

DRAFT

LIENS AND SUPERLIENS

I. Definition of Liens and Superliens

A lien is a legal claim against the title of property to secure the payment of a debt or the performance of an obligation. Once such a claim or debt accrues, the creditor can usually follow a statutory procedure for creating and perfecting a lien. Typically, the holder of a lien accomplishes the perfection of the lien through recordation in a specified office, for example the Recorder of Deeds in which the property is located. Once perfected, the lien is granted priority against any subsequent claims upon the collateral of the lien, and the holder of the lien is considered a “secured” creditor. Secured creditor status becomes particularly significant in the event of a bankruptcy of the person or entity owing the underlying debt. As a general matter, a secured creditor will recover the value of its collateral from the bankruptcy estate prior to any other general, unsecured creditors.

For this reason, liens are frequently viewed as useful tools in the hands of state environmental enforcement agencies. Such agencies may incur costs in the investigation and remediation of contaminated parcels. By virtue of either a state superfund statute, or CERCLA, the federal environmental cost recovery statute,¹ the agencies will be entitled to recover such costs from defined categories of “responsible parties.” The owner of the contaminated parcel is considered to be a “responsible party.”

According to a comprehensive analysis of state superfund programs conducted in 2001 by the Environmental Law Institute,² some thirty-four states have authority to impose liens upon remediated property to recoup state investigation or remediation costs.³ The federal EPA has this power as well.⁴ Delaware law, however, does not provide DNREC with the authority to impose a standard lien upon the property of a party responsible for the incurrence of response costs by DNREC.

Normally, liens obtain priority based upon the order in which they were recorded. Thus, where a state agency files a regular lien on a contaminated parcel, and the parcel is burdened by prior liens, those lienholders will have the right to recover prior to the state. At least nine states have attempted to reorder this priority by the passage of so-called “superlien” statutes. A superlien takes automatic priority over

¹ CERCLA stands for the Comprehensive Environmental Response, Compensation and Liability Act, commonly referred to as the “Superfund” Act. 42 U.S.C. §§ 9601 *et seq.*

² See Environmental Law Institute, “An Analysis of State Superfund Programs, 50-State Study, 2001 Update,” published in November 2002 [hereinafter referred to as the “ELI 50-State Study”].

³ See ELI 50-State Study at 36.

⁴ See 42 U.S.C. § 9607(1). For information about how EPA implements its lien authority, see Office of Enforcement and Compliance Monitoring memorandum, “Guidance on Federal Superfund Liens,” dated September 22, 1987, and “Supplemental Guidance on Federal Superfund Liens,” dated July 29, 1993.

some or all previously recorded liens.⁵ Such a reordering of priority is viewed as justified, for in many cases, the property in question would have little or no security value had not the state incurred its remediation expenses.⁶

The benefits of a superlien provision for an environmental enforcement agency can be significant. As a secured creditor, the agency stands a much better chance of recovering any pre-bankruptcy expenses it incurs in the investigation or remediation of a site. In the event of a bankrupt property owner, the agency would stand first in line to recover its costs, at least where there is some value remaining in the remediated parcel. Without a superlien, the agency would likely find itself in the class of general unsecured creditors, with a lower likelihood of recovering its pre-petition incurred costs. Even where the costs of the remediation are higher than the value of the parcel on which there was a release, the agency may be aided by a lien, because as discussed below, liens can attach to property other than the contaminated parcel.

An additional benefit of an environmental superlien is that the agency can act to create and perfect such a lien after a petition for bankruptcy, an opportunity not typically afforded to an entity seeking secured creditor status. The automatic stay provision of the Bankruptcy Code⁷ stops a wide variety of creditor collection activities against a debtor once a debtor petitions for bankruptcy. However, this automatic stay does not prohibit an environmental enforcement agency which has expended pre-petition funds on investigation or remediation from filing and perfecting a post-petition superlien.⁸

II. Scope of State Superlien Provisions

The one feature common to the various state superlien provisions is that they allow the environmental enforcement agency to impose upon a contaminated parcel a lien which takes priority over any prior liens on the parcel, at least where such prior liens were created after the enactment of the

