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From the Bankruptcy Courts

Benjamin Weintraub* and Alan N. Resnick**

TREATMENT OF CONTINGENT AND UNLIQUIDATED CLAIMS UNDER THE BANKRUPTCY CODE

The Supreme Court’s decision in Northern Pipeline Construction Co. v. Marathon Pipeline Co.,¹ which declared the bankruptcy court unconstitutional, does not eliminate the necessity for courts to deal with contingent and unliquidated claims in bankruptcy cases. Whether they are bankruptcy courts, operating under the authority of a judicial conference rule adopted as a local court rule,² or district courts acting as a bankruptcy court, they face complex and troublesome problems resulting from tort, products liability, warranty, or other contingent or unliquidated claims.³

¹ See former Bankruptcy Act §§ 57(d), 63(d).
³ Thompson v. England, 226 F.2d at 490.

The treatment of contingent or unliquidated claims under the former Act is illustrated in Thompson v. England.⁵ A wife loaned her husband $12,000, to be repaid from the proceeds of his business “as soon as said business is in a sound financial position.”⁶ When the husband filed a

¹ 102 S. Ct. 2858 (1982).
² The Judicial Conference of the United States published a proposed emergency rule to be adopted by local district courts for the purpose of continuing the operation of the bankruptcy courts with limited jurisdiction.
⁴ See former Bankruptcy Act §§ 57(d), 63(d).
⁵ 226 F.2d 488 (9th Cir. 1955); see also Maynard v. Elliott, 283 U.S. 273 (1931); State v. Wilkes, 41 N.Y.2d 655, 394 N.Y.S.2d 849 (1977).

Treatment Under the Former Act

The former Bankruptcy Act dealt with the problem of contingent or unliquidated claims by recognizing them as provable and allowable unless the court determined either that they were not capable of liquidation or of reasonable estimation or that liquidation or estimation would unduly delay the administration of the estate.⁴ The result of this approach was that some contingent or unliquidated claims were discharged and others were not. Consequently, some creditors with these claims were permitted to share in the distribution of the estate and others were deprived of that right.

The treatment of contingent or unliquidated claims under the former Act is illustrated in Thompson v. England.⁵ A wife loaned her husband $12,000, to be repaid from the proceeds of his business “as soon as said business is in a sound financial position.”⁶ When the husband filed a
bankruptcy petition, the wife filed a claim. The court held that the claim was not subject to reasonable estimation and that therefore the wife could not participate in a distribution of the estate. The appellate court noted that, to allow this claim, the bankruptcy judge would have to estimate the probability that the debtor would start his business anew after bankruptcy and would arrive at a sound financial condition. That event was so fortuitous that there was no way to determine whether liability would ever attach in the future.

The Code's Approach

The Bankruptcy Code rejects the approach taken in the former Act with respect to contingent and unliquidated claims. The Code requires that the court estimate the dollar amount of any claim that is disputed, contingent, or unliquidated, even if the administration of the estate or the closing of the case would be delayed.\(^7\) Estimation is an easier process with contingencies that can be resolved by analytical computation, but the process of evaluation becomes more difficult in cases involving disputed allegations of products liability, negligence, antitrust, or stockholder class actions. In these cases, the court is required to put a dollar value on every claim, including any claim that gives the claimant the alternative right to an equitable remedy as well as monetary relief.\(^8\)

This requirement is consistent with the Code's general policy of affording all-encompassing relief in bankruptcy cases. Thus, a Code resolution of the facts of \textit{Thompson v. England} would require the court to hold a hearing to arrive at an estimation of the present value of the wife's claim against the debtor despite the possibility that the husband's debt might never mature. The process of estimation involves a difficult analysis of many factors, but at least one court in a case under the former Act found a method of making a determination of the value of a contingent claim. In \textit{In re Zucker},\(^9\) the court held that a note that was guaranteed by the debtor and that obligated the debtor to pay "solely and only in the event of the death of the maker" was not too contingent to be reasonably estimated despite the fact that the maker was alive and well at the time of the bankruptcy.

The Borne Chemical Case

The \textit{Zucker} case is a constructive approach to the estimation of

\(^7\) 11 U.S.C. § 502(c)(1). But see 28 U.S.C. § 1471(d) which gives the court the power to abstain from hearing a proceeding.

\(^8\) 11 U.S.C. §§ 502(c)(1), 502(c)(2).

\(^9\) 5 Bankr. Ct. Dec. (CRR) 433 (S.D.N.Y. 1979). Although this case was decided under Section 57(d) of the former Act, the court referred to Section 502(c) of the Bankruptcy Code.
a contingent and unliquidated claim. In a recent Code reorganization case under the Bankruptcy Code, a more complicated estimation was approved by the Court of Appeals for the Third Circuit in Bittner v. Borne Chemical Company, Inc.\textsuperscript{10} At the time the debtor filed its Chapter 11 petition, it was defending suits brought in state courts by stockholders of the Rolfite Company based on the debtor's alleged tortious interference with a proposed merger between Rolfite and another company. After the debtor commenced the Chapter 11 case, Rolfite stockholders sought relief from the automatic stay so that the state court litigation could continue. The bankruptcy court lifted the stay, but also granted Borne's motion to disallow these claims temporarily. The court extended the time within which these claims could be filed if they were eventually liquidated, but refused to stay the hearing on confirmation of the reorganization plan. The court also required the debtor to waive the discharge of these claims as a condition for confirming a plan.\textsuperscript{11} In essence, the Rolfite stockholders' claims would not play a role in the Chapter 11 case until resolved in state court, and the reorganization process would continue without delay without the participation of these claimants.

