Fordham Law Review

Volume 6 | Issue 1 Article 2

1937

Provability of Contingent Claims in Bankruptcy

Eugene J. Keefe

PROVABILITY OF CONTINGENT CLAIMS IN BANKRUPTCY

EUGENE J. KEEFE†

IN THE storm and strife of depression eras, interest in and use of bankruptcy and reorganization statutes are immeasurably increased. The depth and breadth of the present commercial collapse, now happily coming to an end, have brought forth a train of moratoria legislation, amendments to the Bankruptcy Act, and radical reorganization programs for the relief of debt-burdened individuals and corporations, private and municipal. Out of these vexatious problems, there is one recurring question, common to all phases of bankruptcy relief: What claims may be proved? It is proposed to consider one aspect alone of this many-sided query, namely, the present-day status of contingent claims in relation to their provability in bankruptcy.

The word "provability" refers to claims which, by their nature, are provable under Section 63(a) of the Federal Bankruptcy Act of 1898 as amended.[1] It must be noted that the word "provability" is to be dis-

† Associate Professor of Law, Fordham University, School of Law.

1. The Section provides: "Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; . . . (4) founded upon an account, or upon a contract express or implied; (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less cost incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary: . . . and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in any amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: *Provided,* That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: *Provided further,* That the provisions of this clause (7) shall apply to estates pending on June 7, 1934 in which the time for filing such claims has not expired." 49 STAT. 1475, 11 U. S. C. A. § 103 (1936).

Subsections (2) and (3) are omitted because they are not material to the discussion in this paper.

tinguished from "validity"[2] and "allowability."[3] A claim may, by its nature, be "provable" and still be totally lacking in "validity." For example, the claim by the payee upon a promissory note is by its nature *provable*, but it may not be successfuly proved if the signature of the bankrupt is forged. A claim may, by its nature, be "provable" and not be permitted to be proved because no dividend could be *allowed*. "Allowability" contemplates the payment of dividends alone, whereas "provability" looks to the nature of the claim *and* the allowability of it. Probably the best instance of this appears in the case of a secured claim. The claim, in kind, may not be lacking in "provability" under Section 63(a), but because of the security, it is totally lacking in "allowability" and hence is not provable, while the security is retained. This paper will concern itself with "provability" of contingent claims rather than their "validity" or their "allowability." The meaning of the words "contingent claims" is the main subject of the paper and will be discussed at length herein. The words "in Bankruptcy" are intended to confine the subject matter to Section 63(a) and associated sections of the Bankruptcy Act and therefore necessarily will exclude provability under Sections 77, 77B and 80[4] of the Bankuptcy Act, which deal with reorganization as distinguished from bankruptcy.

The importance of determining whether or not a claim is provable is two-fold: (1) no dividend can be allowed unless the claim is provable, and (2), provable claims which are contained in the schedules, with certain limitations, are discharged, if a discharge is granted. Non-provable claims are not barred by the discharge.

A claim is by its nature provable if it comes within the elastic provisions of Section 63(a). A brief comparison of this Section appearing in our present Bankruptcy Act[5] with the provisions relating to provable claims appearing in our previous Bankruptcy Acts[6] and the present English Bankruptcy Act,[7] may be helpful in understanding the fundamental cause of conflicting decisions made by the federal courts on this question of the provability of contingent claims. Some of these conflicts have been settled by the Supreme Court[8] and others have been dealt

2. REMINGTON, ELEMENTS OF BANKRUPTCY LAW (3d students' ed. 1926) 61 *et seq.*

3. COLLIER, THE LAW AND PRACTICE IN BANKRUPTCY (12th ed. Gilbert and Rosbrook 1921) 948 *et seq.*

4. Section 80 was recently held unconstitutional by the Supreme Court. Ashton v. Cameron County Water Improvement District, 56 Sup. Ct. 892 (1936), *motion for reargument denied,* 57 Sup. Ct. 5 (1936).

5. Commonly called "The Nelson Act."

6. Act of 1800, 2 STAT. 19 (repealed 1803, 2 STAT. 248); Act of 1841, 5 STAT. 440 (repealed 1843, 5 STAT. 614); Act of 1867, 14 STAT. 517 (repealed 1878, 20 STAT. 99).

7. BANKRUPTCY ACT, 1914, 4 & 5 GEO. V., c. 59, as amended by BANKRUPTCY (AMENDMENT) ACT, 1926, 16 & 17 GEO. V. c. 7, as amended to date.

8. Central Trust Co. v. Chicago Auditorium Ass'n, 240 U. S. 581 (1916); Maynard

with by our Federal Congress in an attempt to eradicate them.[9] This matter will be dealt with subsequently. Before turning to the earlier provisions relating to provable claims it may be of assistance to consider the immediate cause of the conflicting decisions under the present Section 63(a). In some of these cases opposite results on similar facts have been reached on the question of permitting contingent claims to be proved. The immediate cause of this conflict is found in the failure to agree upon what is meant by the term, "contingent claims." It has been written by courts in decided cases[10] and by text-writers[11] that "contingent claims are not provable." By going back to our previous Bankruptcy Acts we may trace the origin and development of this gradually disappearing rule.

The Act of 1800 did not deal with provable claims as such. The Act of 1841 clearly made contingent claims provable by using the following definite terminology " . . . or other persons, having uncertain or contingent demands against such bankrupt, shall be permitted to come in and prove such debts or claims under this act. . . . "[12] The Act of 1867 expressly made "contingent debts and contingent liabilities" provable.[13] Hence we see that the Acts of 1841 and 1867 expressly permitted the proving of contingent claims. It is to be noted that these acts set down specific types of contingent liabilities which would constitute provable

v. Elliott, 283 U. S. 273 (1931); Manhattan Properties Inc. v. Irving Trust Co., 291 U. S. 320 (1934); Irving Trust Co. v. Perry Inc., 293 U. S. 307 (1934).

9. National Bankruptcy Act § 63 (a) (6), (6½) and (7). See note 1, *supra*.

10. *In re* Imperial Brewing Co., 143 Fed. 579 (W. D. Mo. 1906); *In re* Inman, 171 Fed. 185 (N. D. Ga. 1909).

11. Collier, *op. cit., supra* note 3, 977 *et seq.;* Remington, *op. cit. supra* note 2, § 775.

12. Bankruptcy Act of 1841, § 5 (5 Stat. 440) provided *aliunde* as follows ". . . and all creditors whose debts are not due and payable until a future day, all annuitants, holders of bottomry and respondentia bonds, holders of policies of insurances, sureties, indorsers, bail, or other persons, having uncertain or contingent demands against such bankrupt, shall be permitted to come in and prove such debts or claims under this act, and shall have a right, when their debts and claims become absolute, to have the same allowed them: . . . ."

13. Bankruptcy Act of 1867, § 19 (14 Stat. 517). This provided *aliunde* as follows: "If the bankrupt shall be bound as drawer, endorser, surety, bail, or guarantor upon any bill, bond, note, or any other specialty or contract, or for any debt of another person, and his liability shall not have become absolute until after the adjudication of bankruptcy the creditor may prove the same after such liability shall have become fixed and before the final dividend shall have been declared." (*Note that the claim would be provable even though contingent on the date of the filing of the petition*). "In all cases of contingent debts and contingent liabilities contracted by the bankrupt, and not herein otherwise provided for, the creditor may make claim therefore, and have his claim allowed, with the right to share in the dividends, if the contingency shall happen before the order for the final dividend; or he may at any time apply to the court to have the present value of the debt or liability ascertained and liquidated, which shall then be done in such manner as the court shall order, and he *shall be allowed to prove* (italics mine) for the amount so ascertained."

claims.[14] This method of treatment is quite different from the general provisions of Section 63(a) of the present Bankruptcy Act. Because of the express provision permitting contingent claims to be proved in the Acts of 1841 and 1867 and the lack of such an express allowance in the Act of 1898, our courts and text writers apparently had a logical basis for arriving at the conclusion that Congress intended contingent claims to be non-provable under the present Bankruptcy Act.[15] Collier ably argues this inference.[16] The English Bankruptcy Act expressly permits of the proof of contingent claims, with certain limitations.[17] Roper so defines the rule under the English Act, clearly and concisely.[18]

In spite of the frequent repetition of the rule resting upon the argument indicated, to say that contingent claims are not provable is no longer a correct statement of the law, in view of recent Supreme Court decisions and amendments to the Bankruptcy Act.