⁵ According to the ELI 50-State Study, at 37, the states with superlien provisions are Connecticut, Hawaii, Louisiana, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, and Wisconsin. The ELI 50-State Study also lists Delaware as having such a provision, but this appears to be an error, as HSCA has no such provision, and DNREC does not believe that there is any other provision of law which provides it with the authority to file an environmental lien. Other sources which attempt to compile those states with superlien provisions also show some variety in the states listed. *See* Nash, “Environmental Superliens and the Problem of Mortgage-Backed Securitization,” 59 Wash. & Lee L. Rev. 127 at 146 n. 78 (2002) (hereinafter “Environmental Superliens”) (noting variation among recent lists of states with superlien statutes, and attributing the variation to disagreement about what constitutes a true “superlien” statute).

⁶ For detailed discussions of state superlien provisions, *see generally* Nash, “Environmental Superliens” 59 Wash. & Lee L. Rev. 127 (2002); Manaster and Selmi, 1 State Environmental L. §§ 9.26 – 9.31 (2002); Note, “Recovering Costs for Cleaning Up Hazardous Waste Sites: An Examination of State Superlien Statutes,” 63 Ind. L. Rev. 571 (1988); Note, “State ‘Superlien’ Statutes: An Attempt to Resolve the Conflict Between the Bankruptcy Code and Environmental Law,” 59 Temple L.Q. 981 (1986).

⁷ 11 U.S.C. § 362(a).

⁸ *See In re 229 Main Street Limited Partnership*, 262 F.3d 1, 12-13 (1st Cir. 2001).

superlien statute. Certain provisions in several states provide additional powers for the environmental enforcement agency, as discussed below.⁹

A. Property Affected

Certain provisions allow states to impose a lien not just against the contaminated parcel, but against other property owned by the debtor. New Hampshire allows the state to extend a superpriority lien against “business revenues generated from the facility on which hazardous waste or hazardous materials is located and personal property located at the facility on which hazardous waste or hazardous material is located.”¹⁰ However, no other state provisions allow superpriority status for any lien attached to any property other than the contaminated parcel.¹¹ Other states do, however, allow regular liens against non-contaminated property. The New Jersey Department of Environmental Protection, for example, has authority to attach a lien to “the revenues and all real and personal property of the discharger, . . .”¹² Such a lien would be subordinated to any prior liens upon the non-contaminated property.

Because contamination issues are much more likely to arise on commercial properties, most of the state superlien statutes exclude residential property from the scope of property affected.¹³

B. Impact upon Liens Established Prior to Enactment of Superlien Law

In Connecticut and Maine, if there is a lien upon a parcel which was created prior to the enactment of the superlien statutes in those states, the environmental lien does not take priority over such prior lien. However, in Hawaii, Louisiana, Massachusetts, New Hampshire, New Jersey, and Wisconsin, the provisions provide superpriority status against any prior lien, regardless whether such prior lien was created before or after enactment of the superlien statute.¹⁴ Potential constitutional concerns about such provisions are discussed below.

C. Cost Items Recoverable Through Liens

⁹ Professor Nash’s article on superliens contains a comprehensive chart comparing in detail the variations amongst the various state provisions. *See* Nash, “Environmental Superliens,” 59 Wash. & Lee L. Rev. at 152, Table 1.

¹⁰ N.H. Rev. Stat. Ann. § 147-B:10-b(III)(b).

¹¹ The Connecticut statute does provide superpriority against “real estate which has been included, within the preceding three years, in the property description of the affected real estate and is contiguous to such real estate.” Conn. Gen. Stat. Ann. § 22a-452a(f). Maine contains a similar provision. Me. Rev. Stat. Ann. tit. 38, § 1371(2)(A).

¹² N.J. Stat. Ann. § 58:10-23.11(f).

¹³ *See* Nash, “Environmental Superliens,” 59 Wash. & Lee L. Rev. at 152, Table 1.

¹⁴ *See* Nash, “Environmental Superliens,” 59 Wash. & Lee L. Rev. at 156.

