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Introduction

The purpose of this handbook is to provide a general overview of claims in bankruptcy. Claims are defined broadly under title 11 of the U.S. Code, 11 U.S.C. §§ 101, *et seq.* (the “Bankruptcy Code”) to include 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” or a “right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.”¹

While the issues and topics discussed could fill an entire treatise, the purpose behind this handbook is to provide a starting point for legal analysis, highlight key issues, and, perhaps, answer a few questions. This handbook is designed to be accessible to those who are unfamiliar with or only dabble from time to time in the bankruptcy realm, while still being informative to those who labor regularly in this field.

The substantive discussion of the book begins in Chapter 2 with a summary of the debtor’s duties, including the preparation of the debtor’s “schedules,” a record that should include all of the debtor’s assets and liabilities. As explored in greater depth in Chapter 2, practical challenges in the preparation and service of the schedules have led to the development of case law concerning the adequacy of notice and service.

Next, the discussion shifts in Chapter 3 to the life cycle of a claim, from when a claim arises to the contents, effect, timing, and location

1. 11 U.S.C. § 101(5)(A)–(B).

of filing, and concluding with rules regarding amendments to a claim. As will be discussed, the concept of when a claim arises may, at first glance, seem straightforward, but it has resulted in the development of multiple tests adopted by various jurisdictions.

Chapter 4 addresses secured claims, homing in on the valuation and treatment of the collateral-based secured claim, which is the most common type of secured claim, discussing the creation of a secured claim under Sections² 506(a) and 553(a) to the extent a creditor has a right to setoff against the debtor, and concluding by touching briefly on the debtor's right to setoff.

Chapter 5 delves into unsecured claims and the priority structure developed for such claims under Section 507(a)(1)–(10). That Section identifies a number of priority unsecured claims including (i) domestic support obligations, (ii) administrative expenses, (iii) gap period claims, (iv) claims for wages, salaries, and commissions, (v) claims for contributions to employee benefit plans, (vi) certain claims of grain producers and fishermen, (vii) claims for consumer deposits, (viii) claims for taxes and customs duties, (ix) commitments to federal depository regulatory agencies, and (x) claims arising from driving under the influence/driving while intoxicated crimes. Chapter 5 goes on to discuss the “super priority” claim under Section 507(b) of the Bankruptcy Code, the equal priority for claims based on erroneous tax refunds under Section 507(c) and, finally, subrogation of claims under Section 507(d).

The category of administrative expenses has, not surprisingly, generated much discussion and case law development due to its higher priority. Accordingly, Chapter 6 is dedicated to various types of administrative expenses, including the process for asserting claims for such expenses, as well as establishing deadlines for presenting such claims. Administrative expenses include expenses that specifically arise from the debtor being in bankruptcy—most prominently, the fees of bankruptcy professionals—but it also includes the normal, worthwhile expenses of a debtor taking care of business post petition. This may include, for example, monthly rent obligations due to a landlord or equipment lessor. If, however, the debtor decides to reject a lease and the rejection is approved by the court, the landlord or lessor will be entitled to file a claim for “rejection damages,” a topic covered in more detail in Chapter 8.

Section 503(b)(9) of the Bankruptcy Code grants an administrative expense claim for goods delivered to the debtor within twenty days of the petition date. Since its enactment as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Section 503(b)(9) has

2. Unless otherwise noted, all references to “Section(s)” in this handbook shall be to delineated segments of the Bankruptcy Code.

been the topic of much discussion and resulted in significant case law. Accordingly, this subset of administrative expenses (often referred to as 503(b)(9) claims) warranted their own chapter considering the complexity, significance, and timeliness of the issues surrounding them, and are explored in Chapter 7.

Topics covered in Chapter 7 include when and how such claims are allowed and paid, what constitutes a “good” for purposes of Section 503(b)(9), when goods are “received” by the debtor for purposes of Section 503(b)(9), how “value” is defined, whether Section 503(b)(9) expenses are subject to disallowance under Section 502(d), which acts to temporarily disallow certain claims of a transferee of voidable transfers (often a preferential transfer) against the estate if the transferee has not turned over the property received, and whether the holder of an administrative expense under Section 503(b)(9) can use goods shipped during the days prior to the petition date as new value in defense of a preference action.