Before going into the recent cases and amendments, it might be well to consider the weight and soundness of the argument that the absence of an express reference to contingent claims in our present Bankruptcy Act, in the light of its presence in the previous Acts, presents a compelling inference barring these claims. It is submitted that a comparison of Section 5 of the Act of 1841[19] and Section 19 of the Act of 1867[20] with

---

14. See notes 12, 13 *supra*.

15. Riggin v. Maguire, 82 U. S. 549 (1872); Dunbar v. Dunbar, 190 U. S. 340 (1903); First National Bank of Pikeville v. Elliott, 19 F. (2d) 426 (C. C. A. 6th 1927).

16. "The provisions of the Act of 1898 concerning the proof of contingent claims differ materially from those contained in the Acts of 1841 and 1867. . . . it must therefore be assumed that Congress did not intend to include such claims among provable debts. . . . this will be seen by a comparison with the terms of the preceding act." COLLIER, *op. cit. supra* note 3, at 978.

17. Bankruptcy Act, 1914, 4 & 5 GEO. V., c. 59, § 30, which provides as follows:

"(3) Save as aforesaid, all debts and liabilities, present or future, certain or contingent, to which the debtor is subject at the date of the receiving order, or to which he may become subject before his discharge by reason of any obligation incurred before the date of the receiving order, shall be deemed to be debts provable in bankruptcy." [The debts excepted from this provision are unliquidated tort claims.] "(6) If, in the opinion of the Court, the value of the debt or liability is incapable of being fairly estimated the Court may make an order to that effect, and thereupon the debt or liability shall, for the purposes of this Act, be deemed to be a debt not provable in bankruptcy."

18. "Debts Provable and Non-provable:—

"There are three classes of debts or liabilities which are not provable in bankruptcy . . .: (a) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise, or breach of trust. (b) Debts or liabilities contracted by the debtor with any person after that person has had notice of an available act of bankruptcy. (c) Contingent debts and liabilities, the value of which cannot, in the opinion of the court, be fairly estimated." RINGWOOD, PRINCIPLES OF BANKRUPTCY (17th ed. Roper, 1936) 169.

19. See note 12, *supra*.

20. See note 13, *supra*.

Section 63(a)[21] of our present Act does not necessarily support such a conclusion. The two previous Acts were detailed in their statement of the type of claims which would be provable, but our present Act departs from exact tabulation and sets out general, elastic provisions, to wit, Section 63(a) (1) and (4). It might be argued that Congress intended to permit contingent claims to be provable because of the elasticity of the stated subdivisions. This suggestion, however, seems to have been given scant recognition, if any, as a reason for permitting provability of contingent claims. The conflict existing in the negotiable instrument cases, for instance, between *Moch v. Bank*[22] and *First National Bank v. Elliott*,[23] and in the executory contract cases, for instance, between In re *Swift*[24] and In re *Imperial Brewing Company*[25] was fundamentally a conflict between the old rule barring contingent claims and one of the two fundamental purposes[26] of all Bankruptcy Acts, to wit, the relief of an honest debtor from the burdensome debts of an unfortunate venture. The courts deciding the *Moch* case and the *Swift* case gave precedence to the consideration that the debtor should be relieved and so held the contingent claims provable. On the other hand, the courts deciding the *Elliott* case and the *Imperial* case adhered to the old rule disallowing contingent claims. As will be indicated subsequently in dealing with lines of cases individually, the Supreme Court has consistently favored the view adopted by the *Moch* case and the *Swift* case.[27]

The concept of contingency, as it is used in this connection, contemplates either contingency in liability or contingency (uncertainty) as to amount of damage,[28] or both. Considering, first, contingency as to liability, it is not correct to state as a general proposition that claims contingent as to their liability are not provable. In *Maynard v. Elliott*[29] the Supreme Court held that the holder of a promissory note had a provable claim against a bankrupt endorser before the instrument had matured. The liability of the bankrupt was contingent upon default of maker, plus due notice and presentment. It thus is clear that contingency as to liability will not in all cases bar the claim. Then what is the

21. See note 1, *supra*.

22. 107 Fed. 897 (C. C. A. 3d, 1911).

23. 19 F. (2d) 426 (C. C. A. 6th, 1927).

24. 112 Fed. 315, particularly at 319, 321 (C. C. A. 1st, 1901).

25. 143 Fed. 579 (W. D. Mo. 1906).

26. Leidigh-Carriage Co. v. Stengel, 95 Fed. 637 (C. C. A. 6th, 1899); McDonald v. Tefft-Weller Co., 128 Fed. 381 (C. C. A. 5th, 1904); *In re* Mumford, 255 Fed. 108 (E. D. N. C. 1919).

27. Central Trust Co. v. Chicago Auditorium, 240 U. S. 581 (1916); Maynard v. Elliott, 283 U. S. 273 (1931).

28. See Maynard v. Elliott, 283 U. S. 273, 278 (1931).

29. 283 U. S. 273 (1931).

test as to when the claim, contingent as to liability, is provable and when it is not? Collier suggests that the test of contingency as to liability is: "Have all the facts necessary to be proved to fasten liability already occurred? If so the claim is not contingent."[30] If the Supreme Court had applied this test in the *Maynard* case it would have denied provability to the claims presented. Default of maker, notice and presentment had not occurred in the *Maynard* case, and these facts are essential to fasten absolute liability on the endorser. In this case the court formulated the test, contradictory of the above test suggested by Collier: Was the contingency as to liability within the power of the claimant to remove? If he could remove it, the claim was provable, and if not, the claim was deemed to have fatal contingency. In the *Maynard* case it was within the power of the claimant to give notice and to make presentment. Could he be said to be capable of bringing about default? Certainly the holder of the instrument could not bring about default by the maker. The court apparently has in mind the removal of the two technical prerequisites to secondary liability and the rule of the court assumes default by the maker. This is but another indication of the policy of the Supreme Court to permit the claims to be proved in order that the bankruptcy proceeding serve its fundamental purpose by relieving the debtor of subsequent liability.

There still remains for discussion the second element causing contingency, *i.e.*, contingency in amount of damage, which really means uncertainty or nonliquidability of the amount of damage. This objection may well present an insuperable difficulty. Such hiatus of provability is expressly recognized in the English Bankruptcy Act,[31] which contains a provision rendering such claims non-provable. The two leading American cases on this point are *Dunbar v. Dunbar*[32] and *Riggin v. Maguire*.[33] In the *Dunbar* case the bankrupt contracted to pay his divorced wife a specified amount annually so long as she should remain unmarried. The wife's claim was held to constitute a non-provable claim. It is apparent that a situation was presented which defied liquidation, since her claim terminated in the event of her future marriage. In the *Riggin* case a claim for dower upon realty was made against the purchaser from the claimant's husband, the claimant not having joined in the deed. The defendant interposed as a defense a discharge in bankruptcy which proceedings were had while the husband of the claimant was living.

30. COLLIER, *op. cit. supra* note 3, at 979. The author writes "If so the claim is not contingent." He uses the word "contingent" as being synonymous with "non-provable." As will be later contended the terms are not synonymous, because contingent claims have been held provable.

31. See note 17, *supra*.

32. 190 U. S. 340 (1903).

33. 15 Wall. 549 (U. S. 1872).