A lien can only be asserted once a state has expended funds for site cleanup. Preliminary investigative and site assessment costs, in addition to any actual removal or remedial response costs, can be recorded as a lien.¹⁵

Louisiana's lien provision apparently allows for the recording of a lien before the full amount of costs incurred by the agency is known, and allows the lien to relate back to the date of filing.¹⁶

III. Problems Associated with Superlien Provisions

A. Constitutional Issues

Superlien provisions can pose constitutional problems, including the possibility that the laws operate to impermissibly impair contract, that they serve as a deprivation of property without due process of law, and as a taking without just compensation. Such concerns are magnified for a superlien which operates retroactively. If a superlien can displace the priority of a lien which was created and perfected prior to the passage of the state superlien statute, the argument that the superlien operates as a taking without just compensation would undoubtedly be asserted by the holder of the prior lien.¹⁷

At least with respect to New Jersey's aggressive superlien provision, a court has rejected various constitutional attacks, and found the provision to be an acceptable use of the state's police power.¹⁸

B. Potential Negative Impact Upon Credit Markets

Beyond constitutional considerations, superlien provisions raise concerns due to their impact upon credit markets. If a superlien takes priority over prior liens upon a parcel, the owners of the prior liens may fail to recover any value from the collateral, and the settled expectations of the lenders owning those prior liens will be upset. The uncertainty generated by such liens will, to some degree, raise the cost of borrowing funds.

Because prior liens are at risk, the mortgage lending community has not viewed superlien statutes favorably. When Massachusetts passed its superlien statute in 1983, the Federal Home Loan Mortgage Corporation threatened to suspend its purchases of all single-family residences in the state. Massachusetts quickly exempted residential property from the scope of its statute.¹⁹

¹⁵ See *Acme Laundry Co. v. Secretary of Environmental Affairs*, 410 Mass. 760, 575 N.E.2d 1086 (1991).

¹⁶ See ELI 50-State Study at 37.

¹⁷ A detailed analysis of these constitutional concerns is contained in an article in the *Indiana Law Journal*. See Note, "Recovering Costs for Cleaning Up Hazardous Waste Sites: An Examination of State Superlien Statutes," 63 *Ind. L. Rev.* 571, 585-99 (1988).

¹⁸ *Kessler v. Tarrats*, 191 N.J. Super. 273, 466 A.2d 581 (Ch. Div. 1983), *aff'd*, 194 N.J. Super. 136, 476 A.2d 326 (App. Div. 1984).

¹⁹ Nash, "Environmental Superliens," 59 *Wash. & Lee L. Rev.* at 129-30.

Jonathan Remy Nash, an Associate Professor of Law at Tulane Law School, has attempted to use the tools of economics to make some evaluation of the impact of superlien provisions upon credit markets.²⁰ Professor Nash concluded that the direct and immediate costs of superliens on the residential mortgage market are minor, as most statutes exclude residential properties. The more significant potential cost associated with such statutes is the nonuniformity they introduce in the lien priority schemes amongst various states. This nonuniformity may negatively impact the ability of financial institutions to pool large groups of mortgages for securitization. Professor Nash noted that as the trend of increased securitization of commercial mortgages continues to grow, it can be safely predicted that financial institutions will resist any new superlien statutes, even where residential properties are exempted from coverage.²¹ Importantly, however, Professor Nash concluded that states might rationally determine that the benefits of superlien statutes outweigh such costs.²²

IV. Interaction of Liens and Superliens with Bankruptcy Law

A. HSCA's Provision Addressing the Issue of Bankruptcy

Delaware's equivalent to the federal Superfund Act is the Hazardous Substance Cleanup Act, or HSCA.²³ Section 9117 of that act addresses the situation of a bankruptcy. It states:

No obligations imposed by this chapter shall constitute a lien or claim which may be limited or discharged in a bankruptcy proceeding. All obligations imposed by this chapter shall constitute continuing regulatory obligations imposed by the State.²⁴

This language was likely drafted with federal bankruptcy caselaw in mind.²⁵ In a reorganization under Chapter 11 of the Bankruptcy Code, the issue of whether particular obligations of the debtor can be characterized as "debts" for purposes of the Bankruptcy Code frequently arises. A "debt," defined as a "liability on a claim,"²⁶ is subject to discharge in Chapter 11, whereas obligations not characterized as debts may remain effective after reorganization.²⁷ Current caselaw holds that the injunctive orders of an environmental enforcement agency which require responsible parties to address current, ongoing contamination should not be characterized as "debts" for purposes of the Bankruptcy Code. Accordingly,

²⁰ Id.

