The theorem supposes a perfect market in which creditors, the

prioritising the environment over credit providers. Rather, prioritising environmental claims will make it more expensive and, for some companies, harder to obtain credit.[87] This conclusion is also supported by another empirical study conducted by Chen et al on how the *Apex Oil* case affected the actions of operators and creditors. They found that financially stressed firms with specific environmental liabilities experienced a tightening of credit conditions after the *Apex Oil* ruling, in as much as they had to pay higher risk premia and received lower bond ratings.[88]

Making it harder for these companies to obtain credit can potentially exclude them from the market.[89] However, as Michael Ohlrogge shows in another report, "Environmental Claims in Bankruptcy", to this NACIIL meeting, regarding the "judgment-proof" problem, unsatisfied environmental claims in bankruptcies will lead companies to pursue socially inefficient endeavours, producing greater total harm than benefits. These endeavours can be profitable for owners if they can externalise some of the costs of the pollution the company creates. In some cases, the owners will make a profit, and in others, they will lose their investment but, at the same time, externalising environmental costs to society. Without giving priority to environmental claims, the secured creditors can potentially claim the full value of the company's assets. In return, the secured creditor can lend money at a very low interest rate because the environmental costs have been externalised to society. In essence, this subsidises companies that take environmental risks. Excluding these companies from the market is economically efficient for the government and society.

Moreover, an alternative approach to lending for these companies would be to increase equity in the company's capital structure and, at the same time, decrease debt. There are other reasons why it is a good idea to incentivise mining companies to finance

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company, and shareholders have full and equal access to information, and can, among other things, adapt to increases and decreases in risk, among other things, see De Weijs, R., De Vries, J. & Jonkers, A. (2023), Corporate Finance for Lawyers, Understanding the Power Balance Between Shareholders, Secured Lenders and Unsecured Creditors, pp. 145–148. There is, of course, no such thing as a perfect market, still, that (some) creditors adept is shown by the experience in Canada and empirical research on the impacts of the *Apex Oil* case and has been assumed in the literature to hold true. See, for example, Brealey, R. A., Myers, S. C., Allen, F. & Edmans, A. (2023), Principles of Corporate Finance, 14th ed., pp. 466–475; Gullifer, L. & Payne, J. (2020), Corporate Finance Law, Principles and Policy, 3rd ed., pp. 348–358; Bergström, C. & Sundgren, S. (1998), Förmånsrättens teori och empiri, SOU 1999:1, del 2, bilaga 6, pp. 23–27.

87 See Mackie, C. & Fogleman, V. (2016), supra note 85, p. 322. See also Keay, A. & De Prez, P. (2001), Insolvency and Environmental Principles: A Case Study in a Conflict of Public Interests, Environmental law review, Vol. 3, No. 2, p. 102; INSOL International (2023), ESG in Restructuring, pp. 6–8.

88 Chen, J., Hsieh, P.-F., Hsu, P.-H. & Levine, R. (2023), Environmental Liabilities, Borrowing Costs, and Pollution Prevention Activities: The Nationwide Impact of the Apex Oil Ruling, papers.ssrn.com (last accessed 15 June 2024), pp. 4–5 and pp. 21–28.

89 A company's ability to finance itself with secured credit in its assets is often described as fundamental for the ability to grow. See, for example, UNCITRAL (2010), Legislative Guide on Secured Transactions, paras. 2; The World Bank (2010), Secured Transactions Systems and Collateral Registries, pp. 6–13; McCormack, G. (2004), Secured Credit under English and American Law, pp. 15–22; Gullifer, L. & Payne, J. (2020), supra note 86, pp. 348–349.

themselves with equity rather than debt. A limited company allows the shareholders to reduce the risks associated with the company to the assets – the equity – they have invested in the company. The full risks of, for example, environmental hazards and damages caused by the company are therefore not internalised – but rather externalised – as illustrated by the *Blaiken* case. When a company finances itself with secured credit, it amplifies this externalisation. Let me exemplify how.

There are two ways of funding a company: debt and equity. A company's balance sheet consists of a combination of both. Let us say a company has 100' in assets, and the liabilities consist of 35' in debts to unsecured creditors (trade credit, worker's salaries, etc.) and 65' in equity. The equity will serve as a financial cushion for tougher times ahead, and the assets are available to the creditors in an insolvency situation. If the company reduces its equity from 65' to 15' in a dividend recapitalisation by borrowing 50' and providing security to the lender, the cushion will decrease: only 50' (15' in equity and 35' in unencumbered assets) of the debtor's assets will be available to the non-secured creditors if the debtor becomes insolvent. By increasing the company's debt and thereby reducing the equity, the company has amplified the risk of externalising the business risk. At the same time, the shareholders have kept the full financial upside of the company. Giving priority to environmental claims, and thereby, in some cases, forcing these companies to finance themselves with a larger part of equity, can reduce the externalisation of the business risk.[90]

A debt/equity mix with a larger part of equity can, and will likely, increase costs due to, for example, tax reasons (interest payment is often deductible but not dividends).[91] Priority can also increase the costs of external finance. These consequences align with the polluter pays principle: the costs of a business's negative environmental impact should be internalised. Otherwise, the product's price, in these cases ore, will not reflect the costs of the mining process, and the seller and buyers may prosper at the expense of the environment. Furthermore, giving mining companies an incentive to increase their equity is one way of reducing the externalisation of the business risks.

3.6.4 Direct Priority

Nevertheless, there is a trade-off between enabling and facilitating the mining industry and taking care of the environment by providing direct priority in these cases. The trade-off is illustrated by the fact that priority is given in some legal orders but not in others. In Canada, § 14.06(7) BIA gives specific environmental claims a security interest on the debtor's real property affected by the environmental damage. The security interest also applies to any other real property of the debtor contiguous with that real property and

90 Cf. De Weijs, R., De Vries, J. & Jonkers, A. (2023), supra note 86, pp. 142–164, who describe how a debt/equity mix consisting of more debt enables shareholders to externalise a larger part of the business risk.

91 See Gullifer, L. & Payne, J. (2020), supra note 86, pp. 55–58; De Weijs, R., De Vries, J. & Jonkers, A. (2023), supra note 86, pp. 24–29.

related to the activity that caused the environmental condition or environmental damage. In the US, CERLA gives a similar lien, but it only takes precedence over unsecured creditors and creditors whose liens on the property arose after the CERLA lien. However, in certain states, so-called super liens are given to environmental claims that take precedence over liens already granted. In contrast, no direct priority is given to environmental claims in Norway or Sweden.

As already mentioned, a priority should be constructed to internalise the costs associated with the risk of the polluter going bankrupt. Therefore, the point of departure should be a priority constructed so that it affects consensual creditors rather than non-consensual ones. As mentioned above, consensual creditors can ex ante compensate for the lack of priority, making the polluter pay rather than themselves. Alternatively, consensual creditors can choose not to provide credit. However, this line of reasoning does not apply to non-consensual creditors.

In Sweden, non-consensual creditors mainly have unsecured claims; the tax office and tort victims, for example, do not receive priority according to the Rights of Priority Act. Prioritising environmental claims over unsecured creditors in those assets that unsecured creditors normally get to share pro rata effectively makes the unsecured creditors pay for environmental damage, which in turn makes the non-consensual creditors pay. Such a solution should be avoided if possible.

Priority for environmental claims should only be given with regard to those kinds of assets consensual creditors normally can use as collateral. The problem is that most assets can serve as collateral for some form of security, at least in Sweden. Real property can be mortgaged, and movable property can be pledged. Such an arrangement would not leave much – if anything – for the non-consensual creditors.

A discussion on what should be left for the unsecured creditors occurred when the Swedish legislator reintroduced the Floating Charges Act in Sweden.[92] A floating charge generally grants a specific priority right in the debtor's movable property, as stipulated in Chapter 2 § 1 of the Floating Charges Act. But there are certain exceptions. One exception is cash and bank funds, and in the preparatory works, it is explicitly stated that cash and bank funds are exempt from the floating charge because, otherwise, it would disadvantage the non-consensual creditors.[93] A priority for environmental claims could be similarly limited, i.e., encompassing the debtor's property with the exception of cash and bank funds. In line with the discussion in Canada, a priority rule, as such, would create the requested clarity. If environmental claims are given priority in this way, financing will most likely become more expensive, but it would also amount to internalising the costs of the risk that the operator goes bankrupt.

92 In Swe: lag (2008:990) om företagshypotek.
93 See prop. 2007/08:161 p. 39.

However, there are several concerns associated with priority. Priority is limited to the *debtor's* assets, which enables the mining operator to sidestep a priority rule. In Sweden, at least (and I suppose this line of reasoning is also relevant regarding other legal orders), nothing would hinder a mining operator from setting up its operations by using a different company for every mining operation, all owned by the same parent company. Furthermore, the credit provider could be provided with pledges in the parent company's shares in the subsidiaries. The result would be that, even if one of the mining companies went bankrupt, the environmental agency would still have priority over that company's assets, and the credit provider would have priority over the assets of the rest of the companies. Still, the main problem is that there will not be sufficient assets in the estate to cover the remediation costs for mines, as the *Blaiken* case shows. Priority cannot be the *only* solution, but as will become evident in the section on ex-ante solutions, priority can complement other solutions.

3.6.5 Indirect Priority

In section two above, on the environmental background, it was established that both long-term and short-term actions need to be taken to avoid environmental hazards and to be able to remediate the environment. In the short-term, dam safety work needs to be carried out, and water levels in open pits, shafts, and ponds need to be controlled to avoid flooding. Moreover, the water quality needs to be tested continuously to ensure that the water released from the ponds is sufficiently clean. Even if priority cannot entirely solve the problem of the availability of funds to satisfy the first type of claim, it may solve funding of the second.

In many mining cases, short-term actions must be carried out continuously to avoid substantial environmental hazards, even if the polluter goes bankrupt. If priority were given to these claims under the Swedish Rights of Priority Act, someone else still would have to carry out these actions, and, optimally, from day one in the bankruptcy proceedings. The trustee shall notify the Environmental Protection Agency if s/he has reason to believe that the bankruptcy debtor has left chemical products, biotech organisms, or hazardous waste over which control must be taken. This requirement follows from Chapter 7 § 16a of the Bankruptcy Act. Still, there is a risk that these actions would not be carried out with the required urgency, especially since the supervisory agency would have to procure an entrepreneur to take these measures.

If the bankruptcy estate became responsible for taking short-term measures, we would significantly reduce the risk of such damages occurring. The bankruptcy trustee can often hire personnel who were employed by the debtor; the personnel will likely be competent regarding the measures that must be taken continuously. If indirect priority were given to short-term actions, we would not have the same problem of insufficient assets in the estate to fulfil such obligations. Even if the *Blaiken* case shows these actions can be costly, this would typically not be a problem if a time limit were set. Such

a solution would also significantly lower the risk of bankrupting the bankruptcy estate, and other practical problems with indirect priority.

In prescribing which actions the estate should be liable for, we can find inspiration from the US Supreme Court and its ruling in the *Midlantic* case. The court found that the equivalent of the estate cannot avoid liability through abandonment if there is an imminent and identifiable danger. In line with this, the estate should be responsible for temporary measures if there is an imminent and identifiable danger to human health or the environment.

3.6.6 Conclusions

At the beginning of this section, we raised the question of whether providing priority to environmental claims is, in essence, making the creditors pay. The experience from Canada illustrates that consensual creditors will adapt to an increased risk, for example, by charging a higher interest rate. That way, providing priority is not making (consensual) creditors pay, but rather making the polluter pay in advance. That creditors will adapt is also supported by the corporate finance literature and empirical studies of the *Apex Oil* case. Priority to environmental claims provides a way of making the polluter pay, even if it goes bankrupt.

The obvious downside of providing environmental claims with priority is that it will make financing their operations more expensive for mining operators, potentially excluding some mining operators from the market. However, the "judgment-proof" problem demonstrates that if these operators need subsidies in the form of artificially low interest rates in order to conduct their business, it is economically efficient for the government and society to exclude them from the market.

Priority can also have a preventive effect on reducing pollution. Empirical studies of the *Apex Oil* case show that operators in the relevant region have reduced their emissions of environmentally hazardous chemicals by 12 to 30%. When it comes to Swedish mining operators, they can minimise the accumulation of environmental responsibilities at any given time by taking a more holistic view of mining activities over time and space, for example, regarding extractive waste.

Altogether, environmental claims should be provided with priority. Regarding direct priority, environmental claims should get super-priority, i.e. in the debtor's assets, except for cash and bank funds. Furthermore, the bankruptcy estate should be liable for short-term environmental actions if there is an imminent and identifiable danger. With limited liability for the bankruptcy estate, abandonment is unnecessary in these cases. Abandonment is a tool that bankruptcy practitioners and scholars use to ensure that the purpose of bankruptcy is achieved.

As mentioned above, when mining operators go bankrupt, priority cannot solve these problems entirely. The estate will not have enough assets to remedy the environmental damages. Other solutions need to be in place. We need to think ahead.

4. Ex-ante Solutions

4.1 Introductory Remarks

There are several ways to ensure sufficient funding is in place, when a mining operator goes bankrupt. The common denominator is that the funding is ensured in advance rather than when costs occur; we can call them ex-ante solutions. In this section, we will delve into insurance, common risk pools, and financial securities. The first two have certain similarities, and in Sweden, there was a system in place that combined the two. Therefore, these will be described and discussed in the same sub-section. Thereafter, financial securities will be discussed. It represents the solution the EU has preferred in these cases.

4.2 Insurance & Common Risk Pools

To establish if insurance can work in these cases, we need to dip into some basics of insurance. The main characteristic is that the insurance company undertakes a certain responsibility in return for consideration in the form of an insurance premium, and if an event of a certain kind – the so-called insurance case – occurs, the company must compensate for the damage that has occurred. The policyholder's purpose with the agreement is to gain security against certain unfavourable and accidental events. The insurance company issues a number of the same types of insurance, thereby reducing risk by combining enough exposure units to make its individual losses predictable at an aggregate level. This is often expressed as the law of large numbers. The predictable loss is then shared by all units in the combination.[94]

Another benefit of insurance is that it can support risk reduction. Insurance companies are skilled at calculating and pricing risks, which incentivises companies to reduce their risks through hazard identification, risk analysis, risk evaluation, and risk treatment. Thus, insurance premiums can be reduced.[95]

A risk pool can be formed in several ways and, as shown below, can have some of the mechanisms that insurance also has. A main feature is that a number of companies contribute to a common pool, which finances similar risks, such as liability or material damage. The risk pool can be set up by a number of companies or be prescribed by law.

94 See Mehr, R. & Cammack, E. (1961), Principles of Insurance, 3rd ed., pp. 33–41; Hellner, J. (1965), Försäkringsrätt, 2nd ed., pp. 6–14; Bengtsson, B. (2023), Försäkringsavtalsrätt, Allmänt om försäkringsavtalet, JUNO version 5 (juno.nj.se).

95 See World Bank (2023), Financial Resilience against Climate Shocks and Disasters, Recent Progress and New Frontiers, pp. 6–7; Eckerberg, P. J. (2010), Vad är försäkring, egentligen? Juridisk publikation, 2010/2, pp. 3–6.

One fundamental difference is that the pool members are both insurers and insured: there is a risk agreement in which operators agree to share each other's losses. This excludes a third party, such as an insurance company, but simultaneously makes the members dependent on each other.[96]

Under EU law, insurance and similar solutions have been considered in relation to the Environmental Liability Directive. By looking into those considerations, we can learn if insurance can work in the cases discussed in this article. When the Environmental Liability Directive was enacted in 2004, it was discussed whether the directive should entail provisions requiring mandatory insurance against environmental liabilities. However, the legislator stopped short of requiring Member States to demand insurance because there was a lack of these financial products on many of the national markets.[97] Instead, according to Article 14 of the directive, Member States shall take measures to *encourage* the development of financial security instruments and markets by the appropriate economic and financial operators, including financial mechanisms in case of insolvency. The aim is to enable operators to use financial guarantees to cover their liabilities under the directive.

Ever since the directive was introduced, the developments in the EU regarding, primarily, insurance for environmental liabilities have been monitored by the EU Commission.[98] The latest report on the matter was published in 2020, and the conclusion was once again that there was a lack of these financial products in several of the national markets.[99] However, the report also highlighted something else: insurance can work regarding environmental *liabilities* because they are triggered by uncertainties and accidental events. The report is equally clear that insurance does not work in

96 See further below and World Bank (2023), supra note 95, p. 6; Faure, M. & Liu, J. (2017), Pooling Mechanisms for Offshore Liability, Faure, M. (Ed.), Civil Liability and Financial Security for Offshore Oil and Gas Activities, pp. 198–201.

97 See Bergkamp, L., Herbatschek, N. & Jayanti S. (2013), Financial Security and Insurance, Bergkamp, L. & Goldsmith, B. J. (Eds.), The EU Environmental Liability Directive, A Commentary, pp. 118–123; Bocken, H. (2006), Financial Guarantees in the Environmental Liability Directive: Next Time Better, European Environmental Law Review, p. 18 and pp. 20–28.

98 According to Art. 14(2), the Commission had to present a report before April 2010, inter alia, on conditions of insurance and other types of financial security. See Report from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions Under Article 14(2) of Directive 2004/35/CE (2010), on the environmental liability with regard to the prevention and remedying of environmental damage (COM(2010) 581 final), Art. 4, concluding that it was premature for the Commission to propose mandatory financial security.

99 See European Commission (2020), Improving financial security in the context of the Environmental Liability Directive, No 07.0203/2018/789239/SER/ENV.E.4, p. 48. This has been pointed out several times before by Hubert Bocken, see Bocken, H. (1997), Financial Guarantees for Environmental Liability, Alternatives to Liability Insurance, Environmental Policy and Law, Vol. 27, No. 4, pp. 319–320; Bocken, H. (2006), supra note 97, p. 18.

terms of environmental *responsibilities* simply because these are certainties rather than uncertainties.[100]

Here, we can use the distinction between liability and responsibility. Remediating the environment when a mine closes is a responsibility rather than a liability because it is a certainty, not an uncertainty. When mining operations commence, we already know there will be a need to remediate the extraction waste. Insurance does not work because there is no need for risk sharing when it is a certainty that the costs will arise.

However, there is another uncertainty in these cases that, in principle, can be insured: whether the mining operator can fulfil its obligations. In other words, the risk of the mining operator going bankrupt. That is an uncertainty and could potentially be insured.[101] We also need to consider some specific traits regarding the Swedish mining sector that make this risk less suitable for insurance. The number of operators in the sector is small, and one single operator dominates the system. So, an insurance company would *not* be able to issue sufficient numbers of the same type of insurance, which is needed to reduce risk by combining enough exposure units to make its individual losses predictable at an aggregate level; the law of large numbers would not work for the Swedish mining sector. This makes an insurance system defined in the above manner less suitable for the Swedish mining sector.[102]

Moving on to common risk pools, as mentioned earlier, Sweden had a system that combined some elements of insurance and a common risk pool that was supposed to cover environmental remediation in Sweden. The system was introduced in 1999, and its purpose was to lower government remediation costs.[103] Compensation could only be given if the polluter could not pay. The aim was to not infringe on the polluter pays principle. However, the insurance did not cover the remediation of every environmental damage a polluter could be liable for, nor every protective measure for safeguarding against environmentally hazardous activities; its construction was much narrower. The insurance only covered remediation measures of a so-called urgent nature that had to be carried out to prevent or counteract damage to people, property, or the environment.[104]

The system was funded by fees from companies that carried out certain environmentally hazardous activities. The government decided on the total amount, and the size of the fees for the individual businesses was interlinked to the type of hazardous

100 See European Commission (2020), supra note 99, p. 10, pp. 181–183, and pp. 189–206.

101 Cf. Dachis, B., Shaffer, B. & Thivierge, V. (2017), All's Well that Ends Well: Addressing End-of-Life Liabilities for Oil and Gas Wells, C.D. Howe Institute, p. 8, pp. 16–17, and pp. 18–19, suggesting insurance for environmental responsibilities.

102 See SOU 2018:59 p. 119. See also Faure, M. (2002), Environmental Damage Insurance in Theory and Practice, Swanson, T. M. (Ed.), An Introduction to the Law and Economics of Environmental Policy, p. 289, describing the need for the law of large numbers regarding environmental damage insurance.

103 See prop. 1997/98:45 pp. 568–572.

104 See SOU 2007:21 p. 151.

activity the business carried out; no individual assessment of the risks involved in the specific case was made to decide the fees' amounts. The fees were paid to an insurance company that dealt with claims regulation, and this was the case regardless of whether it was the Environmental Protection Agency or someone else who applied for compensation. Furthermore, the insurance company got to keep the surplus.[105]

The combined costs for this insurance – and one that was supposed to cover damage to property and personal injury caused by certain environmentally hazardous activities – exceeded €10 million over eight years.[106] During the same period, these insurances covered costs of roughly €500,000.[107] Despite Sweden having many polluted areas needing remediation, a great deal of resources that should have funded remediation went into the pockets of insurance companies instead.[108]

It is safe to say that the collective insurance system for remediation of environmental damage did not work as intended. The insurance system was abolished in 2009, perhaps not surprisingly, since it was a mismatch of insurance and a common risk pool. It did not use an insurance system's benefit of risk reduction by giving incentives for businesses to reduce risk in exchange for reduced premiums. And it did not use the benefits of a risk pool in so much that every penny went to its intended purpose, in these cases, to remedy the environment.[109] Furthermore, the insurance terms were too narrowly constructed, and the environmental protection agencies had to take several bureaucratic and time-consuming measures without the certainty that the insurance covered remediation costs – in most cases, it did not.[110]

Even if the Swedish system did not work, common risk pools are being used to guarantee the remediation of, among other things, oil spills.[111] But could a common risk pool in the Swedish mining sector be used as much as it would allow the polluter to pay, even if it went bankrupt? To answer this question, we must once more consider the specific traits of this sector, namely that there is a small number of operators, and one single operator dominates the system. In a common risk pool, the members are dependent on each other's ability to bear the risks. It would be very difficult for the smaller operators to bear the risks of the most significant player; the risks in the system are not suitable for this kind of risk-pooling mechanism.[112]

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105 See SOU 2007:21 pp. 134–142.
106 See SOU 2007:21 pp. 140–142.
107 See SOU 2007:21 p. 147 and p. 155.
108 See prop. 2008/09:217 p. 15.
109 Cf. SOU 2007:21 pp. 223–224.
110 See, for example, Naturvårdsverkets rapport 5242 (2003), Om ansvar för miljöskulder i mark och vatten, pp. 74–75; SOU 2007:21 pp. 149–154; prop. 2008/09:217 pp. 9–16.
111 See European Commission (2020), supra note 99, p. 10 and pp. 65–66. See also Faure, M. & Liu, J. (2017), supra note 96, pp. 197–235, with further references.
112 Cf. SOU 2018:59 p. 119.

4.3 Financial Security

Another way of ensuring that there are assets to remedy the environment, even if a mining operator goes bankrupt, is to demand that the operator provides financial security before starting the mining process. If the security covers all closure obligations, it avoids the costs being externalised. Instead, the costs are internalised and borne throughout the operations since there are direct or indirect costs of providing security. For example, bank guarantees are one of the most frequently used securities in the Swedish context. They cost one or a few per cent of the set amount per year, depending on general interest rates and the risks of the specific operator.[113]

As mentioned earlier, under EU law, mining operators are required to provide financial securities for remediation costs concerning extractive waste according to the Extractive Waste Directive. The directive covers the management of waste resulting from the prospecting, extraction, treatment, and storage of mineral resources and the working of quarries. And according to Article 14, the competent authority *shall require a financial guarantee* prior to the commencement of any operations involving the accumulation or deposit of extractive waste in a waste facility. The guarantee can take the form of a financial deposit, including industry-sponsored mutual guarantee funds or equivalent. Unfortunately, the Swedish legislator had not implemented the directive before operations started in the Blaiken mine.

After the bankruptcies in Blaiken and elsewhere, and the decision by the Swedish government to fund the remediation, the Swedish National Audit Office[114] – a part of parliamentary control that ensures that the parliament receives a coordinated and independent audit of state finances – assessed the legal framework for securities for the mining industry.[115] The office found that the system was inadequate.[116] The Environmental Protection Agency and the Geological Survey of Sweden reached the same conclusion in their review of the system, even though Sweden had implemented the Extractive Waste Directive.[117] However, the implementation only covered landfills of waste, and the requirement for financial security in the Extractive Waste Directive covers additional costs. The implementation was, therefore, insufficient.[118]

Overall, the framework regarding financial securities for mining operations was inadequate. In order to reform the framework, the Department of Justice appointed an inquiry chair in 2017. The inquiry chair received the assistance of a group of experts, which consisted of practitioners, academics, and representatives of various public

113 See Miljösamverkan Sverige rapport (2018), Ekonomiska säkerheter, Handläggarstöd, p. 29.
114 In Swe: Riksrevisionen.
115 Riksrevisionen (2015), Gruvavfall, Ekonomiska risker för staten, RIR 2015:20.
116 Ibid., pp. 49–50.
117 Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017a), supra note 1, pp. 57–65.
118 Cf. prop. 2021/22:219 p. 27.

agencies, including the Environmental Protection Agency and the Geological Survey of Sweden. The chair delivered his recommendations in 2018, recommending that the legislator reform the framework and make it mandatory for mining operators to provide financial securities to cover all the relevant remedying needs – not only those interlinked with landfills.[119]

In a recently presented bill, the ambition had been lowered considerably. The Swedish legislator did the bare minimum and ensured that the Extractive Waste Directive was properly implemented (about fifteen years too late). Even though mining bankruptcies had repeatedly forced the government to pay for extensive post-treatment costs, the legislator chose only to require to cover the safety of operations for a waste management plan for extraction waste. The following passage in the preparatory works is telling:

> "There is no reason to regulate extractive activities more strictly than other environmentally hazardous activities in the parts that are not regulated by the extractive waste directive. The government, therefore, does not consider that security for a mining operation should be provided according to the same provision for all parts of the operation [author's translation]."[120]

Fortunately, the practical implications of this position are not significant. The Swedish legislature has stipulated that companies that are subject to a waste management plan for extraction waste shall provide financial security. According to § 23 of the Swedish Ordinance on Extractive Waste, whoever runs an activity that gives rise to extraction waste must have a waste management plan. And in virtually every mining operation, extraction waste is produced.[121] In addition, according to Chapter 15 § 36a of the Environmental Act, security is required for the fulfilment of the obligations that apply to the operation, which means that security will have to be provided for the entire mining operation.

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119 See SOU 2018:59, passim, pp. 11–14, entails a summary.

120 Prop. 2021/22:219 p. 32. In Swe: "Det saknas anledning att reglera utvinningsverksamheter strängare än övriga miljöfarliga verksamheter i de delar som inte regleras av utvinningsavfallsdirektivet. Regeringen anser därför inte att säkerhet för en gruvverksamhet bör ställas enligt samma bestämmelse för samtliga delar av verksamheten."

121 According to § 4 Swedish Ordinance on Extractive Waste (in Swe: förordning (2013:319) om utvinningsavfall, extraction waste refers to waste that was generated as a direct result of exploration, extraction, or processing. And waste, in turn, refers to any substance or object that the holder disposes of, intends to dispose of, or is obliged to dispose of, see § 3 Ordinance on Extractive Waste and Chapter 15 § 1 Environmental Act. As soon as drilling or similar activities are carried out, masses that are of no use to the mining operation will be generated, thereby generating extractive waste. In practice, therefore, every operator needs a waste management plan and to provide financial security. See also Naturvårdsverket och Sveriges geologiska undersöknings skrivelse (2017a), supra note 1, p. 86.

If we look into policy recommendations from the World Bank and the IGF,[122] mining operators should provide financial securities for all post-closure work. These recommendations are primarily based on case studies of specific jurisdictions and provinces considered to be at the forefront of issues involving particular securities and mines, but the literature has also been considered.

According to these recommendations, it is fundamental that the mining operator provides financial security for the total costs of remediating the environment. The main reason is that the costs should not burden the government, or worse, future generations, by non-remediating closed mining sites. Furthermore, enacting a mandatory requirement that the mining operator provides financial security enforces the polluter pays principle. The recommendations also emphasise that the revenue from the mine will no longer exist post-mining to support remediation and that variations in mineral prices can result in premature and unplanned mine closure due to the bankruptcy of the mining operator.[123]

Conclusively, financial security enables the mining operator to pay even if it goes bankrupt. However, this outcome is only achieved if the security covers the costs of the needed remediation work. A number of safeguards must be in place to enable financial securities to fulfil their aim. For example, security should be provided before the commencement of the mining operations. Its size should be based on a closure plan, which has been audited by independent experts. The plan should be reviewed at certain intervals because mining operations often change during the mine's lifetime. For example, new ore deposits can be found.[124]

A mandatory requirement for financial security has other positive effects as well. Since the cost of financial security depends on the costs of the needed remediation work – a bank guarantee costs one or a few per cent of the set amount per year – it incentivises operators to conduct remediation work throughout the mining process, thereby reducing the costs of financial security.[125] As mentioned above, mining operators can minimise the accumulation of environmental responsibilities at any given time by taking a more holistic view of mining activities over time and space, for example, regarding extractive waste.

