1978

Tort Claims Under the Present and Proposed Bankruptcy Acts

Stephen Allen Edwards

University of Michigan Law School

Follow this and additional works at: https://repository.law.umich.edu/mjlr

Part of the Bankruptcy Law Commons, Legal Remedies Commons, Legislation Commons, and the Torts Commons

Recommended Citation
Available at: https://repository.law.umich.edu/mjlr/vol11/iss3/8

This Note is brought to you for free and open access by the University of Michigan Journal of Law Reform at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in University of Michigan Journal of Law Reform by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.
Ideally, the victim of a tort should receive compensation for a valid claim once a judgment is entered against the tortfeasor. Unfortunately, this will not happen if the tortfeasor is insolvent and uninsured or becomes so before the claim can be collected. In such cases the tort claimant may be confronted with the bankruptcy process as the only means of redress. Participation in this process can be frustrating, however, because of the increased expense and delay and the well-known fact that claimants participating in bankruptcy rarely receive more than a small fraction of their claim.¹

Unlike the many commercial business claimants who must deal with bankrupt clients, tort victims have no way of reducing the probability that they will have to contend with this process. Commercial business practices can be altered to reduce the likelihood of dealing with potential bankrupts, but the tort victim has no such opportunity with respect to potential tortfeasors. Although this difference between tort claims and commercial claims argues for equal if not preferential treatment of tort claimants in bankruptcy, such has not been the case. The bankruptcy process has traditionally concerned itself almost exclusively with commercial claims; what little recognition there has been of claims ex delicto has come slowly.²

Congress may soon enact the first complete revision of the United States bankruptcy laws in almost four decades. Among the numerous changes proposed by the legislature is a major alteration of the provability and dischargeability of tort claims asserted against the bankrupt’s estate.³ This article will discuss the treatment of tort claims in the present Act and

---

¹ In the latest year for which figures are available, 1974, the total percentage of liabilities paid in cases in which there were more than nominal assets (i.e., those cases in which administrative expenses did not exhaust the estate in bankruptcy) was 9.4 percent. Administrative Office of the United States Courts, Table of Bankruptcy Statistics, Table 6 (1974)[hereinafter cited as Administrative Tables]. Even more sobering is the fact that 77.1 percent of the 152,500 straight bankruptcy cases filed in 1974 were nominal or no-asset cases. Id. at Table 4A.

² See Schall v. Camors, 251 U.S. 239 (1920).

³ There are two proposed acts: H.R. 8200, 95th Cong., 1st Sess. (1977) and S. 2266, 95th Cong., 1st Sess. (1977). The portions of the Acts that are relevant to the present discussion, however, are almost identical. In the few areas where there are significant differences between the two bills, the differences will be noted.
the changes to be made by the proposed Act, and will evaluate alternative approaches to compensating victims of bankrupt tortfeasors.

I. PRESENT & PROPOSED PROCEDURES FOR RECOVERY OF TORT CLAIMS AGAINST BANKRUPTS

A. Straight Bankruptcy

1. The Present Act—The overwhelming majority of petitions under the Bankruptcy Act are filed in straight bankruptcy.\(^4\) The process may be initiated voluntarily by the filing of a petition by the debtor, or it may be initiated by a petition from creditors, in which case it is considered involuntary.\(^5\) In straight bankruptcy all of an insolvent debtor's nonexempt property is collected, liquidated, and distributed to participating creditors holding provable claims against the bankrupt.\(^6\) In order to participate in the distribution, a creditor must meet three requirements: he must have a provable claim,\(^7\) timely file a proper proof of claim,\(^8\) and have his claim allowed.\(^9\) After the estate is distributed, the debtor is discharged from all provable debts,\(^10\) unless creditors raise objections to discharge under section 14c\(^11\) or exceptions to discharge under section 17a.\(^12\)

Provability is strictly defined in section 63 of the Act, which enumerates the categories of claims that may be proved.\(^13\) The first category of provable claims that may encompass a tort claim is described in section 63a(1): debts founded upon a "fixed liability, as evidenced by a judgment

---

\(^4\) For the past ten years for which figures are available, straight bankruptcies have occupied the following percentages of petitions filed:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>83.8%</td>
</tr>
<tr>
<td>1966</td>
<td>84.7%</td>
</tr>
<tr>
<td>1967</td>
<td>84.1%</td>
</tr>
<tr>
<td>1968</td>
<td>83.7%</td>
</tr>
<tr>
<td>1969</td>
<td>83.8%</td>
</tr>
<tr>
<td>1970</td>
<td>83.6%</td>
</tr>
<tr>
<td>1971</td>
<td>83.6%</td>
</tr>
<tr>
<td>1972</td>
<td>84.2%</td>
</tr>
<tr>
<td>1973</td>
<td>84.2%</td>
</tr>
<tr>
<td>1974</td>
<td>83.4%</td>
</tr>
</tbody>
</table>

These percentages are based on the statistics in Administrative Tables, supra note 1. In fact, according to a Brookings Institution study, in the area of business bankruptcies, nine out of ten bankrupts file in straight bankruptcy. D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEMS, PROCESS, REFORM 120 (1971) (hereinafter cited as BROOKINGS).


\(^6\) The provisions pertaining to straight bankruptcy in the present Act are Bankruptcy Act §§ 1-72, 11 U.S.C. §§ 1-112 (1970).

\(^7\) Bankruptcy Act §§ 1(14), 63a, 11 U.S.C. §§ 1(14), 103(a) (1970).


or an instrument in writing". The obligation need not be immediately due, but it must be "absolutely owing" and therefore cannot be based on a judgment that is being appealed. Although tort claims may come within this category, the category was not intended to provide significant recognition of the tort claimant as an eligible participant in the bankruptcy distribution. It is "the element of merger in judgment that gives the claim a standing independent of its tortious origin." The only major concession to the admission of tort claims into the bankruptcy process is that the court will not look behind the judgment to determine the nature of the claim. Some authority exists for the proposition that a tort claim evidenced by an instrument in writing should constitute a provable claim, not because it stands as a liquidated representation of the tort liability, but because the writing is itself a contractual obligation having as its consideration the moral duty to make the victim whole.

The second major category that may cover a tort claim also reflects the view that bankruptcy is primarily designed to deal with commercial contractual obligations. Section 63a(4) permits debts founded upon "express or implied" contracts to be proved. Inclusion of implied contracts is, of course, necessary to encompass all commercial creditors, but this also introduces many noncontractual claims. The tort claimant can qualify by waiving the tort and suing in assumpsit in an appropriate case. Judgments based on claims of conversion, fraudulent representation, or

---


16 Fidelity Union Casualty Co. v. Hanson, 44 S.W.2d 985 (Tex. Ct. App. 1932) (pendancy on appeal deprives a judgment of finality in bankruptcy). See also Marotta v. American Surety Co., 57 F.2d 829 (1st Cir. 1932) (a verdict alone is not sufficient to constitute a judgment); In re Kroger Bros. Co., 262 F. 463 (E.D. Wis. 1920) (judgment that was rendered in bankrupt's favor before bankruptcy but reversed on appeal not provable).

17 See In re Crescent Lumber, 154 F. 724 (S.D. Ala. 1907).

18 3A COLLIER ON BANKRUPTCY § 63.25[2].

19 This principle became generally accepted only after its recognition by the Supreme Court. Lewis v. Roberts, 267 U.S. 467 (1925). Prior to this, those opposing proof of judgments based on tort claims could rely on the Supreme Court's statement in Wetmore v. Markoe, 196 U.S. 68, 72 (1904): "The mere fact that a judgment has been rendered does not prevent the court from looking into the proceedings with a view of determining the nature of the liability which has been reduced to judgment," citing Boynton v. Ball, 121 U.S. 457 (1887). In expressly rejecting application of this language to judgments based on tort claims the Supreme Court distinguished the Markoe case by pointing out that the "decision rested on the peculiar and exceptional nature of a decree for alimony." Lewis v. Roberts, 267 U.S. at 470.

20 3A COLLIER ON BANKRUPTCY § 63.25[2]. A similar category of provable debts is the class of claims made provable by section 63a(6): "an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication." Bankruptcy Act § 63a(6), 11 U.S.C. § 103(a)(6) (1970).


