NOTES

WHY *WRIGHT* WAS WRONG: HOW THE THIRD CIRCUIT MISINTERPRETED THE BANKRUPTCY CODE . . . AGAIN

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Whether a right to payment is a "claim" is one of the most important determinations in bankruptcy because only "claims" are subject to the bankruptcy process, including the all-important automatic stay and discharge provisions. The Bankruptcy Code ("Code") provides a definition of claim in § 101(5), but courts have differed greatly in what "rights to payment" are covered by that definition. For twenty-six years, the Third Circuit was subject to one of "the most criticized and least followed precedents decided under the current Bankruptcy Code," In re M. Frenville Co.*, which created the overly narrow state law accrual test. The Third Circuit finally heeded the criticism in 2010 and overruled* Frenville *in* In re Grossman's*, in which it adopted the prepetition relationship test. In* Wright v. Owens Corning*, decided in May 2012, the Third Circuit set out to clarify the scope of its new test. Instead of clarifying, however, the court in* Wright *expanded the realm of "claims" in the Third Circuit to include those established by a preconfirmation, rather than a prepetition, relationship. It did so without adequately considering the language of the Code or the policy implications of its decision. This Note argues that a "claims" test should focus on the date of petition, not confirmation, to be consistent with the language and policy of the Code, and that* Wright *was therefore wrongly decided.*

INTRODUCTION

In 2000, Owens Corning filed for bankruptcy. As the United States' top producer of fiberglass insulation, it had $5 billion in annual revenue, a $500 million credit line from Bank of America, and good management.[1] What caused this seemingly healthy company to file for Chapter 11? Seven billion dollars in potential asbestos-related liability.[2] Although Owens Corning stopped selling asbestos products in 1972[3] and derived

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1. Claudia H. Deutsch, Owens Corning Has Filed for Bankruptcy Protection, N.Y. Times, Oct. 6, 2000, at C2.

2. John Seewer, Lawsuits Push Owens Corning into Bankruptcy, Wash. Post, Oct. 6, 2000, at E2.

3. Id.

only $135 million in sales from such products,[4] it became overwhelmed by thousands of lawsuits in the 1990s.[5] By filing for Chapter 11 bankruptcy, Owens Corning could resolve its crippling asbestos liability while continuing to operate its otherwise healthy business. Owens Corning's bankruptcy filing demonstrates the benefits of Chapter 11: An otherwise profitable company can press pause, negotiate with all of its creditors in an organized manner, resolve the claims against it, and continue to operate its business in the meantime. This result can only occur, however, if all of the prebankruptcy claims against the company can be resolved in the bankruptcy process.

Whether a right to payment is a claim under bankruptcy law ("Claim")[6] is one of the most important determinations in bankruptcy, because only Claims are subject to the bankruptcy process, including the all-important automatic stay[7] and discharge[8] provisions. The Bankruptcy Code[9] ("Code") provides a definition of Claim in § 101(5),[10] but courts differ greatly in which "rights to payment" are covered by that definition. For years there were five tests in use, each employing a different criterion;[11] given the multitude of tests, the same right to payment might be considered amenable to resolution in bankruptcy in one circuit and unable to be resolved in bankruptcy in another circuit. In addition, a postpetition right to payment that is not a Claim can be classified as an administrative expense,[12] which entitles it to priority over all other unsecured claims.[13] The choice of test can therefore have a significant effect

4. Deutsch, supra note 1.

5. Seewer, supra note 2.

6. When referring to the specific definition of "claim" provided for in the Code, Claim will be capitalized. The nonspecific term "claim" (used to refer to a right to payment) will be lowercase.

7. 11 U.S.C. § 362 (2012) (providing for automatic stay that prevents creditors from engaging in any sort of debt-collecting activity).

8. See id. § 727 (providing discharge of Claims in Chapter 7); id. § 1141(d)(1)(A) (same for Chapter 11).

9. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.).

10. Section 101(5)(A) provides that a Claim is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A); see infra Part I.B.2 for further discussion.

11. For a discussion of the five tests, see infra Part II.A.

12. See 11 U.S.C. § 503 (defining administrative expenses); infra Part I.C (discussing administrative expenses).

13. 11 U.S.C. § 507. This statement is always true in a Chapter 11 case, in which the debtor is a business. For individual debtors in Chapter 7 or Chapter 13, however, there is one exception: Domestic support obligations have priority over administrative expenses. Id.

on the priority of—and thus the amount of money received by—claimants in a bankruptcy proceeding.[14]

Through bankruptcy, Owens Corning resolved its asbestos liability. It negotiated with contract creditors and asbestos claimants, who consented to its reorganization plan that created a $5.2 billion trust for asbestos victims.[15] After the court affirmed its plan in 2006, Owens Corning probably thought it had resolved all of its bankruptcy issues. In 2009, however, it found itself on the receiving end of a class action complaint alleging fraud, negligence, and strict liability. This complaint had nothing to do with asbestos—the claim was for cracked roofing shingles—but it would still force Owens Corning back into the bankruptcy arena. The shingles at issue cracked and leaked after the reorganization plan was confirmed, though the plaintiffs purchased them preconfirmation.[16] Did the plaintiffs hold Claims under the Code that Owens Corning's lengthy bankruptcy proceeding had already discharged? The Third Circuit set out to answer that question in *Wright v. Owens Corning*.[17]

The Third Circuit and the Bankruptcy Code have had an uneasy relationship. For twenty-six years, the Third Circuit was subject to "one of the most criticized and least followed precedents decided under the current Bankruptcy Code,"[18] *In re M. Frenville Co.*[19] *Frenville* created the state law accrual test, which held that a Claim did not arise until a claimant possessed a right to payment under state law.[20] This overly narrow inquiry received heavy criticism from courts and commentators.[21] The

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14. See Matthew Petrie, Comment, When a Claim Arises and Why It Matters, 16 J. Bankr. L. & Prac. 599, 600 (2007) (explaining determination of Claim has "tremendous effect on the amount that the holder of that claim will receive"). Petrie explains that "if the claim arose prepetition, it will likely be a general unsecured claim. If the claim arose postpetition but preconfirmation, then it will likely be classified as an administrative expense under section 503(b) of the Code." Id.

15. E.g., Owens Corning to Pay Billions in Plan to Exit Bankruptcy, N.Y. Times, May 11, 2006, at C5.

16. See Wright v. Owens Corning, 679 F.3d 101, 103 (3d Cir. 2012) (noting plaintiffs discovered leaks and cracked shingles in 2009 but installed shingles before bankruptcy court confirmed Owens Corning's plan in 2006), cert. denied, 133 S. Ct. 1239 (2013).

17. Id.

18. Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114, 120 (3d Cir. 2010) (en banc) (quoting Firearms Imp. & Exp. Corp. v. United Capitol Ins. Co. (In re Firearms Imp. & Exp. Corp.), 131 B.R. 1009, 1015 (Bankr. S.D. Fla. 1991)) (internal quotation marks omitted). Though based in Ohio, Owens Corning (like many large corporations) is incorporated in Delaware and filed its bankruptcy petition there, which is why the Third Circuit heard the case.

19. Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984), overruled by *In re Grossman's*, 607 F.3d 114.

20. For further discussion of *Frenville* and the state law accrual test, see infra Part II.A.1.

21. See, e.g., Cal. Dep't of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925, 930 (9th Cir. 1993) (per curiam) (arguing *Frenville* misinterprets Code's definition of Claim);

Third Circuit finally heeded the criticism in 2010 and overruled *Frenville* in *In re Grossman's*,[22] in which it adopted the prepetition relationship test. The Third Circuit set out to clarify the scope of its new test in 2012 in *Wright v. Owens Corning*. Instead of clarifying, however, the court in *Wright* expanded the realm of Claims to include those arising from a preconfirmation relationship. It did so without adequately considering the language of the Code or the policy implications of its decision.

This Note argues that a Claims test should focus on the date of petition, not confirmation, to be consistent with the language and policy of the Code, and that *Wright* was therefore wrongly decided. It proceeds in three Parts. Part I provides background information regarding Chapter 11 bankruptcies generally, then specifically examines what constitutes a Claim for bankruptcy purposes and what qualifies as an administrative expense. Part II surveys and evaluates the multitude of tests circuit courts have used to determine when a right to payment arises and examines *In re Grossman's* and *Wright v. Owens Corning*. Part III argues that *Wright*'s preconfirmation test misinterprets the Bankruptcy Code, violates Chapter 11 policy, and creates inefficiencies. Part III also recommends that the Third Circuit return to the rule laid out in *Grossman's*, and analyze postpetition, preconfirmation claims using the administrative expense doctrine.

I. CLAIMS AND ADMINISTRATIVE EXPENSES IN CHAPTER 11

This Part will discuss the Chapter 11 process, the statutory scheme and legislative history of Claims, and the definition of administrative expenses and justification for their priority. Part I.A will provide an overview of Chapter 11, Part I.B will discuss Claims and their importance to the successful resolution of a bankruptcy, and Part I.C will explore administrative expenses and their role in Chapter 11.

A. *Chapter 11 Bankruptcy Proceedings: An Overview*

When a company like Owens Corning is insolvent, it can file for bankruptcy as a way to pause its creditors' actions and take the time to either liquidate its assets or reorganize and renegotiate its debts. A struggling business will usually file under Chapter 11, the reorganization chapter. Chapter 11 is a way for potentially profitable businesses to continue to operate while they straighten out their financial affairs.[23]

Ralph R. Mabey & Annette W. Jarvis, *In re Frenville*: A Critique by the National Bankruptcy Conference's Committee on Claims and Distributions, 42 Bus. Law. 697, 703 (1987) ("The *Frenville* decision is based on a misunderstanding of the policy behind the Bankruptcy Code, the Code itself, prior case law, and the interrelationship of various Code sections.").

22. 607 F.3d 114.

23. See 11 U.S.C. § 363(c)(1) (2012) (providing debtor in possession may "enter into transactions . . . in the ordinary course of business, without notice or a hearing"); id. § 1107 (providing debtor in possession has rights and powers of trustee); id. § 1108

These businesses may be struggling financially but still be efficient, meaning that their assets cannot be put to a better use.[24] Saving such businesses is a primary motivation behind Chapter 11.[25]

A brief outline of Chapter 11 procedures will demonstrate how a business can benefit from bankruptcy. Immediately upon filing a bankruptcy petition, two things happen. First, filing a petition creates the bankruptcy estate, which is a distinct legal entity from the debtor.[26] All prepetition claims are held against the estate, not the debtor. Second, filing a petition triggers the automatic stay provision in § 362, which prohibits any and all debt-collection activities.[27] This gives the company breathing space during which it can renegotiate with its creditors without lawsuits, liens, and foreclosures disrupting its business.[28] In Chapter 11,

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("Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business."); cf. Douglas Baird, The Elements of Bankruptcy 131 (5th ed. 2010) ("The financial structure of the business changes when it is in Chapter 11, but its operations need not.").

Sometimes, however, the motivation for filing under Chapter 11 is not to save the business; it may be to sell the company as a going concern. See id. at 19 (noting one reason to file under Chapter 11 is because "bankruptcy forum provides a straightforward way to sell the business as a going concern"). This is commonly known as a "363 sale," since § 363 gives the trustee the power to sell property of the estate. See 11 U.S.C. § 363(b)(1) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ."). See generally Jacob A. Kling, Rethinking 363 Sales, 17 Stan. J.L. Bus. & Fin. 258 (2012) (discussing 363 sales in depth and considering possible negative consequences of such sales).

24. See Michelle J. White, Does Chapter 11 Save Economically Inefficient Firms?, 72 Wash. U. L.Q. 1319, 1319 (1994) ("[Chapter 11 is for firms] that are economically efficient despite their financial distress since their resources have no higher value use. . . . [E]conomically efficient but failing firms should be saved."); cf. Baird, supra note 23, at 231 (noting Chapter 11 debtors are "worth keeping intact").

