

Establishing the Order of Priority for the Settlement of Environmental Claims in Corporate Bankruptcy

Cheng Li

The Marxism College of Zibo Polytechnic University, Zibo, China

Abstract: Environmental and ecological issues arising from corporate production and business operations remain prominent. Compared to enterprises operating under normal conditions, market entities facing bankruptcy are mired in severe economic difficulties, causing economic hardship and environmental pollution to become intertwined and exacerbating the conflict. However, the current Bankruptcy Law suffers from a systemic failure to address the succession of corporate environmental liabilities and the protection of environmental interests, resulting in significant erosion of the environmental interests of relevant parties. As ordinary claims, environmental claims typically rank behind other priority claims in the order of priority for repayment, making it difficult to effectively safeguard environmental interests and violating the requirements of substantive fairness. Based on the realities of China's ecological civilization construction and bankruptcy system, we must systematically explore the priority of environmental claims in corporate bankruptcy. This is not only an intrinsic requirement for improving China's bankruptcy legal system and ensuring fair compensation for creditors, but also an essential step in advancing the construction of a Beautiful China through the rule of law and realizing the harmonious coexistence of humanity and nature.

Keywords: Corporate bankruptcy; environmental claims; priority of claims.

1. Introduction

Given the current dilemma in bankruptcy practice where remedies for the protection of environmental interests are inadequate, there is an urgent need to restructure the priority of environmental claims in corporate bankruptcy proceedings and to embed the concept of ecological civilization into the legal framework governing bankruptcy. This is not only the appropriate course of action for bankruptcy law to respond to societal needs, but also an institutional necessity for achieving green transformation and sustainable development.

2. The Concept of Environmental Claims

Under the provisions of China's Enterprise Bankruptcy Law, claims held against a debtor at the time a people's court accepts a bankruptcy petition are referred to as bankruptcy claims. Environmental claims are not explicitly defined as a separate category of claims under the Enterprise Bankruptcy Law; they typically arise when a bankrupt enterprise commits an environmental tort or breaches its obligations under an environmental contract. Environmental claims refer to the right of a creditor to demand payment of a specific monetary amount from the debtor in bankruptcy proceedings, arising from the debtor's environmental torts or breaches of environmental contracts. Currently, China's Enterprise Bankruptcy Law does not provide special protection for environmental claims, and in practice, they are generally treated as ordinary claims. Whether an environmental claim qualifies as a bankruptcy claim also depends on whether it can be quantified in monetary terms. Bankruptcy proceedings involve liquidating the bankrupt enterprise's assets to repay creditors in cash; if an environmental claim cannot be quantified in monetary terms, it cannot be realized through bankruptcy proceedings.

Compared to general civil torts, environmental pollution and ecological damage exhibit distinct characteristics. The

consequences of such harm are often diffuse, persistent, and cumulative, frequently affecting numerous victims and even the broader public. Environmental claims not only tend to involve multiple claimants but also generate significant externalities in terms of their social impact. Furthermore, the nature of environmental claims is relatively complex, involving multiple types of interests that may encompass both public and private interests, or even a combination of both. Private interests, in turn, can be further subdivided into personal and property interests. For this reason, the identification, classification, and satisfaction of environmental claims in corporate bankruptcy proceedings are more complex than those of general claims.

3. Types of Environmental Claims

Environmental claims are diverse in nature. The legal consequences arising from acts of environmental pollution or ecological damage may give rise to claims of different types. For example, claims for compensation for personal injury or property damage arising from harm to specific victims primarily serve to remedy individual rights; whereas claims for compensation for ecological and environmental damage, which are aimed at restoring the ecological environment and safeguarding the public interest in environmental protection, possess a more distinct public interest character. Based on a typological analysis and categorization of environmental claims, environment-related claims can be divided into the following categories.

3.1. Claims for Compensation for Ecological and Environmental Damage

Claims for compensation for ecological and environmental damage arise from the damage caused to the ecological environment itself and its ecological functions as a result of tortious acts committed by bankrupt enterprises, such as environmental pollution and ecological destruction. Ecological and environmental damage generally refers to

adverse changes in environmental elements—such as the atmosphere, water bodies, soil, and forests—as well as biological elements—such as flora, fauna, and microorganisms—which lead to the degradation of ecosystem functions. Unlike traditional tort claims, which focus on compensating for personal injury or property damage, the subject matter protected by such claims primarily concerns ecological and environmental elements and ecosystem functions, thereby possessing a public interest nature. In terms of the scope of compensation, it generally includes losses resulting from the loss of service functions during the period from the time of ecological and environmental damage until restoration is completed; losses resulting from permanent damage to ecological and environmental functions; costs for investigation, appraisal, and assessment; costs for pollution cleanup and ecological restoration; as well as reasonable expenses incurred to prevent the occurrence or expansion of damage.[1]

3.2. Claims for compensation for property damage resulting from environmental torts

A claim for compensation for property damage resulting from environmental torts refers to the creditor's legal right to seek compensation from the debtor when the debtor's acts of environmental pollution or ecological destruction result in an actual diminution of the creditor's property rights. The establishment of such a claim typically requires the existence of an environmental tort, the occurrence of property damage, and a legal causal relationship between the tortious act and the resulting damage. This manifests specifically as a reduction in property value resulting from an enterprise's environmental pollution, such as the death of livestock or reduced crop yields. Unlike claims for compensation for ecological and environmental damage, such claims do not have the direct objective of restoring the ecological environment itself; rather, their core purpose is to protect the individual property interests of specific parties.