23 This is usually styled as an action in trover. See Kreitlein v. Ferger, 238 U.S. 21 (1915); Crawford v. Burke, 195 U.S. 176 (1904).

patent infringement\textsuperscript{25} may be considered implied contracts under this theory. The courts have been reluctant to extend this category, though, and the tort claimant attempting to rely on an implied contract to avoid the restrictions on proving tort claims in bankruptcy will find strict limitations in the classification of implied contracts.\textsuperscript{26}

Section 63a(5) admits to proof "provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's . . . discharge."\textsuperscript{27} However, the independent application of this section appears to be extremely limited. Indeed, the section may be coextensive with other subsections because any debt falling into this category must already be "provable" at the time of the filing of the petition.\textsuperscript{28}

The only real recognition of tort claimants is found in section 63a(7), which makes provable any debt founded upon "the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy."\textsuperscript{29} This section does not, however, allow provability of claims for intentional torts that have not been reduced to judgment or settlement.\textsuperscript{30} These claims were not included because the legislature was instead concerned with the overwhelming number of tort claims arising out of the negligent operation of automobiles.\textsuperscript{31} The requirement that the claim be "pending at the time of the filing of the petition in bankruptcy" has been strictly construed. Thus, a claim for negligence will not be deemed provable if the negligence action has been discontinued for any reason prior to the filing of the petition in bankruptcy.\textsuperscript{32}


\textsuperscript{26} See Atherton v. Anderson, 99 F.2d 883 (6th Cir. 1938) (failure to exercise reasonable care in management of a bank is not sufficient); Brown & Adams v. United Button, 149 F. 48 (3d Cir. 1906) (injury to goods is not sufficient); In re Paramount Publix Corp., 8 F. Supp. 644 (S.D.N.Y. 1934); In re Crescent Lumber, 154 F. 724 (S.D. Ala. 1907) (employment relationship with the bankrupt is not sufficient); Resolute Ins. Co. v. Underwood, 230 So.2d 433 (La. App. 1969) (subrogation contract in favor of insurance company is not sufficient); Winfree v. Jones, 104 Va. 39, 51 S.E. 153 (1905) (claim against lessee for negligent damages to premises not sufficient). Cf. Poznanovic v. Gilardine, 174 Minn. 89, 218 N.W. 244 (1928) (promise to repair negligently caused damage to property is sufficient).


\textsuperscript{28} 9 COLLIER ON BANKRUPTCY ¶ 7.05[2.1] note 12.


\textsuperscript{30} 3A COLLIER ON BANKRUPTCY ¶ 63.29 note 11; MACLACHLAN ON BANKRUPTCY § 113 (1956) [hereinafter cited as MACLACHLAN]. There is only one other category which might make a tort claim provable: § 63a(8), which makes "contingent debts" provable. Bankruptcy Act § 63a(8), 11 U.S.C. § 103(a)(8) (1970). The courts have not adopted this view, though, and "have uniformly limited section 63a(8) to debts originating from contract." D. EPSTEIN, DEBTOR-CREDITOR RELATIONS 250 (1973); Resolute Ins. Co. v. Underwood, 230 So.2d 433 (La. App. 1969). See In re Hutchcraft, 247 F. 187 (E.D. Ky. 1917).

\textsuperscript{31} MACLACHLAN, supra note 30, at § 138.

\textsuperscript{32} In re Coutee, 460 F.2d 1201 (5th Cir. 1972).
Once a claim is deemed provable, the claimant must file a proof of claim in accordance with the procedures set out in section 57. The difference between a provable claim and a proof of claim is that the former refers to the nature of the claim while the latter refers to the procedure for participating in the bankruptcy distribution. These procedures do not raise any particular difficulties with respect to tort claims and will not be examined here.

Although a claim is provable and proper proof of claim has been filed, it cannot share in the distribution unless it has been “allowed.” Section 57d provides that claims having been proved and presented to the court “shall be allowed,” unless some objection is raised. There is an important proviso, however, in section 57d: any unliquidated or contingent claim will not be allowed unless the claim can be liquidated or the amount estimated within a period that would not “unduly delay” administration of the estate. Liquidation may take place in a state court, in a federal court in an appropriate case, or in the bankruptcy court. If an unliquidated or contingent claim has been proved but is disallowed under section 57d, section 63d deems it nonprovable even though it would have fit into one of the categories in section 63a.

The discharge of the debtor in bankruptcy releases him from all provable debts, except those that are made expressly nondischargeable by the Bankruptcy Act. Thus, the tort creditor permitted to share with the commercial creditors in the distribution of the debtor’s assets is faced with the quid pro quo of having his claim extinguished, probably in return for a tiny percentage of its actual value if he receives anything at all. In contrast, holders of nonprovable claims, including those disallowed under section 57 and made nonprovable by section 67d may not participate in

---

34 Bankruptcy Rule 306(b).
35 Inclusion in the Bankruptcy Act of provisions for the liquidation of claims, including those of tortious origin, does not make tort claims provable in bankruptcy. Schall v. Camors, 251 U.S. 239 (1920); Brown & Adams v. United Button, 149 F. 48 (3d Cir. 1906).
37 “Where any contingent or unliquidated claim has been proved, but, as provided in subsection d of section 57 of this Act, has not been allowed, such claim shall not be deemed provable under this Act.” Bankruptcy Act § 63d, 11 U.S.C. § 103(d) (1970). See note 34 supra. Allowance is not a condition precedent to proof. Haynes Stellite Co. v. Chesterfield, 97 F.2d 985 (6th Cir. 1938). The claim is proved and then, failing liquidation, it is made nonprovable. In re Hornstein, 122 F. 266 (N.D.N.Y. 1903); St. Paul - Mercury Indemnity Co. v. Dale, 20 S.D. 137, 15 N.W.2d 577 (1944).
38 An individual is automatically discharged following his or her adjudication in bankruptcy. There is no formal application procedure. Bankruptcy Rule 404. Unless the bankrupt waives discharge, the discharge is gained after the expiration of the time fixed for filing an objection to discharge. Id.
40 See MACLACHLAN, supra note 30, at § 138.
the distribution, but they are not affected by the discharge and may later collect their claims.

As an additional measure of protection for some classes of creditors, section 17a enumerates claims that are excepted from discharge and therefore remain enforceable against the debtor after completion of the proceedings. The classes of provable debts and nondischargeable debts are not mutually exclusive. Neither nonprovability of the claim nor participation in the bankruptcy distribution bars the claimant from later asserting nondischargeability if the claim is covered by one of the exceptions in section 17a.

The cumulative effect of several provisions of section 17a is to except from discharge almost all provable intentional tort claims. Section 17a(2)...

---

41 A contrary case would seem to be In re Nething, 137 N.Y.S.2d 96 (Sup. Ct. 1954). In an earlier bankruptcy proceeding the bankruptcy court held that a release given by a person with whom the bankrupt was alleged to have been a joint-tortfeasor served also to release the bankrupt. In a subsequent proceeding the claimants sought reform of the release. The court held that it was bound by the bankruptcy court's determination: "the claims, although not allowable while the original release was in effect, were at the same time provable claims within the meaning of the Bankruptcy Act," and were therefore discharged by the previous adjudication. Id. at 97. See Shapiro v. Lubasch, 58 N.Y.S.2d 695, 186 Misc. 182 (1945). Nething would appear to be in conflict with Kuehner v. Irving Trust Co., 299 U.S. 445 (1936), which held that a discharge does not release a claim which was not provable because it was uncertain and hence not allowable. See also Lesser v. Gray, 236 U.S. 70 (1914). The apparent conflict may be resolved by considering Hagardine-McKittrick Goods Co. v. Hudson, 122 F. 232 (8th Cir. 1903), where the court states that an otherwise provable debt which is disallowed becomes dischargeable only if it has been disallowed because of a valid defense (a "plea at bar") to the claim, rather than because of a mere contingency or difficulty in liquidation. That is to say, a provable disallowed claim is discharged if it is disallowed for reasons other than those set out in § 57d. See Bankruptcy Act § 63d, 11 U.S.C. § 103(d) (1970).

42 The language of § 17a implies that, in order to be excepted from discharge, the liabilities must be provable: "A discharge in bankruptcy shall release a bankrupt from all his provable debts." Bankruptcy Act § 17a, 11 U.S.C. § 35(a) (1970) (emphasis added). However, the creditor need not prove his claim before asserting nondischargeability. In re Warnack, 239 F. 779 (W.D. Tenn. 1917). Conversely, if the claim is not provable, it would fit within the statutory language and judicial interpretation which directs that nonprovable debts, including those which are nonprovable as a result of being disallowed, are not discharged and survive. See note 41 and accompanying text supra.