25. See, e.g., United Trucking Serv., Inc. v. Trailer Rental Co. (In re United Trucking Serv., Inc.), 851 F.2d 159, 162 (6th Cir. 1988) (recognizing bankruptcy's "purpose of enabling the continued operation of insolvent businesses"); Dale Ellen Azaria, When Is a Claim a Claim? A Bankruptcy Code Riddle, 62 Tenn. L. Rev. 205, 222 (1995) (noting Congress's goal of "encouraging potentially profitable businesses to reorganize").

26. 11 U.S.C. § 541(a)(1); see also Stephen D. Hurd, Note, Re-Reading *Reading*: "Fairness to All Persons" in the Context of Administrative Expense Priority for Postpetition Punitive Fines in Bankruptcy, 51 Vand. L. Rev. 1459, 1460–61 (1998) (explaining "persons whose claims arose after filing . . . but before completion of the bankruptcy proceeding, cannot receive payment of their claims through the general bankruptcy distribution because their claims are against the *estate*, rather than against the *debtor*" (footnote omitted)).

27. 11 U.S.C. § 362 (providing stay against collection activities, including "commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor").

28. See, e.g., Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1272 (5th Cir. 1994) ("The purpose of Chapter 11 reorganization is to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state." (quoting Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (In re Little Creek Dev. Co.), 779 F.2d 1068, 1073 (5th Cir. 1986)) (internal quotation marks omitted)); Grady v. A.H. Robins Co., 839 F.2d 198, 200 (4th Cir. 1988) ("[T]he automatic stay is particularly

these negotiations culminate in a plan of reorganization ("Plan"). The debtor has the exclusive right to file a Plan for 120 days; if the debtor does not submit a Plan or its Plan is not accepted by the creditors within 180 days after the petition date, a creditor may file an alternate Plan.[29] Plans are particularly important in the context of Claims because confirmation of a Plan binds the debtor and all creditors. It also discharges the debtor from its prepetition debt, whether or not proof of a claim has been filed or the holder of the claim has accepted the Plan.[30] Thus, because all Claims will be discharged,[31] determining what constitutes a Claim has major repercussions throughout the bankruptcy.

B. *The Significance of Claims and Their Treatment in the Code*

Because only Claims are discharged in bankruptcy, the success of a Chapter 11 reorganization may turn on whether significant liabilities, such as those for asbestos-related illnesses,[32] are Claims that can be dealt with in the bankruptcy proceedings. Part I.B.1 will explain in more depth

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critical to a debtor seeking to reorganize under Chapter 11 because he needs breathing room to restructure his affairs."); Edith H. Jones, Chapter 11: A Death Penalty for Debtor and Creditor Interests, 77 Cornell L. Rev. 1088, 1088 (1992) (describing Chapter 11 as "breathing-space during which a company can avoid paying its creditors while it negotiates to restructure its debt").

29. 11 U.S.C. § 1121(b)–(c) (providing who can file Plan and when). The debtor can request that the court extend either time period, id. § 1121(d)(1), but the 120-day period cannot be extended beyond eighteen months after the petition is filed, id. § 1121(d)(2)(A), and the 180-day period cannot be extended beyond twenty months, id. § 1121(d)(2)(B).

30. Id. § 1141(d)(1)(A). Because of the significant consequences, confirmation of a Plan is "the most significant single event in the case, the climax of efforts that may have lasted years." Frank R. Kennedy & Gerald K. Smith, Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings, 44 S.C. L. Rev. 621, 622 (1993). Each class of creditors votes on the Plan, and for it to be confirmed, each class must either accept the Plan or be unimpaired by it. 11 U.S.C. § 1129(a)(8). However, even if that requirement is not met, a court will confirm the Plan as long as it "does not discriminate unfairly, and is fair and equitable" to the classes of creditors that vote against it. Id. § 1129(b)(1). Confirming a Plan over a class's dissent is known as a "cramdown." E.g., Baird, supra note 23, at 231. See generally Richard Maloy, A Primer on Cramdown—How and Why It Works, 16 St. Thomas L. Rev. 1 (2003) (explaining cramdown in depth).

31. However, many Plans have an exception for administrative expenses, which will continue to be paid postconfirmation. See, e.g., Sanchez v. Nw. Airlines, Inc., 659 F.3d 671, 674 (8th Cir. 2011) (describing Plan excluding five groups of administrative expenses from discharge); Caradon Doors & Windows, Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.), 447 F.3d 461, 465 (6th Cir. 2006) (detailing section in Plan preserving administrative expenses); see also infra Part III.B.2 (discussing such exceptions in Plans).

32. For an example of how courts typically deal with asbestos-related bankruptcies, see Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.), 843 F.2d 636 (2d Cir. 1988), the quintessential asbestos-related bankruptcy case. See generally Barbara J. Houser, Chapter 11 as a Mass Tort Solution, 31 Loy. L.A. L. Rev. 451 (1998) (discussing Code's handling of mass tort claims); Alan N. Resnick, Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability, 148 U. Pa. L. Rev. 2045 (2000) (same).

why the designation of Claims matters in bankruptcy, and Part I.B.2 will explore the Code's definition of Claim and the history behind it.

1. *The Significance of Having a Claim.* — If a claimant holds a Claim, it must pursue the bankruptcy estate instead of the postpetition manifestation of the debtor. Whether a right to payment is a Claim is therefore important both to debtors, who would usually prefer to have Claims that can be discharged, and claimants, who would generally prefer not to have a Claim so they can pursue the debtor in its postbankruptcy form.[33]

In Chapter 11, holding a Claim as a creditor may seem disadvantageous, but Claims also come with various Code-mandated rights. Claims are subject to the automatic stay[34] and discharge provisions,[35] both of which are undesirable from a claimant's perspective. However, to be a "creditor" under the Code ("Creditor"), a claimant must have a right to payment "that arose at the time of or before the order for relief concerning the debtor."[36] The "order for relief" is created when the debtor files its petition.[37] Thus only those claimants with Claims, or prepetition rights to payment, are Creditors in bankruptcy. Creditors are divided into classes based on the nature of their claims,[38] and each class votes on the

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33. See Baird, supra note 23, at 88–89 (noting Chapter 11 claimant "would prefer not to have a claim so it can pursue the debtor after bankruptcy"); Azaria, supra note 25, at 208–09 ("More often . . . putative creditors will prefer to avoid participating in bankruptcy proceedings. . . . [They] may anticipate a better recovery outside the bankruptcy arena."). This discussion, which assumes that most claimants would prefer not to have a Claim, is limited to Chapter 11 cases. In a Chapter 7 proceeding, a creditor generally wants to have a Claim because otherwise it will not receive anything: There is no postbankruptcy manifestation of the debtor, and the debtor's assets are being liquidated. See Baird, supra note 23, at 88 (noting Chapter 7 claimant "would definitely prefer having a claim" because corporation "has no future"); Azaria, supra note 25, at 208 (explaining only Claim holders receive portion of assets in Chapter 7 case).

34. 11 U.S.C. § 362 (providing for automatic stay prohibiting debt-collection activities); see also Azaria, supra note 25, at 209 (noting for postpetition claims automatic stay "does not apply, and the creditor will be free to pursue the claim even while the debtor is still involved in the bankruptcy proceeding"); Laura B. Bartell, Straddle Obligations Under Prepetition Contracts: Prepetition Claims, Postpetition Claims or Administrative Expenses?, 25 Emory Bankr. Dev. J. 39, 42 (2008) ("If the claim against the debtor is not a prepetition claim, the automatic stay does not preclude its assertion against the debtor . . . .").

35. 11 U.S.C. § 1141(d)(1)(A) ("Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan . . . discharges the debtor from any debt that arose before the date of such confirmation . . . ."). Technically, § 1141 states that confirmation of a Plan discharges preconfirmation "debt," not Claims. Debt is defined in § 101 as "liability on a claim." Id. § 101(12). Thus for all intents and purposes, the Plan discharges Claims.

36. Id. § 101(10)(A).

37. See id. § 301 (providing voluntary bankruptcy case begins by "filing with the bankruptcy court . . . a petition" that "constitutes an order for relief").

38. See id. § 1122 (stating claim can be placed in "particular class only if such claim . . . is substantially similar to the other claims . . . of such class").

proposed Plan.[39] For the Plan to be approved, a majority of the Creditors in each class who together hold at least two-thirds of the total value of the class's claims must vote in favor of the Plan.[40] Although it is possible for the court to approve a Plan over a class's dissent,[41] the right to vote provides Creditors with significant bargaining leverage. The right to vote and participate in the bankruptcy's "debtor-creditor democracy"[42] is important to creditors who have an interest in the continued operations of the company, such as trade creditors and institutional investors. However, for most one-time claimants, like those holding tort claims, the ability to pursue the postbankruptcy debtor is more important than participating in the reorganization, and they would prefer not to hold a Claim.[43]

2. *The Code's Treatment of Claims.* — What constitutes a Claim for bankruptcy purposes is often a highly contentious matter. The Code provides a definition of Claim, but the definition leaves the important question of *when* a right to payment arises unanswered, leaving courts to haphazardly fill in the blank.

Claim is defined in § 101(5) as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[44] This definition is intentionally broad.[45] When

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39. See id. § 501(a) ("A creditor . . . may file a proof of claim."); id. § 502(a) ("A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed . . . ."); id. § 1126(a) ("The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan.").

40. Id. § 1126(c).

41. See supra note 30 (discussing "cramdown" power of court, in which judge can confirm Plan over dissent of one or more classes of Creditors).

42. Jones, supra note 28, at 1089.

43. See supra note 33 and accompanying text (explaining one-time creditors in Chapter 11 prefer not to hold Claims so they can pursue debtor's postpetition form).

44. 11 U.S.C. § 101(5)(A). The definition of Claim also includes the "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." Id. § 101(5)(B). Equitable remedies are beyond the scope of this Note, which will focus solely on rights to payment. For a discussion of equitable remedies as Claims in bankruptcy, see Bonnie Kay Donahue & Bryan D. Graham, Definition of a Claim, 9 J. Bankr. L. & Prac. 275, 294–97 (2000) (providing overview of case law regarding equitable remedies in bankruptcy); cf. James Newton, Searching for a "Right to Payment": Defining the Scope of Bankruptcy Code § 101(5)(B) Under RCRA and Other Statutes Not Providing Express "Rights to Payment," 19 Penn St. Envtl. L. Rev. 55 (2011) (examining equitable remedies in environmental context).

45. See, e.g., Donahue & Graham, supra note 44, at 275 (noting definition is "designed to be as broad and encompassing as possible"). In the context of Chapter 11, this benefits debtors, as a greater number of claims will be dealt with (and discharged) in the bankruptcy proceeding. In Chapter 7 cases, contrarily, it benefits creditors, as without a Claim a creditor will be unable to recover anything. See supra note 33 (explaining different motivations for Chapter 7 creditors).

Congress passed the Code in 1978, it purposefully sought to cast a wide net so that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case."[46] This was in direct response to the Bankruptcy Act,[47] the predecessor of the Code, which had a narrow definition of Claim.[48] Specifically, the Act disallowed unmatured and contingent claims,[49] which the Code explicitly includes.

Contingent claims are particularly important when an injury manifests itself postpetition though the cause of the injury occurred prepetition. Although "contingent" is not defined in the Code, courts have held that contingent Claims exist when the harm is conditional upon the future occurrence of an uncertain event.[50] For example, suppose a retailer and a manufacturer enter into an indemnification agreement prepetition.[51] If the manufacturer files a bankruptcy petition, the retailer holds a contingent Claim even if it has not yet exercised its right to indemnification.[52] This means that the retailer's right to payment will be discharged under the manufacturer's Plan as a contingent Claim, even if the retailer's right to payment under the indemnification contract arises postpetition.

