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COMMENTS

BANKRUPTCY — PROOF OF CLAIMS FOR UNACCRUED RENT — In the very recent case of *Manhattan Properties, Inc. v. Irving Trust Co.*,[1] the Supreme Court for the first time authoritatively passed on the validity of a claim in bankruptcy by a lessor against the bankrupt estate for loss of future rents due after the filing of the petition. The Court,

[1] 1 U. S. LAW WEEK, Feb. 6, 1934, p. 464. The Supreme Court in one opinion consolidated the Manhattan Properties case with the case of Samuel R. Brown v. Irving Trust Co., (C. C. A. 2d, 1933) 66 F. (2d) 473, affirming the decision of the Circuit Court of Appeals in the latter case.

In the Manhattan Properties case the lease provided that if the tenant should default in any covenant, or if bankruptcy proceedings should be instituted, the landlord might re-enter and re-let the premises, the tenant to pay each month the deficit between the rent reserved and the present rental value of the balance of the term.

In the Samuel R. Brown case the indemnity covenant, similar to the one in Manhattan Properties, provided that the lessee should compensate the lessor for loss in rentals accruing during the balance of the term. The lessors re-entered and filed a claim for the difference between the rental value for the remainder of the term after re-entry and the rent reserved in the lease.

affirming the decision of the Circuit Court of Appeals,[2] ruled that the landlord's claim was not provable. Mr. Justice Roberts, delivering the opinion of the Court, reviewed the long history of litigation on the subject and was impressed by the fact that although the great majority of the lower federal courts had consistently excluded claims for future rents from the class of provable debts,[3] Congress in the interim had done nothing.[4]

I.

The decisions of the lower courts over the last thirty years are mainly concerned with fitting the letter of section 63 of the Bankruptcy Act [5] to common law rent dogma. Even under the Bankruptcy Act of 1841 which, unlike the present act, expressly permitted proof of contingent claims,[6] demands for unaccrued rent were held not to be prov-

[2] (C. C. A. 2d, 1933) 66 F. (2d) 470.

[3] For an exhaustive discussion of the lower court decisions see Schwabacher and Weinstein, "Rent Claims in Bankruptcy," 33 COL. L. REV. 213 (1933). Also see Radin, "Claims for Unaccrued Rent in Bankruptcy," 21 CAL. L. REV. 561 (1933).

[4] In his own words: "What of the activities of the Congress while this body of decisions interpreting Section 63a was growing? From 1898 to 1932 the Bankruptcy Act was amended eight times . . . without alteration of the section. This is persuasive that the construction adopted by the courts has been acceptable to the legislative arm of the government.

"In this situation 'only compelling language in the statute itself would warrant the rejection of the construction so long and so generally accepted.' Maynard v. Elliott, supra 277. If the rule is to be changed, Congress should so declare." 1 U. S. LAW WEEK, Feb. 6, 1934, p. 8 at 10.

It was urged by counsel that the Bankruptcy Amendment of March 3, 1933, was intended to change the law. 47 Stat. 1467 (1933), U. S. C. A. tit. 11, secs. 201, 202 (1933 Supp.). Section 202[74] deals with compositions and extensions, but concludes with this sentence: "A claim for future rent shall constitute a provable debt and shall be liquidated under section 103b [63b] of this title." In rejecting counsel's contention that this language is declaratory and designed to remove doubt as to the construction of the prior law, Mr. Justice Roberts said: "Sections 73 to 76 inclusive were enacted to permit extensions and compositions not theretofore possible. They apply only to individuals. It is highly unlikely that if the quoted sentence had been intended as an amendment of Section 63(a) it would have been placed in context dealing only with the novel procedure authorized by the new sections." 1 U. S. LAW WEEK, Feb. 6, 1934, p. 8 at 10.

[5] "(a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest . . . (4) founded upon an open account, or upon a contract express or implied. . . .

"(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against the estate." 30 Stat. 562 (1898), U. S. C. tit. 11, sec. 103 (1926).