44 See DeRoberts v. Crimmins, 406 F. Supp. 282 (S.D.N.Y. 1975); Goldsmith v. Overseas Scientific Corp., 188 F. Supp. 530 (S.D.N.Y. 1960); Indemnity Insurance Co. v. Covington, 14 N.Y.S.2d 683 (N.Y. Sup. Ct. 1939). In Crimmins the court reasoned that "although the lists in Sections 17a and 63a were intended to be mutually exclusive, the latter listing the types of claims that are dischargeable, and the former listing the types that are not, the wording of Section 17a makes it clearly dominant: even if one of the types of claims listed in Section 17a may be a 'provable debt' it is nevertheless exempt from discharge." DeRoberts v. Crimmins, 406 F. Supp. at 285.

45 See Friend v. Talcott, 228 U.S. 27 (1913). The Supreme Court explained the relationship between §§ 17a and 63a in the following manner:

"It is apparent that the exemptions do not rest upon any theory of the exclusion of the creditor for the bankruptcy act, or of deprivation of right to participate in the distribution, but solely on the ground that, although such rights are enjoyed, an exemption from the effect of the discharge is superadded. The text leaves no room for any other view, since the exceptions in terms are accorded to certain classes of debts which are provable under § 63, and therefore debts which are entitled to participate in the distribution . . . ."

Id. at 39.
excepts from discharge provable claims for money or property obtained by false representations, including false statements made in a credit application; it also excepts provable claims based on "willful and malicious conversion of...property." This second half of section 17a(2) closely parallels section 17a(8), which excepts provable claims for willful and malicious injuries to person or property. Most courts have interpreted "willful and malicious" to mean merely intentional, thus giving these two subsections coextensive application to almost all provable intentional tort claims. These exceptions may be narrowly construed though because they are in derogation of the debtor's remedy. In conformity with this view, at least one court has interpreted section 17c as requiring that the right to an exception be proved by a preponderance of the evidence.

Section 64a of the present Act sets out certain categories of claims which are to be paid before any other claims. As a consequence, these priority claims receive a considerably higher percentage of the face amount of the liabilities than general claims. These claims, in order of payment, are administrative expenses, wages not exceeding $600 and earned within three months, certain expenses claimed in connection with obtaining conviction of a bankrupt or revocation of an earlier discharge, taxes, and debts given priority by the laws of the United States or given priority by a State law applying to rental claims. The only category which may apply to a tort victim is administrative expenses. Judgment for a tort committed by the trustee or his representative in the process of

---

47 Bankruptcy Act § 17a(8), 11 U.S.C. § 35(a)(8) (1970). Clause (8) was, in fact, part of clause (2) prior to the amendment in 1970 of § 17a by Public Law 91-467, § 6. Until that amendment, clause (2) contained no reference to conversion of the property of another.


49 Tinker v. Colwell, 193 U.S. 473 (1904). This has been extended to "wanton and reckless" negligence, id; United States v. Reed, 86 F. 308 (2d Cir. 1898); In re Dutkiewicz, 27 F.2d 334 (W.D.N.Y. 1928); McClure v. Steele, 326 Mich. 286, 40 N.W.2d 153 (1949).

50 IA COLLIER ON BANKRUPTCY § 17.17. See notes 185-88 and accompanying text infra for a discussion of the fresh start concept.

51 Bankruptcy Act § 17c, 11 U.S.C. § 35c (1970); DeRoberts v. Crimmins, 406 F. Supp. 282 (S.D.N.Y. 1975). Section 17c(2) established the procedure for a claimant seeking dischargeability. The procedures for the exemptions in clauses 17a(2) and (8) as well as for clause (4), are different than those for the other exemptions. A debt within clause (2) will be discharged unless formal proof is made within a period of time prescribed by the court, but no application need be filed for a debt excepted by clause (8) if a right to trial by jury exists and any party to a pending action on such debt has timely demanded a trial by jury or if either the bankrupt or a creditor submits a signed statement of an intention to do so.

Bankruptcy Act § 17c, 11 U.S.C. § 35(c) (1970). See Bankruptcy Rule 409(a)(2). Otherwise, a claimant under clause (8) must also file an application. Id.


53 In the fiscal years beginning in 1965 and ending in 1969, the average return to a priority creditor in an asset case was 35.5 percent of the claim while the return to the general creditor was only 7 percent. In 1974 and 1975, the last years for which figures are available the return to priority creditors was, respectively 35 percent and 29.6 percent; for general creditors it was 4.1 percent and 6.5 percent. ADMINISTRATIVE TABLES, supra note 1.

operating the debtor's business or maintaining the debtor's property during the administration of the case constitute administrative expenses.

Fully secured creditors are given a form of overriding priority in the sense that their collateral is not subject to the claims of the other creditors in bankruptcy, although they must participate as general creditors to the extent their claims exceed the value of the security. Nondischarge is another form of quasi-priority.

2. The Proposed Act—The drafters of the proposed Act have been unanimous in their rejection of the present Act's Byzantine structure for satisfying claims against the estate. H.R. 8200 and S. 2266, the current versions of the proposed Acts and the ones most likely to control in this area, define "claim" very broadly, 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." The Committee Report for the House bill describes this definition as an explicit rejection of the concept of provability used in the present Act.

---

55 See Bankruptcy Act § 2a(5), 11 U.S.C. 11(a)(5)(1970); Bankruptcy Rules 201(a) and 216.
56 Reading v. Brown, 391 U.S. 471 (1968). The cost of insuring against tort claims arising during administration is also deductible. Id.

The irony of this form of priority was noted by Professor Schuchman:

Those creditors with the economic leverage to obtain collateral by means of some legally effective security device are, on the whole, not subject to the drastic adjustments of their debts which befall unsecured creditors. As a result, the discharge of personal liability is usually of less significance to larger creditors and others able to obtain collateral which can be reclaimed from the bankrupt estate and privately liquidated to pay the debt .... It seems an unlikely contention that secured creditors get far greater rights and hence receive more money from bankrupt estates because they are more deserving or because their debts are more worthy.


58 H.R. 8200 § 101(4)(A), S. 2266 § 101(4)(A). The predecessor of the House bill, H.R. 6, contained the same language except the adjective "undisputed." This word was added in the mark-up of the Bill and gives even greater emphasis to the comprehensive nature of the definition. Note too that, unlike the present Act, the proposed Acts do not restrict their definition of "claim" to monetary obligations: "claim" also includes a "right to an equitable remedy for breach of performance if such breach does not give rise to a right to payment, whether or not such right is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured."

59 H.R. REP. No. 595, 95th Cong., 1st Sess. 180 (1977). The authors of the report give the following rather terse explanation for using this definition:

Under the liquidation chapters of the Bankruptcy Act, certain creditors are not permitted to share in the estate because of the nonprovable nature of their claims, and the debtor is not discharged for those claims. Thus, the relief for the debtor is incomplete, and those creditors are not given an opportunity to collect in the case on their claims. The proposed law will permit a complete settlement of the affairs of the bankrupt debtor, and a complete discharge and fresh start.

Id. The original proposal for reform of the bankruptcy laws was prepared by the Commission on the Bankruptcy Laws of the United States, created by Public Law 91-354. This group of bankruptcy experts also rejected the concept of provability. Although it is considerably less specific, their definition of "claim" was intended to be equally broad as that in
Section 502 allows all claims for which proofs of claim have been filed by the creditors\(^{60}\) or, in some cases, by the debtor,\(^{61}\) the trustee,\(^{62}\) or other interested parties.\(^{63}\) As under the present Bankruptcy Rule 306, allowance is conditioned on the failure of a "party in interest"\(^{64}\) to object\(^{65}\) on the basis of certain exceptions,\(^{66}\) but none of these exceptions applies to tort claims.\(^{67}\) Section 502(c) makes it clear that claims that are unliquidated may still be allowable. Unlike the current proviso to section 57d, which disallows certain unliquidated and contingent claims, section 502(c) of the proposed Act requires that such claims be "estimated."\(^{68}\) Nothing in the Act itself indicates how the claims are to be "estimated," but the House Committee Report suggests that this is one of the "matters that will be dealt with by the Rules of Bankruptcy Procedure or by local rules of the Court."\(^{69}\) Consequently, the difficult problem of how disputed, unliquidated tort claims are to be reduced to a dollar amount remains unresolved. Nevertheless, the thrust of the new Act is to make all claims allowable by having the court estimate their proper amount where the claims are not subject to prompt liquidation.