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46. S. Rep. No. 95-989, at 22 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5808; see also Zev Shechtman, A Fresher Start for Debtors in Chapter 11 Reorganization Cases: Binding Future Claimants, 31 Cal. Bankr. J. 607, 610 (2011) ("By defining 'claim' broadly, Congress intended to enable debtors to deal with as many of their liabilities as possible . . . .").

47. Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978).

48. The Act required that a claim be "provable." E.g., Azaria, supra note 25, at 221; Kevin J. Saville, Note, Discharging CERCLA Liability in Bankruptcy: When Does a Claim Arise?, 76 Minn. L. Rev. 327, 334 (1991). To hold a "provable" claim, a claimant had to be able to obtain a judgment under applicable nonbankruptcy law; contingent and unmatured claims were therefore usually not included. See id. at 334 ("Many types of claims, including contingent and unliquidated claims, often were not provable."); id. at 345 (explaining provability required that "[u]nless the creditor possessing a tort or other noncontractual claim could obtain a judgment under the applicable nonbankruptcy law, the creditor did not have a provable bankruptcy claim"). A major criticism of *Frenville* and the state law accrual test is that it, in effect, reinstated the provability requirement. See infra notes 88–90 and accompanying text for further discussion of *Frenville* criticisms.

49. See supra note 48 (discussing requirements of Bankruptcy Act).

50. See, e.g., In re Huffy Corp., 424 B.R. 295, 301 (Bankr. S.D. Ohio 2010) ("Although the term 'contingent' is not itself defined in the Bankruptcy Code, courts have concluded that contingent claims are those in which a debtor will be required to pay only upon the occurrence of a future event triggering the debtor's liability.").

51. The five tests, discussed infra Part II.A, have different ways of determining what prepetition activity is sufficient for a Claim. Without going into detail here, entering into an agreement prepetition is sufficient under all tests currently in force.

52. See, e.g., In re Highland Grp., Inc., 136 B.R. 475, 481 (Bankr. N.D. Ohio 1992) ("Where an indemnification agreement is entered into prior to a bankruptcy filing, such an execution gives the indemnitee a contingent prepetition claim. This is so even where the conduct giving rise to indemnification occurs postpetition.").

The timing of a right to payment determines whether it is a Claim or not; if it arises prepetition, it is a Claim. This is easy to determine when the entire transaction—and, in a tort case, the resulting harm—occurs prepetition.[53] When there is activity spanning the entire length of the bankruptcy proceeding, however, determining when the right to payment arose is more challenging.[54]

C. *Administrative Expenses in the Code and the Courts*

In addition to the benefit of not being subject to the automatic stay and discharge provisions, postpetition claims might be considered administrative expenses.[55] Administrative expenses are a particularly important category of postpetition claims because they receive priority over all other unsecured claims.[56] There are two ways in which a claim can be deemed an administrative expense. The first, which Part I.C.1 will

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53. See Azaria, supra note 25, at 210 ("In most cases, determining whether an obligation is a prepetition claim against the debtor is simple and straightforward. A prepetition cause of action is a prepetition claim, regardless of whether it sounds in tort, breach of warranty, or contract.").

54. See *In re Huffy*, 424 B.R. at 300 ("Determining when a claim arises can be a complicated issue when the claim is based on events that span a time period beginning before the bankruptcy filing, such as with a prepetition contract or the sale of a product, and ending during the life of a bankruptcy case and beyond."); Hurd, supra note 26, at 1461 n.4 ("Determining when a claim 'arose' . . . is by no means an easy issue, particularly with claims for latent tert [sic] injuries . . . where the negligence may occur prepetition but the harm may manifest itself after the bankruptcy has been filed or even resolved."). In addition, providing adequate notice to unknown future claimants is extremely difficult, and therefore presents serious due process concerns. Such concerns are largely beyond the scope of this Note, though relevant to the criticisms of the conduct test discussed in Part II.A.2 and II.B, infra. See generally Russell A. Eisenberg & Frances Gecker, Due Process and Bankruptcy: A Contradiction in Terms?, 10 Bankr. Dev. J. 47 (1993) (discussing due process concerns in bankruptcy); Nicholas A. Franke, The Code and the Constitution: Fifth Amendment Limits on the Debtor's Discharge in Bankruptcy, 17 Pepp. L. Rev. 853 (1990) (same); Ralph R. Mabey & Jamie Andra Gavrin, Constitutional Limitations on the Discharge of Future Claims in Bankruptcy, 44 S.C. L. Rev. 745 (1993) (same).

55. The possibility of an administrative expense designation is an important additional reason that claimants want a postpetition claim. See, e.g., Azaria, supra note 25, at 209 ("[A] putative creditor may hope that its claim arose after the order for relief even if the bankruptcy is on-going because certain post-petition claims are given priority as administrative expenses."). To file a request for payment of an administrative expense, a claimant does not have to be a Creditor—any "entity" can do so. 11 U.S.C. § 503(a) (2012).

56. 11 U.S.C. § 507 (providing administrative expenses have priority over all claims other than domestic support obligations); id. § 726(a) (stating "property of the estate shall be distributed—(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 . . . (2) second, in payment of any allowed unsecured claim"); see also Bartell, supra note 34, at 39 ("Postpetition obligations that constitute administrative expenses are entitled to priority treatment, perhaps mandating payment in full." (footnote omitted)). See generally David M. Reeder, Note, The Administrative Expense Priority in Bankruptcy—A Survey, 36 Drake L. Rev. 135 (1986) (providing overview of history and purpose of administrative expense priority).

discuss, is when the expense is a necessary cost of preserving the business's operations while in bankruptcy, such as, for example, paying employees and suppliers. The second, which Part I.C.2 will discuss, is when the business inflicts harm upon innocent parties while it operates under the protection of the Code.

1. *The Code's Treatment of Administrative Expenses.* — The purpose of Chapter 11 is to save struggling but efficient businesses, but if nobody will transact with the debtor, that is an impossible goal.[57] In order for a business to continue to operate during its bankruptcy, it must be able to pay ordinary business expenses as they arise. Giving such expenses priority ensures that they will be paid, which gives third parties the confidence to continue transacting with companies in Chapter 11.

Despite the fact that firms would be unable to successfully reorganize without the ability to conduct day-to-day business, there is no complete list of expenses that qualify as administrative expenses. The Code instead enumerates some expenses that are clearly necessary for a business to continue operating, such as taxes, attorney's fees, and rent,[58] but also includes a catchall provision: "the actual, necessary costs and expenses of preserving the estate."[59]

This catchall provision has been given specific meaning by courts. Although all administrative expenses are postpetition claims, not all postpetition claims can be labeled administrative expenses;[60] an administrative expense must be an "actual and necessary" expense of preserving the estate. Courts have created a two-part "benefit" test to make this determination. The test requires a claimant to show that first, the claim arises from a transaction with the debtor in possession, and second, the goods or services supplied actually benefit the bankruptcy estate.[61] This test obviously includes everyday business transactions such

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57. Cf. United Trucking Serv., Inc. v. Trailer Rental Co. (In re United Trucking Serv., Inc.), 851 F.2d 159, 161 (6th Cir. 1988) ("The purpose of [administrative expense priority] . . . is to facilitate the rehabilitation of insolvent businesses by encouraging third parties to provide those businesses with necessary goods and services.").

58. 11 U.S.C. § 503(b)(1)(B), (b)(4), (b)(7).

59. Id. § 503(b)(1)(A).

60. See Bruce H. White & William L. Medford, Post-Petition Claims and Administrative Expense Priority: Timing Alone Does Not Entitle You to Payment, Am. Bankr. Inst. J., June 2002, at 24, 24 ("Despite a widespread assumption that all post-petition claims are entitled to administrative expense priority, judicial authority does not support such a view.").

61. See, e.g., Caradon Doors & Windows, Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.), 447 F.3d 461, 464 (6th Cir. 2006) (applying two-part benefit test); Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.), 126 F.3d 811, 816 (6th Cir. 1997) (same); Toma Steel Supply Inc. v. TransAmerican Natural Gas Corp. (In re TransAmerican Natural Gas Corp.), 978 F.2d 1409, 1416 (5th Cir. 1992) (same); In re Jartran, Inc., 732 F.2d 584, 587 (7th Cir. 1984) (same); see also Bartell, supra note 34, at 54–55 (detailing two-part benefit test); Daniel Morman, The Legacy of *Reading Co. v. Brown*: Administrative Claims Arising from Trustee or DIP Misconduct, Am. Bankr. Inst. J., Oct. 2004, at 1, 1 (same); cf. White & Medford, supra note

as paying employees and suppliers,[62] but does not intuitively cover tort victims and other involuntary creditors, whose claims do not preserve the estate, but rather detract from it. The Supreme Court addressed this gap in *Reading Co. v. Brown*.[63]

2. Reading Co. v. Brown*: Postpetition Liability as an Administrative Expense*. — In *Reading*, the Court created a new policy justification based on equitable principles for giving certain claims priority[64] and couched it within the "actual and necessary" language in the definition of administrative expenses. The facts of *Reading* are fairly straightforward. After the debtor filed a Chapter XI petition,[65] its building caught fire and caused damage to surrounding property.[66] Reading Co., a neighbor, filed a claim for almost $600,000 as an administrative expense.[67] The issue confronting the Court was whether liability for damage caused by negligence[68] was an "'actual and necessary' cost of operating the debtor's business."[69]

Justice Harlan, writing for the Court, emphasized equitable principles as a new basis for allowing some creditors to "jump the line" and claim administrative expenses. He found that a tort victim is inherently different from other creditors, who benefit from the continued operation of the business. A nonexistent company cannot commit a tort, and

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60, at 24 ("Demonstrating that the claim at issue benefits the bankruptcy estate is typically easy to satisfy in the context of post-petition operating expense claims.").

62. See Hurd, supra note 26, at 1462 (explaining "costs concerned with the continuing operation of the business" clearly qualify as administrative expenses).

63. 391 U.S. 471 (1968).

64. See, e.g., Hurd, supra note 26, at 1462 (noting *Reading* "established compensatory fairness as a central interpretive principle in determining what costs would receive administrative expense priority"); Reeder, supra note 56, at 152 (explaining rule in *Reading* "applies as a matter of public policy and in derogation to the general rule that administrative expenses must arise from efforts to preserve or rehabilitate the estate"); White & Medford, supra note 60, at 24 ("[T]he *Reading* exception provides a basis for entitlement to administrative expense priority upon the concept of fundamental fairness."). But see Morman, supra note 61, at 44 ("It has been said that *Reading* creates an exception to the general rule that an administrative claim must derive from a transaction that benefits the estate. However, while *Reading* claims arise as a result of injuries . . . they are not very different from other types of administrative claims.").

65. For the pre-1978 Bankruptcy Act, the convention is to use Roman numerals for chapter numbers. E.g., Baird, supra note 23, at 19.

66. *Reading*, 391 U.S. at 473.

67. Id. One hundred and forty-six similar claims were filed, totaling over $3.5 million in potential liability. Id.

68. For the purposes of its decision, the Court assumed that the receiver was negligent and that the receiver's negligence caused the property damage. Id. at 474.

69. Id. at 476. At the time, the Bankruptcy Act applied. Section 64b of the Act provided that "the actual and necessary cost of preserving the estate subsequent to filing the petition" had first priority. Bankruptcy Act of July 1, 1898, ch. 541, § 64b(1), 30 Stat. 544, 563 (repealed 1978). Because the language is the same as the language of the Code, *Reading* remains good law. See infra note 74 and accompanying text for further information on *Reading*'s continued significance.

without bankruptcy law the company would not exist. The victim therefore "did not merely suffer injury at the hands of an insolvent business: it had an insolvent business thrust upon it by operation of law."[70] Allowing tort claims to constitute administrative expenses was therefore more equitable than subordinating the tort victims' claims beneath the claims of creditors for whose benefit the business continued to operate.[71] The Court also examined the statute and determined that tort claims fit comfortably within the "actual and necessary expenses" language because tort liabilities are "costs ordinarily incident" to running a business.[72] The Court concluded that postpetition tort claims are administrative expenses,[73] meaning that tort victims are paid before other unsecured Creditors.