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122 See the World Bank (2009), Financial Surety, Guidelines for the Implementation of Financial Surety for Mine Closure; The World Bank (2021), Mine Closure, A Toolbox for Governments; IGF (2021), Global Review, Financial Assurance Governance for the Post-mining Transition. See above supra note 5, regarding IGF.

123 See the World Bank (2009), supra note 122, pp. 47–49; The World Bank (2021), supra note 122, pp. 23–24; IGF (2021), supra note 122, pp. 1–3.

124 See the World Bank (2009), supra note 122, pp. 47–49; The World Bank (2021), supra note 122, pp. 23–24; IGF (2021), supra note 122, pp. 10–13.

125 Cf. Mackie, C. (2014), The Regulatory Potential of Financial Security to Reduce Environmental Risk, Journal of Environmental Law, Vol. 26, pp. 200–203 and pp. 213–214, discussing how a requirement for financial security can reduce an operator's environmental risk.

Still, it is extremely difficult to forecast remediation costs in advance accurately. The policy recommendations suggest that the cost estimates include a contingency allowance reflecting the uncertainty in the closure planning.[126] At the same time, an overestimation of the costs inflicts unnecessary costs on the industry. A degree of uncertainty, therefore, will always exist. Hence, a requirement for financial securities should be complemented by some other solution as well.

5. Summary and Conclusions

The mining industry has been an important part of the Swedish economy for the last millennia.[127] It still accounts for 0.7% of Sweden's GDP. Even if the industry has contributed to Sweden's prosperity, it has also caused substantial environmental damage. As mentioned in the beginning, 324 contaminated mining areas in Sweden are classified as giving rise to a "very high or high risk" to human health and the environment.

Today, we know a great deal about how to establish, operate, and close mines to reduce the burden on the environment, both in the short-term and long-term. Our legal framework is built on that knowledge. Another pillar of the framework is the polluter pays principle. The principle is a cost allocation norm, meaning that the costs of, inter alia, remedying the environment should be internalised in the business so that the market does not prosper at the expense of the environment. As the *Blaiken* case shows, the environmental liability framework short-circuits if the polluter goes bankrupt. You could say that in these cases the environment goes bankrupt.

To ensure that the polluter can pay even if it goes bankrupt, we need to think ahead and ensure that there is a robust system in place. In this article, we have explored solutions in the form of priority, insurance, common risk pools, and financial security.

Insurance is a great tool for sharing risks. The policyholder gains security against certain unfavourable and accidental events, and the insurance company makes the losses predictable on an aggregate level by combining enough exposure units. A common risk pool does not need the risk element and can be constructed in several different ways. However, neither insurance nor a common risk pool would work in these cases. The Swedish mining sector has a small number of operators, and the system is dominated by one single operator. Thus, both an insurance system and a common risk pool would not work in this sector.

Requiring a financial guarantee for remediation before mining starts is the recommended way of ensuring that a mining operator can pay even if it goes bankrupt.

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126 World Bank (2009), supra note 122, pp. 57–58; IGF (2021), supra note 122, pp. 16–18. See also SOU 2018:59 pp. 132–135; Riksgälden (2023), Redovisning av uppdrag om säkerheter för utvinningsavfall, M2022/02234, pp. 14–20.

127 See "Historiska gruvor", sgu.se (last accessed 15 June 2024).

It internalises the costs associated with a mining operator's business risk. However, securities only work insofar as they cover the costs of remediation. Several safeguards need to be in place to achieve this. However, an amount of uncertainty will always exist, and financial securities should be supplemented with some other solution if we desire a robust framework.

Priority for environmental claims could complement a framework for financial securities in situations where the security is insufficient. If direct priority is given over consensual creditors, these creditors will likely adapt and will, for example, increase the debtor's costs for receiving credit. Thus, priority internalises the costs associated with the risk of the debtor going bankrupt. Non-consensual creditors cannot adapt in the same way, which means that priority over these creditors would simply mean that these creditors would pay. Therefore, in Sweden, priority should not include cash and bank funds. Furthermore, short-term actions must be carried out continuously if a mining operator goes bankrupt to avoid substantial environmental hazards. If the bankruptcy estate becomes responsible for taking short-term measures, we would significantly reduce the risk of such damages occurring. This responsibility should be limited to temporary measures if there is an imminent and identifiable danger to human health or the environment.

In this article, the Swedish mining industry and its regulation have been used as an example. It is typical for the sector that operators, by giving rise to extractive waste and impacting the environment, accrue what can be called latent environmental debts. Yet, the mining sector is not the only sector in which businesses accrue environmental debts. The same holds true for waste management operators, windmills, and petrol stations, to name a few. In all these sectors, operators can go bankrupt, and if we do not make sure that we have a robust system in place that enable the polluter to pay, even if it goes bankrupt, the environment goes bankrupt.

Environmental Claims in Bankruptcy: Dischargeability, Priority, and Other Policy Responses

Michael Ohlrogge[*]

1. The Policy Challenge of Environmental Claims in Bankruptcy

1.1 Theoretical Foundation

For more than a century, economists have recognized that if firms operate while imposing uncompensated harms on third parties, then this can result in both distributional unfairness and economic inefficiency. A conceptually simple solution is to impose liability on firms to the extent of these otherwise uncompensated harms (Pigou, 1920). Nevertheless, a problem arises if there is a subset of firms that do not have sufficient resources to fully pay this assessed liability. This creates a so-called "judgment-proof" problem that can leave this set of firms with excessive incentives to engage in harm-externalizing behavior (Posner, 1976; Shavell, 1986).[1]

The following stylized scenarios illustrate the problem of the corporate form potentially incentivizing harm-externalizing behavior by protecting its owners from liability for harms caused by the corporation, thus giving rise to the judgment-proof problem. In the first scenario, I consider a project undertaken without incorporating and thus without benefitting from limited liability. In the second scenario, I consider how the payoffs and incentives change when limited liability is introduced.

Suppose an entrepreneur develops a new manufacturing process that can take inputs that cost €50 and turn them into a product that sells for €120, yielding a €70 profit.[2] Nevertheless, this new process will release chemicals of uncertain toxicity into

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1 For additional works analyzing these issues, see Shavell (1984a,b), Posner (1976), Jensen and Meckling (1976), Myers (1977), Arlen and Carney (1992), Hansmann and Kraakman (1991), Bebchuk and Fried (1995) and LoPucki (1996). For a fuller summary of pertinent research, see Ohlrogge (2023).

2 All of the examples I give here are framed in terms of investors deciding whether to found a company to pursue a specific new manufacturing process. Nevertheless, the principles illustrated apply in a very wide

the surrounding ground and waterways. There is a 50% chance that the chemicals will be harmless, but a 50% chance that they will cause €200 worth of damage. If the entrepreneur were fully liable for and able to fully pay this €200 of damages, then the entrepreneur would have a 50% chance of making €70 profit (in the event of no toxicity) and a 50% chance of losing €130 (€70 profit minus €200 liability).

Intuitively speaking, a venture that has a 50/50 chance of generating profits of €70 or -€130 is not productive. The good and bad outcomes in this scenario are equally likely, but the net damage in the bad scenario is significantly worse than the benefits in the good scenario. In expected value terms, we could say the project has -€30 expected value (€70*0.5 + -€130*0.5 = -€30). The expected return on investment is -60% (negative).[3] No sensible entrepreneur would undertake this project. A project such as this is not just bad for the entrepreneur – it is bad for society. If people and companies regularly embark on projects with negative expected value such as this, then society will grow increasingly poor, not increasingly wealthy.

Nevertheless, there are some circumstances in which it may be possible for an investor to still on average profit from pursuing a value-destroying project such as this. Suppose the entrepreneur forms a limited liability company to pursue the project and funds it with an initial €50 in cash, which covers the cost of materials needed to operate the new production process. In the event of no toxicity, the initial €50 investment still turns into €120 in sales, yielding €70 of profits for the entrepreneur. Now, however, if the chemical proves toxic, the most the corporation will be able to pay is the €120 it received from selling the product. The corporation has no other valuable assets, so the €200 liability goes unpaid in part. The entrepreneur, however, is protected by limited liability in this scenario. In a downside scenario the entrepreneur will only lose the value of the initial €50 investment. The entrepreneur thus faces the prospect of investing €50 to end up with either €120 and thereby make a profit of €70 in the event of no toxicity, or to end up with €0 and thereby making a loss of €50 in the event of toxicity. In expected value terms, we could say the project has a positive expected value for the shareholder of €10, computed as (€70*0.5 + - €50*0.5 = €10). The expected return on investment is 20% (positive).[4] An investor looking to make a return could undertake this project using the corporate form.

The problematic incentives here also apply to situations where the company could spend money to mitigate the harms that it causes. For instance, suppose that the company could spend €5 to treat its discharges before releasing them. Doing so would not completely eliminate the risks of the pollutants, but it would reduce the harms in the

range of contexts. For instance, they apply to the decision by a company to launch a new product or venture and to decisions by a company to spend more or less money on preventative equipment and personnel designed to lower the risks of environmental harms.

3 To be calculated as (Expected Value Project/Investment) x 100% = (- 30/50) x 100% = - 60%.

4 To be calculated as (Expected Value for Shareholder/Investment) x 100% = (10/50) x 100% = 20%.

bad scenario from €200 to €120. Spending €5 for a 50% chance of saving €80 of damages is socially efficient. In fact, if this precaution is taken, the project switches from being socially inefficient to socially efficient.[5] But, there is no private incentive for the entrepreneur to take this precaution. Because of limited liability, for the firm's owner, all damages from the project above the €120 in firm value they stand to lose are identical. Thus, reducing damages from €200 to €120 in the bad scenario does nothing to improve the firm owner's outcome, but results in a €5 decrease in their profits in the good scenario. If government authorities end up needing to pay to clean up the pollution in the bad scenario, they may end up paying far more than it would have cost to prevent a significant amount of that pollution had better precautions been taken ex ante. This further highlights the potential social inefficiencies that can be caused by the judgment-proof problem.

These problems are exasperated if the firm funds some of its investment with debt that enjoys an equal or higher priority compared to environmental harms. For instance, suppose the firm is founded with €10 of equity investment and €40 of debt from a lender who receives a blanket lien on all of the firm's assets. The lender receives a claim for €50 in present value, reflecting interest and principal repayment of the loan. First, consider the perspective of the equity investors. In the event that the firm's releases prove not to be toxic, the equity investors will have invested €10 and will own a firm whose assets are worth €120 and whose liabilities (to the lender) are worth €50, thus yielding a net value of the firm's equity of €70. In the event the firm's releases prove to be toxic, the equity investors will still lose their entire investment.

Nevertheless, even if the firm's releases have an 80% chance of being toxic, the debt-funded venture will still be profitable in expectation for the equity investors. In particular, they will have a 20% chance of turning €10 into €70, and an 80% chance of turning €10 into €0. The equity owners are thus able to turn €10 into €14 in expected present value (€70*20% = €14), making this an appealing investment for them. In other words, if this project is funded with debt, the social costs of the project can be substantially worse (moving from a 50% chance of causing significant contamination to an 80% chance of this) while still being attractive to equity investors to pursue.

Creditors, in turn, will have no incentive to constrain equity's incentives in this matter. If creditors are granted a claim that enjoys priority over that of environmental harms, they will profit from this venture as well, regardless of whether the firm's releases prove to be toxic.

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5 In particular, in the good scenario, where there is no toxicity, there is still €65 social surplus (the original €70 surplus minus the €5 cost of the discharge treatment). In the bad scenario, where the chemical proves to be toxic, there is €65 surplus generated by the product, weighted against €120 harm, for a net of €55 harm. Now, the project has a 50/50 chance of generating €65 social value or generating €55 net social harm. Intuitively, since these two prospects are equally likely, but the social benefits in the good scenario are greater than the social harms in the bad scenario, the project is socially efficient. In expected value terms, the project now has €5 of positive expected value (€65*0.5 + - €55*0.5).

Even if the claims for environmental harms are given equal priority to the claims of the firm's lenders, there will still be significant scope for socially inefficient projects to be privately beneficial to both the firm's creditors and equity investors.[6]

These scenarios thus illustrate why the prospect of firms entering bankruptcy with unsatisfied environmental claims is so troubling. It is not merely the concerns of distributional unfairness for those who suffer from less-than-fully compensated harms. Instead, there is also real danger that a legal framework that allows unsatisfied environmental claims in bankruptcy will lead companies, investors, and creditors to pursue projects that are socially inefficient, producing greater total harms than benefits. Despite being socially inefficient, these projects can nevertheless be profitable for shareholders and creditors if they can escape the full costs of pollution they create. In this way, society becomes not just dirtier, not just more unfair, but also poorer as a whole.

Furthermore, this economic inefficiency is particularly troubling because there is effectively no way that the harms from it can be remedied. If a firm declares bankruptcy and is unable to fully compensate environmental harms that it has caused, then the government can pay to remedy those harms by raising taxes and cleaning up the environmental contamination. Alternatively, government safety net programs that provide healthcare, income support, and so on can help to compensate those negatively impacted by environmental harms. That is, to the extent that uncompensated environmental harms simply result in distributional consequences, governments can rectify those harms by standard re-distributional techniques. But, where companies engage in activities that are socially net negative, on account of a failure to establish efficient ex-ante incentives, no government policy can miraculously recreate the lost social value.

6 For instance, suppose the project has a 60% chance of producing €200 of toxic chemical harms. If the project is funded completely with equity, as in the original example, then the equity holders will be trading a €50 initial investment for €48 of expected present value (40% chance of receiving €120 and 60% chance of receiving nothing). Thus, they will not favor proceeding with it. But, if the project can be funded with €10 of equity and €40 of debt that enjoys equal priority to the environmental claims, it will still be profitable for both equity and lenders to pursue it. In particular, suppose the lender charges €20 interest in exchange for the greater risk they now bear. In the event the firm's releases are not toxic, the lender will loan €40 and receive €60 in return. In the even the firm's releases are toxic, the lender will have €60 out of €260 total claims on the firm's €120 in assets, and thus will receive roughly €27,70. A 60% chance of the lender getting €27,70 and a 40% chance of the lender getting €60 still yields an expected present value to the lender of €40,62, which is greater than the lender's €40 investment. The equity investors will likewise do very well in this scenario, even given the higher interest payments owed to creditors.

1.2 Empirical Evidence

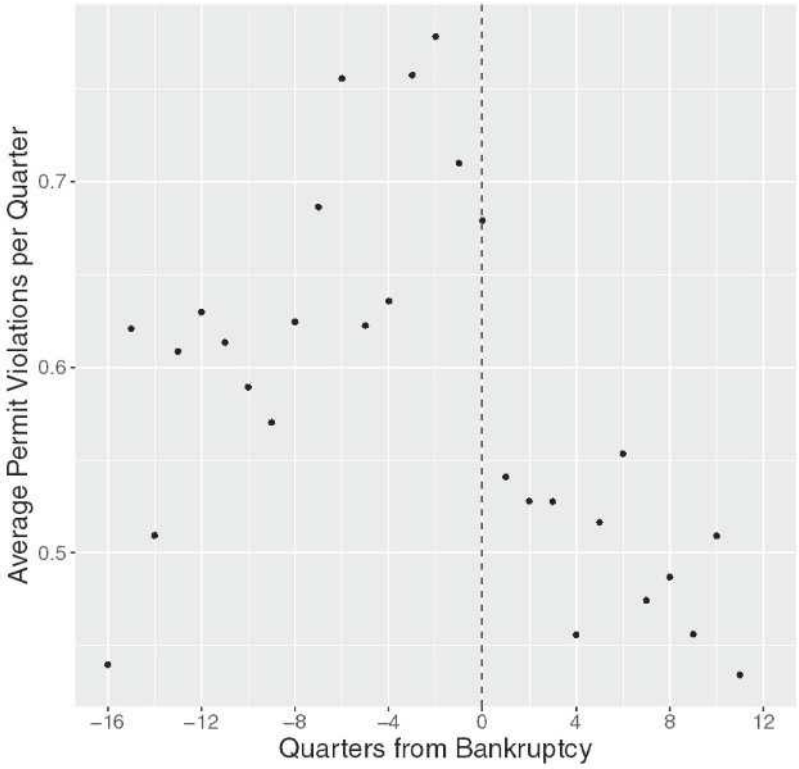
The theoretical foundations that I describe above have been well understood for half a century or more. Nevertheless, there has been some skepticism in the academic literature as to whether these translate into real-world consequences and problems. Authors such as White (1998), Schwarcz (1999), and Listokin (2008) have argued that many of the foundational articles analyzing the problems discussed above are either anecdotal or hypothetical, and that it is unlikely that theoretical incentive problems would cause many practical harms. Listokin (2008), for instance, remarks that "reports of the death of liability are greatly exaggerated" and that future empirical research "may well show that ... causes of the death of liability, such as under-capitalization are ... empirically irrelevant".

There are several challenges in establishing convincing empirical evidence of the theoretical concerns described above. On the one hand, it is relatively simple to show specific instances of firms that have declared bankruptcy and failed to fully pay assessed liabilities for environmental harms. If one is concerned simply about the distributional fairness problems of such uncompensated harms, then this evidence alone is sufficient to document the problem. But, if one is concerned about the incentive and efficiency problems, then simply observing a given failure ex post does little to show to what extent, if any, the failure was made more likely due to liability laws that enable firms to file for bankruptcy while failing to fully compensate externalized harms they have caused. It could be the case that such liability laws are irrelevant to corporate incentives and that large environmental liabilities simply occur randomly across corporations.

There are several ways to overcome these hurdles to establishing empirical evidence. One option is to examine instances in which policies have changed to make it less likely that firms will fail in ways that leave large, uncompensated environmental harms – for instance, policy changes to alter the priority of environmental claims in bankruptcy. If these policy changes appear to result in reductions of polluting activity, then it can suggest that prior policies may have been contributing to excessive amounts of pollution. I discuss evidence of this sort, based in part on the findings in Ohlrogge (2024), in the sections below. Another option is to examine situations in which the policies in existence might lead firms to have particularly low incentives to reduce pollution risks, and to examine whether there is indeed evidence of this occurring.

In Ohlrogge (2023), I pursue this later approach. In particular, I examine a set of firms regulated under the US' Clean Water Act that also declare bankruptcy. Compared to similar firms that are not in financial distress, I find that the firms steadily increase the rates at which they violate limits on pollutant releases as they approach bankruptcy, but that after filing for bankruptcy, rates of environmental compliance return to roughly their pre-bankruptcy levels. Figure 1 reproduces a graph summarizing these results.

Figure 1. Summary of Findings from Ohlrogge (2023)



Average Clean-Water-Act permit violations per facility and calendar quarter, raw data. All facilities represented in this plot are observed at least four years prior to their bankruptcy and at least three years following, thus ensuring that the observed patterns of violations are not driven by compositional changes in the sample.

In particular, as firms approach bankruptcy, the value of their equity gets smaller and smaller, meaning that shareholders have less and less to lose from the prospects of environmental fines and penalties, thereby lessening the deterrent effect. I also find that firms with the lowest book value of equity (relative to assets) at the time of their bankruptcy filings see the largest deterioration in environmental performance in the leadup to bankruptcy, and the largest improvements in their environmental compliance post-bankruptcy.[7]

7 Firms near bankruptcy also lack liquidity to pay for environmental compliance expenses. I find that firms that have the least liquidity immediately prior to filing for bankruptcy also see the largest deterioration in their environmental compliance pre-bankruptcy and the largest improvements in their compliance post-bankruptcy, as the bankruptcy process works to alleviate these liquidity concerns, such as by facil-

The bankruptcy process facilitates transactions that place assets under new ownership of equity holders with much more equity and thus much more to lose, thus resulting in better compliance incentives. Asset sales are one such type of transaction. Here, industrial facilities can be sold to new owners with better capitalization and liquidity who then invest in new compliance equipment and personnel. Even where this does not happen, the bankruptcy process tends to transfer ownership of a firm's equity from thinly capitalized pre-bankruptcy owners with little left to lose, to creditors, who become new equity holders, and who then have much more to lose from additional environmental liabilities that firms accrue.

Furthermore, under US law, penalties for any environmental violations that occur post-bankruptcy enjoy a substantially higher priority as administrative claims, compared to the much lower priority, unsecured claim status, for environmental penalties assessed for pre-bankruptcy violations. This enhances the incentives of creditors to use the expanded powers they enjoy in the bankruptcy process to steer companies towards greater environmental compliance.

In Ohlrogge (2023) I discuss other possible explanations for the pattern of environmental non-compliance depicted in Figure 1, such as that regulators go light on firms in financial distress, or that poorly managed firms are both more likely to violate environmental laws and more likely to become financially distressed. I show that these are not able to account for the patterns of compliance shown in Figure 1. For instance, I show that even firms that do not experience a change in management during the process still markedly improve their environmental compliance after filing for bankruptcy. I likewise show that environmental non-compliance increases as firms approach bankruptcy, even after controlling for levels of enforcement activities by environmental regulators.

Overall, the results here help to illustrate empirically the concerns that firms may take on excessive risks (such as operating while being unable or unwilling to pay for equipment to monitor and treat wastewater discharges) when the prospects of insolvency mean that neither firm owners nor creditors bear the full costs of environmental contamination. Other recent work, such as that by Hartzmark and Shue (2023) and others discussed in Ohlrogge (2023), helps to further document these concerns.

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itating Debtor in Possession (DIP) financing. Nevertheless, the choice to continue operating a firm that lacks the liquidity to pay for necessary equipment and personnel to control pollutant releases is in itself a choice shaped by the liability regime in place. If shareholders and creditors face relatively few losses in the event a firm declares bankruptcy with significant unmet environmental obligations, then clearly this can make it more attractive to continue operating a firm that cannot afford necessary environmental protective measures. Thus, the fact that liquidity can explain some of firms pre- and post-bankruptcy changes in environmental performance in no way invalidates the role that moral hazard plays in driving their actions.

2. Policy Options For Reducing the "Judgment-Proof Problem"

In this section, I briefly review an array of policy options that have been devised to respond to the problem of corporations causing pollution harms while being unable to pay for the ensuing liability.

2.1 Mandatory Insurance or Bonding

If a firm is at risk of causing harms greater than the value of its equity, or perhaps even greater than the value of its total assets, one solution is to require the firm to carry liability insurance to cover those harms. A classic example of this in the US applies to nuclear power companies, which are required to obtain high levels of private liability insurance.[8] Interestingly, while studies such as Ohlrogge (2023) and Hartzmark and Shue (2023) find evidence that firms' propensity to externalize environmental harms increases as their financial condition deteriorates, when studying nuclear power plants, Feinstein (1989) finds no such evidence. This may indicate that the insurance providers are effective at monitoring and incentivizing nuclear power plants to maintain high levels of safety even in situations where the equity investors have increasingly little left to lose in the event of a major contamination event.

Private companies need not be the only source to look to for insurance. For instance, in the US, the CERCLA statute[9] is also sometimes referred to as the "Superfund Statute", named after a fund that companies pay into if they handle chemicals that are at risk of contributing to toxic contamination. In theory, this fund acts as a sort of government provided insurance program. It provides a way to finance contamination cleanup in the event that the firms that created the contamination have become insolvent and unable to pay for the cleanup themselves.

In evaluating the effectiveness of private and public insurance, at least two considerations apply. First, will the insurer have adequate funds? In the US, for instance, the Superfund is chronically underfunded due to lack of will by the US Congress to charge adequate insurance premia. This makes it very imperfect for addressing unpaid environmental harms. At the same time, private insurers might also lack adequate resources, especially if they are small, newly created insurance companies specializing only in ensuring environmental harms, something that defies most principles of effective insurance business but which is becoming a matter of some concern in the US. The second consideration between public versus private insurance is which insurer will be

8 This insurance was mandated by the Price-Anderson Act of 1957, 42 U.S.C. § 2210.
9 CERCLA stands for the Comprehensive Environmental Response, Compensation, and Liability Act.

able to more effectively and efficiently monitor the safety efforts of insured companies, so as to price insurance appropriately given a firm's risks.

A conceptually related policy is to require firms at greater risk of externalizing pollution to post a bond to cover cleanup liabilities. For instance, firms can be required to deposit a certain amount of money with an environmental regulator, or find another company to pledge to do so on their behalf, which essentially amounts to insurance. Alternatively, in some instances, regulation allows firms to "self-bond", whereby they simply make guarantees based on the state of their current balance sheet to cover future environmental cleanup obligations. A recent analysis by the US' Government Accountability Office (GAO) found such self-bonding to be problematic and to not provide the level of protection that may be desired.[10]

Boomhower (2019) examines an instance in which the US state of Texas passed legislation requiring operators of oil and gas wells to either maintain insurance or post bonds to cover their potential future environmental cleanup obligations. Boomhower (2019) finds this law to have been effective in significantly reducing the risk of environmental spills and contamination.

2.2 Persistent Cleanup Obligations and Liens

Another approach for addressing the judgment-proof problem is to make it more difficult for a firm to use bankruptcy to escape its environmental cleanup obligations. In general, this will not directly impact the incentives of a firm's equity holders (since they will usually be wiped out in a bankruptcy proceeding), but it may increase the incentive of a firm's creditors to push for environmental safety through the standard channels by which lenders can influence corporate decisions. There are several variations on how this can be accomplished.

One option is to create an obligation to clean up contamination that stays with whoever presently owns a piece of property. To take a simple, stylized example: suppose a company builds a factory on a piece of land, financing this with a €100 mortgage on the land and facilities. Suppose the firm then causes €50 of environmental contamination to the land and declares bankruptcy. Although the lenders may now have a right to seize the land, on account of their security interest, once ownership of the land transfers to them, they will now be the party responsible for the €50 cleanup obligation. Thus, whatever value the lender can recover from the land will be reduced by the cost of the cleanup. In the US, the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) uses this approach,[11] creating an obligation for the owner

10 See https://www.gao.gov/products/gao-18-305.
11 See in particular CERCLA §106 and §107(a).

or operator of a property to contain and clean up pollution on that property regardless of how that pollution was deposited there.

In essence, persistent cleanup obligations of this sort function as a kind of super-priority lien on contaminated property. A lender may have a right to collect value from a property, but the lender will not be able to access this value of the property without also paying for the cleanup costs, thus in essence placing even a secured claim against the property below the priority of the cleanup obligation.

In at least some respects, general nuisance laws, such as those that exist under US and UK common law, can also work to at least somewhat similar effect. For instance, if a contaminated property is actively leeching contaminants and thus damaging nearby properties, then owners of nearby properties may have the right to demand the owner of the contaminated property take steps that are at least sufficient to prevent the leeching. Thus, if a lender or another party gains ownership of a contaminated property, they may still be liable for costs to prevent leeching or to compensate nearby property owners for the damages caused by escaping contaminants.

A potential limitation of this approach is that a lender may be able to collect on and sell off all non-contaminated property of a bankrupt polluter. If the value of this is enough to satisfy most or all of a lender's claims, then there may be little additional incentive for the lender to monitor and control a borrower's pollution activities.

2.3 Non-dischargeability and Priority

The above limitations of persistent cleanup obligations can in some ways be addressed by making claims for environmental cleanup non-dischargeable in a bankruptcy proceeding. That is, rather than the cleanup obligation adhering to the owner of contaminated property, the cleanup obligation will adhere to the corporation after bankruptcy regardless of whether it continues to own the contaminated property. This can in turn limit the ability of lenders to collect on the value of other, non-contaminated assets owned by a corporation that has contributed to pollution harms. And, on account of this, such policies may strengthen lender incentives to monitor and control environmental safety by borrowers.

In the United States, the Seventh Circuit Court of Appeals adopted this non-dischargeability approach in its decision in *US v. Apex Oil*, which I study in Ohlrogge (2024) and which I discuss in further depth below. The Supreme Court of Canada adopted a somewhat similar ruling in *Orphan Well Association v. Grant Thornton Ltd*.[12] Additional aspects of non-dischargeability are examined by Buccola and Macey (2021).

12 For more information, see https://www.scc-csc.ca/case-dossier/cb/2019/37627-eng.pdf.

Nevertheless, there are potential limitations on the extent to which non-dischargeability succeeds in increasing the priority of environmental obligations in bankruptcy. One limitation is that if a firm is liquidated piecemeal in bankruptcy, there will be no surviving entity to inherit a non-dischargeable claim. Thus, if creditors are able to collect most or all of the value of their investment through the piecemeal sale of a firm's non-contaminated assets, then non-dischargeability will do little to impact the incentives of those lenders. Of course, a piecemeal liquidation will often yield less total value than a reorganization, with the difference in value between the two methods referred to as the "going concern surplus". Non-dischargeability thus only inhibits the ability of creditors to collect on their claims to the extent those creditors depend on a firm's going concern surplus to help meet those claims. In other words, non-dischargeability only serves to increase the priority that environmental claims enjoy vis-a-vis a firm's going concern surplus, rather than increasing priority of environmental claims over all of a firm's asset value.