The Supreme Court held the discharge to be ineffective as a defense because the claim of dower was not a provable one. In the *Riggin* case, the situation presented contingency in both liability and amount of damage. As to the liability, the wife might predecease her husband; as to the amount of damage, the date of the husband's death would determine the length of the dower life estate and thus effect the value of the dower claim.[34] Section 63(b)[35] of the Act does not assist us in this connection. This Section has been consistently interpreted as adding no additional provable claims to those set out in Section 63(a); it merely permits a liquidation of claims provable thereunder.[36]

The discussion thus far has been generally under Section 63(a) without dividing the matter into lines of cases or treating it under the separate sub-sections of 63(a). It is proposed now to consider in detail the decided cases which deal with the question of the provability of contingent claims. The choice presents itself of approaching the matter by taking separate sub-sections of 63(a) and attempting to classify cases under each one or by treating the subject functionally. The latter treatment is preferable for two reasons, (1) the cases cut across more than one sub-section, and (2) more practical classification presents itself by means of this approach.

On this question of contingency of claims the following cases will be discussed in the order indicated—claims based upon (*A*) negotiable instruments, (*B*) surety contracts, (*C*) leases, (*D*) executory sale of goods and service contracts, and (*E*) those based upon torts, liquidated and unliquidated. As the discussion proceeds the reader will observe the gradual extinction of the arbitrary rule denying provability to contingent claims. At the outset, it is well to note the firmly established rule that the status of a claim on the date of the filing of the petition is the controlling status in determining its provability.

(*A*) *Negotiable Instrument Cases*

This type of claim will divide itself into three different classes: (1) claims by a payee or holder against a bankrupt maker; (2) claims by a holder against a bankrupt endorser; and (3) claims by an endorser against a bankrupt maker.

(1). The claim by a payee or holder of an unmatured note against a

34. This case was decided under the Act of 1841, which expressly permitted the proof of contingent claims, but the impossibility of assessment presented an insuperable difficulty. Today life expectancy tables might be used.

35. 30 STAT. 562 (1898), 11 U. S. C. A. § 103(b) (1927). "Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may therefore be proved and allowed against his estate."

36. Matter of Roth & Appel, 181 Fed. 667 (C. C. A. 2d, 1910); *In re* Southern Steel Co., 183 Fed. 498 (N. D. Ala. 1910).

bankrupt maker is a provable claim.[37] This conclusion might be justified under subsection 63(a) (4)[38] if the instrument had matured before the filing of the petition and even if the instrument had not matured on this date, because subsection 63(a) (4) refers to "debts" and the word "debts" is broadly defined in the Bankruptcy Act to include "claims."[39] But we need not resort to this construction of subsection 63(a) (4) because 63(a) (1) is peculiarly worded to include unmatured instruments. Under the latter subsection the words, " . . . absolutely owing . . . whether then payable or not . . . ." were designed to include, and have been uniformly construed[40] to include, unmatured instruments.

(2). The next case in this type presents the question of the provability of the claim held by the holder of a negotiable instrument against a bankrupt endorser. If we were to apply the orthodox rule barring contingent claims, the holder would not have a provable claim. The liability of the endorser is dependent upon the default of the maker and notice and presentment to the endorser. Where the instrument has matured and there has been a default by the maker and compliance with the Negotiable Instruments Law in order to effectuate secondary liability, no difficulty is present, for the contingency has been removed. But we are interested in cases where the instrument has not matured on the date of the filing of the petition, which as before stated, is the date upon which the claim will pass or fail the test of provability.[41] The three leading cases raising this question are *Moch v. Bank,*[42] *Bank v. Elliott*[43] and *Maynard v. Elliott.*[44] The holder was held to have a provable claim against the bankrupt endorser in the *Moch* case. This decision remained the recognized rule for twenty-seven years, without serious question.[45] Then *Bank v. Elliott* was decided in which the court denied the holder's claim of provability upon the ground of contingency. In addition to the question of contingency these two cases presented a most interesting question of construction of Section 63(a): Is subsection 63(a) (1) to

37. *In re* Alexander, 1 Lowell 470 (Mass. 1870).

38. 30 STAT. 562 (1898), 11 U. S. C. A. § 103(a) (4) (1927) which provided *aliunde* as follows:

"Debts of the bankrupt may be proved and allowed against his estate which are. . . . (4) founded upon an open account, or upon a contract express or implied."

39. 30 STAT. 544 (1898), 11 U. S. C. A. § 1 (11) (1927) which provides as follows: " 'Debt' shall include any debt, demand, or claim provable in bankruptcy."

40. *In re* Alexander, 1 Lowell 470 (Mass. 1870).

41. *In re* Burka, 104 Fed. 326 (E. D. Mo. 1900).

42. 107 Fed. 897 (C. C. A. 3d, 1901).

43. 19 F. (2d) 426 (C. C. A. 6th, 1927).

44. 283 U. S. 273 (1931).

45. During this period apparently only one case seriously questioned the correctness of the decision in the *Moch* case: *In re* Schaefer, 104 Fed. 973 (E. D. Pa. 1900). It is interesting to note that the same court shortly thereafter reached an opposite result on this question. *In re* Gerson, 105 Fed. 891 (E. D. Pa. 1901).

be read into subsection 63(a) (4) and hence restrict 63(a) (4)?—or, stating the question in the terminology of the statute—are the words "contract express or implied" appearing in subsection 63(a) (4) to be qualified by the words "absolutely owing" appearing in 63(a) (1)? The *Elliott* case answered this question in the affirmative, thereby denying provability as a consequence; the *Moch* case had previously answered it in the negative and granted provability. Finally in 1931 the question was presented to the Supreme Court in the *Maynard* case. The Supreme Court adopted the rule of the *Moch* case. On the above question of construction the Court wrote: "That section [Section 63] purports to be an enumeration of classes of provable claims—not an enumeration of characteristics which must inhere in every claim proved."[46] In other words the court pointed out that a claim would be provable if it satisfied the requirements of one subdivision; it need not satisfy every subsection. In this case the court gave precedence to the consideration of relieving the debtor rather than to the rule against contingent claims.[47]

(3). The last problem in our analysis of the negotiable instrument type raises the question of the provability of the claim of an endorser against a bankrupt maker. At common law the claim of a surety against the primary obligor is contingent upon payment to the creditor by the surety. The endorser of a negotiable instrument is in the position of a surety. In case the maker of the instrument becomes bankrupt the surety-endorser, who has made no payment, would have no claim against the bankrupt estate under the rule against contingent claims, because the maker's liability to the endorser is contingent upon payment being made to the holder by the endorser. But the Act of 1898 expressly permits the surety to prove a claim in the name of the creditor if the creditor fails to press his claim.[48] Of course the section, while permitting "provability" before payment, does not recognize "allowability" until payment by the claiming endorser. The liability of the estate of the bankrupt maker to the endorser is contingent upon payment, but the act permits "provability" before payment.

46. See Maynard v. Elliott, 283 U. S. 273, 277 (1931).

47. See Maynard v. Elliott, 283 U. S. 273, 277 (1931), wherein the court wrote as follows:

"Possible doubts as to the meaning of the section should be resolved in the light of the purpose of the Act 'to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes'."

48. 32 STAT. 799 (1903), 11 U. S. C. A. § 93(i) (1927), which provides as follows:

"Whenever a creditor whose claim against a bankrupt estate is secured by the individual undertaking of any person, fails to prove such claim, such person may do so in the creditor's name, and if he discharge such undertaking in whole or in part he shall be subrogated to that extent to the rights of the creditor."

In these three lines of negotiable instruments cases, the claims are provable in the bankruptcy proceedings. The importance of provability is brought out by cases wherein the question of the application of a discharge in bankruptcy to a particular debt is raised. An excellent instance is presented in the situation where the maker has been discharged in bankruptcy. The indorser pays the holder the difference between the amount of the instrument and the dividend which the holder received. Thereafter the indorser sues the maker to recover the amount he has paid to the holder,[49] claiming a "new debt" has arisen by his payment which is not affected by the discharge. It was held that the instrument presents one claim and since the endorser has a provable claim upon it, the discharge bars his action.[50]

(B) *Surety Contracts*

The phrase "Surety Contracts" is used here to include "surety" and "guaranty" contracts. Subsequently an attempt will be made to point out that, for some purposes, there is a pertinent distinction between "surety" and "guaranty" contracts in this field of Bankruptcy. The subject falls into three classifications: (1) the claim of a creditor against the bankrupt principal debtor, (2) the claim of a creditor against a bankrupt surety and, (3) the claim of a surety against a bankrupt principal debtor.