Although *Reading* applied the pre-1978 Bankruptcy Act, courts have acknowledged that its reasoning applies equally well under the Code, and it remains good law.[74] District and circuit courts have consistently and expansively applied *Reading* to hold that a variety of legal claims can be administrative expenses, including not only tort claims[75] but also claims for trademark infringement,[76] patent infringement,[77] and breach

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70. *Reading*, 391 U.S. at 478.

71. Id. at 482–83. Without priority, tort victims would not be paid in full, and likely would not be paid at all. See, e.g., Hurd, supra note 26, at 1461–62 ("[P]ayment of postpetition claims is generally an all-or-nothing proposition contingent upon the claim being granted administrative expense priority.").

72. *Reading*, 391 U.S. at 482–83.

73. Id. at 485. Chief Justice Warren filed a dissent, joined by Justice Douglas. Warren pointed out what would become the major issue in this line of jurisprudence: "After today's decision, the status of a tort claimant depends entirely upon whether he is fortunate enough to have been injured after rather than before a receiver has been appointed." Id. at 486 (Warren, C.J., dissenting). Warren would have interpreted "actual and necessary" as limited to costs necessary to preserve the estate, not including negligence claims. Id. at 491.

74. See, e.g., In re Al Copeland Enters., Inc., 991 F.2d 233, 239 (5th Cir. 1993) ("The Court's opinion in *Reading* survived Congress's revisions to the Bankruptcy Code."); Bartell, supra note 34, at 55–56 ("[*Reading* was] decided under the Bankruptcy Act but [is] equally applicable to the concept of administrative expense under the Code."); cf. Reeder, supra note 56, at 137 (stating due to similarity of Act and Code "pre-code case law is accepted as 'extremely relevant' authority for modern courts in determining the administrative nature of a claim").

75. See, e.g., Bartell, supra note 34, at 57 ("Following *Reading*, courts have consistently held that claims arising by reason of postpetition tortious conduct by the trustee or debtor in possession in a chapter 11 case constitute administrative expenses.").

76. E.g., Houbigant, Inc. v. ACB Mercantile, Inc. (In re Houbigant, Inc.), 188 B.R. 347, 356 (Bankr. S.D.N.Y. 1995) (reasoning because "Trademark Claim sounds in tort" and "[c]laims arising from acts committed by the debtor in possession which give rise to tort liability are accorded administrative expense status," trademark claims can be administrative expenses).

77. E.g., Carter-Wallace, Inc. v. Davis-Edwards Pharm. Corp., 443 F.2d 867, 874 (2d Cir. 1971) (relying on *Reading* to find "[d]amages for infringing a patent in the course of sales made for profit would seem an *a fortiori* case for priority").

of contract,[78] among others. Although fairness is the guiding principle, courts have maintained the benefit test requirement that the claim must arise from the debtor in possession's business operations.[79] To get the advantage of holding an administrative expense under *Reading*, therefore, claimants must demonstrate both that their claim arises from the debtor in possession's business operations and that it would be fundamentally unfair for their claim to be subordinated.

II. THE FRAMEWORK FOR DETERMINING WHEN A CLAIM ARISES

Part I explained why Claims are significant and gave the Code's definition of Claim, but in order to actually determine whether a right to payment is a Claim, one must examine the wealth of tangled case law. Before 2010, there were five tests used to determine when a Claim arises; Part II.A will discuss each test in turn. Part II.B will evaluate the tests and conclude that a foreseeability-based standard presents the fewest issues and is preferred by most courts and commentators. Part II.C will examine the Third Circuit's two recent cases, *In re Grossman's* and *Wright v. Owens Corning*, and analyze how they fit within the pre-2010 body of case law.

A. *When Does a Claim Arise? The Multitude of Tests Pre-*Grossman's

Whether a claimant has a Claim affects whether its right to payment is subject to the automatic stay and discharge provisions and whether it is against the prepetition bankruptcy estate or the postpetition manifestation of the debtor. Despite its importance, the case law in this area is divided and generally unclear. Courts have created a multitude of tests for determining when a Claim arises.[80] A brief preview of each test will

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78. E.g., United Trucking Serv., Inc. v. Trailer Rental Co. (In re United Trucking Serv., Inc.), 851 F.2d 159, 162 (6th Cir. 1988) (deciding "priority as an administrative expense is appropriate for [a] claim reflecting post-petition breach of contract").

79. See, e.g., In re Allen Care Ctrs., Inc., 96 F.3d 1328, 1330–31 (9th Cir. 1996) (refusing to allow expense as administrative claim because it did not arise from debtor's business operations); In re Franklin, 284 B.R. 739, 744–45 (Bankr. D.N.M. 2002) (same); In re Unidigital, Inc., 262 B.R. 283, 289–90 (Bankr. D. Del. 2001) (same); Morman, supra note 61, at 40 ("If [the arising from debtor's business] requirement is met, courts often cite fundamental fairness as a basis for allowance. If the claim does not arise from the debtor's business operations, *Reading* will usually not apply.").

80. These tests, and the cases that discuss them, are well known and often cited, but courts and commentators disagree on how to classify them. Compare In re Huffy Corp., 424 B.R. 295, 302–03 (Bankr. S.D. Ohio 2010) (dividing cases into four categories: right to payment, conduct, relationship, and fair contemplation), with Petrie, supra note 14, at 602–05 (dividing cases into four categories: accrued state law, conduct, prepetition relationship, and *Piper*), with Azaria, supra note 25, at 213–21 (dividing cases into three categories: fully accrued cause of action, time of the debtor's conduct, and fair contemplation), and with Saville, supra note 48, at 337–45 (dividing cases into three categories: right to payment, underlying act, and debtor-creditor relationship). This Note will use the narrowest classifications for clarity and thus discuss five tests: the state law accrual test,

provide context for the more in-depth discussion that follows. The state law accrual test held that a Claim did not arise until a claimant possessed a right to payment under state law. This approach was criticized for being too narrow, so courts developed the conduct test, in which the time of the conduct underlying the liability determines when the Claim arises. That test was criticized for being too broad, so courts developed the relationship test, in which the debtor and claimant must have a prepetition relationship in order for the Claim to arise prepetition. In the context of environmental claims, the relationship test was still considered by some to be too broad due to the tension between the policy goals of environmental law (hold polluters accountable) and bankruptcy law (give debtors a "fresh start"), so courts added foreseeability as a requirement: The Claim had to be within the "fair contemplation" of the parties prepetition. The last test, the *Piper* test, was not created in direct response to another test. Instead, the Eleventh Circuit, confronted with unique and unusual facts, combined a prepetition conduct test with a *preconfirmation* relationship test. It was (until *Wright*) the only test to focus on the date of confirmation. This section will discuss each test in turn, explaining its origins, its reasoning, and the views of its critics.

1. *The State Law Accrual Test.* — The state law accrual (or right to payment) test held that a Claim under the Code did not arise until a claimant possessed a right to payment under applicable nonbankruptcy state law. The Third Circuit created this test in *In re M. Frenville Co.*,[81] a case with fairly simple facts. Avellino and Bienes (A&B), a certified public accounting firm, sought to include Frenville Co. as a third-party defendant in a lawsuit alleging A&B "negligently and recklessly prepared" financial statements for Frenville; Frenville argued that the automatic stay in its bankruptcy case barred the suit.[82] The Third Circuit determined that because Congress "focused on the harm, rather than the act" for purposes of the automatic stay, the appropriate test would focus on when the harm occurred.[83] The court reasoned that the timing of the right to payment, indicative of the "harm," determined when the Claim arose; it turned to state law to determine when the plaintiff had a right to payment.[84] Under the applicable state law, an indemnification claim did not accrue at the time of the underlying act but when the party seeking indemnification filed its answer to the underlying lawsuit.[85] Applying its

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prepetition conduct test, prepetition relationship test, fair contemplation test, and *Piper* test.

81. Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984), overruled by Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114 (3d Cir. 2010) (en banc).

82. Id. at 333.

83. Id. at 335.

84. Id. at 335–37.

85. Id. at 337.

new test, the Third Circuit held that the automatic stay did not prevent A&B from asserting its indemnification claim.[86]

Ironically, the Third Circuit noted at the end of its opinion that its "decision [was] in keeping with the policy of the Code,"[87] yet because of this test, *Frenville* has been universally condemned. Criticism of *Frenville* permeates the literature and cases discussing Claims.[88] The main criticism of *Frenville* is that its narrow interpretation of when a Claim arises is contrary to the Code's broad definition of Claim.[89] Commentators note that the Third Circuit appeared to be reinstating the provability requirement of the Bankruptcy Act, which Congress purposefully removed from the Code.[90] Recognizing the wisdom of its critics, the Third Circuit overturned this test in 2010 in *In re Grossman's*.[91]

2. *The Prepetition Conduct Test.* — The prepetition conduct test (also known as the underlying acts test) uses a very broad definition of Claim. Under this test, a right to payment arises when the conduct underlying the liability occurs. For example, if a company designs and manufactures

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86. Id.

87. Id.

88. See, e.g., Cal. Dep't of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925, 930 (9th Cir. 1993) (per curiam) ("[*Frenville*'s test] appear[s] to excise 'contingent' and 'unmatured' claims from § 101(5)(A)'s list."); Azaria, supra note 25, at 221–24 & n.99 (criticizing *Frenville* for interpreting Claim too narrowly and treating similarly situated creditors differently); Mabey & Jarvis, supra note 21, at 703 ("The *Frenville* decision is based on a misunderstanding of the policy behind the Bankruptcy Code, the Code itself, prior case law, and the interrelationship of various Code sections."); see also In re Huffy Corp., 424 B.R. 295, 303 (Bankr. S.D. Ohio 2010) ("*Frenville* has been widely criticized for its failure to address critical bankruptcy laws and policies.").

89. See *In re Huffy*, 424 B.R. at 303 ("[B]y focusing on state law to determine when a claim arises, [*Frenville*] does not fully account for the broad definition of a claim in the Bankruptcy Code that explicitly encompasses a right to payment that is unmatured or contingent."); Azaria, supra note 25, at 221 ("The fully-accrued cause of action standard conflicts with Congress' intent to have the term 'claim' interpreted . . . broadly . . . ."); Mabey & Jarvis, supra note 21, at 705 ("The Third Circuit's narrow construction of claim is not in keeping with congressional intent to define the term expansively."); see also supra Part I.B.2 (discussing definition and legislative history of Claim).

90. See, e.g., Signature Combs, Inc. v. United States, 253 F. Supp. 2d 1028, 1034 (W.D. Tenn. 2003) (explaining *Frenville* "in effect reinserts a 'provability' requirement which was expressly repealed under the 1978 Bankruptcy Code"); Azaria, supra note 25, at 222 ("[*Frenville*], in effect, reinstates part of the provability requirement by refusing to treat an obligation as a claim unless and until it is a cause of action."); see also supra note 48 (discussing provability requirement in Bankruptcy Act). Another major criticism is that the test is ripe for manipulation, as a creditor can decide when to sue and thus when its claim accrues under state law. See Azaria, supra note 25, at 223 (noting possibility of "intentional manipulation of the system"); cf. Mabey & Jarvis, supra note 21, at 704 (stating *Frenville* leads to "inconsistent results in identical factual settings based solely on a creditor's decision as to when it will sue on a claim against a party that may have indemnification or contribution rights against a debtor").