Although there is no definitional section for "discharge," the term is used in the proposed Act\(^{70}\) and its effect is described in section 524. That section voids all judgments representing liabilities for claims arising before commencement of the bankruptcy proceedings (unless, of course, it

---

\(^{60}\) Section 501(a) established a creditor's right to file a claim.

\(^{61}\) After the passage of the proposed Act, "bankrupts" will no longer exist. The "bankrupt" has been rechristened the "debtor." H.R. 8200 § 101(12), S. 2266 § 101(13).

\(^{62}\) The debtor and the trustee receive their authority to file proofs of claims from § 501(c): "In a case under chapter 7 or 13 of this title, if a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim."

\(^{63}\) Section 501(b) provides, "[i]f a creditor does not timely file a proof of such creditor's claim, an entity that is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim with the court."

\(^{64}\) "Party in interest" is not defined in the bills, but a negative definition might be inferred from the definition of a "disinterested person" in H.R. 8200 § 101(13) and S. 2266 § 101(14), both of which provide for only very limited exceptions.

\(^{65}\) H.R. 8200 § 502(a) provides, “[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest objects." S. 2266 also gives a right to object to "a creditor of a partner in a partnership that is a debtor under Chapter 7” in the same section.

\(^{66}\) Section 502(b).

\(^{67}\) See § 502(b)(1)-(9).

\(^{68}\) Section 502(c) provides: "Any contingent or unliquidated claim, liquidation of which would unduly delay the closing of the case, or any claim for which applicable law provides only an equitable remedy, shall be estimated for the purpose of allowance under this section." See H.R REP. No. 595, 95th Cong, 1st Sess. 354 (1977).


\(^{70}\) See §§ 523, 727. The Act proposed by the bankruptcy commission did include such a definition. H.R. Doc. No. 137, Part II, 93d Cong, 1st Sess. 2 (1973).
arises out of a liability excepted from discharge)\textsuperscript{71} and enjoins actions against the debtor for the collection of such debts.\textsuperscript{72} In a proceeding in straight bankruptcy, or liquidation as it is called in the proposed Act,\textsuperscript{73} the discharge relieves the debtor from all unexcepted debts arising before the order for relief.\textsuperscript{74} As in the current Act, such debts are not excepted from discharge merely because no proof of claim was filed or the claim was disallowed.\textsuperscript{75} The debts are excepted, though, if they fall within the categories of debts excepted from discharge by paragraphs (2), (4), or (6) of section 523(a)\textsuperscript{76} and were not listed by the debtor in his schedule of assets and liabilities as required by section 521(1) "in time to permit... timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless [the] creditor had notice or actual knowledge of the case in time for such timely filing and request."

The exceptions to discharge enumerated in section 523 closely follow those set out in section 17 of the present Act.\textsuperscript{78} In recognition of the irrelevance of an exception to the discharge of a corporation,\textsuperscript{79} section 523 applies only to individual debtors, in contrast to present section 17a which applies to all "bankrupts." Also, because the concept of provability has been abandoned, the restriction of the discharge to "provable debts" has been eliminated.

Section 523(a)(2) excepts from discharge claims based on false pretenses in nearly the same circumstances as section 17a(2) of the present Act, although it adds significant qualifications. Section 523(a)(4), corresponding to section 17a(4) of the present Act, excepts from discharge claims "for embezzlement or larceny."\textsuperscript{80} Section 17a(4) is considerably more elaborate, covering liabilities "created by [the debtor's] fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." The exception for claims based on "fraud" has been moved to section 523(a)(2) and the limiting phrase "while acting as an officer or in any fiduciary capacity" has been eliminated because of its uncertain scope.\textsuperscript{81} The terms "misappropriation" and "defalcation"

\textsuperscript{71} Section 524(a)(1).
\textsuperscript{72} Section 524(a)(2).
\textsuperscript{73} The general provisions of chapters 1, 3 and 5 of the proposed act are made applicable to proceedings in liquidation by section 103.
\textsuperscript{74} Id.
\textsuperscript{75} Id.
\textsuperscript{76} Such debts may include tort claims. For a detailed discussion of paragraphs 523 (a)(2), (4), and (6), see notes 78-89 and accompanying text infra.
\textsuperscript{77} Section 523(a)(3)(B).
\textsuperscript{79} See text accompanying footnotes 182-84 infra.
\textsuperscript{80} The official comments to § 4-506(a)(5) of the Act proposed by the Commission on Bankruptcy, which is identical to proposed § 523(a)(4), state that "[t]he standard of 'fraud' is moved to a more appropriate location in clause (2)." Clause (2) is similar to § 523(a)(2). H.R. Doc. No. 137, Part II, 93d Cong., 1st Sess. 139 (1973).
have been discarded as "overbroad and uncertain in meaning,"\(^82\) and "larceny" was substituted because it is amenable to precise definition.\(^83\)

The Committee Report accompanying H.R. 8200 states that section 523 was intended to include liability for conversion where the debtor intends to borrow property for a short period of time with no intent to inflict injury but does in fact inflict injury.\(^84\)

Section 523(a)(6),\(^85\) the counterpart to section 17a(8) of the present Act, excepts from discharge any debt for "willful and malicious injury by the debtor to another person or to the property of another person."\(^86\) The Committee Report on H.R. 8200 raises doubts whether the drafters intended to include section 17a(2) claims for willful conversion in section 523(a)(6) or in section 523(a)(4). In any event, such claims are clearly excepted from the discharge and the present interpretation of "willful and malicious" as meaning deliberate or intentional is intended to be continued under the proposed Act.\(^87\)

Debts otherwise excepted from discharge by paragraph (2), (4), or (6) of section 523(a) are discharged unless the creditor holding such a claim requests a hearing after notice by the court.\(^88\) The only exception to this rule is where the debtor fails to list the tort claim in his schedule of liabilities under section 521.\(^89\)

The proposed Act continues the present pattern of priority, but increases the number of categories of claims from five to six.\(^90\) After the satisfaction of all secured claims, administrative expenses retain first priority, and include certain expenses that are now accorded third priority. Where the petition against the debtor is involuntary, claims arising in the ordinary course of business before appointment of a trustee or issuance of an order for relief are given second priority. Wages are still given priority and the allowable amount is increased to $1,800; claims for contributions to employee benefit plans are given priority; taxes are granted priority in most cases; and there is a new priority granted to deposits made in connection with the purchase or rental of consumer goods by an individual creditor.\(^91\) Again, tort claims are given no explicit recognition.

---


\(^{87}\) H.R. REP. No. 595, 95th Cong., 1st Sess. 365 (1977). "To the extent that Tinker v. Colwell, 139 U.S. 473 (1902), held that a looser standard is intended, and to the extent that other cases have relied on Tinker to apply a 'reckless disregard' standard, they are overruled." Id. See note 49 supra.

\(^{88}\) Section 523(c). In such a hearing, the court must determine whether the debt is indeed excepted from discharge by paragraph (2), (4), or (6). Id.

\(^{89}\) See also § 523(a)(3)(B).

\(^{90}\) Section 507. This section is specifically made applicable to reorganizations (§ 1123(a)(1)) and wage earners' plans (§ 1322(a)(2)).

\(^{91}\) Section 507.
B. Reorganization and Arrangements

1. Reorganization under the Present Act—Chapter X of the present Act provides for the reorganization of corporate debtors. Far fewer cases arise under reorganization than under straight bankruptcy. A chapter X case may be initiated by the debtor, by three or more creditors with liquidated, non-contingent claims aggregating at least $5,000, or by an indenture trustee. Once the reorganization procedure begins, a trustee is appointed by the bankruptcy court. The trustee has a duty to prepare and file a plan of reorganization and, if requested by the court, to conduct an investigation of the corporation’s financial affairs. The plan may affect the interests of general creditors, as well as of stockholders and secured creditors. The ability of the plan to affect the rights of secured creditors may be only “nominal” as a result of the requirement that the plan be accepted by “creditors holding two-thirds in amount of the claims filed and allowed of each class.” In addition to receiving creditor acceptance, the plan must also be confirmed by the court. To confirm, the court must conclude inter alia that the plan is “fair and equitable,” which has been construed to mean that each class of claims must be paid in full before a claim of a lesser class is compensated. These plans are seldom successful.