[6] The Act of August 19, 1841, sec. 5, 5 Stat. 440 at 444 (1841), specified cer-

able.[7] The same result followed as a matter of course from the Act of 1867 which provided that rent claims were provable only for such amount as had accrued up to the date of bankruptcy.[8] However, in *Ex parte Houghton*,[9] Judge Lowell expressed the opinion that, quite apart from the language of the statute, claims for future rent are not provable, "for the reason that rent accrues from time to time, and is not and cannot be due in solido beforehand, since it depends on occupation from time to time." The significance of this analysis has increased, rather than diminished, in the course of time and with the change in the phraseology of the statute.

The Act of 1898 made no express provision for proving contingent claims, and this omission at first gave the courts an additional excuse for denying proof. In *Re Roth and Appel* [10] the court disallowed proof on the ground the claim was not "absolutely owing" at the time of the filing of the petition.[11]

Subsequent to this ruling two important decisions were rendered by the Supreme Court. In *Central Trust Co. v. Chicago Auditorium Association*,[12] bankruptcy was held to be the anticipatory breach of an executory contract to pay annually for a cab privilege which the grantor might revoke.[13] The Court, however, in painstaking dicta distinguished the lease situation from the ordinary executory contract because of the "diversity between duties which touch the realty, and the mere personalty." [14] This reassertion of the historical lease doctrine naturally

tain classes and added a general description of contingent debts, but said nothing about rent. The Act of March 2, 1867, sec. 19, 14 Stat. 517 at 525 (1867), authorized the proof and liquidation of contingent claims, and also proof of a claim for a proportionate part of any rent up to the date of bankruptcy.

[7] Bosler v. Kuhn, 8 Watts and S. (Pa.) 183 (1844); Stinemets v. Ainslie, 4 Denio (N. Y.) 573 (1847); Savory v. Stocking, 4 Cush. (Mass.) 607 (1849).

[8] See note 6, supra. Ex parte Houghton, (D. C. Mass. 1871) 1 Lowell 554, Fed. Cas. No. 6725; In re May, (D. C. S. D. N. Y. 1874) 9 N. B. R. 419, Fed. Cas. No. 9325; Bailey v. Loeb, (C. C. M. D. Ala. 1875) 11 N. B. R. 271, Fed. Cas. No. 739.

[9] (D. C. Mass. 1871) 1 Lowell 554, Fed. Cas. No. 6725.

[10] (C. C. A. 2d, 1910) 181 Fed. 667.

[11] This result was reached by reading into the "contracts, express or implied" clause of 63a (4) the "absolutely owing" limitation of 63a (1). See n. 5, supra. The court ruled the claim was too contingent since many events might occur which would absolve the tenant from further obligation for rent, it being uncertain at the date of the adjudication that the lessor will re-enter, and also the doubt of his suffering loss of rent if he should re-enter.

[12] 240 U. S. 581, 36 Sup. Ct. 412 (1916).

[13] The Association reserved the right to cancel the privilege on six months' notice whenever it deemed the service unsatisfactory, or the management in the hotel changed. After the petition in bankruptcy was filed the trustee disaffirmed the contract.

[14] 2 COKE ON LITTLETON, 19th ed., 292b, sec. 513 (1832). In Gardiner v.

cut down the efficacy of the decision as a foundation for new law on the provability of claims for future rent.

The second decision bearing on our problem was *Maynard v. Elliott.*[15] In that case the holder of certain notes, some of which did not mature until over a year after adjudication, sought to prove his claim against the bankrupt endorser. The Supreme Court held that although neither presentment nor notice of dishonor had been waived, the claim was provable.[16] Although the contingencies on which the accrual of future rent may hinge do not seem to be any more uncertain than the contingency of the endorser's liability which depends primarily on the maker's failure to pay at maturity, *Maynard v. Elliott* had very little influence on the lower federal courts in their handling of the lease problem.[17]

2.

That the courts are perhaps inclined to avoid the rule of non-provability by searching for technical distinctions is suggested by some

William S. Butler & Co., 245 U. S. 603, 38 Sup. Ct. 214 (1918), an equity receivership case, the Court in holding the landlord's claim non-provable said at p. 605: " . . . the law as to leases is not a matter of logic *in vacuo*; it is a matter of history that has not forgotten Lord Coke."

[15] 283 U. S. 273, 51 Sup. Ct. 390 (1931).