One concern with non-dischargeability is that it is often possible to accomplish the functional equivalent of a reorganization through an asset sale. In the US, for instance, it is common for a firm in bankruptcy to sell a large portion of its assets to a newly created corporation, in essence accomplishing a reorganization but through a process that is formally structured as a liquidation sale. Thus, strong laws establishing successor liability, or related principles that carry liability over to the purchasers of assets, are needed to ensure that non-dischargeability is effective. Otherwise, a firm may be able to sell most or all of its assets to a purchaser who does not assume liability, deliver the full proceeds of that sale to the firm's creditors, and leave an empty estate with a useless, although non-dischargeable, claim for environmental harms. US law often provides for successor liability, but the application of these laws are at times arbitrary and uncertain.

For these reasons, while non-dischargeability of environmental claims can result in meaningful improvements, it is almost certainly not a first-best policy option. Instead, granting priority to environmental claims is a significantly preferable option. One method for accomplishing this would be to guarantee firms' environmental cleanup obligations with a super priority lien over all assets. Another method would be to stipulate that neither bankruptcy nor liquidation proceedings could be concluded without paying environmental claims in full.[13]

13 Though this later approach would need to include protections to ensure that creditors and debtors did not seek to circumvent it by, for instance, using ordinary commercial transactions to transfer assets to creditors in satisfaction of their claims. That is, this would require a robust system of successor liability for purchasers or recipients of assets, whereas the super-priority lien approach would not require this and thus may be simpler and more effective.

2.4 Limits to Limited Liability

Another potential solution to the judgment-proof problem is to place limits on the extent to which owners of a company that has contributed significantly to environmental harms can benefit from limited liability protections. Hansmann and Kraakman (1991) consider this possibility, although Grundfest (1992) shows significant practical problems that may well make it infeasible in many situations. One area where restrictions on limited liability may be more practicable is when restricting the extent to which a parent corporation can escape liability of its subsidiary corporations. In the US, the CERCLA statute creates certain circumstances in which parents can be held liable for the unpaid environmental obligations of their bankrupt subsidiaries, and Akey and Appel (2021) show that this provision appears to be effective at encouraging subsidiaries of large parent corporations to more carefully handle toxic chemical wastes.

One concern about imposing liability on parent companies for their subsidiaries' unpaid environmental liabilities is that it might encourage industrial activity to migrate away from large corporate groups and towards small, independent, and thinly capitalized firms that would still be able to take advantage of limited liability for their shareholders. Of course, doing so could destroy efficiencies that come from operating as a larger corporate group (Coase, 1937), and so this would only be advantageous to the extent that the liability saved would be greater than the efficiencies lost. At least in the instance studied by Akey and Appel (2021), there does not appear to be evidence of such fragmentation in response to limits on limited liability within corporate groups.

2.5 Lender Liability

If a firm does not have sufficient assets to cover environmental liabilities, another policy option is to hold the firm's lenders liable. US law provides for this in certain circumstances, but only in very limited situations in which the lender is very actively involved in managing the borrower's affairs.[14] Thus, well-advised lenders can usually avoid this liability without difficulty.

Pitchford (1995) and Che and Spier (2008), among others, analyze the extent to which lender liability can be a useful tool to constrain excessive externalities at firms. In general, they find that lender liability can be useful at improving efficiency, though it is often not a first-best response. Nevertheless, in general, these prior analyses of lender liability operate under the assumption that lenders cannot effectively monitor the levels of care that borrowers take to reduce pollution risks. As I show in Ohlrogge (2024),

14 See, e.g., 42 U.S.C. §9601(20)(G)(iv).

lenders can and do actively monitor the safety of environmental practices of borrowers. This may lead to a reevaluation of some of the conclusions of this prior literature.

2.6 Policies to Reduce and Resolve Financial Distress

A different sort of response to the judgment-proof problem is to use policies that reduce the frequency with which firms are judgment proof in the first place. I discuss this possibility in Ohlrogge (2023). For instance, policymakers can take steps to encourage firms to resolve financial distress earlier rather than later, thereby reducing the number of critically undercapitalized firms there are. This can include reforms to make bankruptcy simpler, cheaper, and easier, which may be particularly valuable for small and mid-sized firms. This can also include examining issues like tax policy and the consequences of restructuring debt outside of bankruptcy (Campello et al., 2019; Donaldson et al., 2022).

Another related line of policy options involves examining whether other policies may encourage firms to fund their operations more heavily with debt than they otherwise would. In the US, for instance, the tax code provides strong incentives for firms to use debt rather than equity financing. This is because debt payments are deductible for the purposes of corporate income taxes, whereas dividend payments to shareholders are not. As documented by Hutchison (2015), this policy did not arise out of any deliberate choice by policymakers, but instead is the result of a series of historical accidents and unintended consequences. Nevertheless, unless environmental claims are given full priority over claims of even secured creditors, any policy that encourages firms to use more debt finance will tend to lead to more situations in which firms declare bankruptcy and are unable to fully compensate environmental harms they have caused. Thus, this may create an incentive for policymakers to reevaluate and revise policies that encourage firms to use excessive amounts of debt finance.

2.7 Targeted Environmental Enforcement

Another policy response that I discuss in Ohlrogge (2023) is for environmental regulators to develop targeted enforcement policies that add extra monitoring and inspections for firms at the greatest danger of being "judgment proof" and thus that may be most likely, as Ohlrogge (2023) documents, to contribute to excessive amounts of environmental risks. For instance, environmental regulators can identify firms that are in financial distress, as well as small firms with low asset value but high potential for environmental harms. These targeted firms can then receive more intensive inspections and enforcement actions in order to promote more efficient incentives for them. This practice is the norm in, for instance, banking and other financial regulatory settings, whereby institutions that are in financial distress are singled out for more intensive supervision.

So far, however, it has proved relatively uncommon in environmental fields. Ohlrogge (2023) discusses some implementation details of this, such as practicable ways that environmental authorities can identify firms in financial distress, even if there is no widely available data on their financial statements.

3. Advantages and Disadvantages of Different Policy Options

3.1 Comparing Policy Options

Each potential policy response to the judgment-proof problem has advantages and disadvantages. For instance, granting environmental claims priority over claims of lenders has a potential disadvantage in that if a company funds its operations with little or no debt, then changing priority of that debt will have little impact on the company's incentives. If a company has sufficient asset and equity value to cover expected environmental liabilities, then this will not be an issue, but if one is worried about small companies with low asset value causing large environmental harms, then changing priority of environmental claims may not be a fully effective response. By contrast, mandated insurance can be effective even for firms that have low asset value compared to their potential harms.

At the same time, one advantage of granting priority to environmental claims is that it can work automatically over a large set of firms that might contribute to significant environmental harms. By contrast, an insurance mandate will need to be imposed on specific groups of identifiable firms. It is likely not a suitable policy response to simply require every firm in the economy to carry environmental damage insurance, no matter how remote the likelihood that a given firm might contribute to environmental contamination. Additionally, an insurance mandate could introduce additional implementation costs due to the added complexity of requiring firms to contract with an additional party – an insurer – rather than simply maintaining their existing contractual relationships with their lenders.

A full comparison of advantages and disadvantages of each policy response is outside the scope of this writing. Furthermore, the particulars of the comparison will generally vary significantly depending on the given setting in which one seeks policy solutions. Nevertheless, it is worth giving thought to which strategy or strategies will likely be most suitable to achieving policy objectives in any given setting.

3.2 International Considerations

Another area that warrants consideration is how international law and international corporations relate to the policy objectives and challenges discussed here. For instance, suppose there is a company with operations in the UK, France and the Netherlands, and suppose it has contributed to toxic contamination in each of those countries. If that company then files for bankruptcy in the Netherlands, how should its environmental liabilities be addressed?

One possibility is an overarching rule that would apply to the environmental obligations in each of the UK, France, and the Netherlands. For instance, the law could stipulate that all of these claims will enjoy super-priority status.[15] Another option, however, could be to allow that different countries may wish to bear different amounts of risk of uncompensated environmental harms from insolvent corporations. In this case, a blanket rule on priority of all environmental obligations might be less preferable than a system in which countries require bonds and priority liens on specific assets to cover potential costs of environmental contamination.

At the same time, such a fragmented approach could run the danger of leaving significant portions of a firm's assets unavailable to meet environmental obligations. For instance, if each country merely secured liens on the physical plants located in this country (in essence what the US CERCLA statute accomplishes), but failed to gain any priority claim over an international company's intellectual property, good will value, assets in other countries, and the like, then one could again be in a situation in which the company's lenders could get priority recovery over many of the firm's assets, to the detriment of environmental claims.

A full analysis of these international law issues lies outside the scope of this writing, but the above discussion sketches at least some of the issues that such an analysis would ultimately need to consider.

15 Though even this could raise complications if the firm does not have enough assets to pay all of the environmental claims in each country in full. How would claims from one country be balanced against those from another country?

4. Addressing Potential Concerns with Policy Interventions

In this section, I address a number of common questions and concerns that come up in the discussion of the above policy reform options to address the judgment-proof problem.

4.1 Will Policy Interventions Raise Borrowing Costs and Discourage Investment?

A question that is persistently raised in response to policies that aim to address the judgment-proof problem is will these interventions cause economic problems by raising borrowing costs or discouraging productive investment?

An important consideration is that if policymakers fail to address the judgment-proof problem, then the anticipated result will be borrowing costs for companies that are artificially low. For instance, consider an extreme situation in which an equity holder founds a firm funded with only a nominal amount of equity, and finances the remainder of the firm's operations with debt that enjoys priority over environmental claims. In this scenario, neither the lender nor the equity holder will be exposed to essentially any risk of losses on account of environmental harms. Instead, all of the costs will be passed on to the public, since in the event of significant environmental contamination, the lender will be able to claim the full value of the firm's assets as compensation for their priority claim against the company. In this scenario, the lender can finance at a very low interest rate, but it is only because all of the costs and risks of environmental contamination have been passed off to the general public.

In a scenario such as this, changing the priority of environmental claims to elevate them above those of a lender quite likely would result in an increase in borrowing costs. But, this increase would merely be what would be expected from causing the firm's owner and creditor to bear the externalized costs of the environmental risks they create. Furthermore, to the extent that these increased borrowing costs deterred some economic activities from occurring, this would actually be a positive development from a social welfare perspective. That is because if a venture will only be profitable to a firm's owners and creditors if those owners and creditors are able to externalize harms onto the general public (by failing to pay the full costs of environmental contamination in the event the company becomes insolvent), then that venture is actually value-destroying from a social welfare perspective. Deterring such ventures thus improves economic efficiency.

4.2 Other Potential Concerns with Policy Interventions

> Question 1: Does giving banks a lower bankruptcy priority than environmental harms imply a value judgment that they are "bad" or that their interests matter less than the environment?

Not at all. Deciding whether secured creditors or environmental claims in bankruptcy have priority has nothing to do with value judgments or about which interests matter more. Instead, it is simply a matter of giving lower priority to creditors that have the ability to assess a borrower's risks and adjust the interest rates, covenants, and other terms of their loans accordingly. In a competitive lending market, banks and other lenders can be expected to pass any added risks that they face on to borrowers in the form of higher interest rates, stricter covenants, or the like. Thus, profits from lending to socially productive ventures should not be significantly diminished.[16]

When banks pass these costs on to borrowers, it causes a more effective internalization of the social costs that ventures impose. By contrast, contingent environmental claims generally do not have any effective way to adjust their interest or other terms ex ante to account for the risk that they might not be paid in full in a bankruptcy proceeding. Thus, they are an example of a so-called "involuntary" or "non-adjusting creditor", upon which it is less efficient to allocate risk.

> Question 2: Is it efficient to demand that banks monitor every single borrower's environmental performance?

As discussed in greater detail below, my work in Ohlrogge (2024) shows that when environmental claims became less dischargeable in bankruptcy, many lenders responded by writing stricter covenants to monitor the environmental safety precautions of borrowers. Yet, clearly, writing such covenants and conducting such monitoring by lenders comes with costs of its own. One may wonder whether it would be excessively costly for lenders to engage in all of this additional monitoring.

Yet, giving environmental claims priority over those of lenders simply places more risk on lenders, it does not dictate any specific response by them to the risk. In some instances, lenders may determine that the most efficient way to manage this risk is

16 As described in the opening section of this report, it is possible for socially unproductive ventures to nevertheless be privately profitable to both a firm's equity holders and its lenders if those lenders enjoy greater or equal priority to environmental claims. Changes in bankruptcy priority could be expected to reduce the extent to which banks can extract profits from loaning to socially unproductive ventures, or from lending to ventures for whom a part of their profitability comes from externalizing costs via uncompensated environmental harms. But, this is not an outcome that should be a concern for public policy.

to inspect borrowers' facilities to ensure they are operating safely and reducing their chances of causing catastrophic environmental damage. In other instances, lenders may determine that the costs of such monitoring are greater than the expected benefits. In such an instance, it may be more efficient for lenders to not monitor and simply charge borrowers additional interest to cover the lenders' additional risk. If monitoring genuinely costs more resources than the benefits it produces, then it is indeed socially unproductive to conduct such monitoring, and a lender's decision not to engage in it helps to advance social welfare. The ability of lenders to make such decisions regarding when monitoring is or is not efficient helps to illustrate the value of placing risk on lenders, since they have the capacity to assess the tradeoffs between higher monitoring versus higher interest rates and to adjust their credit agreements accordingly.

> Question 3: Is it not the job of environmental regulators to ensure companies take adequate environmental precautions? Thus, if environmental contamination occurs, should we not reform the regulators rather than giving contamination cleanup claims priority over lender claims?

Much the same question could be asked about imposing liability on firms outside of bankruptcy – why should we fine solvent firms that violate environmental statutes and release unsafe amounts of toxic contamination? Is it not the job of regulators to stop firms from polluting in the first place? Thus, if environmental contamination occurs, should we not blame the regulators and look to reform them, rather than penalizing solvent companies and ultimately their shareholders?

Yet, this overlooks the fact that imposing fines and penalties is often an effective way for regulators to operate and to enforce the law. Thus, if environmental contamination occurs and a firm is penalized, it may well represent an instance of environmental regulations functioning as they are intended, rather than any kind of failure of regulators.

In theory, environmental regulators could station full-time employees at every industrial firm to constantly oversee every aspect of their operations and to intervene immediately as soon as they detect any unsafe activity. For some situations of sufficiently high risk (e.g. nuclear power plants), this might be an efficient approach. But, in a great many other situations, it is far more efficient for regulators to establish environmental safety requirements and then to penalize firms caught violating those requirements (Shavell, 1984a). If firm owners and creditors bear losses on account of penalties imposed on firms for unsafe environmental behavior, then those owners and creditors will generally have incentives to impose efficient environmental safety procedures at the firms they invest in. Nevertheless, as shown in the opening section of this report, if investors are able to escape the full costs of their firms' actions due to the judgment-proof problem, then this system of ex-post liability becomes less effective. This in turn can force regulators to rely on what may often be less efficient systems that require more intensive supervision and oversight.

Thus, if one hamstrings the effectiveness of environmental regulators by giving lenders priority over environmental claims, and then blames regulators for failing when firms declare bankruptcy with large unmet environmental obligations, the net effect may simply be to force regulators to use less efficient tools of direct oversight, rather than the system of imposing liability for harms that works so well in so many other regulatory situations.

> Question 4: Will imposing personal liability on directors and officers of corporations that cause environmental damage eliminate the need for other policy responses?

As discussed above, no policy response is perfect, and the optimal solution in many situations may involve a mixture of policy responses. Thus, in at least some situations, it is possible that personal liability for officers and directors of companies may be a useful policy tool. Nevertheless, there are significant reasons to doubt that such liability will be a sufficient tool in and of itself.

The biggest reason that liability for directors and officers may be inadequate is that the magnitude of harms that companies can potentially cause tends to be far greater than what almost any individual can pay. In the case of *Apex Oil*, for instance, discussed above, the costs for Apex to clean up the environmental contamination it caused were estimated to be $150 million in 2008, or equivalently roughly $220 million in inflation adjusted terms, as of 2024. Almost no private individuals have anywhere near this amount of personal assets. Thus, there will still be substantial potential for uncompensated harms in the event a company creates significant environmental contamination and declares bankruptcy. And, wherever there are uncompensated harms, there is significant risk of inefficient incentives.

To illustrate these inefficient incentives, consider the following. A company operates an industrial process with an annual 1% chance of causing €200 million of harm. The company could spend €1 million annually to essentially eliminate this risk, but doing so would not be profitable for the company – for instance, as described in the opening sections of this report, €200 million may be far greater than the equity value of the company, meaning that most losses will not be borne by the company's shareholders in the event the harm materializes. Suppose that if the harm materializes, the company's CEO will be held personally liable for the €200 million harm.[17]

If the CEO only has €1 million net personal asset value, then this is the most that they could lose. Rather than spend €1 million on prevention measures, the company

17 For simplicity, I am giving this example in terms of just a single individual, the CEO, being personally liable. All of the reasoning applies also to situations in which multiple individuals, such as those on the board, could be held personally liable.

could instead choose to pay €500,000 annually in additional compensation to their CEO. There are at least a moderate number of people who would accept an additional €500,000 in annual compensation in exchange for bearing a 1% risk of losing a substantial amount of their personal asset value. At most, imposing liability might change the nature of people who choose to become officers or directors of corporations (and not necessarily for the better!). But, if it is profitable for a company to fail to take efficient precautionary measures, it will generally be possible for the company to find a way to incentivize its officers and directors to pursue the profitable strategy, even if doing so imposes risks on those officers and directors.

There are also additional difficulties with such a personal liability system. For instance, prosecutors and juries may be reluctant to pursue charges or deliver convictions against directors and officers of companies, particularly if there was, for instance, "only" a 1% chance of the serious harms materializing. Furthermore, the personal bankruptcy process, or other tools such as placing assets in hard-to-reach foreign jurisdictions, may enable those found liable for corporate harms to shield significant amounts of their assets, further reducing the deterrent effects.

None of these considerations mean that it can never be efficient to consider personal liabilities or penalties for directors and officers of corporations that contribute to significant environmental harms. Nevertheless, these do raise serious doubts that such a liability system can be sufficient in and of itself, without pursuing some of the additional policy reforms discussed in this report.

> Question 5: Will prioritizing environmental claims harm other sympathetic claimants, such tort creditors, tax claims, or employee claims?

If one is concerned about the plight of tort or tax claims in, for instance, bankruptcies, then the most natural response is to also grant those a higher priority, rather than to decline to grant a high priority to environmental claims. This is particularly true given that in most bankruptcies, the magnitude of claims from other sympathetic creditors will tend to be small relative to the value of claims from a company's main lenders. Thus, for example, if a company has a €50 environmental claim, a €100 claim from its lenders, and €10 of claims from tort victims or employees, it seems quite odd to decline to subordinate the €100 of lender claims out of concern for protecting the €10 of claims from tort creditors or employees. The question of what priority to give to different groups of "involuntary" or "non-adjusting" creditors (e.g. environmental versus tort claims) is a more challenging one that is beyond the scope of this article. But, the principle that these involuntary claims should enjoy priority over claims of lenders who can assess borrower risks and adjust the terms of credit accordingly is still quite applicable, even in the presence of multiple types of involuntary claims.

> Question 6: Will making environmental claims non-dischargeable, or granting them priority, lead to inefficient liquidations?

I analyze this issue in Ohlrogge (2024), appendix sections 9.2 and 9.1. In particular, for instance, I show that contrary to concerns voiced by some, a strong non-dischargeability rule should not be expected to increase the number of piecemeal liquidations. Instead, if a reorganization will preserve more corporate value than a liquidation, it will be possible for environmental regulators, in negotiation with creditors, to come to an agreement that allows the reorganization to proceed while splitting the surplus value created by the reorganization.

For instance, suppose that if a firm liquidates, its assets will be worth €30 but if it reorganizes it will be worth €50. Suppose also that there is a non-dischargeable environmental claim worth €50. Under this scenario, it could be difficult to find either creditors or equity investors who would finance the post-reorganization company, if most or all of the value of the company would go to satisfying the pre-bankruptcy environmental obligations. In this scenario, it may well be advantageous for the environmental regulators to agree to write down the value of their claim (for instance, to €40), or equivalently, to agree to fund some portion of required cleanup operations themselves. In this way, it is possible to ensure that value-enhancing reorganizations still take place. Granting priority or non-dischargeability to environmental claims thus does not prevent deals such as this from being struck, it simply gives environmental authorities the leverage and bargaining power to choose to loosen or relinquish priority or non-dischargeability when doing so will be net advantageous to advancing environmental interests.

> Question 7: Is the purpose of bankruptcy and insolvency law to maximize recovery for a firm's creditors? If so, then does giving priority to environmental claims undermine that purpose?

First, properly understood, claims for environmental cleanup are among a firm's set of creditors. So, advancing the interests of those claims does not work against the purpose of bankruptcy and insolvency law. It would be an odd conception of bankruptcy and insolvency law to say that the purpose is to maximize recovery only for a firm's pre-bankruptcy lenders, rather than creditors as a whole.

Furthermore, the advancement of creditor interests in bankruptcy must be constrained by the rules of law and sensible policy. For instance, suppose a company that operates a factory declares bankruptcy. If a bankruptcy judge were to order that the land adjacent to the property be seized from an unaffiliated owner and granted to the debtor's estate, then doing so would no doubt be advantageous to the bankrupt firm's creditors. Yet, doing so would be a terrible precedent from a policy perspective. Based on the analyses in this contribution, it is equally bad policy to allow a bankrupt firm to

render neighboring property unusable by contaminating it with pollution and declining to remedy that pollution.

Ensuring that a bankrupt firm's assets are put to their most valuable use is a sensible objective of bankruptcy and insolvency law, and often this can be reached through a corporate reorganization rather than a liquidation. But, as discussed in the context of question 6, above, granting priority or non-dischargeability to environmental claims should not impede this objective.

> Question 8: Will policy interventions to address the judgment proof problem raise costs of doing business and thereby reduce competitiveness with countries that have less robust laws protecting environmental interests?

If the EU or countries within it make policy changes such as increasing priority for environmental claims, mandating insurance, or other remedies, then one might worry that these will increase the costs to industries such as manufacturing and mining, and make it difficult for European companies to compete with those from countries with less robust policies to combat the judgment-proof problem.

First, whenever a country imposes any type of environmental regulations, these run the risk of reducing competitiveness with countries that have weaker environmental controls. As a first order matter, then, if a country has decided through its political processes to impose environmental regulations, then a reasonable assumption is that it has already decided that the environmental benefits it will gain are greater than any harms to the competitiveness of its industries. Thus, if changes to bankruptcy law, and other similar policy responses, simply result in better enforcement of environmental standards that are already in place, there is a strong argument that this is simply better effectuating the will of the country's citizens who approved the environmental regulations in the first place.

Second, the actual impact on the competitiveness of a country's industries may be extremely limited. One reason for this is that as the judgment-proof problem is reduced, companies may find it increasingly in their interest to take ex-ante precautions that are much cheaper than ex-post cleanup costs. At least in the case of non-dischargeability in the US' Seventh Circuit, which I discuss in more depth below, my research shows that the improvements in environmental outcomes were not accompanied by noticeable drops in firms' profitability or scale of operations. Thus, at a minimum, one should carefully analyze how much, if at all, competitiveness of a country's industries would actually be harmed, rather than taking it for granted that there would be a major harm. Just because someone opposed to a reform claims that it will destroy industry competitiveness is not sufficient grounds to conclude that will certainly be the case.

Finally, if a group of countries, such as in the EU, imposes significantly more stringent environmental regulations (of which better addressing the judgment proof problem might be just one component) than other countries, then one potential response is

to use trade policy such as tariffs to account for this. If a country allows it industries to cause large amounts of uncompensated environmental harms, then it is in essence subsidizing those industries, giving them an unfair competitive advantage over industries in countries that do not allow such large, uncompensated environmental harms. Trade policy has tools to address such subsidies.

5. *United States v. Apex Oil*: Details and Impact of Non-dischargeability Ruling

As I discussed above, establishing environmental claims as non-dischargeable obligations in bankruptcy has the potential to produce meaningfully useful improvements, even if it is not a fully first-best policy solution. The experience in the US States with the *United States v. Apex Oil* decision, which I study in Ohlrogge (2024), illustrates this.

5.1 Background Facts of the Apex Case

Apex Oil was formed in 1979 and throughout the 1980s operated an oil refinery in Hartford, Illinois.[18] During this period, the refinery and pipelines connected to it suffered repeated failures in their environmental controls. This led to substantial pollution of the soil and groundwater in and around the town of Hartford, including one striking incident in which several public streets in Hartford were flooded, four to five inches deep, with fuel oil from the refinery.

In 1987, Apex filed for Chapter 11 bankruptcy. In 1988, while in bankruptcy, Apex sold the Hartford Refinery to Premcor Refining Group. In 1989, a new Apex Oil company was incorporated, merging with the old Apex Oil company in bankruptcy, thus effecting a reorganization. As part of the reorganization, Apex switched its line of business from oil refining to wholesale distribution.

In 2003, the US Environmental Protection Agency (EPA) assumed primary responsibility for enforcing cleanup of the area around Hartford. In 2003 and 2004, the EPA obtained agreements to begin cleanup operations from four companies it identified as responsible for the pollution in Hartford: Premcor Refining, Shell Oil, BP Amoco, and Sinclair Oil Co.[19] Apex was the fifth and final party identified by the EPA as responsible. Apex refused to participate in the cleanup, arguing that any responsibility for the

18 Except as otherwise noted, all information in this background facts section is from the district court judgment: *U.S. v. Apex Oil Co., Inc.*, Not Reported in F.Supp.2d (2008).

19 These were companies that had done business with *Apex* while it operated the refinery, companies that owned pipes going into and out of the refinery, and companies that operated the refinery during periods other than when it was owned by *Apex*.

cleanup was discharged in its bankruptcy. In filings, Apex argued that it would cost €150 million to fulfill its cleanup obligations.

5.2 *Legal Details of the Apex Case*

After Apex refused to participate in the cleanup of the contaminated site, the state environmental authorities believed that trying to collect from Apex would be hopeless, due to its prior bankruptcy and discharge. Nevertheless, a group of attorneys working for the other companies held jointly liable for the site's cleanup got together to craft a novel legal strategy and convince the US Department of Justice (DOJ) to seek contribution from Apex based on this theory.

US law stipulates that "claims" are dischargeable in bankruptcy, but leaves some ambiguity as to what precisely constitutes a "claim". The US DOJ argued, and the Seventh Circuit ultimately accepted, that an obligation in bankruptcy is a claim only if money can be paid to satisfy it. The major innovation in the *Apex* case was that the DOJ brought the cleanup case against Apex under an environmental statue, RCRA (the Resource Conservation and Recovery Act) that allowed the government to demand cleanup from a party that had contributed to pollution but did not provide a way for the culpable party to pay money in lieu of performing the cleanup. By contrast, previously, the DOJ and US EPA (Environmental Protection Agency) had generally brought cleanup actions under the CERCLA statute which provided for nearly identical cleanup responsibilities, but which expressly allowed the government to accept payment of cleanup costs in lieu of polluters performing the cleanup themselves.

When the US Congress passed the RCRA and CERCLA statutes, it had no intention of making the RCRA statute more potent than CERCLA by not providing for the EPA to accept money lieu of cleanup and thus to establish obligations under RCRA as non-dischargeable. Nevertheless, through the quirks of US bankruptcy law and the precise definitions of a "claim", this was the outcome of the litigation that resulted in the *United States v. Apex Oil* decision. Thus, because of the clever lawyering that led the DOJ to bring the case against Apex Oil under RCRA, Apex's cleanup obligations were ruled not to have been dischargeable through its prior bankruptcy.

As I described in more detail above, the non-dischargeability result produced a meaningful change in the status of environmental obligations in the Seventh Circuit. Nevertheless, its changes were incremental, rather than revolutionary. US law had already provided for super-priority liens on contaminated property. Given that non-dischargeability did not give cleanup obligations full priority over a firm's assets, instead, it simply allowed environmental authorities to benefit from at least some portion of the going concern surplus of a firm. Still, the holding produced a big enough change in the effective priority of environmental obligations in bankruptcy to impact the behavior of lenders and firms in the Seventh Circuit.