91. See infra Part II.C.1 for a discussion of *Grossman's*.

a product prepetition, the claimant buys the product postpetition, and the claimant is injured postpetition, that is a prepetition Claim.[92]

A Fourth Circuit case, *Grady v. A.H. Robins Co.*,[93] exemplifies the conduct test. Grady used a Dalkon Shield, an intrauterine contraceptive device manufactured by A.H. Robins Co., that caused her to develop pelvic inflammatory disease and forced her to have a hysterectomy.[94] Grady's doctor inserted the Shield before Robins Co.'s bankruptcy, but Grady's injuries manifested postpetition.[95] The issue before the Fourth Circuit was whether the automatic stay applied to Grady's case. Grady argued that under *Frenville* her claim arose postpetition, but the Fourth Circuit declined to apply the state law accrual test.[96] Instead, the court looked at when the underlying tortious conduct occurred. It reasoned that because the act constituting the tort occurred prepetition, Grady held a contingent Claim, and the automatic stay applied.[97]

The conduct test has been heavily criticized for raising practical problems and due process concerns. Some courts and commentators argue that the conduct test can lead to the absurd result that huge numbers of unknown individuals hold contingent Claims.[98] For example, the Second Circuit developed a frequently cited hypothetical[99] criticizing the impracticality of the conduct test that is worth repeating in full:

> Consider, for example, a company that builds bridges around the world. It can estimate that of 10,000 bridges it builds, one will fail, causing 10 deaths. Having built 10,000 bridges, it becomes insolvent and files a petition in bankruptcy. Is there a "claim" on behalf of the 10 people who will be killed when they drive across the one bridge that will fail someday in the future? If the only test is whether the ultimate right to payment will arise out of the debtor's prepetition conduct, the future victims have a "claim." Yet it must be obvious that enormous practical and perhaps constitutional problems would arise from recognition of such a claim. The potential victims are not only unidentified, but there is no way to identify them. Sheer fortuity

92. The "conduct" in this example is the design and manufacture of the product, which causes the liability to arise.

93. 839 F.2d 198 (4th Cir. 1988).

94. Id. at 199.

95. Id.

96. Id. at 200–01. The Fourth Circuit noted that no court outside of the Third Circuit had applied the state law accrual test. Id. at 201.

97. Id. at 203.

98. E.g., In re Huffy Corp., 424 B.R. 295, 302 (Bankr. S.D. Ohio 2010) (explaining under conduct test "claims of individuals not identifiable, or possibly not even born, at the time of the bankruptcy filing and plan confirmation could be subject to discharge in bankruptcy"); Shechtman, supra note 46, at 613 (noting conduct test "lead[s] to the absurd result that everyone in the world holds a contingent claim").

99. This hypothetical has been fully quoted in, for example, Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1276–77 (5th Cir. 1994); *In re Huffy*, 424 B.R. at 302; Shechtman, supra note 46, at 613–14.

> will determine who will be on that one bridge when it crashes. What notice is to be given to these potential "claimants"?[100]

As the hypothetical suggests, due process is another major concern because of the huge number of possible Claim holders and the impossibility of providing notice to everyone. As one commentator put it, "Despite Congress's repeal of the 'provability' requirement and its broad definition of 'claim,' nothing in the legislative history or the Code suggests that Congress intended to discharge a creditor's rights before the creditor knew or should have known that its rights existed."[101] The conduct test thus presents serious concerns and has received heavy, and well-deserved,[102] criticism for equity, administrability, and due process reasons.

3. *The Prepetition Relationship Test.* — The prepetition relationship test (also known as the debtor-creditor relationship test or narrow conduct test) was created in response to the conduct test. This test builds upon the conduct test by imposing an additional requirement: For a Claim to accrue, the claimant must have had some sort of prepetition relationship with the debtor. A prepetition relationship is established by "contact, exposure, impact, or privity."[103] If, for example, a company manufactures a defective product prepetition but the consumer buys the product postpetition, that is a Claim under the conduct test but not under the relationship test.

The Second Circuit case *In re Chateaugay* demonstrates the operation of the relationship test.[104] *Chateaugay* involved a claim for cleanup costs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).[105] The debtor's environmentally objectionable conduct occurred before it filed its Chapter 11 petition, but the

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100. United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997, 1003 (2d Cir. 1991). The practical problems alluded to by the hypothetical may include discovering the identities of and contacting the potential victims, organizing the potential claimants, calculating the total monetary amount of the combined and individual Claims, dividing assets between these claimants, and so on.

101. Saville, supra note 48, at 349; see also Cal. Dep't of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925, 930 (9th Cir. 1993) (per curiam) (quoting Saville verbatim).

102. See infra notes 135–137 and accompanying text for further discussion of the conduct test's flaws.

103. Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995).

104. 944 F.2d 997. Other cases applying the relationship test include, for example, Olin Corp. v. Riverwood Int'l Corp. (In re Manville Forest Prods. Corp.), 209 F.3d 125, 129 (2d Cir. 2000) (indemnification claim); *Lemelle*, 18 F.3d at 1277 (product liability claim).

105. *Chateaugay*, 944 F.2d at 999; see also Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601–9675 (2006)). CERCLA was enacted in response to hazardous waste contamination. E.g., Saville, supra note 48, at 330. The goal of CERCLA is to "protect public health and the environment by facilitating the cleanup of environmental contamination and imposing the costs on the parties responsible for the pollution." Id. at 327.

Environmental Protection Agency (EPA) had not yet asserted all of its potential response costs.[106] The Second Circuit examined the definition of Claim in § 101(5) and noted that while Congress clearly meant for it to be broad, the legislative history "points us in a direction, but provides little indication of how far we should travel."[107] After criticizing the conduct test,[108] the court noted that the EPA and the debtor had a prepetition regulatory relationship that "provide[d] sufficient 'contemplation' of contingencies to bring most ultimately maturing payment obligations based on prepetition conduct within the definition of 'claims.'"[109] Under this reasoning, a prepetition relationship ensures that the claim will not be unforeseeable to either party;[110] the court even uses the word "contemplation," which the next test adopts.[111] The court did not explicitly require foreseeability as a condition, however, and perhaps for this reason some courts subsequently criticized the Second Circuit and others for defining "relationship" so broadly as to make the relationship test functionally equivalent to the conduct test.[112]

4. *The Fair Contemplation Test.* — The fair contemplation test developed in response to criticism of the relationship test; it imposes the additional requirement that the Claim be within the "fair contemplation" of the parties prepetition.[113] This standard has been applied almost exclusively to environmental cleanup claims under CERCLA[114] and similar

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106. *Chateaugay*, 944 F.2d at 999.

107. Id. at 1003.

108. See supra text accompanying note 100 (quoting Second Circuit's hypothetical criticizing conduct test).

109. *Chateaugay*, 944 F.2d at 1005.

110. See Saville, supra note 48, at 343 n.82 ("The rationale behind this approach is that a creditor should not be forced to anticipate its potential claims against the debtor in bankruptcy before a relationship exists.").

111. See infra Part II.A.4 (discussing fair contemplation test).

112. See, e.g., Signature Combs, Inc. v. United States, 253 F. Supp. 2d 1028, 1037 (W.D. Tenn. 2003) (alleging *Chateaugay* and similar cases "defined 'relationship' so broadly that they have made it the equivalent of the underlying acts approach"); In re Huffy Corp., 424 B.R. 295, 304 (Bankr. S.D. Ohio 2010) (noting criticism that relationship could be defined "so broadly that literally any prepetition interaction between the debtor and creditor would lead to the discharge of all claims held by the creditor even those not within the parties' contemplation prior to the bankruptcy filing").

113. While some courts and commentators view the relationship test and the fair contemplation test as two separate tests, many others view them as one approach. Compare *Signature Combs*, 253 F. Supp. 2d at 1037 (describing them as two separate tests), and *In re Huffy*, 424 B.R. at 304 (same), with Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995) (describing them as one test), Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1277 (5th Cir. 1994) (same), and In re Parks, 281 B.R. 899, 902 (Bankr. E.D. Mich. 2002) (same). Part II.B will take the position that the relationship test and fair contemplation test are essentially equivalent.

114. For more on CERCLA, see supra note 105. Much has been written about the intersection of and tensions between bankruptcy law and CERCLA. See, e.g., Arlene Elgart Mirsky, Richard J. Conway, Jr. & Geralyn G. Humphrey, The Interface Between Bankruptcy and Environmental Laws, 46 Bus. Law. 623 (1991); John R. Bevis, Note, *In re*

state laws. The fair contemplation standard is widely discussed by courts in cases involving other types of claims,[115] however, and it warrants a discussion here.

The Ninth Circuit notably adopted the fair contemplation test in *In re Jensen*,[116] which involved California's hazardous waste cleanup law.[117] The Ninth Circuit emphasized the inherent tension between environmental cleanup efforts and bankruptcy law: One goal of bankruptcy is to give the debtor a "fresh start," whereas the goal of CERCLA and similar laws is to hold parties responsible for their polluting acts.[118] After deciding that neither the state law accrual, conduct, nor relationship test gave "adequate consideration to the policy goals of the environmental laws and the bankruptcy code,"[119] the Ninth Circuit turned to the fair contemplation test, noting that it "carefully balance[s]" the "sometimes competing policy goals" of the two bodies of law.[120] In the case before it, the court found that the state had "sufficient knowledge" of the potential liability to give rise to a contingent Claim that was discharged in bankruptcy.[121]

Courts and commentators approve of this foreseeability-based standard in the environmental context.[122] While it is possible that *In re Jensen*'s

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Jensen: Demonstrating the Need for Supreme Court Resolution of the Conflict Between CERCLA and the Bankruptcy Code, 9 J. Land Use & Envtl. L. 179 (1993); Philippe J. Kahn, Note, Bankruptcy Versus Environmental Protection: Discharging Future CERCLA Liability in Chapter 11, 14 Cardozo L. Rev. 1999 (1993); Kenneth Maxwell, Comment, Bankrupting CERCLA: Amending the Bankruptcy Code to Allow CERCLA Contingent Claims for Contribution, 13 J. Energy Nat. Resources & Envtl. L. 431 (1993); John C. Ryland, Note, When Policies Collide: The Conflict Between the Bankruptcy Code and CERCLA, 24 Memphis St. U. L. Rev. 739 (1994). The complexities of that relationship are beyond the scope of this Note.

115. E.g., *Lemelle*, 18 F.3d at 1277 (tort claim); *Signature Combs*, 253 F. Supp. 2d at 1037 (CERCLA claim); *In re Huffy*, 424 B.R. at 304 (indemnification claim); *Parks*, 281 B.R. at 902 (same).

116. Cal. Dep't of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925 (9th Cir. 1993) (per curiam). The Ninth Circuit based its analysis on In re National Gypsum Co., 139 B.R. 397 (N.D. Tex. 1992). *In re Jensen*, 995 F.2d at 930–31.

117. Carpenter-Presley-Tanner Hazardous Substance Account Act, Cal. Health & Safety Code §§ 25300–25395 (West 2006 & Supp. 2013).

118. *In re Jensen*, 995 F.2d at 927–28. The court emphasized this tension throughout its opinion, succinctly summarizing the conflict as follows: "Few would doubt that courts should not encourage the frustration of environmental cleanup efforts, just as courts should not override congressional attempts to legislate bankruptcy procedures and goals." Id. at 930.

119. Id. at 929.

120. Id. at 930.

121. Id. at 931.

122. See, e.g., Signature Combs, Inc. v. United States, 253 F. Supp. 2d 1028, 1038 (W.D. Tenn. 2003) (explaining fair contemplation standard is "only test which tries to accommodate both the fresh start goal of bankruptcy and the speedy cleanup and polluter accountability CERCLA goals"); Saville, supra note 48, at 360 ("By focusing on the

emphasis on the tension between the Code and environmental law makes its reasoning less applicable to cases that do not feature environmental cleanup statutes,[123] the fair contemplation test is arguably not distinct from the relationship test. Part II.B will explore this idea further.