[16] The Court pointed out that sec. 63 of the Bankruptcy Act purported to be merely an enumeration of classes of provable claims and not an enumeration of characteristics. Hence, the limitation of 63a (1) must not be read into 63a (4). *Cf.* n. 11, supra. Although the actual fact situation was that the maker was insolvent and thus the possible contingency that he might pay the debt was eliminated from the picture, the Court makes no reference in its opinion to his insolvency, and so it is a fair inference that the decision was meant to embrace the fact situation of solvent as well as insolvent makers.

[17] However, Justice Learned Hand in giving the opinion of the Circuit Court of Appeals in the Manhattan Properties case commented that the principal ground for the decision in Re Roth and Appel, (C. C. A. 2d, 1910) 181 Fed. 667, had been overruled by Maynard v. Elliott, 283 U. S. 273, 51 Sup. Ct. 390 (1931), and that the mere contingency of a claim was no longer a valid objection to its proof. Said he: " . . . our decision must rest upon the ground that . . . it is practically too uncertain to be liquidated. . . .

"The law, as we now understand it, is therefore that a contingent claim may in general be proved, provided its liquidation does not involve too speculative considerations, confessedly a variable standard." (C. C. A. 2d, 1933) 66 F. (2d) 470 at 471. (*Cf.* Dunbar v. Dunbar, 190 U. S. 340, 23 Sup. Ct. 757 (1903)).

Justice Hand, although prompted by the compunctions of precedent to agree with his brothers, in no uncertain terms made it clear that his personal opinion was that rent claims are of no more speculative nature than those involved in the Auditorium and Maynard cases: "For myself, while I recognize the force of this application of stare decisis, it seems to me that the basis of the doctrine disappears once contingent claims are held to be provable. That has now been authoritatively declared, and I think that we should make the necessary adjustments." *Ibid.* at p. 472.

It is also interesting to note that the opinion abandons altogether any reliance on the ancient lease law dogma.

decisions which have held that a breach of the lease by the lessee prior to the filing of a petition in bankruptcy may give rise to a provable claim for unaccrued rent.[18] Although it is true that a breach which anticipates the bankruptcy avoids the objection that the claim is contingent in form, and eliminates from the picture the possibility that the lessor may have no cause of action at all, nevertheless the uncertainty as to the amount of the claim or whether there will be any loss in rentals remains the same as where the breach is fixed at the time of the filing of the petition.[19] Is the claim in the one case any more speculative than in the other? Do not these cases in the last analysis support the view that a claim for loss of future rentals may be proved?

What if the landlord insists on an indemnity covenant in his lease? If the lessor is to be protected, the courts are most meticulous in their demand that the covenant meet specific requirements in form and context. A covenant that in the event of bankruptcy the landlord may reenter, and if he does, the tenant will indemnify him against loss of rents for the remainder of the term does not make the claim provable. The Supreme Court in the *Manhattan Properties* and *Samuel R. Brown* cases[20] held that such covenants were not breached by bankruptcy and that there could be no breach until re-entry by the lessor, subsequent to the filing of a petition.[21] The Court, however, by negative implication intimated in the final paragraph of its opinion that an agreement which makes the filing of a petition in bankruptcy ipso facto a breach

[18] In Re Mullings Clothing Co., (C. C. A. 2d, 1916) 238 Fed. 58, a receiver was appointed in proceedings for the dissolution of the lessee corporation and he repudiated the lease prior to the petition in bankruptcy. The court held the claim provable on the theory that the incidence of the liability of the lessee was no longer contingent. This holding was followed by a decision handed down by the Seventh Circuit in Re National Credit Clothing Co., (C. C. A. 7th, 1933) 66 F. (2d) 371, where the assignee for benefit of creditors disaffirmed the lease before the filing of the petition in bankruptcy. The court said at p. 372: "While such cause of action represents a claim which was not liquidated, it was nevertheless not a contingent claim."

However, a breach prior to the beginning of the term but subsequent to the filing of the petition does not give rise to a provable claim. Malavazos v. Irving Trust Co., (C. C. A. 2d, 1933) 66 F. (2d) 482.

That the Second Circuit has definitely abandoned the contingency objection to proof seems clear from its decision in Re Metropolitan Chain Stores, (C. C. A. 2d, 1933) 66 F. (2d) 485.