5.3 *Impacts of the Apex Decision*

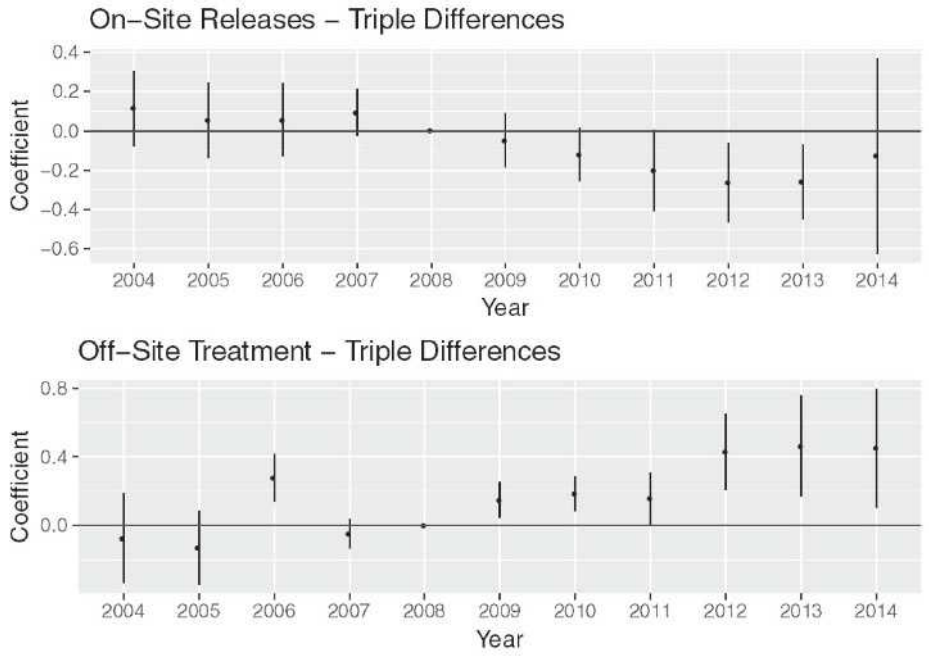
In Ohlrogge (2024), I document a number of important changes produced by the *Apex* decision. In order to determine which changes are attributable to the decision, versus which are due to other contemporaneous changes in industry practice or lending markets, I base my analyses on comparisons between companies that were most affected by the *Apex* decision – those likely to file for bankruptcy in the US Seventh Circuit, versus companies likely to be unaffected by the decision.

First, I find that among companies impacted by the *Apex* decision, but not among other companies, lenders began to write more loan provisions giving them or their designated agents the authority to inspect borrowers' property to assess how safely they were handling toxic chemicals. An example of such a strong provision can be seen in a credit agreement between Supreme Industries and Wells Fargo:

> The Administrative Agent [Wells Fargo] shall have received a Phase I environmental assessment and such other environmental report reasonably requested by the Administrative Agent regarding each parcel of real property subject to a Mortgage by an environmental engineering firm acceptable to the Administrative Agent showing no environmental conditions in violation of Environmental Laws or liabilities under Environmental Laws, either of which could reasonably be expected to have a Material Adverse Effect (Supreme Industries Inc. 10-K. March 22, 2013, p. 56).

Furthermore, in response to the decision and this pressure from lenders, companies in the Seventh Circuit (but not in other circuits) switched to safer disposal methods for toxic chemicals used in their operations, as shown in Figure 2. In particular, I find that companies reduced on-site releases of toxic chemicals, a more dangerous disposal method, by roughly 15-30%, following the *Apex* decision. In place of these, firms substituted for a variety of off-site treatment disposal methods that are generally considered to be safer for environmental purposes. Nevertheless, despite these changes, I find that firms did not significantly reduce total production levels or profitability, although they did switch to using more equity financing and less debt finance. Overall, the results suggest that policy reforms such as making environmental cleanup obligations non-dischargeable in bankruptcy can meaningfully improve firms' ex-ante incentives to reduce their risks of contributing to catastrophic environmental contamination events.

Figure 2. Key results of the *Apex* decision, as documented in Ohlrogge (2024)



These plots depict the annual coefficients estimates for the triple difference methodology, measuring the change in on-site chemical releases, a less environmentally safe option, versus the change in off-site treatment, a more environmentally safe option. Changes are measured relative to 2008, the year of the *Apex* decision. All measured are based on comparisons of firms likely to be most impacted by the *Apex* decisions versus those likely not to be affected by the decision, based on where firms are apt to file for bankruptcy.

6. Conclusion and Recommendations

As I showed in the opening section of this report, the so-called "judgment-proof problem", whereby companies can create environmental harms that are significantly greater than they may be able to pay to compensate, is a serious concern. The ability for a firm's owners and creditors to split the profits from industrial operations that perform well, while passing off to society the costs of ventures that go poorly and contribute to significant contamination, can distort incentives. This can lead companies to take inadequate precautions to prevent pollution harms and encouraging some economically inefficient ventures to go forward that would never occur if lenders and borrowers needed to more fully absorb the environmental costs of their actions. Theorists have pointed to these concerns for many decades, and more recently, empirical research has shown significant evidence of these problematic incentives at play. In particular, research shows that the

less equity a firm's shareholders have to lose from environmental sanctions, the worse the firms perform in terms of obeying environmental laws that limit pollution releases.

Thus, in order to promote environmental interests, distributional fairness, and economic efficiency, it is important to consider how to design a bankruptcy system, as well as a broader environmental and enforcement environment, that accounts for these issues. There are a wide array of policy options available to address the judgemnt-proof problem. Each policy response has different advantages and disadvantages, and so choosing the optimal mix of responses requires careful attention to the specific situation one is operating in. Fortunately, there is good empirical evidence that many of these policy responses can be effective at improving company incentives to handle environmental risks responsibly.

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Preventing Environmental Bailouts: Environmental Liabilities and (Non)-Inclusion and (Non)-Dischargeability under the WHOA

Aart Jonkers and Rolef de Weijs[*]

1. Introduction

A fundamental principle of environmental law is that the polluter pays. What if the polluter cannot pay? The US experience has shown that the answer to this question can have an impact on the environment. *Not* allowing insolvency law to give polluters a fresh start regarding environmental claims can result in cleaner rivers.[1]

The question on treatment of environmental claims in case the debtor cannot pay gains more importance now that the European Union stimulates reorganization procedures. From 2022, all member states must have implemented a preventive restructuring procedure. The Netherlands did so by means of the so-called WHOA-procedure (Wet Homologatie Onderhands Akkoord). The hallmark of such restructuring procedures is that an overindebted company can keep operating the business by amending its capital structure, usually including a forced debt write down for creditors. A key question is whether environmental claims can be included in such forced discharge. This question has until now received little attention.

In this report (*pre-advies*), we will first outline basic policy goals of environmental law and of insolvency law (Section 2), followed by a discussion of the way insolvency law deals with private law environmental claims (Section 3). From there, we will turn to a public authority as a claimant in insolvency procedures (Section 4).

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1 See M. Ohlrogge, 'Bankruptcy Claim Dischargeability and Public Externalities: Evidence from a Natural Experiment', *American Law and Economic Review* (forthcoming). Available on https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3273486.

2. Policy Issues: Goals of Environmental Law and Goals of Insolvency Law

Environmental law and insolvency law prima vista have different founding principles. In determining the relation between these two fields of law, it merits to revisit these principles. As we shall see, there is overlap in the founding principles as well, most notably at the level of a forced internalization of costs and an insolation of public finances from providing bailouts; in the case at hand, environmental bailouts.

2.1 Policy Goals Underlying Environmental Law

Article 19(1) TFEU stipulates the objectives of EU environmental policy:

- preserving, protecting and improving the quality of the environment;
- protecting human health;
- prudent and rational utilisation of natural resources, and
- promoting measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change.

Article 191(2) FTEU continues and articulates how these objectives should be achieved. It provides the following policy principles:

> Union policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Union. It shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay.

One of the most fundamental policy principles is the polluter pays principle.[2] This principle has constitutional status in the EU, established in Article 191(2) TFEU. See for a description of the polluter pays principle, preamble 18 to the Environmental Liability Directive:[3]

2 Principle 16 of the Rio Declaration; OECD Recommendation on the Implementation of the Polluter-Pays Principle C(74)223 (1974); See extensively S. Kingston, 'The Polluter Pays Principle in EU Climate Law: an Effective Tool before the Courts?', *Climate Law*, 10(1), pp. 1-27.

3 See Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ L 143, 30 April 2004, p. 56).

> According to the "polluter-pays" principle, an operator causing environmental damage or creating an imminent threat of such damage should, in principle, bear the cost of the necessary preventive or remedial measures. In cases where a competent authority acts, itself or through a third party, in the place of an operator, that authority should ensure that the cost incurred by it is recovered from the operator. It is also appropriate that the operators should ultimately bear the cost of assessing environmental damage and, as the case may be, assessing an imminent threat of such damage occurring.

The principle is justified by at least two envisioned effects. The first is that the public should be shielded from having to compensate for damages out of the public funds. The second is that liability internalizes costs and is expected to provide an incentive to the actor to steer away from undesirable behavior.

2.2 Policy Goals Underlying Insolvency Law

Corporate insolvency law deals with companies that cannot meet their obligations, now or in the future. Different policy goals can be pursued by insolvency law. It merits to understand these underlying principles since these also explain why insolvency law facilitates either the continued operation of a going enterprise (such as through a pre-pack) or even facilitates the continued existence of legal entities that cannot pay their debts (corporate reorganization). It is especially at those instances, when the business and possibly also the company continue to exist and operate, that the question arises whether old claims arising out of acts conducted prior to an insolvency procedure can still be enforced or are barred because of such an insolvency procedure.

Our review of the policy goals of insolvency law shows that, upon closer inspection, environmental law and insolvency law have a goal in common: internalize costs to the debtor, which in insolvency should be shouldered by the financiers of the debtor.

2.2.1 Preserving Value for Creditors by Preventing a Tragedy of the Commons and Overcoming Anticommons Behavior

The aim of insolvency law is often seen as maximizing return for creditors. The collective nature of an insolvency procedure, instead of the individual pursuit of claims, facilitates better outcomes for creditors as a group.[4] The Creditors' Bargain Theory argues that an important part of the upside can be explained by the capacity of insolvency law

4 Uncitral, Legislative Guide on Insolvency Law, p. 136: "It is a generally accepted principle of insolvency law that collective action is more efficient in maximizing the assets available to creditors than a system that leaves creditors free to pursue their individual remedies (..)."

to capture the going concern value by leaving the business intact.[5] This theory conceptualizes insolvency law as a tool to overcome a tragedy of the commons. Creditors have an incentive to act in their own interest and there is a risk that value is being lost, since individual creditors will still be incentivized to try to seize assets individually. In game theoretical terms, this behavior can be conceptualized as a prisoners' dilemma. By forcing creditors to cooperate, the going concern value can be preserved.

In this elementary assessment of the goals of insolvency law, there is a strong bias towards saving the business as an operating whole. A business that promises to generate future flows will often seem to be worth more than its individual assets. The goals of insolvency law and the beneficial effects created by insolvency law are not limited to capturing going concern value. Even if there is only a single asset with a fixed value, there is still merit to having an insolvency procedure. Other goals, also recognized by the Creditors' Bargain Theory, are reducing coordination costs and preventing a fight of all against all. In addition, well-functioning insolvency laws are thought to reduce monitoring costs.

The traditional Creditors' Bargain Theory needs to be supplemented with an analysis of what happens to creditors and their behavior once they are locked into a collective proceeding. The problem of creditors trying to *opt out* of the collective scheme, most notably by seizing assets or forcing payment individually, is then replaced by the problem of creditors trying to extract value by means of *holdout* behavior. The clearest example of this is when a reorganization plan is presented to all creditors, offering a better outcome than liquidation, but some creditors withhold their consent to secure a larger portion of the going concern relative to other creditors. The game theoretical explanation of this kind of behavior is a game of chicken.[6] It is this kind of holdout behavior that reorganization procedures aim to overcome by providing tools to bind creditors and shareholders to a plan, subject to safeguards.

2.2.2 Predictability and Lowering the Costs of Lending?

Another function ascribed to insolvency law is to provide clear and predictable rules. In turn, such rules can reduce the costs of lending. This notion of a strong connection between the position of a creditor in case of insolvency and the costs of lending seems to have gained more loyal followers than the first notion of increasing the value available for creditors. One can pose several critical remarks, casting doubts on the strength of this

5 T.H. Jackson, *The Logic and Limits of Bankruptcy Law*, (Cambridge MA: Harvard University Press 1986), p. 14 writes: "To the extent that a non-piecemeal collective process (whether in the form a liquidation or reorganization) is likely to increase the aggregate value of the pool of assets, its substitution for individual remedies would be advantageous to the creditors as a group. This is derived from the commonplace notion: that a collection of assets is sometimes more valuable than the same assets would be if spread to the winds. It is often referred to as the surplus of a going-concern value over a liquidation value."

6 See more extensively, R.J. de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool & Anticommons', *International Insolvency Review*, 2012/2.

argument. Here, we name two. The overall availability of credit does not seem to be the problem these days, rather the reverse: an excess of credit.[7] In addition, and in part as a result thereof, secured credit is increasingly involved in financing leveraged constructions among which dividend recaps and share buy backs, rather than investments.

There are limits to the reasoning that insolvency law should function to lower the costs of credit. The clearest limitation is the problem of externalities. If the costs of credit are not lowered by allowing for swift, cheap and reliable procedures, but rather by facilitating externalities, there is no justification for security rights. Externalities can be defined as 'any welfare effect felt by one party as a result of another actor's production or consumption decisions that is not mediated via the price system'.[8] Many distinctions can be made in assessing externalities, for example externalities to trade creditors or to bond holders. The clearest and most pressing examples are externalities to tort victims and to the public at large. Reducing the costs of credit by shielding the parties benefitting from the credit relation from claims of outside parties cannot be justified from a policy perspective.[9]

2.2.3 Saving Viable Businesses and Jobs?

European insolvency law is changing from a tool that seeks to serve the interest of creditors by liquidating the assets into a tool that seeks to capture the going concern value by leaving the business intact. There are two methods that can be used to do this. The first is saving only the business by transferring the business going concern to a new owner, such as by means of a pre-pack.[10] The second method is to keep the business in the same legal entity and reorganize the capital structure, commonly referred to as a reorganization procedure.[11] The shift towards preventive restructuring procedures poses the question what is actually being pursued. Are reorganization procedures an alternative to

7 See IMF Fiscal Monitor with an assessment of the global levels of debt measured in relation to global GDP. See also C.E. Perotti on the risk of financial stagnation by an excess of credit and low demand. See https://cepr.org/voxeu/blogs-and-reviews/financial-stagnation. Perotti explains this process as the combination of a technologically driven drop in loan demand by firms, combined with an inelastic supply of savings.

8 J. Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law', *The Modern Law Review* 2000, p. 363.

9 Compare H. Hansmann & R. Kraakman, 'Toward unlimited shareholder liability for corporate torts', 1990 *Yale LJ* 100, p. 1879. One could reason that there is a possibility of a Kaldor-Hicks efficiency, if the gains would outweigh the losses by third parties, and the third parties *could* theoretically be compensated out of these gains. We would not like to subscribe to such reasoning, especially not if it is clear that such redistribution will not take place.

10 In case of pre-pack, the insolvency is prepared prior to the actual opening of an insolvency procedure by court order. The sale of all assets is formally executed after the opening by the court of a full blown insolvency procedure.

11 A reorganization procedure will provide for a plan offered to creditors and shareholders. This plan commonly provides that creditors accept that they do not get paid in full, but at least the same or more than in a liquidation ("no creditor worse off test"). The essential element of a reorganization procedure is that the financial health of a company is restored by reducing the outstanding debt.

liquidation because reorganisation better serves the interests of creditors? Or is the goal of reorganization procedures to serve society at large by saving viable businesses and jobs? This sounds sympathetic, but pursuing such diffuse goals bears the risk of benefitting the current owners of the legal entity, the shareholders, at the expense of creditors. Nonetheless, the more diffuse view of saving the company as a goal in itself has gained traction, both within academia and with legislators.

2.2.4 Goal of Insolvency Law: Internalizing Losses

The Creditors' Bargain Theory does not only provide an explanation of and a theoretical foundation for insolvency law. It also limits the scope of interests insolvency law should consider. Since the justification of insolvency law by the Creditors' Bargain Theory is found in its superiority as a debt collection device, the Creditors' Bargain Theory argues that insolvency law itself should *only* be concerned with protecting creditors' interests.[12] The strongest critique against the Creditors' Bargain Theory is aimed at this normative, prescriptive element of the Creditors' Bargain Theory.[13] Elizabeth Warren argues that insolvency law should adopt a more open approach. She mentions four principal goals

12 Jackson, loc. cit., p. 26: "Because the issues of who should have entitlements and how to address a common pool problem are distinct, they should be kept separate in the legal response. Nor is this simply an academic point. Bankruptcy law cannot give new groups rights and continue effectively to solve a common pool problem. Treating both as bankruptcy questions interferes with bankruptcy's historic function as a superior debt-collection system against insolvent debtors. Fashioning a distinct bankruptcy rule – such as one that gives workers' rights they do not hold under nonbankruptcy law – creates incentives for the group advantaged by the distinct bankruptcy rule to use the bankruptcy process even though it is not in the best interest of the owners as a group." See also R.J. de Weijs, 'TBTF as a game of chicken with the state: What insolvency law theory has to say about TBTF and vice versa', *EBOR* 2013/14, pp. 201-224.

13 Viewing insolvency as only concerned with the value maximization of creditors bears resemblance to viewing the goal of corporate law's as limited to shareholder value maximization, also referred to as the shareholder primacy model. Although the resemblance invites critical reflection, we should be careful not to reposition insolvency law in such a way that it benefits existing shareholders to the detriment of creditors. See also for criticism against a full creditor primacy model A. van Hees in 'De taak van de curator en maatschappelijke belangen', *TvI* 2023/25. He states that it would be strange to make all other interests a solvent debtor has to take into account all of a sudden as completely subordinate to the interest of the creditors because of insolvency (in Dutch): "Duidelijk is dat de curator bij die taakuitoefening met hun belangen rekening zal moeten houden, maar daarnaast ook met andere belangen. Van een a priori primaat van enig belang, in dit geval van de schuldeisers, is daarbij geen sprake. Een dergelijk primaat zou ook heel gek zijn. Vóór zijn faillissement had de schuldenaar immers behalve met de belangen van zijn schuldeisers, ook met veel andere belangen rekening te houden, zoals die van zijn leveranciers, afnemers en werknemers, maar ook maatschappelijke belangen zoals het voorkomen van gevaarlijke situaties of het voorkomen van milieuschade. Waarom zouden die andere belangen dan na zijn faillissement plotseling ondergeschikt worden aan die van de schuldeisers en er daarmee niet of nauwelijks meer toe doen?" See on the issue of the scope of interest the trustee has to take into account also J.M.W. Pool, 'Maatschappelijk verantwoord vereffenen: belangenpluralisme bij de maatschappelijke taakuitoefening van de curator', *TvI* 2022/20, pp. 134-140.

of insolvency law, of which only the first overlaps[14] with goals accepted by the Creditors' Bargain Theory:

1) to enhance the value of the failing debtor;
2) to distribute value according to multiple normative principles;
3) to internalize the costs of the business failure to the parties dealing with the debtor, and
4) to create reliance on private monitoring.[15]

The objective of insolvency law is indeed not and cannot be limited to protecting creditors' interests by overcoming common pool problems and anticommons problems. An ancillary goal is to force internalization of entrepreneurial risks to the stakeholders and to insulate the public at large from having to contribute (see point 3 above).

The paradigm that insolvency law should function in a way to shield the tax payer from having to make involuntary contributions to save failing companies forms the basis of the bulk of financial regulation since the global financial crises from 2008 onwards. The underlying policy goal is to prevent financial institutions that are Too Big To Fail to receive publicly funded bailouts rather than internalizing losses. Both the US Dodd Frank Act and its European equivalent, the Bank Recovery and Resolution Directive (BRRD), seek to prevent forced public bailouts.

We believe the response to the global financial crises shows the strength and importance of the analysis of Warren, i.e. that insolvency law should function in a way that protects society against the negative effects of business failures and that insolvency law should operate in a way in which it forces businesses and their stakeholders to internalize losses. This reasoning can also be applied to environmental harm. In case the government is not compensated for costs made or damage suffered in relation to environmental harm, this amounts to an Environmental Bailout.

One can question whether the same reasoning would apply to tax claims in general, in the sense that if the tax authorities are not paid in full, this too would amount to a bailout. We believe that is not the case. In case of normal taxes, the government can be compared to a normal operational creditor, charging for the use of public facilities.[16]

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14 Warren does not dismiss the insights provided by the Creditors' Bargain Theory, but rather dismisses its overreliance on efficiency analyses. See E. Warren, 'Bankruptcy policymaking in an imperfect world', *Michigan Law Review*, November 1993, p. 338: "If the enquiry over bankruptcy policy becomes nothing more than a debate over allocative efficiency, it will pass over crucial elements of the policy scheme that cannot be so neatly tied up in economic models. An approach that eschews any role for efficiency analysis suffers a similar fate, (..)."

15 E. Warren, 'Bankruptcy policymaking in an imperfect world', *Michigan Law Review*, November 1993, p. 334. See on this debate also R.J. de Weijs, 'TBTF as a game of chicken with the state: What insolvency law theory has to say about TBTF and vice versa', *EBOR* 2013/14, pp. 201-224.

16 In case of extension of tax payment obligations, as was the response during the COVID-19 pandemic in the Netherlands, one could even argue that the tax authority has repositioned itself as a financial creditor rather than as an operational creditor. A resulting analysis of viewing deferred taxes as claims by a financial

Claims resulting from environmental harm are different, because they do not relate to the normal operation of the business that the government in principle allows and often even stimulates, but subjects to taxation.

If one accepts – which we do – that one of the goals of insolvency law is the internalization of the costs of business failure to the parties dealing with the debtor and one applies this to environmental cases, there is a clear overlap with the goal of environmental law, enshrined in the polluter pays principle. Insolvency law extends this principle to the parties behind the polluter: if the polluter cannot pay, the parties that have been financing the polluter should pay. 'Pay' here, does not mean that the financiers should assume liability themselves. 'Pay' in this context could simply mean that the financiers do not receive a return on their investment or claim until environmental costs have been paid.

2.3 Possible Legal Strategies

In this report, we focus on the treatment of environmental claims in different insolvency procedures and make recommendations in order to ensure that the policy goals underlying insolvency and environmental law will be achieved. Other instruments may also influence the realization of the policy goals discussed and changes to these instruments could be considered as an alternative or addition. We do not discuss these instruments at length, but mention the most evident alternatives:

- The first alternative instrument is to hold shareholders unlimitedly liable for corporate torts, including environmental torts. Limited liability is hard to justify in relation to tort claimants.[17] A popular view to approach corporate law is to view the company as a default contract between all stakeholders, with limited liability of the shareholders vis-à-vis creditors as one of the most important rules. If limited liability is viewed as a standard *contract* term, it becomes difficult to apply this to tort creditors.[18]

creditor is that it would be at odds with the underlying premise of the WHOA to demand a debt write down of operational creditors as part of the tax authorities accepting a write down of their position as a financial creditor.

17 H. Hansmann & R. Kraakman, 'Toward unlimited shareholder liability for corporate torts', 1990 *Yale LJ* 100, p. 1879.

18 See more extensively J.L. Smeehuijzen, 'Aansprakelijkheid van de moeder bij onrechtmatige daden van de dochter', *NJB* 2021/2813. He argues that veil piercing towards the shareholder for tortious liability should be conceptualized differently and probably broader than in relation to unpaid contractual creditors such as unpaid suppliers. See on veil piercing as to corporate groups B. Katan and D. Stein, 'De "onderneming' in het aansprakelijkheidsrecht", *Preadviezen 2023*, Vereniging voor de vergelijkende studie van het recht van België en Nederland.

- Another alternative instrument is to hold directors liable. Directors are the ones running the company. It should, however, be realized that directors' liability does not really *internalize* risk. The director is not a stakeholder themselvesin the same way as shareholders and creditors. One could also argue that directors' liability deflects attention and scrutiny in an undesirable way. Attention is shifted away from the financiers of polluting companies, i.e. the shareholders and creditors, especially secured creditors.
- A third alternative instrument is to weaken the position of secured lenders vis-a-vis environmental claims. US scholar D'Onfro provided a new perspective by conceptualizing secured creditors more as investors rather than a regular creditor.[19] It is well-accepted that property rights come with responsibilities. Security rights are derived from property. If a property owner encumbered all his assets and does not provide recourse in case of environmental harm, one may question whether the secured creditors as the party that now de facto enjoys the benefits of ownership because of its exclusive recourse on such property, should not also carry the burden created by the environmental harm. See along similar lines the more recent proposal by Van Moorsel and Jonasse to provide a preferred claim to tort victims that would also rank above secured creditors.[20]
- A fourth alternative instrument is to require insurance for all activities with a risk of creating environmental harm. The legislator can require mandatory insurance for known risk creating behavior. This approach is increasingly being taken, and the new Dutch Environment and Planning Act provides for this possibility.[21] See further Section 4.2.1 below.
- A fifth alternative instrument is to impose successor liability. Successor liability is much more common under US law, for example for environmental claims, but also for personal injury claims. The question whether there is something like successor liability is important in any asset sale, also out of bankruptcy including, of course, prepacks. Its importance goes much further and should be seen in connection with rules on reorganization procedures. In case a jurisdiction would not allow for discharge of

19 See D. D'Onfro, 'Limited Liability Property' (2017), available on https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2940378.

20 See R.C.M. van Moorsel & S.B. Jonasse, 'Insolventierecht is failliet bij milieuschade', *M&R* 2023/64, pp. 481-489. They propose the following (in Dutch): "De gelaedeerden verkrijgen collectief een bijzonder wettelijk verhaalsrecht op alle activa van de onderneming ten belope van de volledig door de gelaedeerden geleden schade (de 'Vordering')."

21 See Art. 13.5 OW: Bij algemene maatregel van bestuur worden gevallen aangewezen waarin aan een omgevingsvergunning die betrekking heeft op een activiteit die significante nadelige gevolgen voor de fysieke leefomgeving kan hebben, het voorschrift wordt of kan worden verbonden dat degene die de activiteit verricht, financiële zekerheid stelt: a. voor het nakomen van verplichtingen die op grond van de omgevingsvergunning voor diegene gelden, of b. ter dekking van zijn aansprakelijkheid voor schade aan de fysieke leefomgeving als gevolg van die activiteit. See on this new legislation, R.C.M. van Moorsel & S.B. Jonasse, 'Insolventierecht is failliet bij milieuschade', *M&R* 2023/64, pp. 481-489.

certain liabilities as part of a reorganization procedure, but such jurisdiction would allow for shedding these liabilities as part of an asset deals out of insolvency, that would of course open that door to greatest possible extent. The clearest example of successor liability in Europe is TUPE (Transfer of Undertaking and Protection of Employees), where both the contract and liabilities do not only attach to the company, but also attach to the business itself. In case of a successor, the acquirer becomes the new employer.

In this report we will focus on the he possible legal response that a rule providing environmental claims cannot be discharged in a reorganization procedure. Examples of this approach in other fields are the non-dischargeability of public student loans under a debt relief for natural persons and non-dischargeability of claims for reclaiming state aid under a reorganization plan.[22] In exploring the potential for such a rule of non-dischargeability, we distinguish between private law claimants and public law claimants.

3. Private Law Environmental Claims in Liquidation and Reorganization Procedures

In the following sections, we discuss the treatment of private law environmental claims in liquidation and reorganization procedures. We do not discuss the suspension of payments (*surseance van betaling*) procedure. This procedure, which could be used to offer a plan to pari passu ranking creditors, is not used much. Furthermore, its design and the protection offered to creditors are outdated compared to the WHOA reorganization procedure. The WHOA is of a much more recent date and the policy discussions and political debate leading up to its enactment in 2020 should also be kept in mind when contemplating the possibilities of the suspension of payment procedure. In case of friction, it makes much more sense to interpret the suspension of payment towards the WHOA than the other way around.

3.1 Nature of Environmental Private Law Claims

A private law claim arising from environmental harm will usually be based on tort (Art. 6:162 DCC). Such claims can, for example, relate to pollution of land or to illnesses incurred through pollution. In order for a claim arising out of tort to exist,

22 See Art. 362 Fw that is also applicable in case of a WHOA.

all requirements for tortious liability will have to be met, including that damage has been suffered.[23] Both existing and future private law environmental claims can, subject to conditions, be included as a claim in liquidation proceedings. In a WHOA reorganization, existing environmental claims can technically be included but under circumstances cross-class cram down may prove controversial. Future claims can technically not be included, but there may be room for exceptions.