As previously noted, Chapter 8 addresses the claims that result from a debtor’s postpetition rejection of executory contracts or leases. The discussion begins with an overview of the debtor’s right to choose (or the counter party’s right to compel), assumption, or rejection of an executory contract or lease. The discussion then shifts to the deadline (or bar date) for asserting damages resulting from the debtor’s rejection of an executory contract or lease, how claims for such damages are treated in bankruptcy, and the applicable cap on such damages.

Claims asserted on behalf of unique groups or classes, such as displaced employees or mass tort claimants exposed to products containing asbestos, are discussed in Chapter 9. Despite the Bankruptcy Code’s relative silence on such claims, it is important to understand the applicable rules and procedures for filing and seeking allowance of class claims. It is also important to recognize the powerful leverage certain class claimants may wield in a bankruptcy case and the discretion of the bankruptcy court in recognizing class claims.

Chapter 10 discusses the quasi-claim known as a “reclamation” claim, or the right of a vendor to demand the return of certain delivered goods from the debtor, as set forth in Section 546(c) of the Bankruptcy Code and applicable state law, as well as the procedure for making such demands and the limitations thereof (most notably, the fact that such claims are subject to the rights of a secured creditor that holds a lien on the goods or proceeds of the goods sought to be reclaimed).

The various types, categories, and priorities of claims having been addressed in Chapters 4 through 10, Chapter 11 tackles two principles that have the potential to affect the order of distribution or categorization of a claim in bankruptcy, namely: (i) equitable subordination, and (ii) debt recharacterization. Equitable subordination gives the bankruptcy court the

power to impose a lower priority on the payment of claims of a debt or equity holder that had otherwise improved its position in the bankruptcy relative to other similar creditors due to some form of inequitable conduct. Debt recharacterization allows a court to reclassify a claim as equity rather than debt. This equitable remedy is generally used in situations where an insider or capital contributor attempts to decrease the investment's risk by labeling a transaction as debt when, in substance, the transaction is more akin to equity.

Continuing the transition into the postpetition realm, Chapter 12 homes in on the effect and process of a debtor's determination that a particular creditor is a critical vendor, and the assistance this provides a debtor attempting to reorganize in convincing certain essential providers of goods and services, who are reluctant to continue to provide credit to a debtor post petition due to the prospect of not receiving payment in full on their pre-petition receivables. Critical vendor status encourages creditors that are critical to the debtor's continued operations to continue to extend credit in exchange for receiving payment in full or in part on such claims prior to confirmation of a plan.

Those at the helm of the decision-making process—namely, the directors and officers of corporations and other entities—are encouraged to make difficult decisions and take worthwhile risks to assist in the reorganization efforts. Companies often promise to indemnify the directors and officers against liabilities for actions taken in their corporate capacities and to advance or reimburse costs incurred by the directors and officers in defending against lawsuits asserting liability for such actions. Chapter 13 explores these indemnification promises and the types, limits, and exclusions of the liability insurance policies that provide the funds to back up those promises. The analysis goes one step further, summarizing frequent issues that arise concerning the treatment of director and officer insurance in bankruptcy.

Chapter 14 of this handbook explores the claims objection process, the grounds for disallowance of a claim, the consequences of disallowance, and the circumstances under which a claim may be temporarily disallowed.

Chapter 15, which is a new addition to the handbook, discusses the intersection of claim dischargeability and the claims process. This chapter begins with an overview of the types of claims that may be excepted from discharge under Section 523. The chapter then details the process by which a creditor may contest a debtor's ability to discharge a particular debt. Because an adversary proceeding (or lawsuit) is necessary to advance the challenge, the chapter specifies the associated deadlines, pleading requirements, and burden of proof.

When you have reached the final page of this handbook, you should, at the very least, have a basic understanding of the claims process, the rights and duties of both debtors and creditors during this process, the priority scheme, the objection process, and grounds for challenging discharge of a particular claim.