[19] It should be noted that in Re Mullings Clothing Co., (C. C. A. 2d, 1916) 238 Fed. 58, the lessor had re-let the premises for the entire term a month subsequent to the petition in bankruptcy, so that the damages were no longer uncertain in amount. But the fact remains that at the crucial cleavage date of the filing of the petition the damages were speculative.

[20] See n. 1, supra.

[21] In Re Roth and Appel, (C. C. A. 2d, 1910) 181 Fed. 667, the court held that a similar covenant did not insure provability because of the contingency of the landlord's exercising his option to re-enter.

of the lease and in addition provides for measuring the damages by the difference between the rental value and the rent reserved might be made the basis of a provable claim against the estate.[22]

It is submitted that the technical objections to the proof of unaccrued rent claims, if not untenable today, are at least seriously weakened by the course of the decisions. As we have seen, the mere fact that a claim is contingent does not prevent its being proved. The argument that rent is a consideration for the use of land and the landlord's re-entry extinguishes the covenant to pay rent is no longer emphasized in the opinions. Of course, there still remains the contention that the amount of the future damages is too speculative, but that obstacle to proof loses force in the light of the decision in *Re Marshall's Garage*,[23] where the court in computing damages for anticipatory breach of a contract to purchase land accepted the market value of the land at the time of the trial as the best possible means at hand for forecasting its future value at the time of performance five years later. Must we not agree with Justice Learned Hand that "the uncertainty as to the future value of a fee is no less great than as to the value of sequent terms." [24] What we are left with, if we insist on being technical, is the naked distinction that on the one hand we are dealing with executory contracts pertaining to lease rentals, the breach of which will not give rise to a provable claim, and on the other hand with other types of bilateral executory contracts the breach of which will constitute a provable claim.

[22] A covenant so framed, though it makes certain the incidence of the lessee's liability at the date of the petition, does not in any way increase the certainty as to the amount of the damages. And if the parties attempt to insure such certainty by providing for an acceleration of the rent for the balance of the term in the event of bankruptcy, there is danger that the courts will call the covenant a penalty. In Kothe v. R. C. Taylor Trust, 280 U. S. 224, 50 Sup. Ct. 142 (1930), the provision was that in case of bankruptcy the landlord might recover an amount equal to the rent for the balance of the term as damages. The court held that it was in subtsance a penalty measure and not a provision for liquidated damages and, as such, gave a preference to the landlord over the other creditors.

For an excellent discussion of such covenants and in particular the attitude of the courts toward acceleration clauses, see Schwabacher and Weinstein, "Rent Claims in Bankruptcy," 33 COL. L. REV. 213 at 247 (1933). See also 47 HARV. L. REV. 488 at 492 (1934).

[23] (C. C. A. 2d, 1933) 63 F. (2d) 759. Claimant leased premises to the bankrupt for a ten-year period, the lessee contracting (not an option) to purchase the property and the lessor to convey at the end of the term. Bankruptcy intervened when the lease had seven years yet to run. The court held that although the claim for future rent was not provable in bankruptcy, nevertheless damages for anticipatory breach of the contract to purchase did constitute a provable claim.

[24] Manhattan Properties, Inc. v. Irving Trust Co., (C. C. A. 2d, 1933) 66 F. (2d) 470 at 471. And at p. 472 in the opinion: "Certainly I have no more compunction in assessing the future value of realty, than that of chattels. The periods involved are indeed apt to be longer, but the fluctuations are less rapid. Some chances must be taken but that is often so."

3.

The mechanical rationalizations of the cases suggest that certain unexpressed but none the less motivating considerations of policy underlie the decisions. Since the frequency of bankruptcies is highest during severe economic depression, when the rental value of property is at low ebb, it is probable that property values will rise before the end of the period of the long-term lease. Consequently, a claim for the difference between the rent reserved and the rental value at the time of the filing of the petition, properly discounted, may have very little relation to the damage actually suffered by the lessor. It should be observed that the landlord is not obliged to re-rent at once for the whole balance of the term, but may make a short lease and remain free to get the benefit of subsequent appreciation of values.[25] Furthermore, if proof is allowed for the long-term lease and dividends are paid on the present value of the prospective damages, the result would be in many cases that the landlord's dividend would substantially deplete the assets of the bankrupt estate. The landlord's claim is often several times as large as the combined claims of all the other creditors.[26] The size of his demand plus its speculative aspect might well prompt a court to refuse proof.[27]