²¹ Id. at 131-33.

²² Id. at 192.

²³ Del. Code. Ann. tit. 7, §§ 9101 *et seq.*

²⁴ Del. Code. Ann. tit. 7, § 9117.

²⁵ The language appears to have been taken verbatim from the New Jersey Industrial Site Recovery Act, N.J. Stat. Ann. § 13:1K-12.

²⁶ 11 U.S.C. § 101(12). The term "claim" is defined at 11 U.S.C. § 101(5).

²⁷ With respect to an individual debtor, a similar question arises in Chapter 7 proceedings. The issue does not arise in a Chapter 7 liquidation proceeding of a corporate entity, as there is no concept of "discharge" for corporate entities in Chapter 7.

such injunctive orders will survive intact through a Chapter 11 reorganization.²⁸ Section 9117 of HSCA attempts to minimize the risk to DNREC of discharge through bankruptcy by stating that all of the obligations imposed upon regulated entities by HSCA are “continuing regulatory obligations.”

However, it is important to note that in at least some contexts, DNREC may have claims against a responsible party that would face a risk of discharge, notwithstanding the language of HSCA section 9117. The question of what obligations constitute a “debt” for purposes of the Bankruptcy Code is a question of federal law, and the language of a state statute does not control the issue. Thus, although many of the obligations imposed upon regulated entities under HSCA may be “continuing regulatory obligations,” such as an obligation pursuant to a HSCA enforcement order to remediate a site, this is not the case for all of the obligations imposed by HSCA. Where, for example, DNREC itself incurs costs in the investigation or remediation of a site, HSCA allows DNREC to recover such costs.²⁹ If such costs have been incurred by DNREC, and the corporate responsible party subsequently files for reorganization under Chapter 11, or if an individual, under Chapter 7, DNREC’s claim is at risk of discharge by the bankruptcy court, notwithstanding the language of HSCA section 9117.³⁰

Several provisions in the federal Bankruptcy Code operate to ameliorate the risk to DNREC represented by a bankruptcy of an entity responsible for current or historical releases.³¹ However, at least in the situation in which DNREC itself incurs investigation and remediation expenses prior to a bankruptcy petition, the addition of a superlien provision would appear to provide one further potentially useful tool.

²⁸ See *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3rd Cir. 1993).

²⁹ Del. Code Ann. tit. 7, § 9105(b).

³⁰ See *Ohio v. Kovacs*, 469 U.S. 274 (1985). DNREC is, of course, also exposed to the risk of losing pre-petition costs in a Chapter 7 liquidation proceeding of a corporate entity, and in that context as well, the secured creditor status conferred by a superlien provision increases the chances of any recovery.

³¹ As discussed above, the most useful tool in DNREC’s arsenal is its own injunctive powers, because injunctions addressing ongoing releases may survive discharge. See *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3rd Cir. 1993). Yet even where DNREC itself incurs costs, general unsecured creditor status may be avoided. For example, DNREC could argue that any post-petition costs associated with the remediation of a parcel should be characterized as administrative costs of the bankruptcy estate, and therefore given priority over the general unsecured creditors. See *Commonwealth of Pa., Dep’t of Natural Resources v. Conroy*, 24 F.3d 568 (3rd Cir. 1994). Additionally, in the absence of a lien on a parcel, DNREC may be able to obtain priority over even the secured creditor through section 506(c) of the Bankruptcy Code. That provision provides a vehicle for the assessment of remediation costs against the property serving as collateral. The provision allows the trustee to recover “from property securing an allowed claim the reasonable, necessary costs of such property to the extent of any benefit to the holder of such claim.” 11 U.S.C. § 506(c). Thus, where a trustee, or even some other environmental claimant such as DNREC, acts to remediate a release at secured property, and where such action confers a benefit on the secured creditor, by increasing the value of its collateral, such costs may be charged against the value of the collateral, and may be collected prior to the secured creditor receiving any funds.