3.2 Ranking and Claim Validation of Private Environmental Claims in Liquidation Proceedings

Private law environmental claims do not in general enjoy a special status under Dutch insolvency law. An exception is the category of claims by owners (or other exclusive users) of property, for example a plot of land, against the debtor to stop interfering with their property rights. In the environmental context, waste left on rented premisses is one such example. Private law claims for cleaning up waste can enjoy a status as claims against the estate that have to be settled before pre-insolvency creditors are paid.[24]

T.T. van Zanten contemplates that many bankruptcy trustees find it peculiar that, despite a bankruptcy or even a bankruptcy of the estate, there are parties who are not creditors out of a contractual relation, who still have claims that must be immediately and fully satisfied. Van Zanten, however, thinks this is justified (in translation):

> I think the answer should not only be that the trustee simply has to comply with objective law, but also that creditors would otherwise receive more than they are entitled to. The bankruptcy estate may include assets that have a negative value, and the trustee must also include those assets in the settlement. I find the idea appealing that creditors are only entitled to the balance, meaning what remains after that settlement has taken place.[25]

Following Van Zanten's line of reasoning, we suggest that this approach could be more widely adopted for private environmental claims. This neatly fits with the polluter pays principle and the insolvency law principle that forces internalizations of risk. We could assume that environmental claims should be deducted before the balance that creditors are entitled to is paid.

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23 See HR 24 May 1991, ECLI:NL:HR:1991:ZC0247, with annotation P. van Schilfgaarde. See on the requirements also I.E.J. Bakker, 'De toepassing van Credit Suisse/Jongepier q.q. op bestuurlijke handhavingskosten', *TvI* 2024/9, pp. 66-76.

24 Dutch Supreme Court 19 April 2013, ECLI:NL:HR:2013:BY6108, *Koot Beheer/Tideman q.q.*; Dutch Supreme Court 31 March 2017, *NJ* 2018/142, annotation F.M.J. Verstijlen (*VKP/Curatoren Aldel*).

25 T.T. van Zanten, *Classificatie van verplichtingen in faillissement*, Deventer: Wolters Kluwer 2022, para. 2.4.

If private law claims do not enjoy such special status, creditors can be admitted to a liquidation procedure by validating their claim. Not every claim can be validated. Existing claims can of course be validated. However, the scope of claims that can be validated is larger. Claims that come into existence after the opening of insolvency proceedings can still be validated if they arise out of rejection or misfeasance under executory contracts concluded with the debtor (Art. 37a Fw). However, the scope is still broader, as was ruled by the Supreme Court in the case *Credit Suisse v. Jongepier qq*. The court introduced the criterion of admissibility of claims if they "arise out of an existing legal position in relation to the debtor". This provides room to allow for validation of future tort claims in a liquidation procedure.

Liquidation procedures have a clear and structured claim validation process. A creditor can file its claim for validation with the court appointed trustee. The trustee prepares a list of accepted and disputed claims prior to the claim validation meeting.[26] The supervisory judge presides over the claim validation meeting,[27] at which other creditors can dispute the validation of a claim.[28]

Creditors seeking validation of their claim have a clear incentive to do so, because they will share in the distribution of value, if admitted. Other creditors have a clear incentive to scrutinize and dispute the admission of claims, since the more claims are admitted, the lower the pay-out will be.

3.3 Claim Inclusion of Private Law Environmental Claims under the WHOA

Claim inclusion under the WHOA is a different concept than claim validation under liquidation procedures. The issue of existing versus future claims also becomes more pressing.

3.3.1 Claim Inclusion of Existing Private Law Environmental Claims under the WHOA

Technically, nothing prevents existing private law claims related to environmental harm to be included in a WHOA reorganization. This means that creditors vote in classes on the reorganization plan and that the court can declare a plan that meets the criteria binding on all claimants and shareholders, including tort claimants with environment-related claims.

If the environmental harm inflicted by the debtor has led to mass tort claims, one can however doubt whether WHOA reorganization is available to the debtor in order

26 Art. 112 Fw.
27 Art. 119 Fw.
28 Art. 122 Fw.

to settle these claims. So far, there have not been any WHOA cases involving mass tort damages. Although tort claims can, in principle, be included in a WHOA plan, nothing shows that the legislator intended the WHOA to be a device for dealing with mass tort claims, nor has the legislator consider the possibility that the WHOA would be used as such.

Dutch law does have an opt-out mass damage litigation procedure outside bankruptcy, the WAMCA (*Wet Collectieve afwikkeling Massaschade in Collectieve Acties* – Act on the Settlement of Mass Claims in Collective Action). The relation between the WAMCA and the WHOA is unclear.[29]

An indicationthat the WHOA was *not* intended to settle mass tort claims relating to environmental harm is provided by the explanatory memorandum to one of the adopted amendments that were made during the legislative procedure leading to the WHOA. In this explanation to the amendment concerning the inclusion of a 20% minimum payment to certain weak parties such as small businesses, the drafters suggested that it is assumed that claims by consumers cannot be restructured in a WHOA proceeding because of mandatory consumer law.[30] Oddly, the rules of the WHOA itself do not include a provision excluding consumer claims. If consumer claims cannot be included because of (the policy goals behind) mandatory consumer law, it is a small step to exclude mass tort damages from inclusion. One could even argue that any argument against inclusion of consumer claims would apply a fortiori to tort claims, because of the involuntary nature of tort claims.

Inclusion of mass tort claims would be especially controversial if the reorganization plan would be forced on the class of tort claimants through a cross-class cram-down. Under the WHOA, a majority in just one class of the money claimants can, subject to conditions, be sufficient to force the plan in a cross-class cram-down on the other classes. In our view, if the main problem leading to the need for restructuring is a mass (environmental) tort, the court should at least require a majority in favor of the plan in the class of tort claimants.

On this issue, see also a previous NACIIL annual meeting, where the issue of mass tort was discussed. Tavakolnia reported the following on the discussion that took place on the more specific issue of non-consensual third-party release in a cross-class cram-down:

> In theory, mass tort defendants could use the cross class cramdown to enforce non-debtor releases. But when questioned by attendees on the fairness of such an outcome, Hermans stresses: "In practical terms, I simply cannot imagine a

29 See extensively, A. Tavakolnia, 'Insolventierecht als panacee voor massaschade aansprakelijkheid?', *TvI* 2023/27, para. 2.

30 *Parliamentary Papers*, 2019-2020, 35 249, nr. 25.

> Dutch bankruptcy court cramming down a class of tort creditors dissenting to a plan which releases third parties of liability precisely to these tort creditors, only by virtue of a majority vote by an unaffected in-the-money class".[31]

Non-consensual third-party releases are generally not possible under the WHOA. In that sense, it is obvious that a non-consensual third-party release cannot be forced on a large group of tort creditors by virtue of a majority vote by an unaffected in-the-money class. Still, Hermans' statement voices some general unease about cramming down mass tort creditors. As stated above, we would go further and state that not only third-party releases cannot be forced on mass tort creditors, but that a cross-class cram-down of mass tort creditors should not take place. The WHOA was not intended for settling mass torts. The extensive explanatory memorandum to the WHOA does not even mention tort creditors. The WHOA was intended to deleverage overindebted companies and was supposed to target financial creditors, rather than operational creditors such as trade creditors. The suggestion has clearly been made that consumers should simply not be included, but legal instruments can of course develop. The WHOA would become somewhat of a Trojan horse, however, if the full arsenal of cross-class cram-down measures with a laissez-faire interpretation of the already flexible priority rules were used against tort victims. If the WHOA would be used in a mass tort case, the least that should be required is the support of a majority in the class(es) of tort creditors.

3.3.2 Claim inclusion of future private law environmental claims under the WHOA

Environmental claims often linger for a while before surfacing. The most controversial question regarding inclusion of environmental claims in the WHOA is whether it is possible to include creditors who do not even identify themselves as tort claimants yet. This could be the case when they have no knowledge of the (extent of) the damage or of the identity of the liable tortfeasor yet, although they have already suffered damage. Examples are consumers buying defective goods of which the defective nature remains hidden, or persons suffering from adverse health effects that only surface long after the exposure to certain pollution.

The European Preventive Restructuring Directive allows the Member States the possibility to include future creditors in a plan. Preamble 64 states the following:

> The binding effects of a restructuring plan should be limited to the affected parties that were involved in the adoption of the plan. Member States should be able to determine what it means for a creditor to be involved, including in the case of unknown creditors or creditors of future claims. For example,

31 See A. Tavakolnia, 'Third-Party Releases in Modern Insolvency Law: efficient claim resolution or obscure bypass?', Conference Report NACIIL Annual Meeting 2022, *FIP* 2022, 194, p. 13.

> Member States should be able to decide how to deal with creditors that have been notified correctly but that did not participate in the procedures.

Article 385 Fw provides that a WHOA plan is binding on all creditors that are entitled to vote. Article 381 Fw provides that all creditors whose claims are changed under the plan are entitled to vote. A debtor could drag potential creditors into a plan by changing their rights. The WHOA applies a loose approach to which creditors can be bound by the WHOA plan. Article 374 Fw provides that different classes of creditors and shareholders will be formed to ensure sufficient similarity of interests. In case of disputes, the debtor can request the court to rule as to the specific aspect of class formation and in this context also as to class inclusion (Art. 378 sub 1c and sub 4 Fw). The ultimate test will be found in Article 371 sub 1 Fw. Here, the law provides that a debtor can offer its creditors and shareholders a plan that changes their rights. A double test is applied, i.e. that the party needs to be a creditor and that there is a right that is changed.

Mennens argues that under the WHOA only *existing* claims can be included in a plan on the basis of Article 371 Fw. She also explicitly contrasts this with a broader approach in the UK under the Part 26 Scheme and the *Global Garden Products*[32] case, where future claims of employees exposed to asbestos were also included in a Scheme. Mennens offers two main arguments as to the non-inclusion of future claims. First, a prior draft of the WHOA included such a possibility. After being subjected to criticism by Tollenaar[33] and Beekhoven van den Boezem & Mennens[34] herself, this specific provision was removed from the draft. In addition, there is a separate article in the WHOA that allows to change executory contracts to prevent the build-up of future claims. If it was already possible to change future claims, this would not be necessary. The first argument[35] weighs heavily in our view. Also, Advocate-General Snijders is of the view that future claims cannot be included under a WHOA plan.[36]

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32 *Re Global Garden Products Italy SpA* [2016] EWHC 1884 *Ch), nr. 5-6. See A.M. Mennens, *Het dwangakkoord buiten surseance en faillissement* (Kluwer 2020), p. 449.

33 N.W.A. Tollenaar, *Het pre-insolventieakkoord. Grondslagen en raamwerk* (diss. Groningen), (Kluwer 2016) in paras. 8.2.8, 8.10 and 10.4, via Mennens (loc. cit.), p. 447.

34 A.M. Mennens & F.E.J. Beekhoven van den Boezem, 'Wijziging van toe- komstige verplichtingen middels een dwangakkoord buiten insolventie: toekomstmuziek?', *TvI* 2015/32.

35 Although we do subscribe to the conclusion that only existing rights can be altered under Art. 371 Fw, we do not really subscribe to the second argument. The treatment of existing executory contracts and resulting obligations and rights on both sides does deserve its own place, already because the contract does exist but the future claims do not, and, at the same time, the legislator and court cannot simply only intervene in the claim side of such executory contracts.

36 See A-G Snijders in his conclusion for IHC (Conclusion, 26 March 2024, ECLI:NL:PHR:2024:346), in Dutch in full: "Afgaande op de wettekst en de wetsgeschiedenis en gelet op de hiervoor in 4.1 en 4.2 genoemde gezichtspunten maakt de WHOA dus alleen een akkoord mogelijk waarbij bestaande rechten van schuldeisers worden gewijzigd. Wijziging van toekomstige rechten en wijziging van overeenkomsten voor zover deze iets anders inhouden dan een wijziging van rechten, kan alleen plaatsvinden langs de weg van art. 373 Fw. Het opleggen (van wijzigingen) van verplichtingen van schuldeisers is dus niet mogelijk (gemaakt) in de WHOA."

However, J.L. Snijders (not the Advocate-General) is of the view that in general future claims should also qualify for inclusion in a plan. He argues in favor of alignment of the possibilities of claim inclusion under the WHOA and claim validation under liquidation.[37]

As seen above (Section 3.2), there is ample room for admitting future claims in a liquidation procedure, following *HR Credit Suisse v. Jongepier q.q*. The question is whether the same rules should apply under the WHOA. Under liquidation procedures generous admissibility of claims can protect the interest of claimants and would thereby strengthen their position. Allowing for claim validation will normally mean some payout. Under a WHOA procedure, however, broad inclusion could weaken the position of future claimants. Inclusion in a WHOA procedure normally means a, possibly forced, debt write down. This difference in outcome and effect is often overlooked.[38] Not only are the effects are completely different, the initiative also lies with a different party. Under claim validation, the initiative lies with the creditor. The creditor can make its own assessment of how to best protect its interests. In the case of a WHOA, the offering of a plan, class formation and who to include, all lie with the debtor or, if appointed, with the restructuring expert, but *not* with the creditor.[39] The opposed outcomes and the opposed governance rules lead us to argue against an alignment of claim validation under liquidation procedures and inclusion criteria under the WHOA, especially in the field of tort claims related to environmental harm.

On the basis of legislative history and existing literature, one can easily argue against inclusion of future claims, especially those of tort creditors. This is possibly in the end also the best protection that can be given to future tort victims, i.e. that their claim cannot be included in a plan and can therefore not be written down in any way. This

37 J.L. Snijders (not the A-G) writes: "Naar mijn mening hoeft een dergelijk (scherp) onderscheid niet te worden gemaakt en zouden ook toekomstige verplichtingen onder de reikwijdte van art. 370 lid 1 Fw kunnen vallen. Het zou naar de huidige stand van de rechtspraak omtrent de fixatie van het passief in faillissement tot een discrepantie tussen faillissement en WHOA leiden als een dergelijk onderscheid bij de WHOA zou worden gemaakt. Het lijkt mij voor de hand liggen om juist aansluiting te zoeken bij het criterium dat van toepassing is bij faillissement bij de vraag of vorderingen voor verificatie in aanmerking komen."

38 This is of course understandable, if one takes the approach that a higher claim of one creditor, will result in a lower pay out to others. Therefore, quite rightly, pleas have been made for some kind of fixation principle under the WHOA to be combined with a more formal claim validation procedure. See for an example of this reasoning J.L. Snijders, 'Fixatiebeginsel en de WHOA, *FIP*, 2021/172, p. 21: "Uiteindelijk gaat het bij de WHOA net als bij faillissement om de vraag hoe groot de taart is en wie daar aanspraak op mogen maken."

39 As to governance, the WCAM falls in between. It is usually not the creditor but the debtor that defines the group of creditors and that takes the initiative to offer a settlement to this group, but at the same time the individual creditor (or claimant) has the possibility of opt out during the process. The WAMCA is again different. The initiative in a WAMCA is taken by a representative organization that represents creditors and defines the group of creditors to include, and creditors can opt out if they do not want to be represented.

approach could, however, also turn against the interest of tort creditors, even future tort creditors. Tavakolnia[40] raised awareness that a ban against inclusion of future claimants could result in premature liquidation. This exclusion of future claimants and an early liquidation could benefit existing and early tort claimants. The total value for distribution would be lower, but there would also be far fewer claimants, which would result in a higher pay out to existing and early tort claimants.

One could, therefore, think of allowing inclusion of future tort claimants, but only with several additional safeguards in place, most notably a strict compliance with the Absolute Priority Rule. The current WHOA priority rule is ambiguous, and it is difficult to pinpoint its position on the spectrum of EU Relative Priority, at one end and Absolute Priority, on the other. In the case of mass tort, the WHOA Priority Rule should be interpreted in the strictest sense with regard to the relation of tort victims to shareholders.[41] Any future claimant would need to be treated as if they were voting against the plan. In addition, all residual value would need to go to the creditors, also giving the tort creditors equity in the company. This approach is in line with the position taken by Ralph Brubaker under US law and the application of APR in cases with future creditors. He argues as follows:

> Although there is some uncertainty in the case law regarding the implications of an impaired class for which none of the holders of claims in that class have cast a vote on the plan, at least in this particular context, protection of the relative priority rights of future claimants (vis-à-vis both present claimants and equity interests) would seem to compel the conclusion that a class of future claimants (who are unable to participate in the plan process at all) simply cannot be presumed to have accepted the plan and, thus, should be entitled to the full panoply of cramdown protections.[42]

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40 See also footnote 1.

41 The APR is complex rule in itself, as it governs many possible value allocation disputes. The essence is to be found in the question whether old shareholders can retain value while a class of dissenting creditors has not been paid in full. We refer to this as the application of the APR *across* the debt-equity divide. The APR is sometimes also invoked as to value allocation disputes of creditors amongst each other, e.g. the full payment of trade creditors where preferred higher ranking creditors are not paid in full. We refer to this as the application of the APR *above* the debt-equity divide. The importance of the APR is less important above the debt-equity divide than across the debt divide. It is almost unimaginable that trade creditors would deploy a WHOA procedure opportunistically against the tax authorities. This could of course be done by bond holders, especially if they embark on a loan to own strategy. Since the APR governs different kind of disputes and different kinds of opportunistic behavior, ideally the APR would be separated into two separate rules; one governing disputes with the old shareholder *across* the debt equity divide and the other amongst creditors *above* the debt equity divide. If we call for strict application of the APR in case of cross-class cram-down, we only mean the APR in relation to the old shareholders. This does not mean that preferred or secured creditors should be able to easily get rid of tort creditors.

42 R. Brubaker, 'Assessing the legitimacy of the "Texas-Two-Step" mass-tort bankruptcy', *Bankruptcy Law Letter*, 2022/42, p. 8.

3.4 *Discharge of Environmental Claims in Prepackaged Liquidation May Be Problematic*

A liquidation procedure can involve a sale of all or part of the assets as a going concern business to a buyer. That the buyer of the assets is not liable for the private law debts of the bankrupt entity is uncontroversial. The claims against the bankrupt entity still rest on the bankrupt entity and must be settled from the proceeds of the liquidation, including the proceeds of the asset sale to the buyer. In most cases, this means that the claimants, including private law claims related to environmental harm, get paid little to nothing on their claims, although the business continues as a going concern under the wings of the new owner. This may seem controversial at first but can benefit the creditors given that a going concern sale can maximize creditor value because this may fetch a better price for the assets.

This practice becomes questionable in a pre-pack procedure, which is a method of preparing for bankruptcy in order to maximize value and preserve employment. A takeover of the business is pre-arranged, before bankruptcy and usually in private, and executed just after bankruptcy. The takeover is technically an asset sale out of liquidation. The old legal entity will be liquidated and will cease to exist. Most Dutch lower courts have experimented with the pre-pack procedure, although there is no legal basis in Dutch law for such a procedure. There have been proposals for introduction of a legal basis, but these proposals have been mired in controversy, also because of the case law on employees' rights as detailed below.

Although a pre-pack makes use of a liquidation procedure, the crucial difference between a pre-packaged bankruptcy and a regular bankruptcy is that continuation of the going concern business can arguably be seen as the primary objective of the procedure, whereas a normal bankruptcy procedure is primarily aimed at liquidation, with the possibility of continuation of the business through an asset sale as a tool to maximize creditor value. Because of this dual nature of the pre-pack (both liquidation and continuation), leaving unpaid creditors behind in the bankrupt entity becomes harder to justify. Pre-packs are also more prone to abuse as the old business owner can maintain control by acting as the buyer and can orchestrate this prior to bankruptcy.

Because of the policy goals underlying both environmental law and insolvency law (see Section 2 above), the question whether one can shed environmental claims in a pre-pack procedure is more controversial than the possibility to shed other types of claims in a pre-pack. A comparison can be made with employees' rights, which are also generally seen as more deserving protection than the rights of general commercial claimants. The European Directive on the protection of employees' rights during company transfers, also known as the Transfer of Undertakings and Protection of Employment Direc-

tive (TUPE Directive),[43] aims to shield employees from dismissal and adverse changes in their position due to structural or managerial changes within their company. This directive ensures that employment contracts' rights and obligations are automatically transferred from the transferor to the transferee. In the Netherlands, this has been implemented in Article 7:663 Dutch Civil Code (DCC), ensuring comprehensive transfer of employment-related obligations to the new operator of the company, including liabilities like back pay and granted vacation periods.

Article 4 of the directive stipulates that a company transfer itself is not a valid reason for dismissal, except for dismissals due to economic, technical, or organizational reasons (ETO reasons). The directive has been modified over time, with significant clarifications provided by the European Court of Justice, particularly in the *Abels* case.[44] The court highlighted the exceptional nature of insolvency law and the balance between protecting employees and ensuring the feasibility of business transfers from bankrupt entities. The court concluded that Member States could choose whether the TUPE Directive applies in bankruptcy scenarios.

The TUPE Directive specifies that it does not apply in bankruptcy aimed at liquidation unless Member States decide otherwise, as noted in Article 5. The current Dutch implementation explicitly excludes the application of the directive in bankruptcy, stating that the provisions on the transfer of undertaking are not applicable in such cases. This exclusion is detailed in Article 7:666 DCC. The possibility of dismissals on ETO grounds during bankruptcy transfers has not been incorporated into Dutch law as the application of the TUPE Directive is excluded by Dutch law in case of bankruptcy. There is, however, a draft bill (for consultation purposes) that aims to limit the exclusion of the directive's application in bankruptcy to small enterprises with fewer than twenty employees. For all other companies, the proposal simply assumes that employees will transfer. The transfer, however, is envisioned not automatically but by employees receiving an offer from the acquirer. The proposal does allow for dismissal on broadly interpreted ETO grounds during bankruptcy by the trustee. In that case, these employees will not get an offer.

The pre-pack procedure has raised questions on compatibility with the directive's principles. The European Court of Justice has examined cases like *Smallsteps*[45] and *Heiploeg*,[46] assessing whether pre-pack procedures aimed at business continuity rather

43 Directive 2001/23/EC of the European Parliament and of the Council of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

44 Case 135/83, *H. Abels v. Administrative Board of the Bedrijfsvereniging voor de Metaalindustrie en de Elektrotechnische Industrie*, Judgment of the Court (Second Chamber) of 7 February 1985, ECLI:EU:C:1985:55.

45 Case C-126/16, *Federatie Nederlandse Vakvereniging (FNV) v. Smallsteps BV*, Judgment of the Court (Grand Chamber) of 22 June 2017, ECLI:EU:C:2017:489.

46 Case C-472/19, *Vereniging van werknemers in de visserij (VVV) and Others v. Heiploeg Seafood International BV and Others*, Judgment of the Court (First Chamber) of 28 October 2020, ECLI:EU:C:2020:880.

than at liquidation align with the directive. The court has provided nuanced rulings, indicating that pre-pack procedures may fall under the directive's exceptions, but only if they are structured in a specific way and court supervised to ensure fair outcomes for employees and creditors. Much ink has been spilled on the issue. The legal debate revolves around the question whether the pre-pack was undertaken with a view to liquidate the enterprise.

There is no European regulation yet that imposes environmental tort liabilities on the transferee of an undertaking. Such a regulation could have similar effect to TUPE, but for the environment: a TUPE-II, with rules on Transfer of Undertaking and Protection of Environment. Outside of the insolvency context, such successor liability seems less necessary compared to employee rights. In the insolvency context, and especially pre-packaged insolvency, there is a case for imposing environmental claims on the transferee. The effect of TUPE-II would be that the transferee would pay less for the enterprise, because of the environmental damage claim attached to the business. The justification for a TUPE-II Directive can be found in the constitutional principle that the polluter pays (Art. 191(2) TFEU). The polluter is then conceived broadly as not just the legal entity, but also its commercial stakeholders. Costs are then not so much only internalized to the company, which in the end is little more than a legal fiction, but will be internalized to the shareholders and the creditors.

There are good reasons to do this. Shareholders are the ultimate beneficial owners and therefore also possess the dominant voice outside of insolvency. Upon declaration of insolvency, both the economic entitlement and governance are transferred to the creditors.[47] Jackson presents insolvency law as a kind of expropriation of shareholders for the benefit of creditors. He states:

> In bankruptcy the unsecured creditors of an insolvent debtor can be viewed as the new equity owners of the debtor and hence *entitled* (emphasis added, authors) to what the debtor was entitled to outside of bankruptcy.

See similarly Armour, Hertig and Kanda:

> If the firm defaults on payment obligations, its creditors become entitled to seize and sell its assets. At this point, the creditors change roles: they become, in a meaningful sense, the owners of the firm's assets.[48]

47 See R.J. de Weijs, 'Harmonisation of European Insolvency Law and the need to tackle two common problems: common pool & anticommons', *IIR*, 2012, 21/2, pp. 67-141, also available on: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950100.

48 See J. Armour, G. Hertig & H. Kanda, 'Transaction with creditors', *in* R. Kraakman et al. (eds.), *The Anatomy of Corporate Law*, Oxford, Oxford University Press, 2009, pp. 115, 116.

Although insolvency law is concerned with entitlements of creditors and the question of who gets what, it is undeniable that the creditors take over the economic position of the previous owners. One could say that the creditors are owners next in line after the shareholders, or that creditors are already conditional owners. If the goal of environmental law is to internalize costs, it merits to include these conditional owners as well. To accept some kind of conditional economic ownership of creditors, one can simply look at what happens both in governance terms and in terms of economic entitlement upon declaration of insolvency.

The effects of a TUPE-II rule for liability of acquirers in case of pre-packaged bankruptcies would be that less proceeds will be available to creditors. In practice, this would mainly result in less funds being available to secured creditors. Secured creditors are usually financial creditors. They do not make money of delivering goods or specific services, but extend credit to a company and thereby take a share in the entrepreneurial risk of the company. The claims of secured creditors rank higher than the subordinated position of shareholders, which is reflected in a lower risk and, therefore, in a lower payout to secured creditors in case of success. These dynamics are similar to the distinction between common shareholders and preferred shareholders. The company's capital structure thus reflects interconnected agreements of who gets how much in case of success and who gets how much in case of failure. Along the lines of the work of D'Onfro, one could question whether secured creditors are not given too comfortable a position, with the highest-ranking claim without any responsibility. Creating an environmental liability that attaches to the enterprise and thereby a liability that could not be shed by a pre-packaged insolvency procedure, would internalize the costs of environmental harm with such creditors. A TUPE-II rule would simply and effectively ensure a clean waterfall in case of insolvency.[49] Not only do these financial creditors have a strong influence on the company. Also, the only non-generic characteristic of the product delivered by banks can be defined in relation to characteristics of the borrower. A counter argument might be that such measures would increase the cost of credit. If the costs of credit for polluting activities would increase, that would be a good thing, a sign of successful internalization of environmental costs.

European insolvency law seems keen, however, to take a different turn. The draft Article 28 of the proposal for a directive seeking to harmonize certain aspects of insolvency law, including pre-packs,[50] provides:

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49 See for the metaphor G. Ballerini, 'Ensuring a clean waterfall: Different strategies to deal with environmental claims in insolvency', Presentation Amsterdam Centre for Transformative Private Law, 29 January 2024.

50 Proposal for a Directive of the European Parliament and of the Council harmonizing certain aspects of insolvency law, COM(2022) 702 final.

> Debts and liabilities of the business acquired via the pre-pack proceedings: Member States shall ensure that the acquirer acquires the debtor's business or part thereof free of debts and liabilities, unless the acquirer expressly consents to bear the debts and the liabilities of the business or part thereof.

The drafters of this proposal see potential for the pre-pack in leaving all old liabilities behind. More generally, the proposal for a European pre-pack aims to revive the pre-pack to the furthest extent.[51] The draft even explicitly addresses environmental liabilities. The preamble of the European Proposal for Harmonization states the following as to the compliance of the proposed provisions with the Environmental Liability Directive:

> The proposal is also coherent with the Directive 2004/35/EC of the European Parliament and of the Council, which aims to limit the accumulation of environmental liabilities and to ensure compliance with the "polluter pays" principle. Directive 2004/35/EC[52] obliges Member States to take measures to encourage the development of financial security instruments and markets by the appropriate economic and financial operators, including financial mechanisms in case of insolvency, with the aim of enabling operators to use financial guarantees to cover their responsibilities under Directive 2004/35/EC. These mechanisms aim to ensure that claims will be served even in cases where the debtor becomes insolvent. The proposal does not interfere with those measures under Directive 2004/35/EC. On the contrary, a more efficient insolvency framework would support a speedier and more effective recovery of asset value overall and hence would facilitate the compensation for environmental claims against an insolvent company even without having recourse to financial security instruments, in full consistence with the aims of Directive 2004/35/EC.

This preamble suggests that there is nothing to prevent the discharge of environmental claims in insolvency and pre-packaged insolvency procedures, and that this would even be beneficial to the environmental claimants. We rather strongly suggest that the polluter pays principle could dictate otherwise.

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51 The European proposal basically seeks to negate the line of cases of the CJEU that provided that TUPE was applicable in case of certain pre-packs. See Art. 20 proposed Directive, Relationship with other Union legal act: For the purposes of Art. 5(1) of Council Directive 2001/23/EC 40, the liquidation phase shall be considered to be bankruptcy or insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of a competent public authority.