[25] In theory, any other type of executory contract might present the same conditions, but, in the actual practices of the day, there is a difference between leases and other contracts which, though a mere difference in degree, is so great as to deserve recognition in the law. Rare indeed must be the contracts for goods or services which run over the long periods which are commonplace in leases. And as for the extent of fluctuations in values, is not the statement quoted in the preceding note misleading? The market price of some goods, viz. those which have a well organized market, fluctuates with higher frequency, in some cases even from hour to hour, but that is not as material to the question as the width of the swing, in the long pull as well as the short. Speaking to the larger question, and considering the types of goods and lands which are oftenest the subject of executory contracts, can one safely say that there is a difference in the stability of values? At least this is true, that land sometimes becomes practically unsaleable and unrentable, notably in those periods when bankruptcies are most frequent.

For an interesting analysis of fluctuations in realty values as compared with those of wholesale commodity prices see HOYT, ONE HUNDRED YEARS OF LAND VALUES IN CHICAGO 407 ff. (1933).

[26] In forecasting the importance of the impending ruling of the Supreme Court in the Manhattan Properties case, one writer commented: "It is no exaggeration to say that the Supreme Court's decision will probably affect the disposition of millions of dollars. When one chain store organization became bankrupt, for instance, the general claims for merchandise, money lent, and expense items aggregated $9,000,000, whereas claims of $43,000,000 were filed by the landlords for future rent." 1 U. S. LAW WEEK, Jan. 16, 1934, p. 404.

[27] In Re Collignon, 4 A. B. R. 250 at 254 (1900), the court in denying proof of the claim did express its concern for the other creditors of the estate: "Any other ruling . . . would not merely tempt landlords to drag out the administration of estates in bankruptcy, but often make it possible for them, through eleventh hour claims for vacant premises or on fictitious relettings, materially to reduce the dividends of other creditors. . . . "

Why do not the courts which rule the claim non-provable place their decisions squarely on such factors of policy? The answer no doubt lies in the fact that there are also cogent considerations of fairness and hardship which argue for provability. If we take into account the traditional objective of bankruptcy proceedings, which is to discharge the claims of all contract creditors and start the debtor anew free from his honest obligations, it is obvious that in the situation where the bankrupt lessee is an individual debtor the failure to discharge a large rent claim is certain to be onerous. Then, too, landlords are becoming increasingly indignant over corporations which whitewash themselves of their rent obligations by resorting to the bankruptcy courts. Little good does a non-discharged rent claim do a landlord whose lessee was a corporation now defunct. Complaint in this regard has been most bitter against certain large chain-store organizations.[28] Unless the landlord is able to exact adequate security from his lessee, will he not abandon the long-term lease which under the view taken by the courts is but a useless scrap of paper in the face of the actual or threatened bankruptcy of a lessee corporation?

Faced with this confusion of conflicting economic interests it is not surprising that the Supreme Court chose to follow the course set by the majority of the lower court decisions. The law, as far as predicting what the courts will do, appears to be rather definitely settled. However, the problem is certain to remain a sore spot in the business world; it is simply transferred to the lap of Congress.

4.

As to the form prospective legislation might take, it is proposed by the Bankruptcy Conference that the lessor's claim for anticipatory breach be made provable but "shall in no event be allowed in an amount exceeding the rent without acceleration, reserved by the lease, for the twelve months next succeeding the date of the bankruptcy," the bankrupt, however, to be wholly discharged.[29] This solution is a happy compromise of the competing economic interests we have noted. Such revision would on the one hand relieve the tenant who is an individual debtor, and on the other hand give some satisfaction to the landlord. It should be observed that proof is not limited to damages as for a one-year term. Damages for the whole term are provable, subject to a limitation in gross which is measured by one year's rental. Incidentally, this will result in eliminating the necessity of exact valuations in those cases of long terms where it is clear that the damages would exceed the arbitrary limit.

R. C. F.

[28] An enlightening discussion will be found in Smith, "Chain Stores and the Lease Plague," 58 FINANCIAL WORLD 367 (1932).

[29] Final Draft, sec. 63a(4), b(1), b(2).