The district court vacated the temporary disallowance order and directed the bankruptcy court to hold a hearing to estimate the amount of the Rolfite claims as required by Section 502(c) of the Code. The bankruptcy court held the estimation hearing, but valued the claims at zero, reinstated the earlier temporary disallowance order, and, in effect, required a waiver of discharge of the Rolfite claims.

The court of appeals reviewed the manner in which the Rolfite claims were valued at zero. Recognizing that by virtue of Section 502(c) "Congress intended the procedure to be undertaken initially by the bankruptcy judges, using whatever method is best suited to the particular contingencies at issue,"\textsuperscript{12} the court of appeals noted that it may reverse the bankruptcy court's estimation of value only if it finds that there was an abuse of discretion. "That standard of review is narrow."\textsuperscript{13}

The claimants in Borne Chemical argued that the estimate required by Section 502(c) is the

\textsuperscript{10} 691 F.2d 134 (3d Cir. 1982).
\textsuperscript{11} The bankruptcy court based its authority for requiring such a waiver of discharge on Section 1141(d)(1) of the Bankruptcy Code which provides for the debtor's discharge in reorganization cases "except as provided in the plan or the order confirming the plan." In re Borne Chem. Co., 16 Bankr. 509 (D.N.J. 1980); see B. Weintraub & A. Resnick, Bankruptcy Law Manual ¶ 8.24 (1980), for a discussion on discharge for a reorganized debtor.
\textsuperscript{12} Bittner v. Borne Chem. Co., 691 F.2d at 135.
\textsuperscript{13} Id. at 136.
present value of the probability of claimants' success in state court.

"Thus, if the bankruptcy court should determine as of this date that the Rolfite stockholders' case is not supported by a preponderance of 51% of the evidence but merely by 40%, they apparently would be entitled to have 40% of their claims allowed during the reorganization proceedings, subject to modification, if and when the claims are liquidated in state court." 14 Apparently, the bankruptcy court did not estimate the value of the claims in this manner. Instead, it appears that the court assessed the ultimate merits of the claims and, believing that the Rolfite stockholders could not establish their claims by a preponderance of the evidence, the claims were valued at zero. The court of appeals concluded that "we cannot find that such a valuation method is an abuse of discretion conferred by section 502(c)(1)." 15

The court of appeals found justification for the bankruptcy court's use of the "ultimate merits" approach to estimation instead of the "present-value-of-the-probability-of-success" method in this case because of the general policy underlying the reorganization process. After examining the legislative history of the Bankruptcy Code, the court of appeals concluded that if the goals of Chapter 11 are to be realized, reorganization must be accomplished quickly and efficiently. The court noted that the Rolfite stockholders' chances of ultimate success in state court were uncertain at best. "Yet, if the court had valued the Rolfite stockholders' claims according to the present probability of success, the Rolfite stockholders might well have acquired a significant, if not controlling, voice in the reorganization proceedings. The interests of those creditors with liquidated claims would have been subject to the Rolfite interests, despite the fact that the state court might ultimately decide against those interests after the reorganization." 16 The bankruptcy court may decide that this situation will unduly complicate the reorganization proceedings.

The court of appeals concluded:

By valuing the ultimate merits of the Rolfite stockholders' claims at zero, and temporarily disallowing them until the final resolution of the state action, the bankruptcy court avoided that possibility of a protracted and inequitable reorganization proceeding while ensuring that Borne will be responsible to pay a dividend on the claims in the event that the state court decides in the Rolfite stockholders' favor. Such a solution is consistent with the Chapter XI concerns of speed and simplicity but does not deprive the Rolfite stockholders of the right to

14 Id.
15 Id.
16 Id.
recover on their contingent claim against Borne.\textsuperscript{17}

The approach used in \textit{Borne} for the estimation of contingent claims together with temporary disallowance and waiver of discharge may be appropriate in rare cases. But, it reflects a return to the former Act\textsuperscript{18} since it may deprive the debtor of an effective rehabilitation where the contingent claims constitute a substantial portion of the overall debt structure so that a judgment subsequently obtained by the contingent claimant may require "the need for further financial reorganization." This raises the question of whether confirmation of the plan should have been denied on this ground.\textsuperscript{19}

\textbf{The Manville Asbestos Case}

A current case in which contingent and unliquidated claims will undoubtedly play a significant role is \textit{In re Manville Corporation}.\textsuperscript{20} In

\textit{Manville}, at the time of the filing of the petition there were over 16,000 claimants as well as potential claimants with contingent and unliquidated products liability claims alleging injuries arising from exposure to asbestos manufactured by the debtor corporation. The debtor's estimate that the number of claimants undoubtedly will increase as asbestos-related injuries of those who have been exposed are manifested in the future. Manville's Chapter 11 petition was prompted by the need to stay, propose a method of payment, and obtain a discharge with respect to such claims and, therefore, its purpose for commencing the reorganization case would be frustrated entirely if it were required to waive the discharge and to continue to defend these claims in state courts. It remains to be seen how courts will deal with the asbestos-related claims in \textit{Manville}, but there is little doubt that the answer must be found within the parameters of the court's jurisdiction.