(1). The element of contingency arising from the existence of a surety does not offer any great difficulty when the case presents the claim of the creditor against the principal debtor.[51]

(2). However there is far greater difficulty presented from the point of view of contingency when the facts involve the claim of the creditor against the surety. The problem presented is this,—where the principal debtor has in no way defaulted on the date of the filing of the petition against the bankrupt surety, has the creditor a provable claim against the estate of the surety? So far as the writer can ascertain, this question has not reached the Supreme Court. The Circuit Courts of Appeal seem to be in conflict on the point. Provability is denied by the apparent weight of authority. Probably the leading case denying provability is In re *Pettingill*[52] and the best known case conceding provability is In

49. Whether the payment was made before or after the discharge is immaterial because the status of the claim at the time of the filing of the petition is controlling and under Section 57(i) (*supra* note 48) the endorser could prove before the payment.

50. Columbia Falls Brick Co. v. Glidden, 157 Mass. 175, 31 N. E. 801 (1892).

51. Most of these contracts are in writing and hence the claim could be brought under 63(a) (1) (30 STAT. 562 [1898], 11 U. S. C. A. 103 [a] [1] [1927]), the default rendering the debt "absolutely owing", but the broad provision of 63(a) (4) would include this claim, even before default under the disenablement test. See Central Trust Co. v. Chicago Auditorium, 240 U. S. 581 (1916), *supra* note 8, and 63(a) (7), *supra* note 1.

52. 137 Fed. 143 (D. Mass. 1905).

re *Adair*.[53] The *Pettingill* case and the cases[54] following it deny provability squarely upon the ground of contingency. The theory is that since there has been no default by the primary obligor, there is no present liability existing against the surety and, since it is contingent that there will be such liability, the claim is not provable. The *Adair* case and

---

53. 35 F. (2d) 531 (N. D. Ga. 1929).

54. In the *Pettingill* case the bankrupt guaranteed the payment of dividends by another corporation. The principal debtor had defaulted in payment of dividends and an involuntary petition was filed against it nine days after the filing of the petition against the surety, and adjudication of the principal post-dated adjudication of the surety only eight days. The creditor claimed for dividends in arrears and subsequent dividends for the period of the guaranty. The court denied provability for the subsequent dividends, adhering strictly to the rule that the status of the claim being contingent on the date of the filing of the petition, the claim could not be allowed. This result obtained in spite of the conceded insolvency of the principal on the date of the filing of the petition against the surety and the imminent bankruptcy which followed. It is to be noted that all contingency of liability and amount were removed within the time limited for the presentation of claims. The decision is the result of a pure application of the rule of contingency. The result was that the creditor would get nothing. He would receive no dividend since his claim was denied provability. The preservation of his claim after the discharge meant nothing because the guarantor and primary obligor were corporations. Hence only empty shells would remain. These pragmatic consequences were not considered. In the *Maynard* case the Supreme Court held the claim provable against the bankrupt endorser without any indication of insolvency on the part of the maker and even though some of the notes would not mature within the time limited for presenting claims. In view of the decision in this case the Supreme Court would probably hold that a provable claim was presented on the facts of the *Pettingill* case. The foresight of a creditor who obtains a guarantor should entitle him to the same rights enjoyed by the holder of a negotiable instrument in the event of the bankruptcy of an endorser. The preservation of the claim will probably avail the creditor very little satisfaction. *Colman v. Withoft*, 195 Fed. 250 (C. C. A. 9th, 1912). In this case the bankrupt and the claimant were jointly liable for rent under an unexpired lease. Prior to the bankruptcy they agreed between themselves that claimant should attempt to procure a release of the lease for a certain bonus. The bankrupt agreed to reimburse the claimant for one-half the amount expended for that purpose. After the filing of the petition the claimant expended money and obtained the release. His claim for one-half the amount was denied provability, because of contingency. This case really presents a contract of reimbursement, rather than suretyship or guaranty. Here again the contingency could have been removed within the time limit for the presentation of claims. In re *Kaplan*, 44 F. (2d) 669 (N. D. Tex. 1930). In this case the bankrupt contracted to hold *O* harmless from any losses that might result on sales of *O*'s goods made by the bankrupt. The bankrupt sold goods to *D*, to be paid for on November 10th. On the November 4th previous to this, a voluntary petition in bankruptcy was filed by the bankrupt. On the following December 26th an involuntary petition was filed against *D*. The District Court held that the claim by *O*, against his bankrupt surety, was not provable because of the contingency. It is important to note that although default had not occurred before the filing of the petition, the probable insolvency at this time because of the imminent bankruptcy left little doubt as to the default, which would again take place within the time limit for proving claims.

cases[55] consistent with it have rather looked to the fundamental consideration of clearing up the indebtedness of the bankrupt surety.

The cases denying provability[56] were decided before the *Maynard* case and thus did not have the norm of this case as a guide. Compare the liability of the bankrupt endorser with that of the bankrupt surety. Certainly it cannot be successfully argued that there is greater contingency in the case of the surety than exists where the bankrupt is an endorser on a negotiable instrument. On the contrary, the conditions precedent to the secondary liability of the endorser imposed by the Negotiable Instruments Law render the creation of liability against the endorser far more contingent than the liability of a surety on a bond. In the case of the negotiable instrument there must be dishonor by the

55. In the *Adair* case the bankrupt purchased large mortgages and sold mortgage certificates of smaller denominations the payment of which was secured by the mortgage lien acquired by the purchase of the large mortgages and the bankrupt also guaranteed payment of principal and interest. The bankrupt arranged with the Globe Indemnity Co. for the issuance by the Globe Indemnity Co. of certificates of guarantee upon the payment of certain premiums and the giving of certain notices and the indemnitor was not to be liable until a failure of payment evidenced by foreclosure proceedings, and, in any case, not until the bonds shall have been in default twelve months. The court held that *certificate holders* had a provable claim. Some of the makers were in default and in some instances the bankrupt had made good these defaults; in others it had not. The court held these differences in status to be immaterial. But the claims of the Globe Indemnity Co. were denied provability except where the conditions precedent to liability had occurred.

Loeser v. Alexander, 176 Fed. 265 (C. C. A. 6th, 1910). In this case the bankrupt was surety upon a deputy treasurer's bond. The bank in which the principal debtor had deposited public funds had failed. The principal debtor had defaulted. The obligee was held to have a provable claim. The contingency as to liability and amount had been removed, but the certainty of default of the principal would not seem any greater than in the *Pettingill* case.

In re *Paramount Publix Corp.*, 72 F. (2d) 219 (C. C. A. 2d, 1934). In this case the bankrupt agreed to pay the whole amount of outstanding bonds in case of default in the payment of principal when due. The due date could arrive by the bonds maturing, or upon a call for redemption or upon declaration of maturity by the trustee for the bondholders. The trustee could declare maturity, if a thirty-day default in the payment of interest occurred or if the corporation (Paramount Publix Corporation) should be adjudicated a bankrupt and the adjudication should continue in effect ninety days. The trustee (for bondholders) and individual bondholders themselves claimed provability. When the petition was filed there had been some defaults in the payment of interest but there had been no declaration by the trustee. The claims were held provable on the authority of *Maynard v. Elliott*. Here the claims were contingent, but the contingency could be removed and this could occur within the time limited for the presentation of claims. This decision is indicative of the later trend of thought, which ignores the weak shackles of an old rule and gives heed to the fundamental purpose of freeing a debtor from unfortunate debts upon payment of a dividend.

