

Regulatory Fines Dischargeable in Bankruptcy

Debtors facing regulatory fines and penalties want to shed them in bankruptcy and emerge without paying them. With certain exceptions, the Bankruptcy Code provides for the discharge of most debts that arise before a plan is confirmed. In *In re Exide Technologies*, a case currently pending in Delaware, an environmental agency argued that certain penalties were non-dischargeable as debts "obtained by . . . false pretenses, a false representation, or actual fraud."

Shortly before Exide filed its Chapter 11 case, the state of California ordered the suspension of Exide's operations for failing to comply with certain state requirements relating to the Clean Air Act. Following Exide's bankruptcy filing, the South Coast Air Quality Management District filed an administrative proof of claim for approximately \$39 million in liquidated penalties against its bankruptcy estate as a result of Exide's failure to comply with environmental regulations. Exide objected to the claim after its plan was confirmed and argued that the fines had been discharged under [Section 1141\(d\) of the Bankruptcy Code](#), which, subject to certain exceptions, discharges all debts arising prior to confirmation of the plan. The agency responded that the penalties were "debts" that had been incurred due to Exide's "alleged misrepresentations, fraud, and fraud-like activities" and, thus, were non-dischargeable in the bankruptcy proceedings. Exide replied that the agency's claim consisted of "ordinary noncompensable penalties owed to a governmental unit" and, therefore, was properly the subject to discharge. Additionally, and citing *Pennsylvania Dep't. of Env'tl. Res. v. Tri-State Clinical Labs., Inc.*, 178 F.3d 685, 698 (3d Cir. 1999) Exide claimed that criminal fines arising from post-petition behavior are not administrative expenses of the estate subject to payment in full. The agency attempted to distinguish *Tri-State*, arguing that the penalties against Exide were civil in nature.

The U.S. District Court for the District of Delaware ultimately sided with Exide and found that the agency's claim was dischargeable. The court further held that the fines were not entitled to administrative priority, regardless of whether they were labeled as civil, because the fines were intended to "punish and deter" the debtor and clearly did not "benefit the estate." While this decision is a victory for entities seeking to discharge fines and penalties, potential debtors burdened with regulatory fines should be aware of and evaluate the exceptions to dischargeability provided by [Section 1141\(d\)\(6\)\(A\)](#) of the Bankruptcy Code.

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