Section 102 makes the straight bankruptcy provisions found in Chapters I to VII applicable to proceedings in reorganization “insofar as they are...”

---

92 “Arrangement” is technically an anachronism. It does not appear in the present Bankruptcy Rules.
96 Bankruptcy Act § 156, 11 U.S.C. § 556 (1970). If the indebtedness is less than $250,000 the appointment is a matter of discretion. Id.
99 MACLACHLAN, supra note 30, at 374.
103 Only about one-quarter of the period from fiscal year 1964 to fiscal year 1968 were successful. BROOKINGS, supra note 4, at 145. See ADMINISTRATIVE TABLES, supra note 1, at Table F4b.
not inconsistent or in conflict with the provisions of [Chapter X].”107 One major departure from straight bankruptcy procedure is the definition in section 106(1)108 of “claims” for the purposes of reorganization. That section explicitly rejects the concept of provability established in section 63 and allows all claims, “whether secured or unsecured, liquidated or unliquidated, fixed or contingent.”109 The broad admissibility of claims in reorganization is extended still further in section 201, which provides that claims need only arise before the qualification of a receiver or trustee to be provable. Tort claims of all types arising before the qualification of the receiver or trustee are thus provable against the estate in reorganization.

There are no exceptions to discharge in reorganization, and all creditors are bound by the disposition of property under the plan, regardless of whether they filed proofs of their claims or whether their claims were scheduled or allowable.110 Provision may be made, however, in the plan or in the order confirming the plan for the exception of particular claims from the discharge.111

The marked differences between the allowability and provability provisions under reorganization and those under straight bankruptcy are due to the different purposes behind the two procedures. Unlike straight bankruptcy, which has as its goal the “expeditious liquidation and distribution of the debtor’s assets,”112 the goal of reorganization is “preservation of going concern values and the rehabilitation of the debtor or the transfer of its property to a successor to carry on the business.”113 In order to accomplish its goals, the straight bankruptcy process omits certain claims that are not capable of prompt liquidation, while the reorganization process makes all debts provable.

2. Arrangements114 under the Present Act—Section 306(1) of Chapter XI states that “‘arrangement’ shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms.”115 The arrangement can be an extension,
in which debts owed by the debtor are paid later than originally agreed; a composition, in which creditors receive less than the full amount of their claims; or a combination of the two, in which different classes of creditors may be affected differently.\textsuperscript{116}

Where the arrangement provides that creditors receive less than the full amount of their claims, the rules in straight bankruptcy governing provability and allowability apply.\textsuperscript{117} In contrast, an arrangement that only extends the time of payment but still provides for full payment covers all unsecured claims, regardless of their provability under section 63 or their allowability under section 57d.\textsuperscript{118}

An arrangement will be confirmed by the court if it has been accepted by a majority in number and amount of the creditors whose claims have been proved and are affected by the arrangement.\textsuperscript{119} The debtor is discharged from unsecured debts covered by the arrangement with the important exception of the debts enumerated in section 17, as well as those debts excepted or not affected by the plan.\textsuperscript{120}

3. The Proposed Act—H.R. 8200 and S. 2266 continue the general pattern of the present reorganization provisions of Chapter X.\textsuperscript{121} Instead of being an alternative to liquidation, though, reorganization is the only course open to a corporation that seeks a discharge.\textsuperscript{122} The proposed Act authorizes the court to accept a plan only if all claimants accept the plan or will be compensated in an amount equal to or greater than the amount they would have obtained in a liquidation of the debtor.\textsuperscript{123} Moreover, each class of claimants must accept the plan unless its claims or interests are unimpaired under the plan.\textsuperscript{124} Acceptance of a plan by a class is deemed to have occurred if holders of claims aggregating at least two-thirds in dollar amount and one-half in number of allowed claims have accepted the plan.\textsuperscript{125} If the plan is not accepted by each class of claimants

\textsuperscript{117} This includes the definition of “creditor” and “debts” in subsections 1(11) and (14). Bankruptcy Act §§ 1(11), (14); 11 U.S.C. §§ 1(11), (14) (1970). See 1 COLLIER ON BANKRUPTCY § 2.22. These provisions are made applicable by § 302. Bankruptcy Act § 302, 11 U.S.C. § 702 (1970).


\textsuperscript{119} Bankruptcy Act § 362(1), 11 U.S.C. § 762(1) (1970). If the creditors have been divided into classes, there must be a majority in each of the classes so divided.


\textsuperscript{121} Chapter 11 of the proposed Acts is designated simply as “Reorganization” and incorporates aspects of present Chapters IX, X, XI and XII.

\textsuperscript{122} Section 727(a) states that “[t]he court shall grant the debtor a discharge unless—(1) the debtor is not an individual.”

\textsuperscript{123} H.R. 8200 § 1129(a)(7); S. 2266 § 1130(a)(8).

\textsuperscript{124} Section 1129(a)(8). Section 1124 defines “claims or interests unimpaired under a plan.”

\textsuperscript{125} Section 1126(c). Where a “class of interests” is involved, the requirement that the interests aggregated one-half in number is eliminated under § 1126(d). See § 1122, which describes the classification of claims or interests. Under § 1126(g), “[a] class is deemed to
whose claims or interests are impaired by the plan, it still may be approved if two requirements are met. First, no unsecured claimant may receive compensation in an amount greater than the allowed amount of the claim. Second, either creditor may receive compensation in an amount less than the allowed amount of the claim unless he has agreed to different treatment, or the plan must conform to what is approximately the old "absolute priority" rule that

the plan does not discriminate unfairly against such class, and
the holders of claims or interests of any class of claims or
interests, as the case may be, that is junior to such class will not
receive or retain under the plan on account of such junior claims
or interests any property.

Section 103 applies the provisions eliminating provability and requiring estimation of disputed or unliquidated claims in the liquidation chapters to Chapter 11 cases. Section 1141(a) provides that the plan will bind all creditors regardless of whether their claims have been impaired or whether they have accepted the plan. The section is expressly modified, however, by paragraph (d)(2), which excepts from discharge the claims listed in section 523.

C. Wage Earner Plans

1. The Present Act—Chapter XIII of the present Act provides for plans in the nature of arrangements for individual debtors whose principal income is derived from wages, salary, or commissions. A wage earner plan may deal with debts secured by personal property as well as unsecured debts, and may establish a priority of payment between these two classes of debts if the plan involves an extension. Future wages must be submitted to the court's control for the duration of the plan.
The wage earner plan must be accepted both by a majority in number and dollar amount of the affected unsecured creditors holding claims that are provable and allowable, and by all secured creditors whose claims are affected.\textsuperscript{137} The plan must also be approved by the court.\textsuperscript{138}

This Chapter incorporates by reference all provisions of Chapters I-VII that are not inconsistent with it.\textsuperscript{134} This incorporation, however, does not extend to the definition of "claims" used in straight bankruptcy. In addition, the concept of provability as it is used in section 63 is expressly eliminated, and contingent and unliquidated claims may be proved.\textsuperscript{140}

Discharge occurs upon one of two events: First, the debtor may successfully comply with all provisions of the plan.\textsuperscript{141} Alternatively, if after three years the debtor has not completed all payments under the plan, he may apply for a determination by the court that this failure was due to circumstances beyond his control.\textsuperscript{142} The discharge only affects debts provided for by the plan and does not affect debts excepted from discharge under section 17 unless the creditor holding the excepted claim accepted the plan.\textsuperscript{143} If the debtor fails to make the payments required under the plan and the court finds that the failure was not beyond the debtor's control, the creditors retain their claims for the unpaid amount of the original debt, regardless of whether they accepted the plan.\textsuperscript{144}

2. The Proposed Act—An individual\textsuperscript{145} may resort to Chapter 13 of the proposed Acts only if he has a "regular income"\textsuperscript{146} and owes at a date of filing less than $100,000 ($50,000 in the Senate Bill) in "noncontingent, liquidated, unsecured debts" and less than $500,000 ($200,000 in the Senate bill) in "noncontingent, liquidated, secured debts."\textsuperscript{147} The reference to "noncontingent, liquidated ... debts" apparently only limits the