56. *In re* Pettingill, 137 Fed. 143 (D. Mass. 1905); *In re* Merrill & Baker, 186 Fed. 312 (C. C. A. 2d, 1911); Colman v. Withoft, 195 Fed. 250 (C. C. A. 9th, 1912); *In re* Kaplan, 44 F. (2d) 283 (N. D. Tex. 1930).

party primarily liable, followed by notice and presentment before liability will attach to the endorser. Only default by the principal debtor is prerequisite to the liability of the surety. In spite of the greater contingency as to liability in the case of the endorser, the Supreme Court, as we have seen, held definitely that the estate of the bankrupt endorser must be subject to the claim of the holder.[57] While it is to be regretted that this question has not presented itself to the Supreme Court, there would seem to be little doubt as to the Court's decision, when the question is presented; arguing *a fortiori* from the *Maynard* case, the court will probably decide in favor of provability.

Furthermore, in the *Pettingill* case, it is interesting to note that the liability of the surety was really not contingent. On the date of the filing of the petition the primary obligor was hopelessly involvent[58] and nine days after the filing of the petition against the surety, a petition was filed against the primary obligor and the adjudication of the bankruptcy against the surety was followed eight days later by a similar adjudication against the primary obligor. Liability of the surety was most imminent on the day of the filing of the petition against it. The discharge in bankruptcy obtained by the primary obligor would be an absolute defense, in a subsequent suit, and liability against the surety would attach; nor did the possibility of performance by the primary obligor exist after bankruptcy because it was a corporation.

The court in the *Pettingill* case failed to consider the pragmatic result of its decision. The consequence was that the creditor was left without adequate satisfaction. The following brought about this result. Both the primary obligor and the surety were corporations. Insofar as the primary obligor is concerned the creditor has a provable claim in that bankruptcy proceeding;[59] his claim will therefore be discharged. But in the case of the surety he has no provable claim and the survivability is meaningless because the surety was a corporation. The assets will, of course, be entirely dissipated by the payments of dividends. This means that the creditor, who has sufficient foresight to require a surety upon a contract, is left remediless against the surety in case of the supervening bankruptcy of the latter. There is no sound reason for preferring the position of the holder of the negotiable instrument over that of the creditor when this question arises.

On this question of provability against the estate of the bankrupt surety, where there has been no default by the primary obligor, there would seem to be running through these cases, although not expressly

57. Maynard v. Elliott, 283 U. S. 273 (1931). See *supra* notes 44, 46, 47.

58. ". . . the Nervura Corporation became bankrupt but a few days after the bankruptcy of Pettingill, *and was undoubtedly insolvent at the time of the Pettingill bankruptcy.*" *In re* Pettingill, 137 Fed. 143, 148 (D. Mass. 1905) (italics supplied).

59. *In re* Alexander, 1 Lowell 470 (Mass. 1870).

stated, the distinction between surety and guaranty. Where the contract is one of suretyship, the claim is provable; but where it is one of guaranty, the claim must be denied provability. The liability of a true surety is primary,[60] and so cannot be contingent upon default by the primary obligor, whereas the liability of a true guarantor is secondary, dependent upon default by the one primarily responsible. This is in substance stating, that where there is contingency in liability, no provable claim exists. This prevalent state of judicial authority, of course, adds no progress in the gradual annihilation of the contingency rule insofar as it relates to liability. A complete abolition of this principle is desirable, but if that goal is not attainable, there is a happy medium existing between the two extremes. A careful reading of the suretyship and guaranty cases, cited in the footnotes,[61] will show that in many of them the contingency attaching to the liability of the party secondarily liable was removed[62] within the time limited for proving claims set out in the Bankruptcy Act.[63] There is no sound reason for adhering strictly to the principle that the status of the claim at the time of the filing of the petition shall be the controlling status, where it is apparent that the status of the claim insofar as liability is concerned will be materially changed within the period allowed for presenting claims.[64]

(3). There remains for discussion the third division—the claim of the surety against the bankrupt principal debtor.[65] This is provided for in the Bankruptcy Act.[66] The surety may claim in the creditor's name if

60. McIntosh-Huntington v. Reed, 89 Fed. 464 (N. D. Pa. 1898).

61. *Supra*, notes 54 and 55.

62. If this test of allowing provability where all contingency would be removed within the time limited for presenting claims (*supra* note 63) had been applied in the *Pettingill* case (*supra* note 52), the *Merrill & Baker* case (*supra* note 56), the *Colman* case (*supra* note 54), and the *Kaplan* case (*supra* note 54) provability would have been allowed.

63. Bankruptcy Act, § 57 (n) (44 STAT. 666 [1926], 11 U. S. C. A. § 103 [a] [6½] [1927]), which provides *aliunde* as follows: "Claims shall not be proved against a bankrupt estate subsequent to six months after the adjudication; . . ."

64. This is most forcibly brought out by the *Pettingill* case (*supra* note 52). See the new 63(a) (6½) where provability is granted even though the claim is not reduced to judgment until after the filing of the petition. Note 1, *supra*.

65. In this problem we have a contingency similar to that presented where a surety on a bond seeks to prove his claim against a bankrupt primary obligor. At common law the surety's claim is contingent upon payment to the creditor, and likewise the endorser has no claim against the maker at common law or under the Negotiable Instruments Law, until he has made payment to the holder. The provability of this contingent claim is provided for in Section 57(i) of the Bankruptcy Act. See note 66, *infra*.

66. Bankruptcy Act, § 57(i) (32 STAT. 799 [1903], 11 U. S. C. A. § 93 [i] [1927]) provides as follows:

"Whenever a creditor, whose claim against a bankrupt estate is secured by the individual undertaking of any person, fails to prove such claims, such person may do so in the creditor's name, and if he discharge such undertaking in whole or in part he shall be subrogated to that extent to the rights of the creditor."

the creditor fails to prove. The evident purpose of the Section is to give to the surety the benefit of a dividend if a creditor who knowing his surety is fully responsible, or for any other reason, neglects to prove his claim against the bankrupt estate. The leading case on this question is *Williams v. United States F. & G. Co.*[67] The principal debtors entered into a contract with the creditor for the erection of a building. They had defaulted on their contract prior to the date of the petition in bankruptcy against them. The creditor proved its claim and it was allowed. A bond had been given by the principal debtors indemnifying the creditor against loss in case the principal debtors defaulted. Such bond also contained a clause whereby the bankrupt (principal debtor) promised to reimburse the surety. The surety had paid nothing on the date of the filing of the petition against the principal debtors. Later the surety having paid the creditor sued the principal debtors claiming reimbursement under the bond provision. The principal debtors interposed the discharge obtained in the bankruptcy proceedings as a defense. Because the surety did not have a provable claim, as of the date of the petition, the lower court held that the discharge was no defense, and that the claim was contingent and hence non-provable. Reversing the lower court, the Supreme Court held that the surety did have a "claim" provable in bankruptcy.[68] The indemnification provision was construed as giving a contractual claim under subsection 63(a) (4) at the time of the filing of the petition. Here the Supreme Court expressly referred to the fundamental purpose of the Bankruptcy Act as it did in the *Chicago Auditorium* case[69] and the *Maynard* case.[70] The court, of course, logically held that the discharge was a complete defense.

(C) *Leases*

A brief approach to the problem involved seems necessary. Where there is an existing lease and the lessee becomes bankrupt, voluntarily or involuntarily, the trustee of the bankrupt lessee's estate has an option of adopting or rejecting the lease.[71] If he adopts the lease, the lessor has no basis for a claim unless the lease contains a provision giving the landlord an option of re-entry in case of bankruptcy or a provision making bankruptcy *ipso facto* a breach. The election to perform by the trustee of course contemplates full performance. This option passes to the trustee even though the lease prohibits assignability unless it is as-

67. 236 U. S. 549 (1915).

68. The court places the concept of "claim" under the broad definition of "debt" as debt is defined in § 1 (11) of the Bankruptcy Act. See note 39, *supra*.

