

## Environmental Liabilities, Creditors, and Corporate Pollution: Evidence from the Apex Oil Ruling

*Jianqiang CHEN (National Tsing Hua University), Pei-Fang HSIEH (National Tsing Hua University),  
Po-Hsuan HSU (National Tsing Hua University) and Ross LEVINE (University of California, Berkeley and ABFER)*

Corporate pollution harms public health and the environment. The Environmental Protection Act (2014-2016) shows that industrial pollution accounts for most U.S. land and water pollution. Previously, in a series of landmark cases, U.S. courts ruled that obligations to clean up polluted sites were financial "claims", making those environmental obligations dischargeable under Chapter 11 like other debts. However, in a pivotal decision—the 2008 Apex Oil decision – the courts materially reduced the circumstances under which environmental liabilities could be discharged in Chapter 11 bankruptcy.

In *Apex*, the Department of Justice and EPA brought an action under the **Resource Conservation and Recovery Act (RCRA)**, seeking injunctive relief requiring the corporate successor of Apex Oil to clean up a site that Apex Oil contaminated before filing for Chapter 11. On July 28, 2008, the U.S. District Court for the Southern District of Illinois ordered Apex Oil Company Inc. (the successor) to clean up the contamination. In essence, the decision makes the environmental obligations under RCRA "non-claims" as defined by Chapter 11 and hence not financially dischargeable.

Against this backdrop, Jianqiang Chen, Pei-Fang Hsieh, Po-Hsuan Hsu of National Tsing Hua University, and Ross Levine of the University of California, Berkeley, presented their paper titled *Environmental Liabilities, Creditors, and Corporate Pollution: Evidence from the Apex Oil Ruling*.

In this paper, the authors evaluate the impact of the 2008 Apex Oil court decision that made the creditors of some corporations more liable for the environmental damage caused by their corporations. Before the court decision, firms in bankruptcy could shift their environmental cleanup liabilities from creditors to taxpayers. The 2008 court decision effectively means that a firm's creditor will collect less from a bankrupt firm with environmental cleanup liabilities. Creditors, therefore, will price such exposure in their lending to firms potentially legally liable for environmental damages.

The authors found that after the 2008 *Apex Oil* court decision, corporations heavy in emitting RCRA pollutants released fewer such contaminants, and the drop was larger among firms closer to bankruptcy. Furthermore, there was no change in non-RCRA-chemical releases after *Apex*.

The authors also found a significant drop in the prices of bonds issued by heavy RCRA-polluters with high default probabilities. However, there was no change in the value of bonds issued by heavy RCRA-polluters with low default probabilities.

The authors found similar results when analyzing interest rates, discovering a significant increase (+39 bps) in interest rates after the 2008 Apex Oil court decision for heavy RCRA-polluters close to bankruptcy. Likewise, the bank loan spreads also widened appreciably for heavy RCRA-polluters closer to bankruptcy. These findings indicate that creditors and debtholders are aware of the enhanced risk and potential loss due to the *Apex* decision and reacted rationally in pricing the higher environmental risk and expected loss.