52 See Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ L 143, 30.04.2004, p. 56).

4. Public Law and Public Claims in Insolvency

4.1 Environmental Claims: Public and Private Law

There are a myriad of sources of environmental claims. In this report, we primarily discuss environmental claims by the government against a polluter based in public law. We understand 'government' to include government agencies and local governments, such as municipalities and provinces. We will in short discuss claims by the government based on private law when pursuing public goals. We will not discuss criminal law,[53] nor private law environmental claims by the government as a private actor, such as when that government property has suffered environmental damage.

4.1.1 Public Law Claims: Administrative Law Enforcement of the Environment and Planning Act

Since January 2024, there has been a new overarching legislative act on environmental law in the Netherlands: The Environment and Planning Act (*Omgevingswet*, hereafter: OW). The Environment and Planning Act is primarily administrative law and is a comprehensive piece of legislation designed to streamline and simplify the regulatory framework governing spatial planning, environmental management, and public works in the Netherlands. Enacted to replace and integrate numerous existing laws, the Environment and Planning Act aims to create a more efficient, coherent, and flexible system for managing the physical living environment. As will be seen, administrative sanctions enforcing the Environment and Planning Act can result in claims against an insolvent debtor. In that case, the ranking of administrative sanctions will compete with private law claims. We discuss the Environment and Planning Act below, although other specific acts also continue to play a role in environmental law, not only as a transitional regime.

The new central provisions are to be found in Article 1.6 and 1.7 OW, which lay down general duties of care for the environment. In the event of a violation of Article 1.6 and 1.7 OW and/or more specific provisions, administrative law may be enforced by imposing an administrative enforcement order (*handhavingsbesluit*). The authority for this enforcement is given in Article 18.4 OW to the minister and in Article 125 Municipal Act (*Gemeentewet*), Article 122 Provincial Act (*Provinciewet*) and Article 61 Water Board Act (*Waterschapswet*) to decentralized bodies. Article 18.2 OW determines when which government has the power of enforcement.

Ifan enforcement order is not complied with, the competent government may resort to administrative coercion (*bestuursdwang*). Administrative coercion is regulated by

53 Criminal provisions may play a role in establishing tortious liability, but are in general outside the scope of our analyses. Bauw and Brans (*Milieuprivaatrecht*, 2023) mention Arts. 172, 173, 173a and 173b Penal Code with regards to polluting drinking water, surface water, the air and the soil. Furthermore, they mention Arts. 161 quater and 161 quinquies with regards to exposure to ion rays and radioactive materials.

Article 5.21 of the General Administrative Law Act (*Algemene Wet Bestuursrecht*, hereafter Awb). This article also allows for the recovery of costs in case the the government itself cleans up. This results in an administrative financial debt under Article 4:85 Awb that can be collected by writ of execution (Art. 4:114 Awb).

Articles 19.1-19.7 OW regulate enforcement in the event of 'unusual occurrences'. An 'unusual incident' is defined as: an event, regardless of its cause, that deviates from the normal course of an activity, such as a malfunction, accident, calamity, which causes or threatens to cause significant adverse consequences for the physical environment, including: (a) a case of a breach of permit conditions referred to in Article 8 of the Industrial Emissions Directive, or (b) a major accident referred to in Article 3(13) of the Seveso Directive. In the event of such 'unusual incidents', measures may be required based on the polluter pays principle. This is a specific power that exists in addition to the general power, as described above, for enforcement in the event of a violation. Even if there is no violation, action may be taken in an unusual incident. If the administrative body itself acts, the costs can be recovered (as with the general enforcement power) (Art. 19.6 OW). The Awb rules on enforcement apply mutatis mutandis.

4.1.2 Moment of Coming Into Existence of a Public Law Claim

The public law obligation to pay a sum of money is determined by a public law decision (Art. 4:86 Awb). The public law claim thus comes into existence at the moment that the governing body decides to apply administrative coercion and specifies the claim in a decision.[54]

4.1.3 The Addressee of a Public Law Claim for Environmental Damage

Attention should be paid to the definition of 'causer' (or: instigator) in Article 19.1 OW. The intention is to boradly define the perpetrator, so that the person 'who actually (economically) has it in his power to end the adverse consequences of the unusual incident' can be addressed.[55]

The definition of the offender in 5:1 Awb is also relevant. According to established case law, the offender is primarily the person who physically performs the prohibited act. In addition, in certain cases, the person who does not actually commit the offense himself, but to whom the act is attributable, can be held responsible for the offense and is therefore the offender.[56] As will be seen, even if a company has undergone a WHOA reorganization, administrative action can under circumstances still be taken under this concept (see Section 4.3). The same applies to an enterprise with a new owner following a pre-pack (see Section 4.4).

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54 See also I.E.J. Bakker, 'De toepassing van Credit Suisse/Jongepier q.q. op bestuurlijke handhavingskosten', *TvI* 2024/9, pp. 66-76.

55 *Parliamentary Papers*, 2013/14, 33962, 3, p. 587.

56 ABRvS October 15, 2008, ECLI:NL:RVS:2008:BF8999, AB 2008/364, with reference to F.C.M.A. Michiels.

Further attention should be given to the specific public rule that is violated. Consider a company that owns a plot of land that houses a factory which, under the previous owner, polluted that plot and a neighbouring plot not owned by the company. The business owner may for example be in continuous violation regarding their own plot, even if the previous owner polluted the plot, because someone that owns polluted land can under certain circumstances be seen as (continuous) offender. Regarding the neighbouring plot, the new business owner is not the offender, because he neither caused the pollution nor owns the land.[57]

4.1.4 Private Law Damages Recovery by the Government

The government can also rely on private law in pursuing public goals and may recover damages and claim compensation on the basis of unjustified enrichment through private law, provided that no unacceptable interference with public law occurs (*Windmill* criteria).[58] Article 13.3a OW confirms that this private law possibility exists and expands it by exempting the relativity requirement. Assessment of the *Windmill* criteria is not necessary since this article confirms that private law remedies are available for the recovery of costs in the event of contamination of the physical environment.

Article 13.3a OW stipulates that cost recovery is possible if determined by general administrative order. Article 8.1 of the Environmental Decree is such an order and identifies pollution or damage to the soil and pollution or damage to the bottom or bank of a surface water body as cases in which cost recovery is possible.

4.2 Ranking and Claim Validation of Public Claims in Liquidation Procedures[59]

Before discussing the possibility to discharge environmental claims in a WHOA procedure or with a pre-pack, we discuss the ranking of such claims in an ordinary insolvency procedure.

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57 Zie ook R. Mellenbergh, *Bedrijfsovername en milieurecht: een onderzoek naar juridische aspecten van bedrijfsovername en milieu*, (diss. VU, 2009), p. 464: "Ook de koper van activa uit de faillissementsboedel, bijvoorbeeld een bedrijfsterrein, kan door het bevoegd gezag verantwoordelijk worden gehouden voor de sanering van de bodem voor niet door hem zelf veroorzaakte bodemverontreiniging. Het uitvoeren van een goed bodemonderzoek is dus eigenlijk onontbeerlijk in dergelijke gevallen. Een faillissementscurator zal potentiële gegadigden meestal de mogelijkheid bieden om een bodemonderzoek te verrichten."

58 Dutch Supreme Court 26 January 1990, *NJ* 1991/393, annotation MS (*Windmill*).

59 See for literature, amongts others, Rik Mellenbergh (PhD UvA) https://pure.uva.nl/ws/files/780309/63379_14.pdf; F.M.J. Verstijlen, 'De faillissementscurator tegenover milieurechtelijke normen', *in* S.C.J.J. Kortmann et al, *De curator, een octopus*, Deventer: W.E.J. Tjeenk Willink, 1996; A.A.J. Smelt, *Goederen met negatieve waarde in het Nederlandse vermogensrecht* (diss.), Deventer: Kluwer, 2006; J. Hummelen, 'Met lege handen? Verborgen bodemverontreiniging en faillissement', *NTBR* 2012/35 and J.M.W. Pool, 'Maatschappelijk verantwoord vereffenen: belangenpluralisme bij de maatschappelijke taakuitoefening van de curator', *TvI* 2022/20, pp. 134-140.

There are no special statutory rules on ranking of environmental claims in insolvency in Dutch insolvency law. The new Environment and Planning Act, however, contains a provision on requiring security for future environmental claims, which shows the legislator is intent on giving such claims de facto priority. Furthermore, based on case law, in some cases public law environmental claims can qualify as claims against the estate (*boedelvorderingen*), which must first be paid as administrative expenses before the insolvency creditors are paid. The leading case *Ridderkerkse Taxicentrale* is discussed below (Section 4.2.2), followed by some variations on that case (Section 4.2.3).

4.2.1 Possibility to Ask Security for Future Public Law Environmental Claims

The legislator is not blind to the problem of environmental claim recovery against insolvent entities. The new Environment and Planning Act allows imposition of a requirement of providing financial security for environmental permits linked to activities with potentially significant adverse effects on the environment (Art. 13.5 OW). If the permit holder who has provided such security breaches certain permit conditions or causes environmental damage, the competent authority can use the financial security provided to recover costs for enforcing compliance or to repair the damage. During bankruptcy, this provision grants the competent authority a position similar to that of a secured creditor, enabling them to collect these specific claims as if there were no bankruptcy proceedings.[60] This shows that the legislator wanted the government to have some priority for public law environmental claims. This immediately raises the question why this priority is restricted to claims for which such a provision requiring insurance was made ex ante.

4.2.2 Ridderkerkse Taxi Centrale: Treatment of Environmental Claims against the Trustee as Claims against the Estate

The leading case as to the ranking of public environmental claims is the *Ridderkerkse Taxi Centrale*. In this case, the authorities issued an order against the bankruptcy trustee to establish the environmental harm and an order to clean up. The acts leading to the environmental damage all occurred prior to thestart of the procedure, but the orders were issued after formal declaration of insolvency and were addressed to the trustee. The Dutch Supreme Court reasoned that, according to settled case law of the highest administrative court (*Afdeling bestuursrechtspraak van de Raad van State*), obligations arising from environmental legislation with regard to an establishment belonging to the bankrupt estate, issued after the declaration of bankruptcy, form obligations of the trustee in his capacity as administrator of the estate, and not of the bankrupt (legal) person.

60 See also R.C.M. van Moorsel & S.B. Jonasse, 'Insolventierecht is failliet bij milieuschade', *M&R* 2023/64, para. 4.3.

According to the Dutch Supreme Court, this means that the trustee in his capacity has his own, independent obligation to comply with environmental legislation with regard to an establishment belonging to the estate, and that if the trustee does not comply with an obligation, administrative law orders (such as an administrative penalty or an order subject to penalty) may be imposed on him in his capacity. In such a case, debts arising from such administrative law charges are claims against the estate (*boedelvorderingen*).

This qualification as 'claims against the estate' entails that the environmental claims in this case must be paid before all pre-insolvency creditors. Such claims rank highly, just after the salary of the trustee. It should be noted that secured pre-insolvency creditors are not affected directly in case of normal liquidation procedure. Under Dutch law, secured creditors are protected up to the value of their collateral and are allowed to enforce their security rights and even to seize the collateral, also during the bankruptcy proceeding. There is no automatic stay regarding secured creditors, though there is a limited possibility for a request to a temporary stay, also referred to as a cooling-off period. As will be seen, the position of secured creditors will be affected when the insolvency procedure is not used to liquidate the company or the business, but takes the form of a WHOA or a pre-pack.

Boekraad is of the opinion that the Supreme Court has once again allowed itself to be led astray with the judgement in *Ridderkerkse Taxi Centrale*.[61] According to Boekraad, the qualification as claims against the estate requires sufficient connection between the creation of an obligation and the settlement of the bankruptcy by the trustee. In this sense, a claim against the estate would need to be attributable to the management and liquidation of the bankrupt's assets for the benefit of the bankruptcy creditors, and the claim in *Ridderkerse Taxi Centrale* is not such a claim in his view.[62] Boekraad sees the obligation in *Ridderkerse Taxi Centrale* as a latent obligation, a legacy from the past with which the trustee themselves had nothing to do and for which the link to the bankruptcy settlement is far-fetched, and which is only promoted to an estate debt because public law coincidentally allows addressing the bankruptcy trustee.

We disagree. The policy arguments for qualifying the claim of an involuntary claimant, such as the government that claims costs related to environmental damages as a pari passu ranking claim, with no recourse on other entities, are weak in the first place.[63] There are clear policy arguments to support the promotion of such debts to estate debts. Most notable is the argument that it prevents a public bailout. If the government would take measures to establish the pollution and even engage in cleaning up, these are costs that should not be borne by the government and the public at large.

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61 Dutch Supreme Court 4 June 2021, ECLI:NL:HR:2021:833, *TvI* 2022/10, annotation G.A.J. Boekraad.

62 Ibid.

63 Compare H. Hansmann & R. Kraakman, 'Toward unlimited shareholder liability for corporate torts', 1990 *Yale LJ* 100, p. 1879.

Providing such claims only a pari passu ranking and allowing discharge in bankruptcy would amount to a government bailout of the debtor that inflicted the environmental harm. This would be a subsidy of the debtor and its financiers, rewarding the infliction of environmental harm. The costs the company, and thereby its financiers, should have incurred will now be borne by outside parties. We do agree with Boekraad, however, that promotion to estate debts is dogmatically not the cleanest solution, but it does provide some solution to the problem that joint creditors would otherwise be receiving a government subsidy. The true potential of risk externalization would, however, lie in reorganization procedures. We will expand on the merits of forcing stakeholders to internalize environmental harm in the next paragraph (Section 4.3).

Bakker et al. are critical of the ranking of public environmental claims as claims against the estate.[64] One of Bakker's arguments is that the position of public environmental claims is not that different from that of tort victims. We are in full agreement with her analysis as to the comparison of private individual tort claims and public law claims. We do not agree, however, as to what the consequences should be. We recognize that most that can be said in favour of a higher ranking of public claims also applies to tort victims. However, we do not think this would warrant a downgrade of public law claims back to the ranks of ordinary insolvency creditors. Rather, this could justify rethinking the position of tort victims. More generally, a stronger position for tort victims in insolvency has often been argued in literature, i.e. as the plea to allow unlimited shareholder liability for tort claimants.[65]

4.2.3 European Dimension: EU Environmental Policy May Derogate from Dutch Insolvency Law

The question regarding the ranking of public law claims in insolvency can also have a European dimension. A substantial amount of environmental law is regulated or influenced by European regulations or directives. We already mentioned the Environmental Liability Directive and the principles of environmental law enshrined in the TFEU. Another example is the Emission Trading System (ETS) Directive.[66] The Court of Justice is the highest authority for the interpretation of EU law. The question whether the application of EU environmental law can lead to priority, for example by qualification as duties of or claims against the estate, of environmental claims in national bankruptcy

64 I.E.J. Bakker, De toepassing van Credit Suisse/Jongepier q.q. op bestuurlijke handhavingskosten, *TvI* 2024/9, pp. 66-76.

65 H. Hansmann & R. Kraakman, 'Toward unlimited shareholder liability for corporate torts', 1990 *Yale LJ* 100, p. 1879; and recently in Dutch literature R.C.M. van Moorsel & S.B. Jonasse, 'Insolventierecht is failliet bij milieuschade', *M & R* 2023/64, pp. 481-489.

66 Directive (EU) 2023/959 of 10 May 2023, amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading system.

procedures has not been answered directly. However, We believe a future answer by the Court of Justice of the European Union confirming a special status for public EU environmental claims is likely.

Remmink and Schuijling come to a comparable conclusion, specifically in relation to the EU Emission Trading System.[67] They discuss Court of Justice cases *Bitter v. Germany*[68] and *Air Berlin*,[69] and distill that the court leans towards strict compliance with EU rules on emission rights, also in the context of bankruptcy. They also discuss a case still pending at the EFTA court, in which the Norwegian government firmly takes the stance that it is not appropriate to convert the obligations under EU emission rules into a monetary amount and to only allow the emissions authority to participate based on that amount during an insolvency procedure. The Norwegian state argues that the obligation is an environmental obligation that must be fully complied with, also in bankruptcy.[70] Remmink and Schuijling contemplate (in translation):

> We do not consider it unlikely that, against the backdrop of the ETS's objective and the strict enforcement needed to achieve that objective, the Court of Justice (and the EFTA Court) will advocate for strict compliance with the obligation to surrender [emission rights], even if it means overriding insolvency law where necessary.[71]

4.2.4 Variations on *Ridderkerkse Taxi Centrale*: Pre-Insolvency Public Law Environmental Orders

If the public law order to pay was issued before bankruptcy, the question whether the order extends to the bankruptcy trustee is more complicated. Case law of the administrative courts suggests a distinction should be made between the obligation of the trustee to comply with environmental legislation, and the addressant of the public law decision to enforce environmental legislation.

It is clear, as also emerges from the Supreme Court ruling in *Ridderkerkse Taxi Centrale*, that the trustee has his own, independent obligation to comply with environmental legislation. That does not automatically mean that the trustee must comply with orders that were addressed to the bankrupt entity before bankruptcy. The trustee in bankruptcy is responsible for compliance with the environmental rules applicable to the entity after the opening of bankruptcy proceedings, but does not have to ensure

67 M.H. Remmink & B.A. Schuijling, 'Emissierechten in faillissement', *in* M.N. de Groot et al., *Dilemma's van nu. INSOLAD Jaarboek 2024*, Deventer: Wolters Kluwer, 2024, para. 10.4.

68 CJEU 17 December 2015, Case C-580/14, *Bitter v. Germany*.

69 CJEU 23 September 2021, Case C-165/20, *ET v. Germany (Air Berlin)*.

70 EFTA Court case E-12/23 (pending), *Norwegian Air Shuttle ASA v. the Norwegian state*.

71 M.H. Remmink & B.A. Schuijling, 'Emissierechten in faillissement', *in* M.N. de Groot et al., *Dilemma's van nu. INSOLAD Jaarboek 2024*, Deventer: Wolters Kluwer, 2024, para. 10.4.

the implementation of an order imposed not on the trustee, but on the bankrupt entity prior to bankruptcy.[72]

Consequently, if penalty payments have been forfeited before the date of the bankruptcy on the order, this will lead to claims on the bankrupt entity that will qualify as regular insolvency claims. If penalty payments are forfeited by the entity after the date of bankruptcy, they may not even be accepted as part of the claim validation process in bankruptcy.[73] In any case, these penalty payments are owed by the bankrupt entity as the addressant of the order and are not claims against the estate.

Here, we see that both Boekraad and Bakker raise a valid argument in their criticism of the ruling in *Ridderkerse Taxi Centrale*. Why would an administrative order issued just before bankruptcy not lead to the qualification of administrative debt, whereas an order issued after bankruptcy does? Again, the conclusion based on this analysis should be different than Boekraad and Bakker suggest. There are clear policy arguments for including claims resulting from orders issued prior to bankruptcy priority in one way or another (as the Environment and Planning Act does indirectly by imposing a financial security requirement for new permits, Art. 13.5 OW). If the claim has a European law dimension, this may even be necessary to comply with EU environmental law (see Section 4.2.3). The divergence between claims based on orders issued before and after bankruptcy may be less relevant than it seems. Because the trustee in bankruptcy is responsible for compliance with the environmental rules applicable to the entity after the bankruptcy, the government body may be able to issue a new order after bankruptcy addressed to the trustee in its capacity, resulting in a claim that does qualify as an administrative expense. Whether the governing body can issue another order against the trustee after issuing one against the debtor before bankruptcy, will depend on the public law rules applicable.

4.3 *Claim Inclusion versus Non-dischargeability of Public Claims under the WHOA*

The WHOA itself does not contain any special rules or criteria for the treatment of environmental claims, nor for the treatment of public law claims more generally.

72 ABRvS 13 February 2013, r.o. 4.3, ECLI:NL:RVS:2013:BZ1261, *JOR* 2013/157, annotation J.J. van Hees (*Infra Tech*).

73 ABRvS 13 February 2013, r.o. 4.3, ECLI:NL:RVS:2013:BZ1261, *JOR* 2013/157, annotation J.J. van Hees (*Infra Tech*) suggests they are not, but based on the later case *Credit Suisse/Jongepier* this may now be assessed differently, HR 23 March 2018, ECLI:NL:HR:2018:424, r.o. 3.5.4, *JOR* 2018/254, annotation N.E.D. Faber; *NJ* 2018/290, annotation Verstijlen (*Credit Suisse/Jongepier qq*).

4.3.1 Public Law Claims Following from Decisions Taken after the Start of Reorganization Cannot Be Discharged nor Precluded

The treatment of future public law claims under a WHOA appears to be simpler than future private law claims and their inclusion under the WHOA as discussed above (Section 3.3). Using the reasoning from the Supreme Court in the case of *Ridderkerkse Taxi Centrale* as a stepping stone, public law claims cannot be discharged or precluded if not already issued in full previously.

We once more recall the discussion as to whether future private claims can or cannot be included under the WHOA (see Section 3.3). We saw that the WHOA provides few possibilities to include truly future claims. If we combine this with the reasoning of the Supreme Court in *Ridderkerkse Taxi Centrale*, we conclude that the WHOA does not in any way bar or preclude liabilities under public law not yet issued. The reasoning in the case of *Ridderkerkse Taxi Centrale* cannot be applied directly because there is no bankruptcy trustee in reorganization cases and the debtor remains in possession, and because the debtor is not dissolved in a WHOA reorganization. However, given that in liquidation procedures the bankruptcy trustee must comply with environmental orders issued during bankruptcy and must pay any claims emerging from such orders as claims against the estate, it seems unthinkable that the debtor in possession in a WHOA procedure would be able to fend off such orders during or after the procedure.

At this stage, the merit of giving latent public law claims the status of non-dischargeability becomes clear. One only needs to imagine how the WHOA could be used, especially by secured creditors, to capture the going concern value in a company while the it could shed public environmental damages.

Taking the internalization of environmental harm seriously will not only prevent government subsidies on harmful behavior, but it is also likely to change the behavior of companies. Internalization of environmental harm thus protects public finances and the environment itself. The standard mix of financing of equity, secured financial debt and unsecured trade debt, does not provide the right incentive structure to prevent environmental harm. Especially in the case of thinly capitalized companies (little equity), the shareholder stands to lose only a little. The costs of insurance and cleanup could be high in relation to the downside risk and the shareholder will therefore forego incurring such costs. At the same time, a secured creditor would have little incentive to ensure that the company takes adequate precautionary measures and takes out insurance, especially not if the secured creditor will be fully secured in case of bankruptcy. This effect has already been identified by Fried and Bebchuk. They state the following as part of the debate on full priority versus partial priority:[74]

74 Under partial priority the secured lender would only be secured up to a percentage of its secured claim.

> In essence, the rule of according full priority to secured claims exacerbates the distortions created by limited liability, a problem that has recently attracted considerable academic attention. As that literature has explained, limited liability allows shareholders to avoid internalizing the full costs imposed on tort victims by limiting the victims' claims to the amount of the borrower's assets in bankruptcy. This leads firms to underinvest in precautions and overinvest in risky activities that externalize harm to other parties. According full priority to secured claims allows shareholders to avoid internalizing even more of the costs in the manner we have just described.[75]

Rather than tinkering with the scope of priority (full versus partial), a more decisive approach under a WHOA procedure is not to allow for discharge of public law claims related to environmental harm. Not allowing a reorganization procedure to preclude liability for public law environmental claims forces all other parties in the capital structure to consider this effect. This not only forces the company and their shareholders to internalize the costs, but also the creditors, most notably the strong financial creditors with security rights. The WHOA cannot be used to escape latent liability for public law environmental liabilities.

4.3.2 Existing Public Law Environmental Claims Cannot Be Discharged if the Offence Continues

The same reasoning applies if the environmental law claim pre-dates the start of the WHOA-reorganization in case the violation continuous.

Consider the case of a polluted plot of land that a company owns and assume that owning polluted land constitutes a violation of environmental law. The nature of the environmental claim dictates that a claim to clean up the polluted plot can still be enforced against the reorganized entity, in the same way as it could be enforced against a new owner of the plot. The question whether already forfeited penalty payments can be discharged would pose more difficulties.

4.3.3 Existing Public Law Claims for Historic Offenses May Be Dischargeable

Whereas treatment of the previous two categories is clear in our analysis, the category of existing public law claims for historic offenses poses questions. An example is the case in which the soil was polluted, an order for cleanup was issued and the governing body itself eventually cleaned up and presented the bill to the entity, all before the start of a reorganization procedure. Because cleanup was finished before reorganization, there will

75 See L.A. Bebchuk & J. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*' Harvard John M. Olin Centre for Law, Economics and Business, Discussion Paper (1996) 166, pp. 1-93.

be no ongoing offence at the start of reorganization and no new order can be issued after insolvency.

There are no clear legal rules or case law that prevent such claims from being included in a reorganization procedure. There are, however, policy considerations not to allow this, as discussed above in Section 4.3.1, because allowing discharge would be a subsidy that gives incentive to pollute rather than to invest in precautions if this is financially attractive.

4.4 Prepackaged Liquidation and Public Law Claims

If parties would seek to evade environmental liability, the pre-pack seems a route with more options. The pre-pack is the weakest link in preventing insolvency law as a tool in shedding environmental claims. In Section 3.4 we analyzed the weaknesses in insolvency law as to private law claims by private actors. The pre-pack may provide less of an opportunity to escape or shed public law claims. Relevant is the definition of the offender in Article 5:1 Awb. According to established case law, the offender is primarily the person who physically performs the prohibited act. But in addition, in certain cases, the person who does not actually commit the offense themselves, but to whom the act is attributable, can be held responsible for the offense and is therefore the offender.[76] Administrative action can possibly still be taken under this concept, also when the enterprise has a new owner following a pre-pack. As discussed in Section 3.4, we suggest to more generally attach environmental claims to the enterprise and not simply to the legal entity.

5. Conclusion

We started with the question: what if the polluter cannot pay? While the primary aim of environmental law is to ensure that the polluter pays, insolvency law seeks to maximize the return for creditors. These objectives may seem at odds with each other because it seems in the interest of creditors if the government or (future) tort victims would pick up the bill. However, insolvency law also aims to internalize risk for the financiers. We argue that this should also be applied to (the costs of) environmental harm. If such costs are not internalized, harming the environment rather than investing in precautions is subsidized and an environmental bailout would be granted if the company goes bankrupt. If internalization of risk is accepted as a goal of insolvency law, the objectives of both fields overlap: environmental law ensures that the polluter pays and insolvency law extends this principle to the financiers of the polluter.

76 ABRvS October 15, 2008, ECLI:NL:RVS:2008:BF8999, AB 2008/364, with reference to F.C.M.A. Michiels.

Our analysis reveals several key points. First, environmental private law claims could be given special treatment as claims against the estate. Also, in those cases where private law claims do not favor the treatment as claim against the estate, reorganization of private environmental claims in mass tort cases under the WHOA should be treated with much restraint. The least that should be required is the support of a majority in all classes of tort creditors. Second, there is a critical distinction between voluntary claim validation in liquidation procedures and forced claim inclusion under a WHOA reorganization. Whereas generosity in claim validation can be beneficial for tort creditors, forced inclusion under the WHOA can be detrimental if no proper safeguards are in place. Third, public environmental claims should be treated as claims against the estate in liquidation procedures, reinforcing the policy goal of internalizing environmental costs. Alternatively, such claims should be given priority or otherwise created through legislation. Fourth, the pre-pack procedure, while offering benefits, poses significant risks in potentially shedding environmental liabilities, necessitating stricter oversight and a TUPE-like regime (TUPE-II) for environmental claims.

To prevent environmental bailouts and to ensure internalization of environmental costs, it is crucial that these claims are not easily dischargeable in reorganization plans and pre-packs. This approach is in line with the policy goals of both environmental law and insolvency law. This not only protects public finances but also incentivizes companies to adopt more responsible environmental practices.

The ESG Factor in Dutch Insolvency and Restructurings: A Debtor's Perspective on Environmental Claims

Marc Noldus & Daniella Strik[*]

1. Introduction

Environmental damages have become a key topic in the insolvency landscape. Companies grappling with severe environmental issues – such as land contamination, water pollution, or biodiversity loss – often face financial claims from both governmental and private entities. There is also a notable increase in climate and environmental litigation.[1] Major energy corporations, including the likes of Shell and Eni, have recently found themselves at the centre of such legal actions. Additionally, in 2023, the US chemical firm Chemours was found responsible for environmental harm in the Netherlands due to the emission of PFAS chemicals.[2] These damage claims can be exacerbated by fines and penalties from public authorities. Polluters may also be ordered to remedy or clean up contamination and prevent additional environmental harm, leading to (further) costs.

The financial repercussions of all these liabilities can be enormous for all stakeholders involved. In this report, we will focus on the company's options if it cannot meet its environmental claims and penalties, or fund its cleanup obligations. In near-bankruptcy situations, statutory restructuring proceedings are typically considered. But can these proceedings also restructure environmental liabilities? Are these liabilities even capable of discharge in restructuring proceedings and if so, do (or should) they enjoy bespoke treatment? And how do these questions inform a company's choice for the right restructuring tool?