5. *The* Piper *Test.* — The *Piper* test, created by the Eleventh Circuit in *In re Piper Aircraft*,[124] is the only test to focus not only on the time of the petition, but also on the time of the Plan's confirmation.[125] The bankruptcy court had created a class of future claimants who might assert claims against Piper Aircraft postconfirmation; the issue before the Eleventh Circuit was whether the class held Claims.[126] After rejecting the state law accrual test as "imposing too narrow an interpretation on the term claim,"[127] the conduct test as "defin[ing] claim too broadly,"[128] and the relationship test as "unnecessarily restrict[ing] the class of claimants to those who could be identified prior to the filing of the petition,"[129] the court created a new test, known as the *Piper* test. The *Piper* test combines a preconfirmation relationship test with a prepetition conduct test:

> [A]n individual has a § 101(5) claim against a debtor manufacturer if (i) events occurring *before confirmation* create a *relationship*, such as contact, exposure, impact, or privity, between the claimant and the debtor's product; and (ii) the basis for liability is the debtor's *prepetition conduct* in designing, manufacturing and selling the allegedly defective or dangerous product.[130]

The *Piper* test must be taken with a grain of salt. *Piper*, though decided in 1995, remains solely Eleventh Circuit law. Perhaps this is because the facts of *Piper* were very unusual: The debtor challenged a proof of claim for the class of future claimants, which consisted of a representative but no actual claimants.[131] *Piper* was thus a rare instance of a Chapter 11 debtor arguing that claims are not Claims and a claimant's representative arguing that they are. In addition, there were no actual claimants in *Piper*—the class was created as a trust of sorts for consumers who had not yet been injured or asserted claims. The "missing" claimants

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foreseeability of the debtor's CERCLA liability, courts . . . can extend the term 'claim' to its broadest possible limit without undermining the EPA's recovery of cleanup costs.").

123. See, e.g., Shechtman, supra note 46, at 616 (cautioning *In re Jensen* "might be read to apply narrowly to those [environmental cleanup] cases").

124. Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573 (11th Cir. 1995).

125. The *Piper* test, intuitively, can only apply to Chapter 11 cases, as Chapter 7 cases do not have Plans and thus do not have dates of confirmation.

126. *Piper*, 58 F.3d at 1574–75.

127. Id. at 1576 n.2.

128. Id. at 1577.

129. Id.

130. Id. (emphases added). Because the future claimants did not have preconfirmation relationships with Piper Aircraft, the court held they did not have Claims. Id. at 1578.

131. Id. at 1574–75.

were expected to appear far into the future, if at all; the court may have used the date of confirmation to show that even using the broadest definition of Claims possible, the class of potential claimants could not hold Claims. Its unique factual situation seems to have made *Piper* an outlier. When discussed by other courts, *Piper* is usually included as an example of cases applying the relationship test rather than as creating its own test,[132] suggesting that courts have disregarded the unique preconfirmation element.

B. *Analyzing and Evaluating the Claims Tests*

The five tests created by circuit courts for determining when a right to payment arises focus on different moments within the life of a claim. The state law accrual test, which has been overturned, focused on the moment when the right to payment accrued under applicable nonbankruptcy law. The prepetition conduct test focuses on when the debtor engaged in the conduct underlying the liability. The prepetition relationship test focuses on when the claimant bought the product or otherwise entered into a relationship with the debtor. The fair contemplation test focuses on the date of the petition and whether, by that date, the claim was foreseeable to the parties. Finally, the *Piper* test focuses on both the date of the debtor's conduct, which must be prepetition, and the date of the debtor-claimant relationship, which must begin preconfirmation.

Recent courts and commentators generally favor a foreseeability-based test, whether labeled the relationship test or the fair contemplation test, because it presents the fewest issues. The state law accrual test can be readily dismissed as both universally criticized[133] and now overturned.[134] The conduct test presents serious equity, administrability, and due process concerns because of its overly broad definition of Claim.[135] As discussed above in Part II.A.2, the conduct test can lead to the absurd result that huge numbers of unknown persons hold Claims against a

132. See, e.g., Watson v. Parker (In re Parker), 313 F.3d 1267, 1269 n.1 (10th Cir. 2002) (listing *Piper* among cases applying "narrow conduct theory," another name for relationship test); Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1276–77 (5th Cir. 1994) (describing *Piper* as example of relationship test); Signature Combs, Inc. v. United States, 253 F. Supp. 2d 1028, 1036 (W.D. Tenn. 2003) (citing *Piper* among cases applying "debtor-creditor relationship" test); In re Huffy Corp., 424 B.R. 295, 304 (Bankr. S.D. Ohio 2010) (using *Piper* to define relationship test); In re Parks, 281 B.R. 899, 902 (Bankr. E.D. Mich. 2002) (citing *Piper* as example of prepetition relationship test).

133. See supra notes 88–90 and accompanying text (detailing criticisms).

134. See Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114, 121 (3d Cir. 2010) (en banc) (overruling *Frenville* and its state law accrual test); see also infra Part II.C.1 (discussing *Grossman's*).

135. For criticisms of the conduct test's breadth, see supra notes 98–101 and accompanying text.

debtor.[136] Aside from the equity and administrability issues such absurdity raises, it also presents serious due process problems: How can the massive number of potential claimants receive adequate notice? As the Second Circuit pointed out, "The potential victims are not only unidentified, but there is no way to identify them."[137] Because of these issues with the conduct test, courts turned to the relationship and fair contemplation tests.

Under the relationship test, the number of potential claimants is limited to those persons who have had prior contact or exposure to the debtor or its product.[138] This solves the conduct test's administrability problem by limiting the number of potential claimants; it also eliminates the due process issue by ensuring that each claimant will have knowledge of her possible claimant status, since she has had a previous relationship with the debtor. There have been criticisms that the relationship test can be defined so broadly as to become, in effect, the conduct test; these criticisms are assuaged by limiting the test to its original reasoning, that relationships will "provide[] sufficient 'contemplation' of contingencies."[139]

This may sound like the fair contemplation test,[140] and in essence it is. Many courts have not recognized a distinction between the relationship and fair contemplation tests.[141] Indeed, the fair contemplation test seems to have simply made explicit the underlying assumption of the relationship test: that the claim will be foreseeable to the parties. Given that the fair contemplation test and the relationship test apply the same foreseeability-based standard, it would be beneficial to more clearly unite them.

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136. See *In re Huffy*, 424 B.R. at 302 (explaining under conduct test "claims of individuals not identifiable, or possibly not even born, at the time of the bankruptcy filing and plan confirmation could be subject to discharge in bankruptcy"); Shechtman, supra note 46, at 613 (noting conduct test can "lead[] to the absurd result that everyone in the world holds a contingent claim"); see also United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997, 1003 (2d Cir. 1991) (noting "enormous practical" problems arising from conduct test); Azaria, supra note 25, at 225 (stating conduct test treats unknown and unforeseeable liabilities as Claims).

137. *Chateaugay*, 944 F.2d at 1003.

138. See supra Part II.A.3 (discussing and defining relationship test).

139. *Chateaugay*, 944 F.2d at 1005.

140. See supra Part II.A.4 (discussing and defining fair contemplation test).

141. See, e.g., Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995) (failing to distinguish between relationship test and fair contemplation test); Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1277 (5th Cir. 1994) (same); In re Parks, 281 B.R. 899, 902 (Bankr. E.D. Mich. 2002) (same); cf. Petrie, supra note 14, at 604 (stating Ninth Circuit adopted relationship test in *In re Jensen*).

Debtors and creditors alike would benefit from uniformity across the circuits, which could provide predictability that is sorely lacking.[142] Indeed, the constitutional mandate to establish national bankruptcy laws explicitly states that bankruptcy law should be uniform.[143] The fair contemplation and relationship tests could be easily "combined" into one foreseeability-based standard. The *Piper* test, though it uses the date of confirmation, has been almost exclusively considered an offshoot of the relationship test;[144] it too could be unified within this standard.

Although commentators have argued for a unifying rule for nearly two decades,[145] neither Congress nor the Supreme Court has intervened. If either ever does, a relationship test with foreseeability as the underlying principle would be the option most in line with the current consensus. The en banc panel in *Grossman's* recognized this and adopted the prepetition relationship test as the law of the Third Circuit. Unfortunately, that decision was short-lived.

C. *The Third Circuit Reevaluates What Constitutes a Claim*

After leaving its Claim doctrine untouched for twenty-six years, the Third Circuit decided two major cases in a two-year period. The first, *In re Grossman's*, eliminated the much-maligned state law accrual test and adopted the prepetition relationship test.[146] The second, *Wright v. Owens Corning*, purported to clarify *Grossman's* but actually replaced its prepetition relationship test with a preconfirmation relationship test. Part III.A will argue that focusing on the date of confirmation instead of the date of petition violates both the Code's language and the underlying policy of Chapter 11. For now, this Note will present the cases without criticism: Part II.C.1 will discuss *Grossman's*; Part II.C.2 will discuss *Wright*.

1. *Correcting* Frenville*:* In re Grossman's. — The Third Circuit, responding to widespread criticism, overruled *Frenville* in *In re*

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142. See Azaria, supra note 25, at 212 ("A single standard would be preferable because it would enhance predictability, which is an important virtue in any law that affects commercial transactions. Predictability . . . facilitates commercial transactions by enabling the parties who enter into those transactions to know, in advance, what their rights and liabilities will be.").

143. U.S. Const. art. I, § 8, cl. 4 (stating Congress has power to establish "*uniform* Laws on the subject of Bankruptcies throughout the United States" (emphasis added)).

144. See supra note 132 and accompanying text (noting inclusion of *Piper* test within relationship test by various courts).

145. See, e.g., Azaria, supra note 25, at 207 (arguing in 1994 that "[r]ather than allowing this unpredictability to continue unchecked, either Congress or the courts should adopt a single standard for determining when a claim arises under the Code").

146. As discussed supra in Part II.B, by choosing the prepetition relationship test, *Grossman's* aligned the Third Circuit with most other circuits. See Joel S. Moss, *Frenville*: Dead and Buried in the Third Circuit, Am. Bankr. Inst. J., Sept. 2010, at 1, 1 ("*Grossman's* brings the Third Circuit more in line with the jurisprudence of other circuits on the issue of when a 'claim' arises . . . .").

Grossman's.[147] Sitting en banc, the court was "persuaded that the widespread criticism of *Frenville*'s accrual test is justified," and declared that "the *Frenville* accrual test should be and now is overruled."[148] By overruling *Frenville*, the Third Circuit remedied a flagrant misinterpretation of the Code. It was left, however, with a void to fill: How would Third Circuit courts determine when a Claim arises?

In *Grossman's*, the plaintiff suffered from a latent asbestos-related illness. The plaintiff bought products containing asbestos from Grossman's, a home improvement retailer, in 1977.[149] Grossman's filed for Chapter 11 in 1997 and had its Plan confirmed the same year.[150] The plaintiff developed symptoms of mesothelioma in 2006, was diagnosed in 2007, and passed away in 2008 while the case was still pending.[151]

When the Third Circuit decided to reexamine *Frenville*, it had a wealth of case law upon which to draw.[152] The court divided the cases into two categories: those following the conduct test and those following the prepetition relationship test.[153] Although it analyzed both tests, the court did not explicitly align itself with either.[154] The court found that, irrespective of title, most courts found "that a prerequisite for recognizing a 'claim' is that the claimant's exposure to a product giving rise to the 'claim' occurred prepetition, even though the injury manifested after the reorganization."[155] The Third Circuit agreed with the consensus and declared that "a 'claim' arises when an individual is *exposed prepetition* to a product or other conduct giving rise to an injury."[156]

Though the court did not explicitly label its holding as the prepetition relationship test, it seems clear, given its language, that such was the

147. Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114, 121 (3d Cir. 2010) (en banc).