69. Central Trust Company v. Chicago Auditorium, 240 U. S. 581 (1916).

70. Maynard v. Elliott, 283 U. S. 273 (1931).

71. Gazlay v. Williams, 210 U. S. 41 (1908).

sented to in writing by the lessor.[72] This prohibition is construed as referring to voluntary assignments as distinguished from assignments by operation of law.[73] But the factual set-up which gives rise to our problem appears when the trustee rejects an existing lease. The word "existing" means, of course, that the lease is unbroken on the date of the filing of the petition. In this situation, has the lessor a claim for *future rent*? The claim is not one for *damages* unless the lease contains a particular provision causing the bankruptcy itself to constitute a breach.[74] There never has been any difficulty about accrued rent; such an item is clearly provable.[75] Future rents had been generally understood to be non-provable[76] prior to June 7, 1934. The three important highlights in the development of this subject are *Manhattan Properties Inc. v. Irving Trust Co.*,[77] *Irving Trust Co. v. Perry, Inc.*,[78] and subsection 63(a)(7)[79] of the Bankruptcy Act. Prior to the *Manhattan Properties* case the leading case was probably In re *Roth & Appel*.[80] In the latter case the claimant had let certain premises to the bankrupts for a term of five years. A few weeks before the term began an involuntary petition was filed against the lessees, and the premises remained vacant for several months thereafter. The landlord's claim for the period of vacancy was held non-provable. There is a wealth of excellent editorial matter upon this question.[81] At the outset the question was presented as to whether the bankruptcy, voluntary or involuntary, gave rise to a breach of the lease, in the absence of a particular provision upon this subject appearing in the lease. It was generally accepted that the anticipatory breach theory based upon disenablement to further perform, applicable to executory contracts generally, was not applicable to leases[82] because

72. Gazlay v. Williams, 210 U. S. 41 (1908); *In re* Prudential Lithographing Co., 265 Fed. 869 (S. D. N. Y. 1920).

73. Gazlay v. Williams, 210 U. S. 41 (1908).

74. Irving Trust Co. v. Perry, 293 U. S. 307 (1934).

75. REMINGTON, *op. cit. supra* note 2, § 790.

76. *In re* Roth & Appel, 181 Fed. 667 (C. C. A. 2d, 1910).

77. 291 U. S. 320 (1934).

78. 293 U. S. 307 (1934).

79. *Supra* note 1.

80. 181 Fed. 667 (C. C. A. 2d, 1910).

81. Schwabacher and Weinstein, *Rent Claims in Bankruptcy* (1933) 33 COL. L. REV. 213; Radin, *Claims for Unaccrued Rent in Bankruptcy* (1933) 21 CALIF. L. REV. 561; Douglas and Frank, *Landlord Claims in Reorganizations* (1933) 42 YALE L. J. 1003.

82. *In re* Roth & Appel, 181 Fed. 667, 669 (C. C. A. 2d, 1910), wherein the court wrote: "Rent is a sum stipulated to be paid for the use and enjoyment of land. *The occupation of the land is the consideration for the rent.* If the right to occupy terminate, the obligation to pay ceases." Here the court is recognizing the historical thought—rent is earned by occupation. The court continued: "The lessee may be evicted by title paramount or by acts of the lessor. The destruction or disrepair of the premises may, . . . justify the lessee in abandoning them. The lessee may quit the premises with the

of the historical background surrounding leases.[83] This difference was recognized in the *Chicago Auditorium* case,[84] but has been subjected to considerable criticism.[85] However, the subject was rendered academic by the inclusion of provisions in leases to the effect that the bankruptcy of the lessee would give to the lessor an option of re-entry[86] or to the effect that the bankruptcy of the lessee would *ipso facto* break the lease.[87] The question of the provability of a claim for future rent by the lessor against the bankrupt estate of his lessee under leases containing these provisions arose twice before the Supreme Court in 1934 and each decision was written by Mr. Justice Roberts. In the *Manhattan Properties* case, the Supreme Court in dealing with a situation containing a lease having a "re-entry" clause held the lessor's claim non-provable, because of contingency of liability.[88] The Court pointed out that the lease was not broken until re-entry by the lessor and since he might not re-enter, there was an existing contingency. A few months later the *Perry* case[89] was presented to the Supreme Court. In that case the lease contained a clause which provided that the lease was *ipso facto* broken upon the filing of a petition by or against the lessee. The Court held the claim to be provable. Since re-entry was not a condition precedent, the contingency as to liability was removed. The Court held, therefore, that the claim for future rent[90] was provable in that case. Then Congress added subsection 63(a) (7) to the Bankruptcy Act.[91] This amendment abolishes the distinction between the

lessor's consent. . . . On the contrary, the obligation upon the rent covenant is altogether contingent. . . . Both its existence and amount are contingent upon uncertain events." (Italics supplied.)

83. Co. LITT. *292.

84. Central Trust Co. v. Chicago Auditorium, 240 U. S. 581, 590 (1916) wherein the court, having referred to and cited landlord and tenant cases, wrote: "Cases of the latter class are distinguishable, because of the 'diversity between duties which touch the realty, and the mere personalty'."

85. See Schwabacher v. Weinstein, *supra*, note 81, at 238.

86. The usual "re-entry" provision is as follows:

"In case the lessee is declared bankrupt, the lease shall terminate and the lessor has a right to re-enter . . . and its legal representatives will pay . . . the difference between the rents and sums reserved and those otherwise reserved or with due diligence collectible."

87. The usual *"ipso facto"* provision is as follows:

". . . the filing of any petition in bankruptcy . . . by or against the lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the lessor, this lease shall become and be terminated; . . . "

88. Manhattan Properties v. Irving Trust, 291 U. S. 320 (1934). *Accord: In re* F. & W. Grand Stores, 70 F. (2d) 691 (C. C. A. 2d, 1934).

89. Irving Trust v. Perry, 293 U. S. 307 (1934).

90. Since the bankruptcy constituted an *ipso facto* breach of the lease, the claim was really for *damages,* and not for *future rent.*

91. See note 1, *supra.*

Manhattan Properties case and the *Perry* case.[92] Hence today it is immaterial whether the lease provides for "re-entry" or contains an "*ipso facto*" clause. The amendment also attempts to remove the contingency as to the amount of the provable claim. There is some ambiguity as to the meaning of the words ". . . but the *claim* of a landlord . . . shall in no event be *allowed* in an amount exceeding the rent reserved . . . for the year next succeeding the date of the surrender of the premises . . ." (italics supplied). It is not clear whether the congressional intent was to allow *proof* of future rent for the one year designated and the *allowance* of a dividend on that amount, or whether the landlord may prove for the full amount of the rent for the lease-term and be restricted in his dividend to the rent for the year designated. Because of the use of the words ". . . shall in no event be allowed in an amount exceeding the rent reserved . . ." the latter construction would seem to be the proper one. Another interesting query raised under this liquidation provision concerns the binding effectiveness of it. It may be that this statutory maximum can be altered by the consent of the parties, but it might be forcibly argued that the words, "in no event," would preclude this privilege of altering the terms of the statute.

The amendment, 63(a) (7)[93] in so far as it relates to future rent is a step in the right direction. Under the former law if the lease had been broken prior to the filing of the petition, a claim for *damages* could be successfully made for the balance of the term. This of course was not a claim for future rent, but rather for *damages*, and the rule against provability applied to future rent and not to damages flowing out of a broken lease. The careful wording of subsection 63(a) (7) indicates the intention of Congress to deal solely with future rents. Since the enactment of this subsection it has been argued that where a trustee rejects a lease, the subsection providing for the provability of "future rents" cannot apply, since the claim cannot be for rent because the lease has been broken.[94] Such contention would seem to ignore the fundamental rule which views the status of the claim at the time of the filing of the petition as the decisive status. It was obviously the purpose of the subsection to give a provable claim to a lessor in the event of the bankruptcy of his lessee.