\textsuperscript{138} The court must approve the plan if it finds that the following conditions have been met:
\begin{enumerate}
\item The provisions of this chapter have been complied with;
\item it is for the best interest of the creditors and is feasible;
\item the debtor has not been guilty of any of the acts of failed to perform any of the duties which would be a bar to the discharge of the bankrupt; and
\item the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or actions forbidden by this act.
\end{enumerate}
\textsuperscript{140} Bankruptcy Act § 606(1), 11 U.S.C. § 1006(1) (1970) defines "claims" to include those uncertain in amount or liability. There is no distinction between plans by way of settlement and plans by way of satisfaction in defining provability under Chapter XIII. 10 COLLIER ON BANKRUPTCY ¶ 22.02 n.7. If the plan is subsequently converted into a straight bankruptcy proceeding, § 63 applies. Bankruptcy Act § 643, 11 U.S.C. § 1043 (1970).
\textsuperscript{144} 10 COLLIER ON BANKRUPTCY ¶ 29.10.
\textsuperscript{145} All other entities are excluded. H.R. 8200 § 109(e); S. 2266 § 109(d).
\textsuperscript{146} Regular income is defined as income which is "sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title." H.R. 8200 § 101(23); S. 2266 § 101(24).
\textsuperscript{147} H.R. 8200 § 109(e); S. 2266 § 109(d). Spouses may file as a single unit provided one spouse is not a stock or commodity broker. For joint husband and wife filings the maximum amounts of permissible claims continue to apply as if they were a single individual. Id.
debts that may be considered in the qualification of the debtor for participation in a Chapter 13 plan, and does not affect the provability or allowability of the debts. The all-inclusive definition of claims in section 101 applies in all chapters unless there is a specific exclusion. There appear to be no such exclusions in Chapter 13, for it refers to the plan as involving all claims without any reference to their possibly unliquidated or contingent nature.

The plan must provide for control by a trustee of an amount of the debtor's income sufficient for successful execution of the plan and payment of claims entitled to priority under the liquidation sections. Unsecured claims may be divided into classes based on substantial similarity or on amount, but each claim within a particular class must be accorded the same treatment and there may not be unfair discrimination against any class. The rights of both secured and unsecured claimants may be modified.

There is no longer a requirement that the unsecured creditors approve the plan, although the value of the property to be distributed to each of them must not be less than the amount each would have received under a liquidation. Approval by each of the secured creditors is no longer necessary to confirmation of the plan, though it remains sufficient; other sufficient conditions are surrender by the debtor to each secured party of the property securing the claim or full satisfaction of each secured claim.

After the debtor completes all payments required by a confirmed plan, the debtor is discharged of all debts provided for by the plan or disallowed. Excepted from the discharged debts are liabilities for willful and malicious injury to another "entity" or to the property of another. If the debtor fails to complete the required payments, a discharge may still be granted if the court finds that the failure was a result of "circumstances for which the debtor should not justly be held accountable." This provision for discharge without full payment differs from that of the present Act because it does not require that three years elapse

---

148 Although the provisions in Chapter 13 of both the Senate and House bills cannot apply to any other proceedings, § 103(h), Chapters 1, 3, and 5 apply to proceedings under Chapter 13. § 103(a).
149 Section 1322(a).
150 Section 1322.
151 Section 1322(b)(2). The Senate Bill prohibits modification of "claims wholly secured by mortgages on real property." S. 2266 § 1322(b)(2).
152 Section 1325(a)(4). Those creditors who do not accept the plan are nevertheless bound. § 1327(a).
153 Section 1325(a)(5)(A).
154 Section 1325(a)(5)(B), (C).
155 Section 1328(a).
156 As in the case of a liquidation, disallowance cannot occur merely because of the unliquidated character of the claim and is permitted only in specific situations not related to an otherwise enforceable tort claim. Sections 502, 1328.
157 Entity is defined to include any "person, estate, trust, governmental unit, and United States trustee." H.R. 8200 § 101(14); S. 2266 § 101(15).
158 Section 1328(a)(2).
159 Section 1328(b)(1).
between confirmation of the plan and discharge. The new Act does require, however, that prior to discharge without full payment each unsecured creditor must receive payment equal to the amount he would have under a Chapter 7 liquidation and that the court must find modification of the plan to be impracticable. In the event that discharge without full payment is granted, the entire array of claims excepted from discharge under a Chapter 7 liquidation is also excepted.

II. Discussion

A. Provability

The most significant step taken in the area of tort claims by the drafters of the proposed Act has been to assure the provability of all tort claims. In assessing the effect of this change, it is important to note that the conflicting interests on the provability issue are held by the commercial creditors and the tort claimants, while on the dischargeability issue the primary conflict is between the tort claimants and the debtor. By making a new class of claims provable, and therefore eligible to share in the distributions, Congress will effectively decrease the pool of assets available for the unsecured commercial claimants. On the other hand, by making a claim nondischargeable the measure of the debtor's relief is lessened. This distinction must be modified by noting that the present system links provability with dischargeability, so that nonprovable claims automatically become nondischargeable. Also, to the extent that a claim is nondischargeable, the debtor wants the claimant to share in the distribution so that the undischarged portion of the claim will be at the expense of the other claimants.

The proposed provision reverses the present view that, with the exception of few specific tort claims, all tort claims are nonprovable. As was

---

160 See note 142 and accompanying text supra.
161 Section 1328(b)(2).
162 Section 1382(b)(3); but see § 1329.
163 Section 1328(c), § 523(a).
165 The present rules allow a debtor in bankruptcy to file a nondischargeable but provable claim for wages or taxes to allow its diminution before the discharge. Bankruptcy Rule 303. The drafters of the Rules stated their purpose in so doing as follows:

It is the policy of the Act that debtor's estates should be administered for the benefit of creditors without respect to the dischargeability of their claims. After their estates have been closed, however, discharged bankrupts may find themselves saddled with liabilities... which remain unpaid because of the failure of creditors holding nondischargeable claims to file proofs of claims and receive distributions thereon. The result is that the bankrupt is deprived of an important benefit of the Act without any fault or omission on his part and without any objective of the Act being served thereby.

Bankruptcy Rule 303, Advisory Committee's Note. The rules allow the debtor or the trustee to do this for all claims in a case in reorganization, relying upon the same rationale. Bankruptcy Rule 13-303.
suggested earlier, one reason for this approach is historical: traditionally, bankruptcy has been viewed as concerned only with claims *ex contractu*, not *ex lege* or *ex delicto*. There has been a steady movement away from this conception of bankruptcy, though, and the traditional perspective should have little force in this area. Moreover, in many cases a tort claim is essentially a cost of doing business and is thus indistinguishable in theory from commercial claims. This similarity is especially true with regard to quasi-contractual claims under the present scheme; the admission of such claims is necessary to any distribution scheme for purely commercial claims, but their admission makes it difficult to rationally explain the exclusion of simple tort claims from participation.

Certain practical reasons also require that tort claims be given greater recognition than they receive under the present Act. The relationship that gives rise to a tort is often involuntary, whereas a contractual relationship is by its nature voluntary. In contrast to the tort claimant, who in most cases has no previous contract with the tortfeasor, the commercial claimant generally has the opportunity to assess the likelihood that the debtor will resort to liquidation procedures. Thus, the contractual claimant is ordinarily better able to demand security, to obtain insurance or to demand that the debtor obtain insurance. Also, an uncompensated tort victim bears an extremely heavy burden in many cases, especially where personal injuries are involved. Finally, eliminating the concept of provability will ameliorate the complexity of the present system. The resulting simplified system should permit easier and less costly access to the process for both the debtor and the claimant.

One argument against the new Act's approach is that allowing tort claims not provable under the present Act will introduce disputed and

---

166 See notes 70-88 and accompanying text *supra*.
170 *MacLachlan, supra* note 30, at § 113.
173 *See note 195 infra.*
174 The National Bankruptcy Commission recognized that the present scheme has become "encrusted with qualifications and exceptions and provisos over the years, until it is intolerably complicated and is unjust." *Report of the Commission on the Bankruptcy Laws of the United States* 33 (CCH ed. 1973). [Hereinafter cited as *Bankruptcy Commission*]. In revising the present Act, the Commission recognized that "the process should be intellectually accessible. The substantive laws, procedural rules, and administrative practices should be simplified and clarified to permit broader debtor, creditor, and
unliquidated claims into the bankruptcy process, causing unnecessary delay to commercial claimants. The possible delay caused by liquidating or estimating some tort claims should not cause a blanket exclusion of all tort claims, however. Moreover, for those claims that would cause an undue delay, it is undoubtedly more equitable to have the bankruptcy court estimate it for inclusion in the distribution, as the proposed act specifies, than to exclude the claim entirely from distribution. Another objection to proof of tort claims is that the debtor should be punished by being forced to pay damages, not the creditors. The reply to this argument is that most tort awards are compensatory, not punitive.