148. Id.

149. Id. at 117.

150. Id.

151. Id. at 117–18. The plaintiff's husband was substituted in her stead. Id. at 118.

152. See supra Part II.A (discussing multitude of tests).

153. *In re Grossman's*, 607 F.3d at 122. The court included the fair contemplation and *Piper* tests within the realm of the relationship test, which is consistent with the approach of other courts. See supra note 132 and accompanying text (explaining *Piper* test is often considered part of relationship test); supra note 141 and accompanying text (same for fair contemplation test).

154. *In re Grossman's*, 607 F.3d at 125; see also Alexandra E. Olson, Comment, Treading Murky Waters: The Third Circuit's Search for When a Claim Arises in *In re Grossman's, Inc.*, 52 B.C. L. Rev. E. Supp. 27, 37 (2011), http://bclawreview.org/files/2012/12/03_olson.pdf (on file with the *Columbia Law Review*) ("Following an extensive discussion of the two tests, the Third Circuit . . . oddly failed to identify explicitly the test it used . . . ."); Moss, supra note 146, at 63 ("In *Grossman's*, the Third Circuit did not explicitly endorse either the conduct test or the prepetition relationship test.").

155. *In re Grossman's*, 607 F.3d at 125.

156. Id. (emphasis added). The court then mentioned that due process might be a concern, id. at 125–26, before remanding to the district court, id. at 128.

court's intent. "Exposure" to either a product or conduct implies that there must be a relationship between the debtor (who made the product or engaged in the conduct) and the claimant. "Exposure" is also included in the definition of "relationship" used in the relationship test: A relationship stems from "contact, *exposure*, impact, or privity."[157] The court in *Grossman's* even used "exposure" when defining the relationship test elsewhere in the opinion.[158] Thus, although (oddly) not calling it by its name, the Third Circuit effectively adopted the prepetition relationship test.

2. *The Third Circuit Relapses with* Wright. — In 2012, the Third Circuit was again confronted with a case asking when a Claim arose, but instead of applying *Grossman's* newly adopted prepetition relationship test, the three-judge panel created a new test. In *Wright v. Owens Corning*, two (unrelated) plaintiffs hired contractors who installed Owens Corning shingles on their roofs.[159] One plaintiff, Wright, installed shingles prepetition; the other plaintiff, West, installed shingles postpetition.[160] Both plaintiffs' shingles later cracked and leaked; both sent a warranty claim to Owens Corning.[161] Owens Corning, already postconfirmation in its Chapter 11 bankruptcy, denied their claims; Wright filed a putative class action alleging "fraud, negligence, strict liability, and breach of warranty," which West joined as a named plaintiff.[162] The district court granted Owens Corning's motion for summary judgment, holding that Wright's and West's claims were discharged under Owens Corning's Plan.[163] The plaintiffs appealed that decision to the Third Circuit.

The Third Circuit's analysis began with *Grossman's* but quickly devolved into a reinterpretation of Third Circuit Claim law. After applying *Grossman's* prepetition relationship rule to Wright and finding she

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157. Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995) (emphasis added) (quoting In re Piper Aircraft Corp., 162 B.R. 619, 627 (Bankr. S.D. Fla. 1994)); see also Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1277 (5th Cir. 1994) (using same definition); In re Huffy Corp., 424 B.R. 295, 304 (Bankr. S.D. Ohio 2010) (same).

158. *In re Grossman's*, 607 F.3d at 123 ("Under [the relationship] test, a claim arises from a debtor's prepetition tortious conduct where there is also some prepetition relationship between the debtor and the claimant, such as a purchase, use, operation of, or *exposure* to the debtor's product." (emphasis added)).

159. 679 F.3d 101, 103 (3d Cir. 2012), cert. denied, 133 S. Ct. 1239 (2013).

160. Id. An overview of the timeline will be useful. Wright bought her shingles in late 1998 or early 1999. In 2000, Owens Corning filed for Chapter 11. In 2005, West bought his shingles. In 2006, Owens Corning's Plan was submitted and confirmed. In 2009, both Wright's shingles and West's shingles cracked, and they individually submitted warranty claims that Owens Corning rejected. Id.

161. Id.

162. Id. See supra notes 1–5 and accompanying text for a discussion of the circumstances surrounding Owens Corning's bankruptcy.

163. Wright v. Owens Corning, 450 B.R. 541, 557 (W.D. Pa. 2011), aff'd in part, rev'd in part, 679 F.3d 101, cert. denied, 133 S. Ct. 1239.

had a Claim,[164] the court turned to West.[165] The Third Circuit noted that the rule in *Grossman's* "reflects the Code's expansive treatment of claims"[166] and expressed its desire to expand the definition of Claims even further.[167] It did so by holding that *preconfirmation* exposure to a defective product or tortious conduct would be sufficient for a Claim.[168] Under this rule, West also held a Claim subject to discharge.[169] By creating this new preconfirmation test, the *Wright* court effectively overruled *Grossman's* less than two years after it was decided and made the Third Circuit an outlier in Claims jurisprudence once again.

III. WHY *WRIGHT* WAS WRONG, AND HOW IT CAN BE FIXED

The irony is that after years of interpreting Claim much too narrowly in *Frenville*, the Third Circuit in *Wright* interpreted it far too broadly. Part III.A will argue that the date of petition is the proper date to consider when deciding a Claim case because doing so is more consistent with the Code's language and policy, and that *Wright* was therefore wrongly decided. Part III.B will recommend that the Third Circuit remedy its mistake in two ways: first, by returning to the prepetition relationship rule laid out in *Grossman's* for its Claims jurisprudence, and second, by considering future postpetition, preconfirmation claims under the *Reading Co. v. Brown* administrative expense framework.[170]

A. *Petition Versus Confirmation: The Trouble with* Wright

The court in *Wright* erred by using the date of confirmation instead of the date of petition in its relationship test. Although one other circuit,

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164. Because Wright held a Claim, Owens Corning's Plan discharged her right to payment. Thus, somewhat counterintuitively, by having a Claim, Wright did not have any recourse against Owens Corning. (At least in theory—the court held that the notice was insufficient, so the Claim was not discharged. See infra note 169 (discussing this point).)

165. 679 F.3d at 106. The court stated that while Wright's claim was clear-cut, "[w]hether West held a claim is less obvious." Id.

166. Id.

167. Id. at 107 ("Not extending our test to post-petition, but pre-confirmation, exposure would unnecessarily restrict the Bankruptcy Code's expansive treatment of 'claims' that we recognized in *Grossman's*.").

168. Id. ("We thus restate the test announced in *Grossman's* to include such exposure and hold that a claim arises when an individual is exposed *pre-confirmation* to a product or other conduct giving rise to an injury that underlies a 'right to payment' under the Code."). The *Wright* court changed the test with very little discussion: The court's discussion of Claims law takes up less than two full pages. Id. at 105–07.

169. Although the court held that both West and Wright held Claims under the Code that were subject to the discharge provision, in a separate analysis the court held that Owens Corning's notification procedure constituted insufficient due process, so the Claims were allowed to proceed. Id. at 108.

170. For an overview of *Reading*, 391 U.S. 471 (1968), and its progeny, see supra Part I.C.2. For an overview of the Code's treatment of administrative expenses, see supra Part I.C.1.

the Eleventh, has used the confirmation date in its Claims test (in *Piper*[171]), it did so in a case with unusual facts quite distinct from the facts of *Wright*, and no other court has followed its lead.[172] Using a preconfirmation relationship test—particularly without any prepetition element, which *Piper* at least has[173]—is not consistent with either the Code's language or the policies underlying Chapter 11. Part III.A.1 will analyze the Code's language; Part III.A.2 will argue that a preconfirmation test creates economic inefficiencies and violates Chapter 11's policy of saving potentially profitable businesses.

1. *Statutory Problems.* — The court in *Wright* began its bare-bones statutory analysis with § 1141.[174] The Third Circuit reasoned that confirmation is the proper date to use because the Code provides that confirmation of a Plan "discharges the debtor from any debt that arose before the date of such confirmation."[175] The court's analysis essentially ended where it began; other than § 1141, the court mentioned two other Code sections in a citation sentence and never cited § 101, which provides the actual definition of Claim.[176] This was a mistake. Section 1141 states that confirmation discharges "debt." "Debt" is defined in § 101 as "liability on a claim."[177] Because the scope of § 1141 depends on the definition of Claim, to pull the definition of Claim from § 1141 is circular and suspect.

The Code supports defining Claims as rights to payment that arise prepetition. "Creditor" is defined in § 101 as an "entity that has a claim against the debtor that arose *at the time of or before the order for relief* concerning the debtor."[178] Section 301 states that a voluntary bankruptcy case begins by "filing with the bankruptcy court . . . *a petition*"; such peti-

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171. Epstein v. Official Comm. of Unsecured Creditors (In re Piper Aircraft, Corp.), 58 F.3d 1573 (11th Cir. 1995).

172. See supra notes 131–132 and accompanying text (critiquing *Piper*).

173. Recall that the *Piper* test requires both prepetition conduct and a preconfirmation relationship. See supra Part II.A.5 for further discussion.

174. *Wright*, 679 F.3d at 107.

175. 11 U.S.C. § 1141(d)(1)(A) (2012).

176. Other than quoting § 1141, the court limited its statutory analysis to the following:

> *See also id.* § 348(d) (providing, in the context of conversion from a Chapter 11 or Chapter 13 proceeding to a Chapter 7 proceeding, that claims other than priority claims arising after the petition date, but before conversion, are treated as prepetition claims in the Chapter 7 proceeding); *id.* § 502(e) (providing that "a claim for reimbursement or contribution . . . that becomes fixed after the commencement of a case" is a prepetition claim for purposes of allowance).

Wright, 679 F.3d at 107.

177. 11 U.S.C. § 101(12).

178. Id. § 101(10)(A) (emphasis added).

tion "constitutes *an order for relief*."[179] Together, these two provisions provide that a Creditor is an entity that has a *prepetition* claim against a debtor.

Chapter 11 exists as a platform for lenders and debtors to renegotiate, and only Creditors have the right to a seat at the negotiating table. Only Creditors participate in the "debtor-creditor democracy" and "negotiate and reach a consensual arrangement with the debtor to reorganize the debts."[180] Only a Creditor may file a proof of claim, which gives it the right to vote on the debtor's Plan.[181] In addition, Creditors may file alternate Plans.[182] Given the rights attached to being a Creditor and the fact that only prepetition claim holders are Creditors under the Code, it follows that Claims must arise prepetition. The holder of a postpetition right to payment does not have the right to vote on the Plan; Congress cannot have intended to disenfranchise Claim holders in this way. Limiting Claims to rights to payment that arise prepetition aligns Claims and Creditors, which must have been the intent of the Code's drafters.

2. *Policy, Efficiency, and Potential Consequences.* — *Wright's* potential consequences undermine the policy goal of Chapter 11. On its face, the decision in *Wright* benefits debtors. An ultra-broad definition of Claims increases the number of claims that can be discharged by a Plan, which reduces the liabilities of the debtor's postbankruptcy manifestation. However, for a Chapter 11 debtor continuing to operate its business, reorganization will only succeed if third parties, including suppliers, employees, and customers, continue to transact with it. The holding in *Wright*—which qualifies seemingly ordinary business expenses that arise postpetition but preconfirmation as Claims that can be discharged[183]—creates a serious disincentive for customers to transact with businesses in bankruptcy. If a potential car purchaser knows that there is effectively no warranty on a car bought from a Chapter 11 company, that consumer will buy her car from another company.[184] This will make it extremely difficult for Chapter 11 businesses to continue to operate.

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179. Id. § 301 (emphases added). Section 302 provides the same for joint cases. Id. § 302. Involuntary cases under § 303 are more complicated, and beyond the scope of this Note.