3.3. Claims for compensation for personal injury resulting from environmental torts

Claims for compensation for personal injury arising from environmental torts are closely related to personal interests. They refer to the legal right of victims to seek liability from a bankrupt enterprise when such an enterprise infringes upon the rights to life, bodily integrity, or health of others through environmental pollution or ecological damage. Such claims typically manifest as personal injury, including illness, disability, or even death. In terms of the scope of compensation, this primarily includes reasonable expenses incurred for treatment and rehabilitation, such as medical expenses, nursing fees, nutritional expenses, and hospitalization meal allowances, as well as lost income due to missed work. In cases resulting in disability, compensation should also include the cost of assistive devices and disability compensation; in cases resulting in death, compensation should include funeral expenses and death compensation.

3.4. Claims for Breach of Environmental Contracts

A claim for breach of an environmental contract refers to the right of a party to a contract for environmental services to seek legal remedies against the debtor for breach of contract,

arising from the debtor's failure to fulfill its contractual obligations. Based on the cause of the obligation, claims can be classified into contractual obligations and statutory obligations; the former are based on the mutual consent of the parties, while the latter arise directly from legal provisions. Claims arising from breach of environmental contracts fall under the category of consensual environmental claims. Their essential characteristic lies in the fact that the creditor-debtor relationship is established through mutual agreement between the parties and transforms into a right to claim monetary performance due to one party's breach of contractual obligations. In the context of corporate bankruptcy, such claims typically arise when the counterparty to an environmental services contract—having provided services such as energy performance contracting, environmental remediation, environmental cleanup, and environmental impact assessments in accordance with the contract—is entitled to demand payment of the contract price and liquidated damages from the bankrupt enterprise. For example, if the counterparty has fulfilled contractual obligations such as waste and wastewater cleanup, but the debtor has failed to pay the corresponding fees as stipulated in the contract, a claim for breach of an environmental contract arises.

3.5. Claims for punitive damages for environmental torts

A claim for punitive damages for environmental torts refers to the right of an injured party to seek punitive damages from a debtor who has intentionally committed illegal acts that pollute the environment or damage the ecosystem, thereby causing serious consequences, in accordance with the law.[2] The establishment of such claims is predicated on the debtor having acted with intent, having objectively committed acts of environmental pollution or ecological destruction, and having caused serious consequences.

3.6. Claims for Environmental Administrative Fines and Criminal Fines

Claims for administrative fines and criminal fines for environmental violations refer to monetary claims arising from fines imposed by administrative agencies or criminal fines imposed by people's courts in accordance with the law against debtors who have polluted the environment, damaged ecosystems, violated environmental laws, or breached criminal law provisions.

4. Priority Ranking for Environmental Claims

Against the backdrop of the revision of the Enterprise Bankruptcy Law and the imminent implementation of the Ecological and Environmental Code, the issue of the priority of environmental claims in bankruptcy proceedings has become a key link between bankruptcy law and environmental law.[3] Bankruptcy proceedings are a process through which a debtor makes a comprehensive settlement of debts to all creditors. After covering bankruptcy expenses and administrative expenses, the bankruptcy estate is used to satisfy, in the following order, claims by employees, social insurance contributions, tax liabilities, and unsecured claims; if the estate is insufficient to satisfy claims within the same priority class, distribution is made on a pro rata basis. Environmental claims are treated as ordinary claims during

the bankruptcy distribution phase, making it difficult to obtain full satisfaction. Given the legitimacy and feasibility of environmental claims taking priority over ordinary claims, their priority ranking should be guided by the principles of fairness and efficiency, balancing the interests of all parties to the greatest extent possible.

4.1. Environmental Claims and Secured Claims

In bankruptcy proceedings, secured claims (i.e., claims with a right of set-off) enjoy an exclusive priority in repayment under the law, based on existing security interests or special priority rights in specific assets of the bankrupt enterprise. When establishing the order of priority for the repayment of environmental claims, a prudent approach should be adopted, and the existing priority of secured claims should not be easily disrupted. Placing environmental claims above secured claims would improperly shift the environmental liabilities that should be borne by the bankrupt enterprise onto innocent secured creditors. Since the secured creditors of a bankrupt enterprise are predominantly financial institutions such as banks, any damage to their interests would inevitably transmit risks to the broader base of small and medium-sized depositors, thereby undermining the stability and security of the social financial order. It should be noted that environmental claims arising after the filing of bankruptcy constitute foreseeable operating costs. Their resolution is critical to the enterprise's lawful continued existence and the preservation of its operational value; therefore, they should be classified as administrative expenses and given priority for repayment after secured claims.[4]