(D) *Executory Sale of Goods and Service Contracts*

It might be well to orient briefly. When a party to an executory

92. See Comment (1935) 22 VA. L. REV. 199.

93. See note 1, *supra*.

94. See Comment (1935) 22 VA. L. REV. 199. If the claim of the lessor be one for damages, it would seem to be provable under 63 (a) (4). Subsection 63 (a) (7) made future rents provable; it did not change *future rent* into *damages*.

contract goes into bankruptcy, the trustee usually has the privilege of adopting or rejecting that contract. Of course, in personal service contracts which are not assignable by reason of the nature of the employment, all rights and duties are absolved by the bankruptcy as well as by the death of a party. But in the ordinary sale of goods or service contract, not involving the personal services of one individual, the contract is an asset of the bankrupt and will pass to his trustee in bankruptcy.[95] If the contract doesn't pass or the trustee adopts the contract there is no question of a provable claim. If the contract doesn't pass to the trustee, it is not an asset or liability in the bankruptcy matter and not affected by the discharge. If the trustee adopts it, full performance is thereby promised, and therefore the question of provability for a dividend does not arise. But where there exists "passibility" under Section 70(a)[96] of the Act, plus rejection of the contract by the trustee, the question of provability of the contract does arise.

If the contract has been executed, the claim arising therefrom is provable under the Act.[97] But a difficulty arose in those cases where the sales or service contract was executory in that deliveries or services were still due when the petition was filed. This situation, of course contemplates, that there is no breach or express repudiation before the petition was filed. Hence the question arose: Where the contract was executory and unbroken on the date of the filing of the petition has the vendor or the vendee a provable claim in case of bankruptcy of the other party to the contract? At the outset, we have the problem as to the effect of the bankruptcy upon the existing contract. If the bankruptcy is construed as an anticipatory breach,[98] contingency as to liability is removed,[99] but if the bankruptcy is not construed as an anti-

95. Bloxam v. Sanders, 4 B. & C. 941, 107 Eng. Reprints 1509 (K. B. 1825); 2 WILLISTON, SALES (2d ed. 1924) 1668. There are some situations where the personal contract could pass. See GLENN, LIQUIDATION (1935) § 480.

96. 32 STAT. 800 (1903), 11 U. S. C. A. § 110 (a) (1926) provides *aliunde* as follows: "The trustee of the estate of a bankrupt upon his appointment and qualification . . . shall in turn be vested by operation of law with the title of the bankrupt, . . . to all . . . (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him . . . (6) rights of action arising upon contracts or from the unlawful taking or detention of or injury to, his property."

97. There being no difficulty in so far as contingency as to liability is concerned, the claim is provable under Section 63 (a) (4) which provides as follows:

"Debts of the bankrupt which may be proved and allowed against his estate which are . . . (4) founded upon an open account or upon a contract express or implied."

98. The leading case recognizing this doctrine of anticipatory breach is Roehm v. Horst, 178 U. S. 1 (1900), following Hochster v. De la Tour, 2 E. & B. 678, 118 Eng. Reprints 922 (Q. B. 1853).

99. Contingency as to amount does not exist in the ordinary sales case. Difference can be established between contract price and market value.

cipatory breach, there is the uncertainty as to whether there will be a breach. The conflict, existing for several years, on this question of provability was caused by some Circuit Courts of Appeal construing bankruptcy as an anticipatory breach of the executory contract, and by other courts refusing to place such a construction upon bankruptcy. Probably the leading cases exemplifying this conflict are In re *Stern*,[100] wherein the buyer-claimant under an executory sales contract was held to have a provable claim, and In re *Imperial Brewing Company*,[101] where a seller-claimant under an executory sales contract was held not to have a provable claim against a bankrupt buyer. The difference in result lies in the different effect upon the contract given by the courts to the intervening bankruptcy.[102] Finally this question was presented to the Supreme Court[103] in *Central Trust Co. v. Chicago Auditorium Ass'n*, and after referring to the cases above mentioned, the court repudiated the principle of the *Imperial Brewing Company* case and laid down the rule permitting a claim to be provable under an executory contract where the bankrupt's insolvency incapacitated him from further performance. In this case a transportation company entered into a contract with a hotel corporation whereby the transportation company was to have exclusively the business of transporting passengers and baggage to and from the hotel. This contract was made for a definite period of time. Shortly after performance started the transportation company became involved in financial difficulties and was eventually adjudged a bankrupt. Performance of the contract was, of course, incomplete. There had been no breach of the contract by either party prior to the filing of the petition in bankruptcy against the transportation company. Upon these facts the question was clearly raised as to what effect, if any, the bankruptcy of a party to an executory contract would have upon that contract. The Supreme Court noted that the transportation company would be unable to further perform its contract because of its inability to furnish, equip and maintain the

100. 116 Fed. 604 (C. C. A. 2d, 1902). The vendor of an executory contract to sell ice suffered the filing of an involuntary petition against him. One of the petitioners was a vendee under the executory contract. He was held to be a proper petitioning creditor, which meant he must have a provable claim under § 59(b) of the Bankruptcy Act which provides as follows: "Three or more creditors who have provable claims against any person . . . may file a petition to have him adjudged a bankrupt."

101. 143 Fed. 579 (W. D. Mo. 1906).

102. In the *Imperial Brewing* case, *id.* at 581, the court stated: "I am unable to consent to the proposition that such an adjudication in bankruptcy, ex vi termini, is in law tantamount to a refusal of the bankrupt to perform, or that it thereby permanently disabled itself from performance, to bring the claim asserted by petitioner within the operation of the rule laid down in Roehm v. Horst, supra."

103. Central Trust Co. v. Chicago Auditorium, 240 U. S. 581 (1916). While this was a sale of service case, the rule applies to sale of goods cases as well.

vehicles necessary to complete performance. The Court, therefore, held that the hotel company had a provable claim because the bankruptcy had disenabled the transportation company to further perform.

The next step in the development of the law on this subject occurred on June 7, 1934 when subsection 63(a) (7) was added to the Act. The addition makes provable, "claims for damages respecting executory contracts." The inquiry might be raised as to whether the new subsection really adds anything[104] in view of the Supreme Court's decision in the *Chicago Auditorium* case. The words above extracted from the statute might be construed as including executory contracts without the necessity of satisfying the disenablement test imposed by the *Chicago Auditorium* case. If the stated clause is not so construed, it adds nothing to the force and effect of the *Chicago Auditorium* decision. If it is so construed, then executory sales contracts will present provable claims even where the liability is contingent, because if there is not disenablement to perform, *there may never be a breach.*

(E) *Tortious Claims*

Prior to the amendments of 1934 it was the general rule that unliquidated tort claims were not provable in bankruptcy.[105] Frequently the reason advanced is that this is a continued reflection of the earlier English Bankruptcy Acts which confined their application to traders' claims, that is, claims resulting from business transactions only. It might be observed, in passing, that claims arising from the transportation of merchandise are incidents of commercial activities and are just as distinctly mercantile as that phase which deals with the actual selling and buying of goods. Where the business is exclusively a transportation enterprise, claims for injuries arise in the conduct of the very business itself. The fact that judgments founded upon tort claims are provable is another basis for attacking this stated historical reason which favored the claims of traders as the basis for the rule excluding unliquidated tort claims; the reduction of the tort claim to judgment does not change the nature of the claim set out in the complaint from *ex delicto* to *ex contractu*. Probably the real reason, at least for the continuance of the rule, is that the tort claim usually does not lend itself to liquidation upon any scientific basis. One cannot, with any degree of accuracy,

104. This question is raised by GLENN, *op. cit. supra* note 95 at 698. The author writes as follows: "So, in the writer's opinion at least, the amendment of June 18, 1934 was not very far ahead of our courts. Except for rent claims, . . . the amendment added five words only. It stated that provable debts should include 'claims for damages respecting executory contracts.' Our courts, as has been seen, had got that far before the amendment came."

105. Schall v. Camors, etc., 251 U. S. 239 (1920).

translate into monetary values the elements of damages which the law receives in evidence[106] in the trial of these cases.