This report examines how a company can reorganize or discharge such environmental liabilities under Dutch bankruptcy law. We will focus that examination on two statutory instruments: the suspension of payments proceeding and the WHOA (also

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1 'Litigation process limited in curbing Big Oil emissions', *Financial Times* (29 November 2023).

2 District Court of Rotterdam 27 September 2023, ECLI:NL:RBROT:2023:8987.

known as the "Dutch scheme"). The choice between these two instruments is critical as it significantly influences the treatment of environmental liabilities and the extent to which it can be an efficient and effective restructuring method.

We will first identify relevant categories of environmental liabilities and why a company may wish to restructure these. Secondly, we will outline how these liabilities would rank and be treated in a Dutch bankruptcy process, given that the outcome of a bankruptcy liquidation is used as the benchmark against which a Dutch court will assess whether a suspension of payments plan or WHOA plan offers any improvements to creditors. Next, we will discuss how these two restructuring tools can be used to restructure environmental liabilities. Finally, we will present our insights on the considerations a company should weigh when selecting the most suitable restructuring tool.

2. Environmental Liabilities

Environmental liabilities can take different forms. An initial distinction can be based on the statutory origin of the claim. There may be civil law claims, which in the case of Dutch law are based on the Dutch Civil Code (*Burgerlijk Wetboek*, hereafter DCC), and there may be public law claims, which may be based on various administrative acts, in particular the Dutch Environment and Planning Act (*Omgevingswet*) and associated regulations. The category of public law environmental claims has gained specific attention within insolvency law circles with regard to their ranking and treatment in bankruptcy proceedings, which has led to landmark case law such as the *Ridderkerkse Taxi Centrale* judgment in the Netherlands (discussed below).[3]

A further distinction can be made on the basis of the type of redress. On the one hand, the claim can be monetary in nature, such as a claim for compensation of (personal or property) damages in the case of a civil law claim or a penalty or cost reimbursement in the case of a public law claim. Damage claims in particular are wrought with complexities in environmental cases. The damage caused by contamination can take significant time to materialize and take various forms of indirect harm (e.g. knock-on effects of pollution for biodiversity and public health). The effects of environmental harm can be international, or even global in the case of excess greenhouse emissions by multinational conglomerates. All of these factors make it difficult to assess the quantum of the damage, establish causality and identify the parties, properties and areas affected (in each case depending on the applicable law(s)). On the other hand, the claim can be non-monetary. This is particularly relevant for public law claims, as envi-

3 Dutch Supreme Court 4 June 2021, ECLI:NL:HR:2021:833, *NJ* 2021/233, with annotation F.M.J. Verstijlen (*De Ranitz/Ontvanger*).

ronmental statutes confer various powers on governmental authorities to order cleanup measures, emission reductions, or other remedial actions.

Applied to the topic of this report, we will examine the following categories of environmental liabilities:

(i) Civil law claims for (monetary) damages. Given the potentially wide range of parties affected by environmental damage, our examination will focus on mass (environmental) damage claims based on civil tort.
(ii) Public law claims, i.e. claims of public authorities based on administrative acts. These can further be categorized into:
   (a) monetary claims (i.e. fines, penalties or cost reimbursements requiring payment of a sum in connection with an environmental violation); and
   (b) non-monetary claims (i.e. an order to take remedial actions in connection with an environmental violation).

Companies looking to restructure their liabilities may have various reasons to specifically address the abovementioned types of environmental liabilities. Restructuring can be crucial to avoid bankruptcy when faced with substantial liability risks, including imminent penalties or costly cleanup demands that threaten business continuity. A restructuring may provide the company with the means to stabilize its business in order to create a runway to finance a cleanup operation over time or fund a settlement of mass damage claims, thereby resolving associated civil liability risks.

3. Treatment of Environmental Liabilities in Bankruptcy

3.1 Ranking and Priority in Dutch Bankruptcy Proceedings

The main categories of claims in Dutch bankruptcy law are (i) claims against the bankruptcy estate (*boedelvorderingen*), (ii) insolvency claims (*faillissementsvorderingen*), and (iii) non-enforceable claims (*niet-verifieerbare vorderingen*).

Holders of claims against the estate (*estate claims*) are paid in priority over insolvency claims. Estate claims do not need to be filed with the bankruptcy trustee and can be realized directly from the bankruptcy estate. If it is clear that the bankruptcy estate is insufficient to discharge all estate claims, the bankruptcy trustee may suspend the payment of these claims until the end of the bankruptcy proceedings, at which point they are discharged on a pari passu basis (subject to grounds for priority).[4]

4 Dutch Supreme Court 28 September 1990, ECLI:NL:HR:1990:AD1243, *NJ* 1991/305, with annotation P. van Schilfgaarde.

Generally speaking, estate claims are the costs arising from the administration and liquidation of the estate. Dutch statutory law does not expressly define estate claims or regulate the manner in which they should be discharged. In our view, this is a clear legislative gap:[5] in the vast majority of Dutch bankruptcies, the liquidation proceeds are only sufficient to discharge (part of) the estate claims, in which case no distributions are made to insolvency creditors at all.[6] The classification of estate claims instead comes primarily from case law.[7]

Holders of insolvency claims compete for a distribution of liquidation proceeds on a pari passu basis, subject to statutory grounds for priority based on security rights, preference or other statutory grounds.[8] Insolvency creditors need to file their claim with the bankruptcy trustee for verification and, if applicable, distribution of liquidation proceeds. Secured creditors can directly enforce their security rights (unless a moratorium is ordered) without filing their claim.[9] Insolvency claims without priority are categorized as *ordinary insolvency claims*.

To qualify as an insolvency claim, the claim must arise from a legal position (*rechtspositie*), e.g. a tort or contract, that existed at the time of commencement of the bankruptcy proceedings.[10] The moment that the claim itself arises is not determinative. This means that a claim that arises after the commencement of bankruptcy proceedings can still qualify as an insolvency claim, provided it is based on a pre-existing legal position.[11]

Non-enforceable claims are claims that are neither estate claims nor insolvency claims. Holders of these claims are not entitled to any liquidation proceeds.

3.2 Mass Environmental Damage Claims

In the past, Dutch bankruptcy proceedings have facilitated cases involving large numbers of claims and claimants. Examples include the bankruptcy proceedings of the Dutch

5 This view was echoed in various responses from insolvency practitioners to a consultation of a discussion note prepared by the Ministry of Justice and Security regarding the future of Dutch insolvency law: L.D.N. de Baar and B.R. Slooter, 'Consultatie insolventierecht: reacties uit de praktijk', *TFZI* 2022/5, p. 23.

6 Report by the Dutch Central Bureau of Statistics (*CBS*), 'Faillissementen: oorzaken en schulden', 2015, pp. 18-19; B. Wessels, *Insolventierecht: Faillietverklaring*, Deventer: Wolters Kluwer, 2018, para. 1466.

7 Dutch Supreme Court 19 April 2013, ECLI:NL:HR:2013:BY6108, *NJ* 2013/291, with annotation F.M.J. Verstijlen (*Koot Beheer/Tideman*).

8 Arts. 3:277(1) and 3:278 DCC.

9 Art. 57 Dutch Bankruptcy Act.

10 Dutch Supreme Court 19 April 2013, ECLI:NL:HR:2013:BY6108, *NJ* 2013/291, with annotation F.M.J. Verstijlen (*Koot Beheer/Tideman*); Dutch Supreme Court 23 March 2018, ECLI:NL:HR:2018:424, *NJ* 2018/290, with annotation F.M.J. Verstijlen (*Credit Suisse/Jongepier*).

11 Dutch Supreme Court 23 March 2018, ECLI:NL:HR:2018:424, *NJ* 2018/290, with annotation F.M.J. Verstijlen (*Credit Suisse/Jongepier*), par. 3.12.1.

finance entity of the Lehman Brothers Group and of the Dutch bank DSB.[12] These cases involved contractual claims arising from structured notes and claims arising from a breach of duty of care, respectively. In our view, the same principles can be applied to (other) non-contractual (damage) claims. Conceptually, tort claims (that qualify as insolvency claims, see below) can be discharged in Dutch bankruptcy proceedings, including in a composition plan in bankruptcy proceedings.[13] Insolvency scholars in Dutch legal literature have also taken the view that Dutch bankruptcy proceedings can be used to discharge mass damage claims.[14]

A practical hurdle here is that, by default, all ordinary insolvency creditors must submit their claims with the bankruptcy trustee before a deadline determined by the supervisory judge.[15] The bankruptcy trustee is tasked with verifying these claims for (provisional) inclusion on a list of claims admitted for a liquidation distribution (after discharge of estate claims).[16] This is problematic in bankruptcies involving mass damage claims, given the large amount of (sometimes extremely complex) claims. To address this, the bankruptcy trustee may offer an opt-out collective settlement to mass damage claimants as part of the liquidation of the bankruptcy estate.[17] The claimants that fall within the scope of the collective settlement file their claims in the manner (and for the amount) set out in the collective settlement agreement, instead of through the (costly and inefficient) claims admission and verification process in ordinary bankruptcy proceedings.[18]

The next question is how mass environmental damage claims are admitted and ranked in a Dutch bankruptcy.

Environmental damage claims are eligible for admission as insolvency claims if they arise from a legal position that existed prior to the commencement of the bankruptcy proceedings (see Section 3.1). It is not a requirement that the damage has arisen

12 The complexities arising from a large volume of claims/claimants in Dutch bankruptcy proceedings are discussed in detail in N.E.D. Faber, F. Verhoeven and N. Vermunt, 'The use of a composition plan as a valuation and distribution framework', in N.E.D. Faber & N. Vermunt (Eds.), *Bank Failure: Lessons from Lehman Brothers*, Oxford University Press, 2017.

13 *Parliamentary Papers* 2016/17, 34 740, nr. 3, p. 37, which refers to tort claims in the context of bankruptcy. A confirmed composition plan in a bankruptcy proceeding is binding on all ordinary (unsecured and non-preferred) insolvency creditors: Art.157 of the Dutch Bankruptcy Act.

14 R.D. Vriesendorp, 'Faillissement en massaschade: twee kanten van dezelfde medaille?', *in* E.J. Numann et al. (Eds.), *Massificatie in het privaatrecht*, Deventer: Wolters Kluwer, 2010, pp. 173-185.

15 Art. 108 *et seq*. of the Dutch Bankruptcy Act.

16 In most Dutch bankruptcies, there is no verification and admission process because there are insufficient funds to fully discharge the estate claims. As a result, it will not be possible to make a distribution on insolvency claims and a verification and admission process for those claims becomes unnecessary.

17 Art. 110(3) Dutch Bankruptcy Act jo. with Art. DCC.

18 For a detailed discussion of the settlement of mass damage claims inside insolvency procedures, please refer to: R.M. Hermans, 'Settling mass damage claims inside and outside insolvency procedures. A comparison of the available procedures', *in* R. Brubaker et al. (Eds.), *Third party releases by means of bankruptcy law guarantees and (mass) tort*, Den Haag: Eleven Publishing, 2022, pp. 73-80.

before bankruptcy.[19] In other words, environmental damage claims can be admitted as insolvency claims if the tort was committed prior to the commencement of bankruptcy proceedings, but the damage only thereafter. This is crucial for the purposes of including (mass) environmental damage claims in bankruptcies, since environmental damage (or at least the full extent of it) can take significant time to reveal itself.[20]

Damage claims based on civil tort do not benefit from any statutory preference under Dutch law – very specific exceptions to this rule exist, but not for environmental damage claims as a category.[21] This outcome does not change in case the environmental damage claims are governed by a foreign law that assigns a preference to those claims: in a Dutch bankruptcy, Dutch law determines the ranking of claims.[22] This means that mass environmental damage claims classify as ordinary insolvency claims in a Dutch bankruptcy. This significantly reduces, if not eliminates, the likelihood of any financial recovery from those claims (as discussed above).

3.3 Public Law Environmental Claims

There are a large number of acts, both on a state and municipal level, governing a wide array of environmental subjects, such as cleanup obligations, permit requirements and emission limits. Time is too short to delve into the landscape of environmental legislation, but we note that the most important acts and decrees include the Environment and Planning Act (*Omgevingswet*), the Living Environment Activities Decree (*Besluit activiteiten leefomgeving*) and the Environmental Management Act (*Wet milieubeheer*). Companies can also be subject to environment-related taxes, such as waste taxes and emissions taxes.

These regulations, together with the General Administrative Law Act (*Algemene wet bestuursrecht*) provide a legal basis for various (administrative) monetary claims against companies. The question arises whether these claims classify as (ordinary) insolvency claims or as estate claims in a Dutch bankruptcy.

The Dutch Supreme Court addressed this issue in the *Ridderkerkse Taxi Centrale* judgment, following a request from the District Court of Rotterdam to rule on preliminary questions.[23] The case concerned a taxi service that was found in violation of the

19 Dutch Supreme Court 23 March 2018, ECLI:NL:HR:2018:424, *NJ* 2018/290, with annotation F.M.J. Verstijlen (*Credit Suisse/Jongepier*), para. 3.5.5.

20 R.M. Hermans, 'Settling Mass Damage Claims Inside and Outside Insolvency Procedures: A Comparison of the Available Procedures', in: R. Brubaker et al. (Eds.), *Third Party Releases by Means of Bankruptcy Law Guarantees and (Mass) Tort*, Den Haag: Eleven Publishing, 2022, p 75.

21 For instance, Arts. 3:283 et seq. DCC.

22 Art, 7(2)(i) of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

23 Dutch Supreme Court 4 June 2021, ECLI:NL:HR:2021:833, *NJ* 2021/233, with annotation F.M.J. Verstijlen.

Environmental Management Act due to failing to coat a carwash terrain where chemical cleaning products were used. Shortly afterwards, the taxi service went bankrupt. The municipality ordered the bankruptcy trustee to perform a soil investigation and restore the quality of the soil. The bankruptcy trustee refused, following which the municipality carried out the cleanup and ordered the bankruptcy trustee to reimburse the costs of the cleanup and to pay a penalty for failing to perform a soil investigation. The Duch Supreme Court determined that, according to administrative case law, following the commencement of bankruptcy proceedings a bankruptcy trustee has an independent obligation in its capacity to comply with environmental obligations relating to a facility belonging to the estate. Therefore, the Dutch Supreme Court reasoned, any debts arising from non-compliance qualified as estate claims. The Dutch Supreme Court reasoned as follows (unofficial translation):[24]

> The case law […] of the Administrative Jurisdiction Division and the CBb implies that the bankruptcy trustee, in his capacity, has an independent obligation to comply with environmental legislation concerning a facility belonging to the estate. If the bankruptcy trustee does not comply with this obligation, administrative sanctions (such as an order under administrative coercion or a penalty payment) can be imposed on him in his capacity. In such a case, according to the case law […] of the Supreme Court, debts arising from such administrative sanctions are considered estate claims. After all, these debts result from an act or omission by the bankruptcy in violation of an obligation he must comply with in his capacity.

It did not matter whether these debts arise from actions pre- or post-commencement of the bankruptcy proceedings.[25] The result was that the cost reimbursement and penalty qualified as estate claims, even though the violation in question occurred before bankruptcy.

A key factor in the judgment was that the applicable environmental regulations (and associated administrative case law) deemed the bankruptcy trustee to be the addressee of the violated environmental norm. The bankruptcy trustee "inherited" the underlying environmental obligations, as it were, from the (bankrupt) company. Whether this would also apply to other environmental violations will depend on the environmental regulations in question. The classification of an environmental penalty or cost reimbursement claim therefore requires an in-depth assessment of the relevant environmental regulations on a case-by-case basis.

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24 Ibid., para. 2.6.4.
25 Ibid., para. 2.6.5.

The Dutch Supreme Court did not specifically address the classification of the orders to remedy the environmental violation, as the preliminary questions the court was asked to rule on related to the debts arising from those orders (i.e., the cost reimbursement claim and the penalty). The non-monetary nature in itself should not be a reason to disqualify those orders from classifying as an estate claim or insolvency claim. An estate claim can be non-monetary in nature (e.g. an obligation on the bankruptcy trustee to remove inventory from a leased property).[26] The same is true for insolvency claims.[27]

However, the administrative or public law nature of those orders warrants a more bespoke assessment. The legal basis and specifics of a non-monetary order to remedy an environmental violation should be considered on a case-by-case basis to determine whether it is capable of being classified as an estate claim or insolvency claim. However, the relevance of that question is probably more academic than practical. A conversion of a non-monetary administrative order into a monetary claim is the likely outcome in most situations: if the company fails to comply with an order to remedy an environmental violation, the relevant authority can either issue a penalty or take remedial action itself and order a cost reimbursement.[28] A decision from a public authority to "sit still" in the face of an environmental violation will be highly exceptional: public authorities are subject to a general obligation to enforce compliance with administrative regulations, even if the company has entered into bankruptcy proceedings.[29]

What does this all mean for public environmental claims? Public authorities either have an elevated priority if the applicable environmental regulation leads to classification as estate claim (at the expense of lower ranking holders of ordinary insolvency claims, including damage claims), or they qualify as holders of (ordinary) insolvency claims if – again, depending on the applicable environmental regulations – the claim arises from a "legal position" (*rechtspositie*) that predates the bankruptcy.[30] That "legal position" could, for instance, exist in the form of an administrative coercive order issued prior to bankruptcy, leading to an obligation to reimburse cleanup costs (which remained outstanding).

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26 Dutch Supreme Court 19 April 2013, ECLI:NL:HR:2013:BY6108, *NJ* 2013/291, with annotation F.M.J. Verstijlen (*Koot Beheer/Tideman*), para. 3.8.

27 Non-monetary insolvency claims can be submitted in bankruptcy proceedings but are converted into an estimated monetary claim for the purposes of their admission and distribution: Art. 133 Dutch Bankruptcy Act.

28 Arts.5:21 and 5:31d et seq. General Administrative Law Act (*Algemene wet bestuursrecht*).

29 Council of State 19 August 2020, ECLI:NL:RVS:2020:1996, para. 4; Council of State 23 July 2014, ECLI:NL:RVS:2014:2752, para. 4.

30 Environment-related tax claims enjoy a statutory preference with respect to assets of the tax debtor, ranking them higher than ordinary insolvency claims: Art. 21(1) Collection of State Taxes Act 1990 (*Invorderingswet 1990*).

4 Treatment of Environmental Liabilities in a Suspension of Payments Plan

4.1 Summary of Process

The suspension of payments (*SoP*) proceeding is one of the main insolvency processes in the Netherlands. The debtor may request the opening of SoP proceedings if they anticipate that they will not be able to meet their debts as these become due.[31] This proceeding triggers a general deferment of payment of ordinary insolvency claims. The court appoints one or more administrators who manage the estate together with the managing directors.[32]

As part of the SoP proceedings, the debtor can prepare and implement a restructuring through a composition plan (*SoP plan*). The scope of the SoP plan is limited to ordinary insolvency creditors only. The SoP plan must be approved by a regular majority of ordinary insolvency creditors attending the voting hearing or, if a committee of representation is appointed (discussed below), a 75%[33] majority of committee members attending the voting hearing. Once approved by the requisite majority of creditors or committee members, the court will set a date for a hearing on the sanctioning of the SoP plan. The court will consider whether any of the statutory mandatory grounds to refuse sanctioning apply. The court also has a discretionary power to refuse sanctioning on "other grounds".[34] If no rejection grounds apply, the SoP plan is sanctioned by the court and becomes final and binding on all ordinary insolvency creditors.[35]

4.2 Mass Environmental Damage Claims

4.2.1 Dischargeability in an SoP Plan

The rules regarding ranking and qualification of claims in bankruptcy proceedings apply largely mutatis mutandis to SoP proceedings. Consequently, claims arising from a tort committed prior to the commencement of the SoP proceedings qualify as ordinary insolvency claims (Section 3.2). As discussed in Section 3.2, conceptually tort claims (including mass damage claims) can be discharged in Dutch bankruptcy proceedings, including in a composition plan in bankruptcy proceedings. These types of claims can also be

31 Art. 214(1) Dutch Bankruptcy Act.
32 Art. 215(2) Dutch Bankruptcy Act.
33 Arts. 268(1) and 281e (3) Dutch Bankruptcy Act.
34 Art. 272(2) Dutch Bankruptcy Act.
35 Art. 273 Dutch Bankruptcy Act.

included in an SoP proceeding which renders the SoP an effective tool to restructure these damage claims, e.g. by way of a settlement payment against full and final release.[36]

The District Court of Amsterdam in the *Steinhoff* restructuring confirmed an SoP plan which effectively contained a settlement of mass tort claims for the first time. The court considered that seeking such confirmation did not constitute an abuse of rights (*misbruik van recht*), because the law provides for the possibility to enter into a settlement agreement pending SoP proceedings, and Steinhoff showed that it would be unable to finance the potential exercise of an opt-out by individual mass damages claimants.[37] This confirms that such claims can be subject to Dutch insolvency proceedings, including composition plans. The *Steinhoff* judgment received a warm welcome from legal practitioners. Salah, for instance, labelled the SoP proceeding as "(…) an excellent tool for the restructuring of mass litigation claims".[38]

One can debate whether mass claims can indeed be discharged through composition plans in insolvency proceedings. Under the Dutch Act on the Collective Settlement of Mass Damage Claims (*Wet collective afwikkeling massaclaims (WCAM)*), the tool of having a court declare a class settlement generally binding can result in mass damages claimants being crammed down, albeit with the exception of individual mass claim creditors that timely exercise their right to opt out. At first glance, the absence of the right to opt out from a court approved composition plan may seem like a potentially valid concern in this respect. After all, the right to opt out from a court-approved class settlement was included in the WCAM to compensate for the inherent limitation the collective settlement mechanism entails to the fundamental principle of party autonomy, the right to individual claimants' access to justice (Art. 17 of the Dutch Constitution (*Grondwet*)), and the right to a fair trial (Art. 6 of the European Convention on Human Rights).[39]

However, as in practice, the right to opt out effectively becomes moot in situations where the tortfeasor would not be able to finance an opt-out. The absence of this safeguard does not materially change any individual mass damages claimant's ability to recover its losses. Therefore, in our view the absence of the right to opt out should not be considered an obstacle to discharging mass damages settlements in the context of composition plans in insolvency proceedings. In the *Steinhoff* case, the District Court

36 See D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, pp. 390-394, discussing pros and cons for applying an SoP plan to resolve mass claims.

37 District Court of Amsterdam 23 September 2021, ECLI:NL:RBAMS:2021:5452, *JOR* 2022/17, with annotation R.J. van Galen (*Steinhoff*), para. 5.14.

38 O. Salah, Steinhoff restructuring: The Dutch suspension of payments as an excellent tool for the restructuring of mass litigation claims, 2022, available here: https://www.nortonrosefulbright.com/en-nl/knowledge/publications/9c340bd2/the-netherlands (last accessed July 2024).

39 *Parliamentary Papers*, 2003/04, 29 414, nr. 3, p. 4.

of Amsterdam dismissed an argument of a creditor that the use of an SoP plan in lieu of seeking court approval of a settlement under WCAM was an abuse of rights. This court acknowledged that in that case the WCAM procedure was not an option for the debtor, because it was satisfied that Steinhoff would not be able to finance a potential opt-out, while Steinhoff would eventually go bankrupt if a settlement would not be achieved.[40] Under the WCAM it is not possible to exclude an opt-out in the event the debtor is in a distressed situation, so a so-called limited fund settlement is not possible.[41] In short, a debtor is free to opt for an SoP proceeding to discharge mass environmental damage claims, notwithstanding the availability of other legal regimes that can be used for collective settlements (such as the WCAM).

Furthermore, in situations where the exercise of the right to opt out in the WCAM proceedings would lead to the bankruptcy of the tortfeasor, a court in bankruptcy proceedings may be better equipped to take decisions on proposed mass damages settlements that appropriately balance the interests of all stakeholders, including mass damages and non-mass damages creditors.[42] A relevant factor in this regard is that the court's assessment of the mass damages settlement in bankruptcy proceedings should be considered equally akin to the abovementioned discretionary power to reduce damages award pursuant to Article 6:109(1) DCC. In fact, according to the legislative history of this provision, the discretionary power to reduce damages awards is meant to include situations where there are multiple creditors whose claims do not give rise to a reduction on an individual basis, but do give rise to a reduction on a collective basis. The legislator considered that in such circumstances, the judge should base its potential reduction decision on all claims against the injurer resulting from the same incident.[43]

4.2.2 Grounds for Rejection of an SoP Plan

If approved at the voting hearing, the court will consider possible grounds for rejection of the sanctioning of the SoP plan. A key mandatory ground for rejection applies

40 District Court of Amsterdam 23 September 2021, ECLI:NL:RBAMS:2021:5452, *JOR* 2022/17, with annotation R.J. van Galen (*Steinhoff*), para. 5.14.

41 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, pp. 408-414 discusses pros and cons of allowing court approval of limited fund class settlements through exclusion of opt-out under WCAM.

42 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, pp. 398-403 discusses the complications that may arise in the event court approval is sought for a settlement with a tortfeasor in financial distress and the manner in which the court should take into account the position of non-mass claim creditors.

43 Parliamentary Papers, 1975/76, 7729, nr. 6-7, p. 111: "In the preliminary report, the question was finally raised as to how it should be handled when there are multiple creditors whose claims individually do not, but collectively do, provide grounds for reduction. The undersigned gladly concurs with (…) that in such a case, the court should take into account all claims against the debtor that have arisen from the relevant event." (unofficial translation)

if creditors receive substantially less under the terms of the SoP plan compared to what would be available upon liquidation of the debtor in bankruptcy proceedings.[44] Where mass environmental damage claims are likely to receive nil distribution in a bankruptcy scenario, any payment offered in an SoP plan under a mass settlement would be an improvement over a bankruptcy scenario.

A more fundamental question is whether the court could use its discretionary power to reject sanctioning of the SoP plan on the grounds that (mass) environmental damage claims, by their nature, cannot (or should not) be discharged in an SoP proceeding. We do not see a legal basis for that proposition. The discretionary ground for rejection has mainly been applied to cases of significant (and unjustified) violations of the pari passu treatment of (groups of) ordinary insolvency creditors.[45] Other cases include inaccurate or incomplete information provision.[46] We have not seen published case law showing a consideration of public policy or public interest (let alone environmental interests) in the exercise of the discretionary ground for rejection. Recent WHOA case law suggests that, by analogy, there can be scope for such consideration (Section 5.2.3). A categorical exclusion of (mass) environmental damage claims form the scope of an SoP plan would, however, in our view, require a statutory basis – much like secured and preferential claims are excluded from the scope of SoP proceedings[47] and certain criminal liabilities are excluded from the scope of a personal debt restructuring plan (*schuldsanering*).[48]

4.2.3 Practical Considerations

Whilst mass environmental damages claims can be discharged in an SoP plan, practical hurdles exist due to the nature of environmental damage claims. As noted above, it can be (extremely) difficult to quantify the various damages, determine causality and identify the relevant claimants under potentially a multitude of applicable laws. This leads

44 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, p. 401.

45 District Court of Utrecht 9 August 1989, *NJ* 1990/399 (*Breevast*); Court of Appeal 's-Hertogenbosch 29 October 1997, *JOR* 1998/33, with annotation A.D.W. Soedira (*Combifleur*); Court of Appeal Arnhem Leeuwarden 21 July 2015, *JOR* 2015/317, with annotation N.W.A. Tollenaar (*Spyker*); District Court of Rotterdam 18 December 2018, *JOR* 2019/112, with annotation A.M. Mennens (*He&D Industrial*); District Court of Amsterdam 23 September 2021, ECLI:NL:RBAMS:2021:5452, *JOR* 2022/17, with annotation R.J. van Galen (*Steinhoff*).

46 District Court of The Hague 20 May 2015, ECLI:NL:RBDHA:2016:5828; District Court of Zeeland-West-Brabant 23 December 2015, ECLI:NL:RBZWB:2016:8608 (both cases concerning the sanctioning of bankruptcy composition plans).

47 Art. 232(1) Dutch Bankruptcy Act.

48 Art. 358(4) Dutch Bankruptcy Act.

to complications in effectively informing claimants on the (vote on the) SoP plan and determining their (provisional) claim values for voting purposes.[49]

For mass damage claims, the SoP proceeding provides a distinct feature that addresses part of these complications. In SoP proceedings with over 5,000 creditors, the court may appoint a committee of representation.[50] If appointed, the committee of representation has exclusive voting rights on the adoption of the SoP plan.[51] This significantly simplifies the voting process and takes away the need for submission and review of large numbers of claims for voting purposes. This regime was recently applied in the SoP proceedings concerning the holding company of the Steinhoff group and the Dutch bank DSB.[52]

It is required by law that the committee of representation is representative of the most important categories of creditors, with a minimum of nine members.[53] In an SoP plan involving the settlement of mass environmental damage claims, the committee members could include (a mix of) environmental experts, representatives of environmental organizations, or even a selection of individuals affected by the damage. The proper representation of creditor constituencies – in particular the creditors that are subject to a mass settlement – is important, since individual creditors can no longer vote themselves. The committee of representation also provides the debtor with a single platform where they can engage with (groups of) affected creditors that fall under the mass settlement, in addition to public communication channels.