A third argument against the liberal provability of tort claims pertains to the debtor's duty to list all potential claimants. A listing of all potential tort claims may cause the filing of claims that would otherwise be allowed to lapse. It is feared that the debtor's act of listing the claim may constitute an admission of liability. This reasoning, however, applies equally to commercial claims. Keeping tort claims from being proved unless and until sued upon unjustifiably deters the filing of petitions in bankruptcy by tortfeasors until a suit is filed.

B. Dischargeability

The issue of whether tort claims ought to be dischargeable is closely related to the issue of whether they ought to be provable. Indeed, under the present system a nonprovable claim is nondischargeable. Consequently, leaving tort claims nonprovable may appear to be the best alternative because it allows the injured party to recover against the debtor after bankruptcy. Survival of the claim after discharge will be useful to the claimant only if the debtor is later rehabilitated. Although there has been no systematic study of the frequency of complete financial recovery, the vast majority of individual bankrupts have post-bankruptcy incomes that are below

counselor participation." Id. at 88. See also id. at 91.

175 One Circuit Court, in justifying a discretionary disallowance of a tort claim under § 57d, stated that allowing all tort claims would run counter to the purpose of the Act, which is to promote the prompt liquidation of each debtor's estate and the expeditious distribution of the proceeds to the bona fide general creditors holding provable claims so that they will not be forced to wait unduly long for payments due them. Thompson v. Tulchin (In re Cartridge Television Inc.), 535 F.2d 1388, 1390 (2d Cir. 1976).

176 Section 502(c); see § 502(b).

177 Note, Tort Claims and the Bankrupt Corporation, 78 YALE L.J. 475, 479 (1969). The general policy of the present Act is not to inflict penalties incurred by the bankrupt upon the bankrupt's creditors. See § 57(j) (disallowing governmental penalties beyond pecuniary loss and interest).


179 MACLACHLAN, supra note 30, at 138. Conversely, the claimant wishing to have a nondischargeable claim will be motivated to convince creditors with provable claims to start an involuntary proceeding before they start suit. Id.

180 See notes 41-42 and accompanying text supra.
average, suggesting that the discharged individual debtor may be unable to satisfy a large tort claim. While some chance of post-bankruptcy recovery exists against individual debtors, there is no possibility of post-bankruptcy recourse to the assets of a corporation. The discharged corporation effectively disappears as a source of payment at the end of the bankruptcy case, and most corporations do not even seek a discharge. Even though an adjudication in bankruptcy does not terminate the corporate entity, all that remains after bankruptcy is a shell without assets.

In addition to providing the tort claimant with little effective relief, the nondischargeability of tort claims can have a devastating effect on the likelihood of the debtor receiving a "fresh start." Originally, the primary purpose of the bankruptcy law was to provide equal treatment for all creditors of the same class, but there has been increasing emphasis on the objective of relieving "the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." Where a

181 In 1965, 99 percent of a sampling of former bankrupts reported that their annual post-bankruptcy income was below $15,000. Ninety-three percent reported that their income was below $10,000. Eighty-four percent were below $8,000 and 61 percent were below $6,000. Brookings, supra note 4, at 44.

182 Before the promulgation of the Bankruptcy Rules (see Bankruptcy Rule 404) a corporation had to apply for a discharge even though an individual was granted one automatically. A mere 2.5 percent of corporate bankrupts took this additional step and those who did were never opposed. Brookings, supra note 4, at 128.


184 Professor Schuchman summarizes the normal situation in the following way:

In theory, the discharge from personal liability is not necessary for persons engaged in business in the usual corporate form. In order to promote commerce and the necessary accumulation of capital for business enterprises, other laws limit the liability of such persons to their capital investment and what business assets that investment has produced. Although the capital and assets are lost in a business bankruptcy, the individual entrepreneurs are not ordinarily liable for unpaid debts, i.e., adjusted claims. As individuals, they may retain their personally held property, and, as entrepreneurs, they may again attempt success in business enterprises, the bankruptcy having been but an unhappy chapter. Schuchman, An Attempt at a Philosophy of Bankruptcy, 21 U.C.L.A. L. Rev. 403, 421 (1973). See Brookings, supra note 4, at 114-15. This has even been recognized by the House of Representatives. "Although a corporate bankrupt is theoretically not discharged, the corporation normally ceases to exist upon bankruptcy and ... unsatisfied claims are without further recourse ...." H.R. Rep. No. 687, 89th Cong., 1st Sess. 2 (1965). One court considered and rejected the argument that disallowance pursuant to § 57d of unliquidated claims is an abuse of discretion where a bankrupt corporation is involved because the claims are, in effect, discharged without any possibility of satisfaction. Thompson v. Tulchin (In re Cartridge Television Inc.), 535 F.2d 1388 (2d Cir. 1976).


186 Brookings, supra note 4, at 10.

187 Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554-55 (1915). See also Local Loan v. Hunt, 292 U.S. 234, 244 (1934). The shift in attitudes from concern for creditors' rights to concern for debtor's rights may be illustrated by observing that the earliest laws did not provide for discharge of the bankrupt's debts. Brookings, supra note 4, at 10. Within
discharge is necessary the debtor is clearly in no position to assume a large, undischarged debt. The eagerness to free the debtor from "the pressure and discouragement of preexisting debt" should be tempered, though, by a consideration of the purposes behind the fresh start concept. At least one of the reasons for this approach to bankruptcy is loss allocation: the burden of the debt should be placed on the party best able to pay, and the creditor is generally better able to pass a commercial loss along to his other customers. With normal commercial claims, only a very small increase in the cost of credit to other debtors is necessary to compensate for the loss. Moreover, failure to release debtors from debts which they cannot pay could result in a constriction of the credit markets by inhibiting the entrance of marginal borrowers. The same reasoning may not apply, however, to a noncommercial obligation such as a tort claim. This kind of claim differs from a commercial claim in that it is not normally voluntary, the incidence of the loss is not easily transferred from the tort

the present Act, the section on exemptions provides clear recognition of the need to provide the debtor with a fresh start. Bankruptcy Act § 6, 11 U.S.C. § 24 (1970). This recognition is continued in § 522 of the proposed Acts. See BROOKINGS, supra note 4, at 15. The continued validity of the principles enunciated in Local Loan can be seen in such recent cases as Perez v. Campbell, 402 U.S. 637 (1971) and Lines v. Frederick, 400 U.S. 18 (1970). The movement toward more complete relief may actually be accelerating. See 1A COLLIER ON BANKRUPTCY ¶ 17.17; BANKRUPTCY COMMISSION, supra note 174, at 16. The reference to "business" misfortunes has become less important as the courts have applied the fresh start concept to nonbusiness bankruptcies. See Lines v. Frederick, 400 U.S. 18 (1973). The Court in Local Loan also said

[t]he new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.


See BANKRUPTCY COMMISSION, supra note 174, at 90. See Schuchman & Jantscher, Correlation of Bad Debt Losses and Nonbusiness Bankruptcy Rates, 77 COM. L.J. 358 (1972). The Brookings Study reported that

[s]ome $2 billion of debt were discharged in the bankruptcy courts in 1968—about .2 percent of the private debt outstanding—a cost that is widely diffused throughout the economy being borne partly by borrowers as a whole, through higher interest rates, but principally by customers of business borrowers, through higher prices.

BROOKINGS, supra note 4, at 40.

Encouragement of credit is often mentioned as an important goal of the bankruptcy process. BROOKINGS, supra note 4, at 39; Kennedy, Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start, 76 W. VA. L. REV. 427, 436-37 (1974); BANKRUPTCY COMMISSION, supra note 174, at 81-87. The Brookings Study indicates that the sharp increase in bankruptcies since World War II "apparently resulted from the increase in the amount of indebtedness of the population rather than from deteriorating credit standards or a greater willingness of persons to enter bankruptcy." BROOKINGS, supra note 4, at 42. The absence of such a bad debt loss could very well indicate that the commercial credit system is not functioning optimally and that no marginal borrowers are receiving credit. Id. at 39.