4.2. Environmental Claims and Employee Claims

Under the law, employee claims are granted a statutory priority ranking second only to claims subject to the right of set-off, bankruptcy expenses, and debts for the common benefit. The theoretical basis for granting employee claims priority in repayment lies in the fact that workers occupy a relatively disadvantaged position in bankruptcy proceedings, and that such claims directly concern individuals' fundamental rights to subsistence and development, constituting a core social security interest essential to maintaining social order and stability. For employees of a bankrupt enterprise, corporate bankruptcy not only entails a reduction in existing wages but also results in the loss of expectations for stable future income. Therefore, the priority settlement of employee claims provides vulnerable groups with necessary livelihood security during the transition period and effectively mitigates the negative impacts of bankruptcy. Claims for personal injury resulting from environmental torts similarly occupy a vulnerable position, being difficult to prevent and unforeseeable. Consequently, such environmental claims may be settled in the same order as employee claims to reflect the priority protection of supreme legal interests, such as the right to life and the right to health.[5]

4.3. Environmental Claims and Tax Claims

Taxes are the primary source of funding for the government to provide public goods. Through coordinated planning, the government allocates tax revenues to various aspects of social development. Taxes serve as the economic foundation for the government to fulfill its public management responsibilities,

sustaining social development and stability. They play a vital role in promoting social equity and advancing common prosperity. Claims for compensation for ecological and environmental damage are claims arising from infringements upon the public interest. Their function is similar to that of tax claims and social insurance claims, with the core objective being to safeguard and remedy public interests in the ecological and environmental sphere. The funds corresponding to such claims are primarily allocated to specific expenditures such as the remediation and restoration of ecological and environmental damage. Although claims arising from breaches of environmental contracts and claims for compensation for property damage resulting from environmental torts reflect contractual liability and tort liability, respectively, they are not ordinary claims in the general sense; they possess significant externalities and social implications. Granting these three categories of environmental claims priority in the order of repayment will, on the one hand, enhance society-wide environmental protection awareness and public recognition of green enterprises, and on the other hand, compel market entities to establish long-term, environmentally friendly development mechanisms. This is not only a crucial means of implementing enterprises' primary responsibility for environmental protection but also an inevitable choice for achieving sound social governance. In summary, to ensure that such environmental claims are settled reasonably and fairly, corporate bankruptcy proceedings should align with the concept of green development and place the aforementioned three categories of environmental claims on the same priority level as tax claims.

4.4. Environmental Claims and Ordinary Claims

China's Enterprise Bankruptcy Law is fundamentally aimed at achieving a fair, orderly, and reasonable distribution of claims, with the goal of effectively safeguarding the legitimate rights and interests of all types of creditors. The legitimacy of the bankruptcy priority system primarily lies in its alignment with the requirements of distributive justice and substantive justice. With regard to claims for punitive damages for environmental torts, claims for administrative fines for environmental violations, and claims for criminal fines, all three possess distinct "punitive" attributes; the purpose of punishment is not to compensate for damages but to sanction illegal conduct. Consequently, the priority of such claims in bankruptcy proceedings should, in principle, be subordinate to that of compensatory claims aimed at remedying harm. Otherwise, if punitive claims were granted the same priority as ordinary claims, the result would be that the debtor would not actually bear the punitive liability; instead, the "punishment" would be shifted to other creditors by reducing the share of the bankruptcy estate allocated to them. Such an outcome not only runs counter to the original purpose of establishing punitive claims but also conflicts with the fundamental principle of equitable distribution under bankruptcy law. Therefore, it is necessary to place claims for punitive damages arising from environmental torts, administrative fines for environmental violations, and criminal fines in the bankruptcy distribution order behind ordinary claims.

As a cornerstone of national governance, the rule of law is fundamentally about achieving a deep integration of governance by rules and ecological considerations.

Accordingly, embedding the underlying logic of green development into bankruptcy law and promoting a paradigm shift toward a greener bankruptcy system is not only the inevitable path to addressing the challenges of our time, but also the inherent logic of bankruptcy law's development within the context of ecological civilization.

5. Summary

The fundamental purpose of bankruptcy proceedings is to ensure the fair and reasonable settlement of claims and to balance the interests of all parties in order to achieve the optimal social outcome. However, China's current Enterprise Bankruptcy Law pays insufficient attention to environmental claims, making it difficult to effectively safeguard the interests of environmental creditors—a situation that runs counter to the inherent requirements of building a rule of law for ecological civilization. Therefore, it is imperative to draw upon China's environmental legal practices, adopt a holistic approach, and refine the top-level design of legislation to explicitly elevate the priority of environmental claims, ensuring they receive priority in the distribution of bankruptcy assets. On this basis, a systematic supporting safeguard mechanism should also be established. Only in this way can the practical challenges in bankruptcy cases involving ecological and environmental issues be systematically resolved, the recovery rate of environmental

claims be effectively improved, and the “polluter pays” principle be consistently implemented throughout all stages of a company's lifecycle. This will provide a solid institutional guarantee for advancing the rule of law in ecological civilization, safeguarding public interests, and protecting citizens' environmental rights.

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