\textbf{The Braniff, White Motor, and UNR Cases}

In addition to \textit{Borne Chemical}, an aid in solving the problems presented by a large number of claimants or potential claimants may be found in \textit{In re Braniff Air-
ways, Inc. where the debtor in its capacity as debtor in possession and as plan administrator under certain pension plans, as well as other plan administrators, commenced four actions in the bankruptcy court seeking declaratory, injunctive, and interim relief naming the trustees of each four pension plans and representative members of certain groups of beneficiaries under each plan as defendants. In their complaint, plaintiffs requested the court to certify each action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure, seeking interim relief by way of a reduction in amounts to be received by the plan beneficiaries, the holding of an expedited trial on the merits, and the issuance of a permanent injunction as to the effective termination date of the plans.

At the hearing on class certification, the court made tentative appointments of counsel for various unrepresented classes. Passing over the jurisdictional question raised by the *Marathon* case in view of the Supreme Court's stay of the effect of the decision, the bankruptcy court certified the classes upon finding that (1) each class was composed of more than 1,000 members; (2) there were common questions of law or fact; (3) all members of each class would have exactly the same claims or defense; and (4) classes would be fairly and adequately represented by competent attorneys either employed or appointed and funds would be available for compensation of counsel.

Seeking a solution for the disposition of approximately 160 products liability claims, the debtor in *In re White Motor Credit Corporation* sought the appointment of a special master to hear the claims. Although the district court reversed the bankruptcy court's appointment of the special master on jurisdictional grounds, the district court acknowledged that in "appropriate circumstances" such appointment may be made to deal with a large number of claims. Upon appeal to the court of appeals the request of the debtor, as appellant, for a stay was granted and the special master's appointment was ordered reinstated pending a decision on the merits. In any event, the nature of the procedure requested indicates the apparent necessity to resolve the burdensome problem of delay in reorganization cases caused by the existence of numerous claims which are in suit in various federal and state courts throughout the nation.

21 22 Bankr. 1005 (N.D. Tex. 1982).
23 23 Bankr. 276 (N.D. Ohio 1982). The court held that the Supreme Court's decision in *Marathon Pipe Line* prohibited the appointment of a special master to decide issues outside the jurisdictional scope of the bankruptcy court.
24 Id. at 279.
25 _ F.2d _ (6th Cir. 1982).
Another procedural device for dealing with unknown putative product liability claimants was suggested in *In re UNR Industries, Inc.*, where the United States trustee, in response to the debtors' request that the bankruptcy court appoint a legal representative to represent the interests of unknown putative asbestos-related claimants, made the following comment in a "Statement" with respect to those claimants: "[D]ue process would seem to require some form of representation for them in order for these cases to proceed to confirmation of a plan of reorganization." As to the nature of the claim, the United States trustee's "Statement" comments: "The argument in favor of treating the future claimants as holders of claims, accordingly, is primarily equitable and entails a very broad reading of the definition of claim in Code section 101(4)(A). Such a reading is not inconsistent with the legislative intent to provide for the rehabilitation of debtors through the discharge of debt."

**Conclusion**

In sum, *Borne Chemical*, *Braniff*, and *White Motor* pose significant signposts for *Manville* and other reorganization cases which involve the treatment of numerous contingent and unliquidated claims. *Borne* approves zero valuation based on inability to prove likelihood of success. *Braniff* approves the use of class actions and suggests the use of a fund to finance competent legal representation. *White Motor* suggests the appointment of a special master to resolve factual issues otherwise within the jurisdiction of the bankruptcy court.

*UNR Industries, Inc.* suggests the appointment of a legal representative to represent putative claimants. There is no doubt that other creative devices will be employed by district courts, as well as bankruptcy courts operating under the rule suggested by the Judicial Conference and adopted locally, to assure that a reorganization does not falter because of an inability to process numerous unliquidated and contingent claims resulting from products liability.

One such proceeding has just been commenced in the *Manville* case, where a complaint was filed by Manville pursuant to section 502(c) of the Code initiating a class action pursuant to Rule 23(b)(1)(B) of the Federal Rules of Civil Procedure for the estimation of all contingent, unliquidated asbestos-related health claims of all persons prior to the filing of the petition whether or not any injury or illness has yet been manifested.

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26 Index No. 82 B 9841-9851 (N.D. Ill.) at 5-6.

27 Complaint filed Feb. 4, 1983.