See notes 171-72 and accompanying text supra. H.R. REP. No. 595, 95th Cong., 1st Sess. 90 (1977). Because of their involuntary nature, there is no possibility of arguing that, by engaging in a commercial transaction with the debtor, the tort claimant has considered and made arrangements for the possibility of bankruptcy.
victim to a broader class,194 and the burden of loss is likely to be much heavier.195 Consequently, the allocative effect of the bankruptcy process may differ according to the kind of claim under consideration.196 As a result, it may be desirable to resolve the dischargeability issue by engaging in a balancing process to decide who should bear the burden.197 With regard to tort claims, this requires balancing the debtor's interest in obtaining a fresh start against the societal interest in spreading out the tort victim's loss.

This balancing approach to the dischargeability of tort claims may require consideration of other factors beside the allocative effects. For example, feelings that intentional, and, to a lesser extent, negligent tortfeasors are morally culpable may require nondischargeability.198 Some intentional tortfeasors may be inhibited by the realization that they will not be discharged in bankruptcy. There may also be a lingering fear that making tort claims dischargeable will increase the likelihood that tortfeasors will use the threat of bankruptcy to force settlements, although the empirical evidence does not support this fear.199 All of these beliefs are clearly open to question, however, and even if indisputably true, they would probably not be sufficient to require a complete exception of these torts from dischargeability.

In sum, the competing considerations involved in deciding whether a particular class of torts ought to be discharged are more closely balanced than those involved in deciding whether they ought to be provable. A decision that is just in one situation may be unjust in another.200 If the

194 The tort claimant may not even be able to recover from the bankrupt's insurer if the insurance policy held by the debtor will reimburse only those claims actually paid by the insured party. W. VANCE, INSURANCE § 135 (3d ed. 1951). A number of courts have prohibited this form of insurance, id., but it is still unclear that an individual or business in enough financial difficulty to require resort to bankruptcy will have had the foresight or incentive to devote limited assets to the payment of insurance premiums. Note, Tort Claims and the Bankrupt Corporation, 78 YALE L.J. 475 (1969). Further, insurance against willful and malicious tort claims is unlikely. Id. at 478.

195 BANKRUPTCY COMMISSION, supra note 174, at 81, 83, 90.

196 Id. at 89.

197 The Bankruptcy Commission suggested that "[e]ach creditor's net burden should be weighed against the burden of excepting the debt from discharge." Id. at 90. Tax claims, by contrast, are nondischargeable in spite of the fact that the taxing authority, as a "single holder of a larger number of claims,... is unlikely to be affected substantially by the bankruptcy process because only a minute percentage of almost any population of debtors obtain relief under the Act." Id.

198 Claims arising from conduct of the debtor egregiously violating community standards, such as claims for fraud, larceny, embezzlement, willful and malicious wrongs, and civil penalties, should not be discharged because social policy directs, impliedly at least, that the debtor should not be able to escape his responsibility through the bankruptcy process. BANKRUPTCY COMMISSION, supra note 174, at 91.

199 Fifty-one percent of a group of plaintiffs' lawyers interviewed by the authors of the Brookings Study reported that they had never settled a case because of a threat of bankruptcy by the defendant; twenty-eight percent had made such a settlement in one to five percent of their cases, and twenty-one percent had settled for this reason in greater than five percent of their cases. BROOKINGS, supra note 4, at 49. It is interesting to note that neither plaintiffs nor defendants perceived tort judgments as being a significant cause of bankruptcy. Id.

200 See MACLACHLAN, supra note 30, at § 138.
balance tilts in either direction, however, it tilts toward the discharge of all torts. While it may appear to allow a "willful and malicious" tortfeasor to escape with impunity, it is unlikely that the debtor will be able to accumulate assets sufficient to satisfy a major tort claim. It may be no less abhorrent to burden a person with a debt he cannot hope to pay. If the debtor's financial difficulties are great enough to require resolution in a court of bankruptcy, it serves little purpose to begrudge a discharge of the tort claim.

C. Priority

Although the new law will extend priority to at least one class of commercial claims previously unrecognized, no effort is made to grant priority to tort claims. The purpose of the priority sections is to prefer certain categories of claims that are more important or more deserving of payment than others. Consequently, many of the same considerations which apply in determining whether a debt ought to be dischargeable or not also apply here.

Several justifications have been advanced for the existing scheme of priorities. The administrative expense priority has been supported for a purely practical reason: without it the system could not operate. One commentator supports the tax priority because it involves an involuntary transaction for which the government cannot demand security, and increases the government's already serious financial difficulties. This rationale is also adopted in the House Committee Report. Stanley and Girth criticize the tax priority on the ground that it has only a very small effect on the federal budget. In fact, they recommend retaining only the

---

201 See Brookings, supra note 4, at 208.
202 Daniel Webster described the debtor with nondischargeable debts in the following way:

\[
\text{[H]owever good his intentions or earnest his endavors, it subdues his spirit, and degrades him in his own esteem; and if he attempts any thing for the purpose of obtaining food and clothing for his family, he is driven to unworthy shifts and disguises, to the use of other persons' names, to the adoption of the character of agent, and various other contrivances, to keep the little earnings of the day from the reach of his creditors.}
\]


203 See note 91 and accompanying text supra.
207 Id. at 344-46.
209 Brookings, supra note 4, at 131.
priority for wage earners, which they feel is needed to protect employees who are essentially unable to gauge the possibility that their employer will go bankrupt.\footnote{Id.}

The basic justifications for priorities underlying the views of each of these commentators are never explicitly stated, although the House Committee does refer broadly to the goal of protecting people in situations involving "special circumstances or special need."\footnote{H. R. REP. No. 595, 95th Cong., 1st Sess. 186 (1977).} Professor Schuchman states a somewhat more refined test: "Presumably, one would look to the need and deserts of the creditors and the moral worthiness of the debt."\footnote{Schuchman, \textit{An Attempt at a Philosophy of Bankruptcy}, 21 U.C.L.A. L. REV. 403, 446 (1973).} Professor Shanker argues that the priorities should protect creditors who "(1) did not choose to deal with or extend credit to the bankrupt, (2) did not intend to take the risk of his insolvency, (3) had no advantage or profit to gain from becoming a creditor of the bankrupt, and (4) had no way of insisting upon cash or security before the debt was incurred."\footnote{Shanker, \textit{The Worthier Creditors (And a Cheer for the King)}, 1 CAN. BUS. L.J. 340, 349 (1976).} Stanley and Girth would probably add inability to obtain information enabling the claimant to calculate the likelihood of bankruptcy.\footnote{Brookings, \textit{supra} note 4, at 209.}

Tort claims meet these criteria squarely:\footnote{Id. at 349-50.} the relationship is involuntary, no profit motive exists, and the victim certainly has no way of insisting on security. Moreover, giving tort claims priority would give the claimant a greater chance of being paid without impairing the debtor's fresh start.

By increasing the priority of tort claimants the return on commercial claims would be correspondingly decreased. If this resulted in a significant decrease in the return on commercial loans, the cost of credit would increase. The result would be a kind of bankruptcy insurance borne by credit users. Though this cost would apply to some degree to the entire borrowing community, borrowers who presented a greater risk of bankruptcy because of a poor financial position would clearly bear a greater proportion of the cost. In contrast, tortfeasors would be likely to come from all classes of debtors, and commercial creditors could distribute their anticipated losses due to bankruptcies caused by tort claims more evenly among the entire population. Unfortunately, it is still the higher risk debtors who are more likely to react to a tort claim of any significant size by seeking a discharge in bankruptcy so that the incidence of the increased cost might still fall on lower income debtors.\footnote{Brookings, \textit{supra} note 4, at 10.}
The present Bankruptcy Act allows tort claims only a limited share in the distribution of the estate in bankruptcy. Their participation depends on the nature of the claim, whether suit has been brought against the tortfeasor, and the form of relief which is sought by the debtor. If the tort claimant is not allowed to prove his claim in the bankruptcy court, he may be able to pursue the debtor after the discharge, and some forms of tort claims survive even for tort claimants who share in the distribution.

The proposed Act admits almost all tort claims into the bankruptcy process, but retains many of the provisions regarding the nondischargeability of certain types of tort claims. This expansion of the tort claimant’s right to participate in the distribution of the proceeds aids both the debtor and the tort claimant and simplifies a procedure which is now overly complex. By continuing to limit the dischargeability of tort claims, though, the proposed Act diminishes the debtor’s fresh start, without significantly increasing the probability that the claimant will eventually be paid. The tort claimant could receive the same protection provided by the dischargeability provisions if he were granted priority over commercial creditors. This would have the additional benefit of not impairing the debtor’s fresh start.

—Stephen Allen Edwards