Whilst the above signifies the use of an SoP plan for settlement of mass environmental damage claims, we expect that its practical utility for reorganizaing operating companies in financial distress caused by environmental factors will be limited. Secured and preferential claims are excluded from its scope. Therefore, debtors, where a significant portion of the debt matrix consists of such debt (e.g. trading companies), will not be able to effect a holistic restructuring in an SoP proceeding that addresses the debtor's wider debt position. A WHOA plan is more suited for that, as will be discussed below.

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49 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, p. 415.

50 Arts. 281b and 281e Dutch Bankruptcy Act.

51 Arts. 281e(2), 218 and 268 Dutch Bankruptcy Act.

52 The authors of this report have advised Steinhoff on its SoP proceeding and SoP plan.

53 Art. 281e(1) Bankruptcy Code.

4.3 Public Law Environmental Claims

Can an SoP proceeding also be used to discharge public law claims? This requires a detailed assessment of the underlying environmental regulations to determine whether the environmental claims qualify as estate claims, e.g. if the applicable regulation provides that the debtor remains subject to ongoing cleanup obligations (comparable to the *Ridderkerkse Taxi Centrale* case). If these claims classify as estate claims, they are excluded from the scope of the SoP proceedings and cannot be discharged in an SoP plan.

If, on the other hand, the public law environmental claims do not qualify as estate claims, the question is whether they still fall within the scope of the SoP proceedings as ordinary insolvency claims. This, again, requires an assessment of the applicable environmental regulations to establish whether the claims arise from a pre-existing legal position. Issued penalties and cost reimbursement orders would likely qualify as such if they were already outstanding when the SoP proceedings commenced. The same is likely true for pre-existing fines and penalties that are based on criminal law, e.g. because they arise from the Economic Offences Act (*Wet op de economische delicten*). From a recent judgment of the Dutch Supreme Court, it can be derived that a criminal fine that has been issued or is "expected" before the commencement of SoP proceedings would also classify as an (ordinary) insolvency claim and fall within the binding effect of (and therefore can be discharged in) an SoP plan.[54] Whether public claims for non-monetary performance, such as cleanup obligations or other remedial actions, can also be discharged in an SoP plan is less certain. As discussed in Section 3.3, the practical relevance of that question is limited because such an order in most cases will be converted into a monetary claim.

Dutch environmental tax claims enjoy a statutory preference, and are therefore excluded from the scope of the SoP proceedings.[55] These claims cannot be discharged in an SoP plan.

To summarize, depending on the relevant environmental regulation, the SoP plan can be an effective tool to discharge public environmental claims, in particular outstanding penalties or cost reimbursement claims that originate from a legal position that predates the commencement of the SoP. However, the SoP is ruled out as a tool to discharge public law environmental claims that are estate claims (such as certain ongoing cleanup obligations) and environmental tax claims. As noted above, the SoP proceeding does not provide any tools to deal with secured and preferential debt, ren-

54 Duch Supreme Court 2 February 2021, ECLI:NL:HR:2021:112, *NJ* 2021/323, with annotation F.M.J. Verstijlen. This case concerned a bankruptcy composition plan, but the ruling by the Dutch Supreme Court can be applied to the scope of an SoP plan as well.

55 Art. 232(1) Dutch Bankruptcy Act.

dering the WHOA plan a more effective tool if those debts should be restructured together with environmental liabilities.

5 Treatment of Environmental Liabilities in a WHOA Plan

5.1 Summary of Process

The *Wet homologatie onderhands akkoord* (*WHOA*) is a legislative framework implementing the Preventive Restructuring Frameworks Directive 2019/1023 of 20 June 2019 in the Netherlands. Under the WHOA, a debtor in a pre-insolvency state (i.e., it is reasonably likely that they will not be able to continue to pay their debts as these become due) can offer a restructuring plan (a *WHOA plan*) to certain or all of its creditors and/or shareholders. Throughout the WHOA process, the debtor remains in possession of their assets.[56]

Voting takes place in classes of creditors and shareholders whose rights are amended by the WHOA plan, with an approval threshold of two-thirds in value per class.[57] If at least one on-the-money class of creditors has approved the WHOA plan, the debtor can request the court to sanction the WHOA plan.[58] At a subsequent sanction hearing, the court will assess the WHOA plan and sanction the plan unless one or more rejection grounds apply.

Alternatively, the court may appoint a restructuring expert (*herstructurerings-deskundige*) at the request of a creditor, shareholder, works council or the debtor themselves.[59] The restructuring expert is tasked with preparing and offering the WHOA plan.[60] The debtor may still prepare their own WHOA plan, which the restructuring expert is obliged to offer to the relevant creditors and/or shareholders at the debtor's request (potentially leading to two plans being offered in parallel).[61]

The WHOA plan has a cross-class cram-down feature.[62] If sanctioned, the WHOA plan is binding on all classes of creditors and shareholders to whom it was offered, including dissenting (classes of). creditors and shareholders.[63]

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56 M.H. Remmink, 'De toekomst van surceance. Een verslag van de expertmeeting georganiseerd door de Nederlandse Vereniging voor Herstructurering', *Tvl* 2023/9, p. 2.
57 Art. 381(7) Dutch Bankruptcy Act.
58 Art. 383(1) Dutch Bankruptcy Act.
59 Art. 371(1) Dutch Bankruptcy Act.
60 M.H. Remmink, 'De toekomst van surceance. Een verslag van de expertmeeting georganiseerd door de Nederlandse Vereniging voor Herstructurering', *Tvl* 2023/9, p. 6.
61 Art. 371(1) Dutch Bankruptcy Act.
62 R.M. Hermans, 'Settling Mass Damage Claims Inside and Outside Insolvency Procedures: A Comparison of the Available Procedures', *in* R. Brubaker et al. (Eds.), *Third Party Releases by Means of Bankruptcy Law Guarantees and (Mass) Tort*, Den Haag: Eleven Publishing, 2022, p 77.
63 Art. 385 Dutch Bankruptcy Act.

5.2 Mass Environmental Damage Claims

5.2.1 Dischargeability of Mass Damage Claims in a WHOA Plan

A WHOA plan can amend the "rights" of creditors.[64] The WHOA does not define what "rights" can be amended, although it is clear from certain statutory provisions[65] and case law[66] that these rights can include civil damage claims. We see no impediment against the application of a WHOA plan to the discharge or release of damage claims on a large scale.[67]

Jonkers and De Weijs[68] have argued that mass tort claims cannot be subject of discharge via a WHOA plan, because

(i) there is no indication that the legislator intended the WHOA as a device to deal with mass tort claims, whereas the relationship between the WHOA and WCAM – which serves as the Dutch opt-out mass damages litigation procedure outside bankruptcy – is unclear;
(ii) inclusion of mass tort claims would be especially controversial if the WHOA plan would be forced on a class of tort claimants through a cross-class cram-down; and
(iii) the drafters of the WHOA considered that it is assumed that mandatory consumer protection laws prevent consumer claims from being restructured in a WHOA process, suggesting that this could be taken as a hint that WHOA was not intended to settle mass tort claims (related to environmental harm).

With regard to (i), it is useful to bear in mind that the WCAM was not designed as an exclusive regime for settling mass damages claims, but rather as an alternative mechanism to facilitate efficient and effective mass claims settlement. The WCAM does

64 Art. 370(1) Dutch Bankruptcy Act.

65 Art. 373(2) Dutch Bankruptcy Act provides a basis for the release of damage claims arising from a court-approved termination of a contract as part of a WHOA process. Art. 384(4)(a) Dutch Bankruptcy Act provides a ground for rejection of a WHOA plan if a class of SME creditors with civil tort claims would recover less than 20% of their claim without a compelling justification.

66 District Court of Amsterdam 21 March 2024, ECLI:NL:RBAMS:2024:1608. This case involved a release of an arbitral damages award. The authors of this report have advised a creditor in this WHOA process.

67 See D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, pp. 394-395 for a discussion of pros and cons of applying a WHOA plan for the resolution of mass claims and pp. 415-416 for suggestions to amend WHOA in order to make this process more suitable for application to mass claims. For a comparison between the WHOA and the US Chapter 11 process as a means to discharge mass damage claims, see A. Tavakolnia, 'Insolventierecht als panacee voor massaschade aansprakelijkheid? Recente Amerikaanse pogingen tot afwikkeling van massaschade in Chapter 11', *Tijdschrift voor Insolventierecht* 2023/27, pp. 221-230.

68 Please see the Report by A. Jonkers and R. de Weijs, 'Preventing environmental bail outs: Environmental liabilities and (non)-inclusion and (non)-dischargeability under WHOA', p. 75. This report is published together with this report following the NACIIL annual meeting of 10 June 2024.

not preclude the use of other procedural mechanisms to obtain court approval for the settlement of mass damages. There is no indication in (the legislative history of) the WCAM or elsewhere that the legislator intended to rule out the settlement of mass (tort) damages claims through insolvency proceedings.

With regard to (ii) – the possibility that a reorganization plan would be forced on a class of mass tort claimants – it follows from the legislative history of the WCAM that the legislator expressly considered the cram-down of mass damages claims in scenarios where the potential tortfeasor would be insufficiently solvent to offer full compensation of damages to all mass damages claimants.[69] That scenario seemed to be a key reason for the introduction of WCAM in the first place. The objective of the Dutch legislator was that, in such cases, a court approval of a class settlement would achieve that the available funds will be distributed proportionally among the injured parties.[70] In this context, it is relevant to highlight that the legislator in the context of the court's assessment of the criterion under WCAM whether a settlement should be considered reasonable referred to the general civil law discretionary power of judges pursuant to Article 6:109(1) DCC to reduce the amount of damages to be awarded in the event full compensation would be manifestly unacceptable (*kennelijk onaanvaardbaar*) in view of inter alia the financial position of the tortfeasor.[71]

With regard to (iii), Jonkers and De Weijs rightly pointed out that the legislative history of the WHOA contains a reference to the possible exclusion of consumer claims. However, we think that the significance of this reference should not be overstated: the reference was made by individual members of parliament in the context of an amendment they proposed to the WHOA legislative proposal, rather than in the Minister's explanatory memorandum to the proposed law.[72] Moreover, it refers to "assumed" exclusion of consumers in practice due the desirability to continue deliveries to consumers

69 *Parliamentary Papers*, 2003/04, 29 414, nr. 3, p. 3: "It should also be noted that particularly in events where there are many victims, it is quite conceivable that the responsible party (or parties) may not offer sufficient compensation (…).Through a settlement on behalf of the entire group of victims, it can be ensured that the available assets of the perpetrator(s) are distributed proportionally among those harmed. However, this is only truly feasible if the settlement is binding for each of the injured parties, to prevent one or more of them from attempting to claim their full damages through the court outside the settlement. This ensures that the injured parties are treated equally." (unofficial translation)

70 *Parliamentary Papers*, 2003/04, 29 414, nr. 7, p. 22.

71 Art. 6:109(1)DCC: "In the event awarding full compensation under the given circumstances, including the nature of the liability, the legal relationship between the parties, and their respective financial capacities, would lead to manifestly unacceptable consequences, the court may reduce a legal obligation to pay damages." (unofficial translation)

72 *Parliamentary Papers* 2019/20, 35249, nr. 25, p. 3, clarification to SP amendment: "It should be noted, however, that consumers are not included. It is assumed that in practice they will never be involved as creditors in a settlement. Unlike in bankruptcy, the business continues to operate under a WHOA agreement, so it can still fulfil the orders placed by consumers. If the business fails to deliver, consumer protection regulations ensure that the consumer's claim against the business for non-performance remains valid. This is mandatory law that cannot be deviated from in a settlement." (unofficial translation)

during the WHOA process.[73] Such an exclusion does not imply that consumer damage claims cannot be included in a WHOA plan as a whole. At no stage did the WHOA include a categorical exclusion of consumer claims.

According to the legislative history of Article 6:109 DCC, in applying the discretionary power with regard to whether or not to reduce, and if so, by how much, the judge should weigh the interests of both the creditor(s) and the debtor. Significantly, in doing so, the legislator expressly considered that the judge could also take into account elements like the nature of the liability – e.g. whether the liability results from breach of contract or tort – and the nature of the act or omission that lead to the breach of contract or tort. By way of example, the legislator considered that the damages resulting from the deliberate destruction of objects might require a different treatment than damages resulting from a minor traffic violation.[74] Similarly, the judge in bankruptcy proceedings could take into account the nature of the mass damages claims to which the settlement relates and/or the act(s) or omission(s) from which the claims arose. The discretionary power to reduce damages can be applied to any type of damages claim, including consumer claims. After all, Section 10 of Book 6 DCC, including Article 6:109 DCC, applies to all legal obligations to pay damages, and does not distinguish between the legal bases from which they arise.[75]

Notably, Article 6:109(1) DCC does not prohibit courts to apply their discretionary power to reduce damages under said provision that result from (a breach of) obligations arising from mandatory law. If such partial cram-dawn of tort claim is possible outside insolvency proceedings, there does not seem to be a reason why to unduly limit a cram-down of such claim in the context of WHOA. Rather than categorically excluding (certain types of) mass tort claims from the possibility of being discharged in insolvency proceedings, such proceedings provide the court with useful tools to take decisions that are tailored to the specific circumstances of the case and strike an appropriate balance between the tortfeasor's obligation to pay damages to mass damage claimants on the one hand and its obligations vis-à-vis other creditors on the other hand.

5.2.2 Dischargeability of Future Claims in a WHOA Plan

In practice, environmental damage claims can take time to fully materialize, in particular where damage arises (long) after the tortious act has been committed.[76] A key question is whether a WHOA plan can also include those future damage claims, since the WHOA

73 *Parliamentary Papers*, 2019/20, 35 249, nr. 25, p. 3.
74 *Parliamentary Papers*, 1975/76, 7729, nr. 6-7, p. 109.
75 See Art. 6:95 DCC.
76 R.M. Hermans, 'Settling Mass Damage Claims Inside and Outside Insolvency Procedures: A Comparison of the Available Procedures', in: R. Brubaker et al. (Eds.), *Third Party Releases by Means of Bankruptcy Law Guarantees and (Mass) Tort*, Den Haag: Eleven Publishing, 2022, p. 75.

is silent on whether future claims are categorically included in its scope.[77] There are differing views on this topic.

Some insolvency authors argue that the WHOA expressly *includes* specifically identified future claims in its scope, which implies that – a contrario – future claims are *excluded* as a rule, save for those specifically identified future claims.[78] In our view, however, the same principle should apply in a WHOA process as in bankruptcy (and SoP) proceedings: the WHOA plan is capable of including current *and* future damage claims, provided they arise from a pre-existing 'legal position' – meaning, a pre-existing tortious act. This follows from the nature of the WHOA plan, which is designed to offer an improvement over – and be compared to – recovery in a bankruptcy process. A claim that can be admitted in bankruptcy proceedings should, therefore, in principle also be capable of being amended in a WHOA plan.[79]

In order to determine whether a "legal position" is pre-existing, a cut-off date is required. Unlike bankruptcy proceedings and SoP proceedings, the WHOA does not have a statutory commencement or fixation date for that purpose. Case law suggests that the debtor (or restructuring expert) has a degree of flexibility to determine such a cut-off date. In our view, the cut-off date can in any event be no later than the date on which creditors are admitted to vote on the WHOA plan. The WHOA plan can then be applied to environmental damage claims that arise from torts committed prior to that cut-off date, even if the damage arises thereafter (comparable to the SoP plan, see Section 4.2.1).

5.2.3 Dischargeability of Environmental Claims in a WHOA Plan

A more fundamental issue that remains is whether there are substantive reasons why *environmental* damage claims, by their nature, cannot (or should not) be amended in a WHOA plan. For the reasons mentioned above with regard to the SoP plan, we see no ground for excluding damage claims from the WHOA solely based on their nexus to environmental actions. A recent WHOA case suggests, however, that a discretionary ground for rejecting a WHOA plan[80] can be derived from the "public interest". The

77 Art. 370(1) Dutch Bankruptcy Act refers only to the amendment of 'rights' of creditors and shareholders in a WHOA plan.

78 For a discussion of this and other arguments against the (categorical) inclusion of future claims, see Concl. A-G G. Snijders, 26 March 2024, ECLI:NL:PHR:2024:346, paras. 4.8-4.17 and 4.41 et seq.; A.M. Mennens, *Het dwangakkoord buiten surseance en faillissement*, Deventer: Wolters Kluwer, 2020, pp. 446-447; A.H. Kroezen, 'Cassatie in het belang der wet: zijn gedwongen financiering van werkkapitaal en wijziging van rangorde mogelijk in een WHOA-akkoord?', *TvI* 2024/10, para. 2.5.

79 Similar views can be found in: J.L. Snijders, 'Fixatiebeginsel en de WHOA', *FIP* 2021/172, pp. 25-26; F.A. van de Wakker, annotation to District Court of Rotterdam 9 March 2023, ECLI:NL:RBROT:2023:2800, *NJ* 2023/184 (*IHC*), paras. 7-8; M.R. Schreurs & S.W. van den Berg, Art. 370 of the Bankruptcy Code, para. 4.1, *in Groene Serie Faillissementswet* 2023.

80 Art. 384(2)(i) Dutch Bankruptcy Act.

District Court of Amsterdam considered the following (unofficial translation, emphasis added):[81]

> In order to be able to approve a sanction application, the proposer of the restructuring plan must make it plausible, in light of Article 384, paragraph 2, sub i of the Bankruptcy Act, that the restructuring plan is reasonable. However, refusal on the grounds of Article 384, paragraph 2, sub i of the Bankruptcy Act can also occur *if the interests of third parties or the public interest are harmed*, for example, because the content of an restructuring plan is contrary to a mandatory legal provision or because the application of a legal provision is circumvented.

The consideration was prompted by the debtor's choice to structure the WHOA plan in a "tax neutral" way, which lead to the appointment of an independent expert to opine on whether this choice was contrary to the purpose and intent of fiscal laws and regulations.[82] The court's decision leaves scope in future cases to consider the public interest and application of mandatory provisions (e.g. deriving from consumer law) in determining whether a WHOA plan discharging mass environmental damage claims is "reasonable" and its sanctioning should be rejected.

5.2.4 Practical Considerations

An advantage of the WHOA is that the debtor (or restructuring expert, if appointed) has considerable flexibility in shaping the process, including determining the class composition, the voting process and the provision of information. This makes the WHOA particularly adaptable for managing a mass settlement process. The WHOA plan also offers significant flexibility to the debtor (or restructuring expert) to shape the terms of a plan.[83]

To the extent (current and future) mass environmental damage claims can be included in the WHOA plan then, as with the SoP plan, there remain practical hurdles to consider that stem from the difficulty to quantify damage claims for voting purposes (and in the case of a mass settlement, for the purposes of settlement distributions) and identify the relevant claimants.[84] These hurdles can be exacerbated in a WHOA process. We will give a few examples.

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81 District Court of Amsterdam 11 April 2024, ECLI:NL:RBAMS:2024:2361 (*Bio City*), para. 5.3.

82 The independent expert concluded that this was not the case, and the WHOA plan was subsequently sanctioned: District Court of Amsterdam 15 May 2024, ECLI:NL:RBAMS:2024:3441 (*Bio City*).

83 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, p. 395.

84 Ibid., p. 415.

Firstly, the WHOA imposes relatively far-reaching information obligations on the debtor (or restructuring expert, if appointed). This includes clear identification of the creditors whose rights are amended by the plan, by name or by category, and the causes of the financial distress.[85] Therefore, the debtor should be prepared to disclose (the causes of) the environmental harm that prompted the launch of a WHOA process and those who are affected by it.

Secondly, unlike SoP proceedings, the WHOA does not expressly provide for the appointment of a committee of representation with exclusive voting rights in large restructurings.[86] The legislator missed an opportunity here to import the practical benefits of that regime (see Section 4.2.3) to the WHOA. In our view, there is scope for a Dutch court to appoint a more informal creditors' committee with advisory or consultation rights, using its statutory power to order "special measures" in the interests of creditors.[87] Other authors have suggested this as well.[88] This can fulfil a function similar to that of the creditors' committee (*schuldeiserscommissie*) in bankruptcy proceedings.[89] A committee with advisory or consultation rights consisting of representatives of the mass damage claimants can create a channel through which the debtor can engage with (and inform) those claimants.

5.3 Public Law Environmental Claims

As remarked with respect to the SoP plan, public law environmental claims require careful examination of their regulatory context before considering the use of a WHOA plan. If the debtor is subject to ongoing cleanup obligations that qualify as estate claims in a bankruptcy (for instance, cleanup obligations that continue past the cut-off date described in Section 5.2.2), those obligations – including monetary claims arising from non-compliance (penalties and cost reimbursement orders) – can in, our view, not be discharged in a WHOA plan.

If the public law environmental claim does not qualify as an estate claim, the inclusion in a WHOA plan will depend on whether the public law environmental claim arises from a "legal position" that pre-dates the cut-off date described in Section 5.2.2. A penalty that was issued and remains outstanding as per that cut-off date can likely be included in a WHOA plan. By way of comparison, pre-existing monetary claims from

85 Art. 375(2)(b) and (e) Dutch Bankruptcy Act.

86 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer 2024, p. 396.

87 Art. 379 Dutch Bankruptcy Act.

88 H.J. de Kloe, *Invloed van schuldeisers in insolventieprocedures (Uitgaven vanwege het Instituut voor Ondernemingsrecht nr. 129)*, Deventer: Wolters Kluwer, 2023, para. 8.6.

89 Arts. 74-79 Dutch Bankruptcy Act.

government parties, such as the tax authority and the Government Employee Insurance Agency (*UWV*), are routinely included in WHOA plans. Whether a pre-existing cleanup order can be included is at present an untested issue, although we expect that the practical relevance of that question will be limited since these orders are more likely to be converted into monetary claims (see Section 3.3), which can be discharged in a WHOA plan.

Instead of seeking to discharge a public law environmental claim, a debtor can also use a WHOA plan to fund compliance with that claim. For example, a debtor can combine a temporary deferment of a public environmental claim with a WHOA plan that amends other financial liabilities that enable the debtor to meet that claim (e.g. extension of its credit facilities or provision of new money). The creditors of those amended financial liabilities may even, as a condition, demand environment-related undertakings in the (amended) credit documentation. This can be particularly attractive to retail banks seeking to improve their ESG profile. A WHOA plan can also provide for a transfer of the debtor company to a third-party acquiror that has the capabilities of continuing operations and pay for compliance with environmental regulations (in effect a distressed M&A transaction). In summary, the WHOA's flexibility as a restructuring tool provides a debtor with ample ways to address pre-existing public environmental liabilities.

6 Strategic Considerations in Choice of Restructuring Plan

Consider a debtor operating a factory that uses a volatile and corrosive chemical which, in violation of environmental regulations, is improperly stored. As a result, this chemical contaminates the nearby soil and water supply, leading to widespread harm to biodiversity and raising public health concerns. The municipality has issued administrative orders for the debtor to investigate the quality of the water supply (under threat of a penalty) and sanitize the affected soil. At the same time, an environmental NGO is calling for residents to join a class action against the debtor. The debtor was already in financial distress; they can neither fund the ordered investigation and cleanup nor pay the resulting penalty and the damages potentially awarded in a class action. Can the SoP or WHOA help discharge the environmental liabilities to avert bankruptcy?

In any restructuring scenario involving a multitude of interconnected liabilities, a debtor in financial distress should avoid dealing with each set of liabilities on their own and instead pursue a holistic approach that takes into account the interests of all creditors involved. It will be in the debtor's interest to reach an amicable solution with the relevant authorities (or at least seek engagement) prior to commencement of a restructuring process.

In the abovementioned hypothetical scenario, a first key step is to examine the applicable environmental regulations. These will indicate whether the administrative orders would classify as an (ongoing) estate claim in a bankruptcy, in which, in principle, it cannot be discharged in a WHOA plan or SoP plan. The debtor would then likely need to pursue an alternative restructuring to enable them to comply with the administrative orders (e.g. provision of new money, coupled with an amendment and extension of its credit facilities). Both the WHOA and SoP provide options for this route – if an amendment of secured debt is required, however, the WHOA remains the only option. If the administrative orders would *not* classify as an (ongoing) estate claim, then it is uncertain whether it can be discharged in a WHOA or SoP. In reality, however, it is more likely that the administrative orders would convert into monetary claims if the municipality carries out the cleanup of the soil (resulting in a cost reimbursement claim) and issues a penalty for the debtor's failure to investigate the water supply. Depending on the applicable environmental legislation and the moment that the legal position underlying those claims is deemed to have arisen, these monetary claims may be capable of discharge in a WHOA or SoP plan. However, this should not encourage a debtor to delay compliance with cleanup obligations in the hopes that these convert into a dischargeable claims, as such actions may lead to separate civil and administrative liability risks.

Both the WHOA and SoP proceedings provide a basis for the settlement of environmental mass damage claims, although the process of quantifying claims (for voting and/or distribution purposes) and identifying claimants remains an extremely complex endeavour. The SoP proceeding provides specific tools to address some of these hurdles, such as voting by a committee of representation instead of individual claimants.[90] However, assuming that an isolated resolution of mass environmental damage claims does not suffice to return the debtor to a going concern scenario, a WHOA plan provides a more flexible tool that can also amend rights that cannot be discharged in an SoP plan (e.g. environmental tax claims and secured debt).[91]

This consideration between the specific tools of SoP proceedings and the flexibility of the WHOA plan forms a part of a wider discussion within the field of insolvency specialists. The discussion at hand comes down to whether a SoP plan has any viability next to a WHOA plan. Van Galen states that a WHOA procedure is preferential in most cases, but appreciates that in certain situations SoP proceedings would be preferred.[92]

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90 D.A.M.H.W. Strik, 'Afwikkeling van massaschade in *distressed* situaties', *in* T.M.C. Arons, P.W.J. Coenen & G.F.E. Koster (Eds.), *100 jaar VEB bundel ter gelegenheid van het honderdjarig bestaan van de Vereniging van Effectenbezitters*, Deventer: Wolters Kluwer, 2024, p. 391.

91 Ibid., p. 395.

92 R.J. van Galen, 'Is er nog ruimte voor de surseance- en faillissements-akkoorden naast de WHOA', *FIP* 2023/2, p. 33.

In some scenarios a WHOA process may be preferred because it allows the debtor to continue paying their creditors. In contrast, during SoP proceedings a debtor has to pay off its creditors collectively in proportion.[93] Moreover, a WHOA procedure is a so called "debtor in possession"-procedure. Consequently the debtor has more control over the process compared to a SoP procedure.

On the other hand, an SoP is a relatively predictable and affordable process, bringing the benefit of the knowledge and experience of an appointed administrator and a supervisory judge. An administrator can provide support in case the board has difficult decisions to make and forms a safeguard for creditors. There is also an argument to be made for the fact that a fresh pair of eyes can advance (informal) negotiations that were previously stuck. The attendance of a supervisory judge during SoP proceedings is at times well-appreciated because it contributes to the transparency of the restructuring process.[94] As aforementioned, the SoP also provides the unique possibility to institute a committee of representation (see Section 4.2.2). When restructuring a company with many creditors this could be an argument to choose a SoP plan over a WHOA plan.[95] A SoP plan is also, in practice, the shortest route to a cooling-off period (*afkoelingsperiode*), as is underlined by Remmink and Van Galen.[96] Whichever restructuring tool proves to be the right fit, the debtor has to contend with the current global emphasis on environmental responsibility. This means that addressing environmental liabilities at a large scale not only necessitates a legal perspective but also requires a tactful approach to managing the associated social and reputational risks.

7 Concluding Remarks

Environmental responsibility and corporate restructuring are becoming increasingly intertwined as debtors face heightened liability risks and various stakeholders – including banks and investors – place greater emphasis on ESG-related objectives. In the advent of the newly introduced WHOA, the horizon of restructuring possibilities has broadened. This presents the restructuring landscape with new opportunities to simultaneously address financial liabilities and environmental accountability. In our view, it seems only a matter of time before we witness the first significant ESG-driven restructuring. It is incumbent upon the restructuring community to continue refining its understanding of the insolvency and ESG landscapes and their interaction.

93 Art. 233 Dutch Bankruptcy Act.

94 M.H. Remmink, 'De toekomst van surceance. Een verslag van de expertmeeting georganiseerd door de Nederlandse Vereniging voor Herstructurering', *Tvl* 2023/9, p. 2.

95 Ibid.

96 Ibid. See also R.J. van Galen, 'Is er nog ruimte voor de surseance- en faillissements-akkoorden naast de WHOA', *FIP* 2023/2, p. 33.