180. Jones, supra note 28, at 1089.

181. 11 U.S.C. § 501(a) ("A creditor . . . may file a proof of claim."); id. § 502(a) ("A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed . . . ."); id. § 1126(a) ("The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan."); see also supra notes 38–41 and accompanying text (explaining Creditor voting rights in more detail).

182. 11 U.S.C. § 1121(c).

183. See infra Part III.B.2 for an analysis of why postpetition, preconfirmation claims should be considered administrative expenses, which can be paid after a Plan is confirmed.

184. The Internet makes information—including news of bankruptcy filings of large companies—readily available to average consumers. A consumer making a large purchase,

This analysis supports drawing the line at petition rather than confirmation. Before the debtor files for bankruptcy, customers, suppliers, and others doing business with it have no reason not to enter into transactions. Once the petition has been filed, they have no ability to alter their behavior in response. Postpetition, preconfirmation customers, contrarily, can adjust their behavior in response to the bankruptcy and refuse to do business with the debtor if they know they will be paid pennies on the dollar for their claims.[185] In addition to making it harder for Chapter 11 companies to recover, these adjustments create inefficiencies.[186] For example, postpetition customers must identify bankrupt companies and research alternative companies in order to avoid having their future Claims discharged; doing so creates transaction costs. It is therefore more efficient to draw the line at the time of the petition than at the time of confirmation, as doing so prevents the creation of incentives for customers, suppliers, and other creditors to change their behavior.

The goal of a Chapter 11 bankruptcy is for the debtor to straighten out its financial situation while "[t]he rest of the world continues to do business with the corporation the same way as before."[187] If *Wright* remains the law of the Third Circuit, that might not be possible.

B. *The Third Circuit's Next Move*

Wright unwisely modified the Third Circuit's approach to Claims, but the mistake does not have to be permanent. The Third Circuit can remedy its jurisprudence by returning to the prepetition relationship test adopted in *Grossman's* for all future Claims cases. In addition, when confronted by a postpetition, preconfirmation right to payment that does not fit under the Claims test, the Third Circuit should apply the administrative expense doctrine. Part III.B.1 argues that the Third Circuit should re-adopt the prepetition relationship test; Part III.B.2 analyzes the post-*Reading* administrative expense framework and concludes that the Third Circuit should adopt that framework for future postpetition claims.

1. *Return to* Grossman's. — The Third Circuit should reject *Wright*'s preconfirmation test and return to the prepetition rule set out in *Grossman's* for both precedential and policy reasons. Fourteen Third

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such as a car or computer, is likely to conduct significant research beforehand and would almost certainly discover the Chapter 11 status of any company from which she is contemplating making a purchase.

185. The alternative to holding a Claim is to hold an administrative expense, as Part III.B.2 discusses infra. In that case, the claimant will likely be paid in full and is therefore likely to continue doing business with the debtor.

186. Efficiency, as used here, refers to the option that least distorts an individual's preferences.

187. Baird, supra note 23, at 231.

Circuit judges considered the state of Claims law in *Grossman's*,[188] and after a careful analysis the en banc panel determined that the appropriate test was that "a 'claim' arises when an individual is exposed *prepetition* to a product or other conduct giving rise to an injury."[189] There was nothing to prevent the court at that time from creating a test based on the date of confirmation. The *Grossman's* court considered *Piper*[190] and therefore knew that a confirmation-based test was a possibility. The court had a Chapter 11 case in front of it and could have created a test based on the date of confirmation without altering the final result of that particular case,[191] but it did not.

The Third Circuit should also return to *Grossman's* prepetition relationship test because that test is more consistent with the Code's language and policy. Statutory analysis shows that the date of the petition is the proper date to consider in Claims law because of the importance of Creditors in Chapter 11 and the misalignment of Claims and Creditors if postpetition rights to payment are considered Claims.[192] More importantly from a practical standpoint, if potentially profitable businesses are to be saved under Chapter 11, postpetition rights to payment cannot be Claims.[193] For these reasons, the Third Circuit should re-adopt the prepetition relationship test used in *Grossman's* at its next opportunity.

2. *Postpetition, Preconfirmation Claims.* — If the Third Circuit is confronted with another postpetition, preconfirmation claim like West's claim in *Wright*, it should consider the claim under the administrative expense doctrine.[194] Section 1141 states that preconfirmation claims are discharged "[e]xcept as otherwise provided . . . in the plan."[195] Many Plans, including Owens Corning's,[196] contain an exception to discharge

188. Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114, 116 (3d Cir. 2010) (en banc) (listing sitting Judges McKee, Sloviter, Scirica, Barry, Ambro, Fuentes, Smith, Fisher, Chagares, Jordan, Hardiman, Greenaway, Vanaskie, and Roth).

189. Id. at 125 (emphasis added).

190. Id. at 123–25.

191. In *Grossman's*, the debtor filed a petition and had its Plan confirmed in the same year, with the plaintiff's illness manifesting long afterward. Id. at 117. Therefore, on remand, the district court would have reached the same conclusion regarding the plaintiff's claim whether the Third Circuit created a prepetition or preconfirmation test.

192. See supra Part III.A.1 (analyzing Code's language).

193. Without a reasonable expectation of being able to recover should a claim arise, customers, suppliers, and others will refuse to do business with a company in Chapter 11. See supra Part III.A.2 (discussing inefficient incentives created by *Wright* that contradict Chapter 11's policy goals).

194. For a summary of administrative expense law, see supra Part I.C. The defendant in such a case would be foolish not to cite *Wright* and argue that the liability is actually a dischargeable Claim, but the Third Circuit should be wise enough to ignore such an argument.

195. 11 U.S.C. § 1141(d)(1) (2012).

196. Douglas N. Candeub, When Does a Post-Petition Ordinary-Course Expense Become a Dischargeable Claim?, Am. Bankr. Inst. J., Aug. 2012, at 46, 90 (explaining Owens Corning's Plan contained exception so "'no request for payment of an

for administrative expense claims incurred in the ordinary course of business.[197] There is a line of cases stemming from *Reading* that has consistently held that postpetition, preconfirmation tort claims are administrative expenses that fit within such an exception.[198] These cases use a two-part test to determine which claims qualify: The claimant must demonstrate, first, that her claim arises from the debtor in possession's business operations, and second, that it would be fundamentally unfair, under *Reading*'s analysis, for her claim to be subordinated.[199]

West's claim fits squarely within those criteria. In *Reading*, the Supreme Court determined that tort liabilities are "costs ordinarily incident" to running a business.[200] Honoring warranties for cracked roofing shingles is an ordinary cost of running a shingle-selling business and West bought his shingles from the debtor in possession,[201] so his claim meets the first prong of the test. West's claim also meets the second criterion. *Reading* held that it is more equitable to pay a tort victim than the general creditors that benefit from the debtor's ongoing operations.[202] In addition, voluntary creditors can protect themselves by requiring

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Administrative Claim need be filed with respect to an Administrative Claim, which is paid or payable by a Debtor in the ordinary course of business'" (quoting Notice of Effective Date, In re Owens Corning, No. 1:00-bk-03837 (Bankr. D. Del. Nov. 2, 2006))).

197. See, e.g., Sanchez v. Nw. Airlines, Inc., 659 F.3d 671, 676 (8th Cir. 2011) (describing Plan that excluded five groups of administrative expenses from discharge, including "[l]iabilities incurred in the ordinary course of business"); Caradon Doors & Windows, Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.), 447 F.3d 461, 465 (6th Cir. 2006) (detailing section in Plan that preserved administrative expenses).

198. See supra notes 74–79 and accompanying text (discussing post-*Reading* line of administrative expense cases). A brief summary of two recent cases will be illustrative. In *Sanchez v. Northwest Airlines*, the Eighth Circuit held that a claim alleging violations of the Americans with Disabilities Act was an administrative expense not discharged upon the Plan's confirmation. 659 F.3d at 679. In *Eagle-Picher*, the Sixth Circuit held that patent infringement and breach of contract claims were administrative expenses incurred in the ordinary course of business and were therefore preserved under the debtor's Plan. 447 F.3d at 466. In both of these cases, the debtor's Plan had a section that preserved administrative expenses incurred in the ordinary course of business. See supra note 197 (discussing these Plans). Both the Sixth and Eighth Circuits use the two-part benefit test to determine if a claim is an administrative expense. *Sanchez*, 659 F.3d at 677; *Eagle-Picher*, 447 F.3d at 464. Applying that test along with the reasoning in *Reading* and its subsequent line of cases, both courts held that the plaintiff's claims were administrative expenses. *Sanchez*, 659 F.3d at 678; *Eagle-Picher*, 447 F.3d at 466–67.

199. See supra note 61 and accompanying text (detailing two-part benefit test used for administrative expenses); supra notes 75–79 and accompanying text (explaining how post-*Reading* courts adopted modified version of benefit test).

200. Reading Co. v. Brown, 391 U.S. 471, 483 (1968); see also supra Part I.C.2 (discussing *Reading* in more detail).

201. West bought his shingles in 2005, when Owens Corning was already five years into its Chapter 11 proceedings. See Wright v. Owens Corning, 679 F.3d 101, 103 (3d Cir. 2012), cert. denied, 133 S. Ct. 1239 (2013).

202. *Reading*, 391 U.S. at 482–83.

collateral or charging higher interest rates prepetition;[203] involuntary creditors,[204] such as tort claimants, cannot. It would thus be "fundamentally unfair," under *Reading* and its progeny, for West's claim to be subordinated. Because West's claim meets both prongs of the test, it should have been treated as an administrative expense.

Why, then, did the Third Circuit completely ignore this body of law when deciding *Wright*? To be fair, it was primarily a result of poor lawyering: West's attorney never made an administrative expense argument.[205] The Third Circuit, however, is not totally innocent. Instead of overruling *Grossman's* in order to include this sort of claim, it could have noted that when a Plan has an exception for ordinary course of business expenses, a postpetition tort claim falls within that category and should not be subject to discharge. The court did not need to create a test that eliminates the possibility of another lawyer successfully making the argument in the future.

CONCLUSION

Although the en banc panel in *Grossman's* stated that Third Circuit precedents are overruled on "rare occasion,"[206] the court in *Wright* effectively overruled *Grossman's* less than two years after it was decided, with very little discussion and arguably no consideration of the consequences. *Grossman's* short-lived prepetition relationship test, coming after the long-in-force and much-maligned state law accrual test from *Frenville*, was a brief beacon of hope for the Third Circuit. *Wright*'s confirmation-based test violates the language and principles of the Bankruptcy Code and may have damaging consequences for both debtors and claimants in the Third Circuit, but it does not have to be permanent. Hopefully this time the Third Circuit will not take twenty-six years to remedy its mistake.

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203. See, e.g., Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 13 (1986) (explaining creditors know about chance of default and "can account for it . . . in the interest rate they charge").

204. "Involuntary" creditors are those who "do not consent to their status in any meaningful sense. They become creditors only by the wrongful acts of their debtors." Lynn M. LoPucki, The Unsecured Creditor's Bargain, 80 Va. L. Rev. 1887, 1896 (1994).

205. Brief of Appellants, *Wright*, 679 F.3d 101 (No. 11-2026), 2011 WL 2526594. The omission of an administrative expense argument is likely due to the conflation of West's claim with Wright's (she was the original plaintiff), as well as the fluctuating state of Claims jurisprudence in the Third Circuit at the time. It is unfortunate that West's claim was "blown by the tailwinds," as he likely had an ordinary course of business expense. Candeub, supra note 196, at 46. Candeub believes that if West's claim was heard by, for example, the Sixth or Eighth Circuit (as discussed supra note 198), "it would have readily been characterized as an ordinary-course-of-business administrative expense and the lawsuit would have been allowed to proceed." Id.

206. Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114, 117 (3d Cir. 2010) (en banc).

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