This rule excluding unliquidated tort claims has four important modifications: (1) A judgment based upon a tort claim is provable by the express provision of the Bankruptcy Act.[107] This cannot be said to be an exception to the rule, because the judgment is the basis of the claim rather than the tort and since the entry of the judgment changes the tortious claim into a quasi-contractual one, the claim based upon the judgment might be provable under Section 63(a) (4)[108] of the Bankruptcy Act. The word, "implied," appearing in this subsection has been construed as including contracts implied in law.

(2). Torts resulting in the unjust enrichment of the defendant (bankrupt) are provable claims. Wherever the tort could be waived and the action brought in quasi-contract, the claim is provable.[109] In these tortious cases the amount of recovery lends itself to liquidation because it is based upon the extent of the unjust enrichment. This is a powerful argument in favor of the test of uncertainty of the amount being used as the basis and rationale of the rule excluding unliquidated torts. The Act itself, however, as indicated above, permits of the proof of such unliquidated tort claims under the broad construction given to the word, "Implied," appearing in Subsection 63(a) (4). The decisions permit the proving of such a claim even where the claimant has previously instituted an action based upon a theory of tort liability.[110]

(3). A genuine modification of the general rule appeared in the recent amendments to the Bankruptcy Act. In 1934 Subsection 63(a) (6½)[111] was added, which makes personal injury claims, founded on negligence, provable when evidenced by a judgment, even though the judgment is obtained after the petition is filed. The claim founded in negligence, was probably the most frequent tortious claim excluded from provability by the rule of exclusion previously obtaining. In personal

106. GLENN, LIQUIDATION (1935) § 466.

107. 30 STAT. 562, 11 U. S. C. A. § 103 (a) (1) (1926) which provides: "Debts of the bankrupt may be proved . . . which are (1) a fixed liability, as evidenced by a judgment. . . ."

108. 30 STAT. 562, 11 U. S. C. A. § 103 (a) (4) (1926) which provides as follows: "Debts of the bankrupt may be proved . . . which are . . . (4) founded . . . upon a contract express or *implied*"; (Italics supplied).

109. *In re* S. W. Strauss & Co., 67 F. (2d) 605 (C. C. A. 2d, 1933); *In re* International Match Corp., 69 F. (2d) 73 (C. C. A. 2d, 1934).

110. Crawford v. Burke, 195 U. S. 176 (1904).

111. "Debts of the bankrupt may be proved . . . which are . . . (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary." 48 STAT. 923, 991, 11 U. S. C. A. § 103 (6½) (1934).

injury cases particularly, the prohibition against provability caused unjust results. Injustice resulted in the cases where the personal injury claim existed against an uninsured corporation. The claim was not provable against the bankrupt estate of the corporation; hence nothing could be realized in the form of a dividend. This, of course, meant that the claim would survive against the corporation, but it was valueless, because while bankruptcy will not dissolve the corporate entity, it leaves only a financially irresponsible shell against which no satisfactory execution of judgment may be obtained. The amendment also obviated the necessity of the practice, which had arisen, wherein the defendant, in the personal injury suit, would await the obtaining of a judgment against him before filing or procuring the filing of a petition in bankruptcy. The obvious reason was to subject the debt to the effective bar of the discharge to be subsequently obtained. If the petition was filed while the claim was unliquidated by judgment the claim would not be provable and hence would survive the discharge. This use of the Bankruptcy Act to defeat just personal injury claims brought ridicule upon the Act; the obliteration of it is commendable.

(4). Prior to the amendments of 1934 an *award* given by a Workmen's Compensation Referee to an injured employee was not a provable claim against the estate of the bankrupt employer.[112] The new subsection 63(a) (6)[113] makes such claims provable. Prior to its enactment in 1934, the question as to the provability of such an award arose. It was argued that an award constituted a judgment under subsection 63(a) (1). Provability was denied because the award lacked finality and might be remanded or altered by the commission.[114] Hence the new amendment was needed, particularly where the bankrupt employee was a corporation, in which case the survivability of the employee's claim after the bankruptcy discharge would avail him nothing. By and large it undoubtedly will be more just in cases where the bankrupt employer is an individual as well. Even under the amendment if the claim has not been reduced to an *award,* no provable claim exists. The purpose of this undoubtedly was to give the creditors of a bankrupt employer some protection against unfounded claims by employees.

The stated reason for the continuance of the general rule excluding unliquidated tort claims from provability lies in the uncertainty of the amount of the damage. In the first two modifications of the rule, this objection to their provability does not exist. The judgment liquidates the tort and the amount of damage in the quasi-contractual action is

112. Matter of Rockaway Soda Water Co., 226 Fed. 520 (E. D. N. Y. 1913).

113. "Debts of the bankrupt may be proved . . . which are . . . (6) founded upon an award of an industrial accident commission. . . ." 49 STAT. 1475, 11 U. S. C. A. § 103 (6) (1936).

114. Lane v. Industrial Comm'r, 54 F. (2d) 338 (C. C. A. 2d, 1931).

usually not difficult to ascertain. In the last two modifications the objection has been provided for expressly in the amendments. In the case of the personal injury action based upon negligence the claim must be "evidenced by a judgment" although the judgment need not be in existence when the petition is filed.[115] The compensation claim must have been reduced to an "award" under the provisions of subsection 63(a) (6).[116] The issues of liability and the amount to be granted in either of the latter two cases could be adjudicated before a referee in bankruptcy, but undoubtedly it was thought better to leave these issues with the courts now having that jurisdiction. As a practical matter this was a wise decision. The present tribunals are better equipped to handle these issues, and to further encumber the work of the bankruptcy referee would only add to our bankruptcy delay. This consideration was undoubtedly the cause for requiring some liquidation by award or judgment, rather than a formalistic desire to adhere to the old rule denying provability to unliquidated tort claims.

Conclusion

From this collection of cases and statutory authorities, recent for the most part, it is apparent that the ancient barrier against contingent claims is being slowly annihilated. In so far as claims based upon contract are concerned, the only cases wherein provability is denied are the guaranty cases wherein the creditor presents a claim against the bankrupt guarantor prior to default by the primary obligor. This situation has never been presented to the Supreme Court. It is tempting to conjecture the probable outcome. Certainly this situation is no more contingent than the claim of a holder of a negotiable instrument against a bankrupt endorser, which, as we have seen,[117] was held by the Supreme Court to present a claim provable in Bankruptcy.

In regard to the tortious claims, Congress has broken down the long accepted rule in so far as injury claims are concerned by giving them provability even though they are unliquidated on the date of the filing of the petition, but leaving their liquidation with the courts now having jurisdiction. It would seem that this innovation might be extended to include all torts. This would not leave overhanging indebtedness to further encumber the bankrupt after his discharge and it would permit the claimant to share in the assets of the estate. Section 17(a)[118]

115. The *claim* must be pending before the filing of the petition and the action instituted before the adjudication. The judgment apparently must be entered within the time limited for filing claims. In case of a congested calendar, a court would undoubtedly grant a calendar preference in the event of the defendant's bankruptcy.

116. See note 113, *supra*.

117. Maynard v. Elliot, 283 U. S. 273 (1931).

118. Section 17(a) sets out several claims including wilful and malicious torts, em-

would prevent a wilful or malicious tortfeasor from escaping further liability after the discharge.

It is to be regretted that Congress did not follow the English Bankruptcy Act[119] and expressly provide for the proving of contingent claims in bankruptcy. This would accomplish the two major purposes of bankruptcy legislation referred to previously, to wit, the privilege of sharing in the assets of the bankrupt estate and the relief of the debtor through the medium of discharge. The survivability resulting from non-provability is usually of no great value. Subsequent diligence of the bankrupt, in most instances, prevents any later realization being gained by the claimant.

---

bezzlement, taxes and others which are not barred by discharge. 42 STAT. 354, 11 U. S. C. A. § 35 (1926).

119. See note 17, *supra*.