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Bankruptcy-Provable Claims-Contingent Liability

RECENT CASE NOTES

BANKRUPTCY—PROVABLE CLAIMS—CONTINGENT LIABILITY—The bankrupts were indorsers of promissory notes payable to the petitioners, some of them within the year after adjudication allowed by section 57n of the Bankruptcy Act for proof of claims, others at later dates. There was no waiver of presentment or notice of dishonor. Petitioners filed proofs of claim upon the indorsements which were allowed. The trustee in bankruptcy brings proceedings to expunge the claims as not provable. *Held,* the claims were properly allowed. *Maynard v. Elliott,* 51 Sp. Ct. 390 (1931).

The court cited *Moch v. Market St. Bank,* 107 Fed. 897 and *In re Buzzini,* 183 Fed. 827 and further relied strongly by way of analogy on the cases which held that a surety on the bond of a bankrupt principal may prove his claim of indemnity against the bankrupt principal's estate though he has not yet paid the debt on which he is secondarily liable, or that he did not pay such debt until after the filing of the petition in bankruptcy. *Williams v. United States Fidelity Co.,* 236 U. S. 549, 33 S. Ct. 289, 59 L. Ed. 713, and *In re Lyons Beet Sugar Refining Co.,* 192 Fed. 445. The court also puts stress on *Central Trust Co. v. Chicago Auditorium,* 240 U. S. 581, 36 S. Ct. 412.

The goal of clarity with reference to provability of contingent claims has proved to be elusive. The general rule seems to have always been that contingent claims are not provable. *In re Arnstein,* 4 A. B. R. 246, 101 Fed. 706; *In re Swift,* 7 A. B. R. 381, 112 Fed. 315; *In re Pettingil & Co.,* 14 A. B. R. 728, 137 Fed. 143; *In re Roth & Appel,* 24 A. B. R. 588, 31 L. R. A. (N. S.) 270, 181 Fed. 667; *In re American Vacuum Cleaner Co.,* 26 A. B. R. 621, 192 Fed. 939; *In re Mullings Clothing Co.,* 38 A. B. R. 189, L. R. A. 1918A, 539, 238 Fed. 58. The last case cited defined a contingent claim as one as to which it remains uncertain, at the time of the filing of the petition in bankruptcy, whether or not the bankrupt will ever become liable to pay it; and the court said the present act makes no provision for the proof of such claims (contingent claims) and it is well understood that they are not provable. Compare in reference to the general rule above stated *Dunbar v. Dunbar,* 190 U. S. 340. Another general rule is that whether or not a debt is provable turns upon its status at the time of the filing of the petition. See in *In re Pettingill & Co.; In re Roth & Appel; In re Mullings Clothing Co., supra. In re Swift, supra,* held that the part of the bankruptcy act which describes what debts may be proved must be considered at all points as repeating the words "owing at the time of the filing of the petition."

The case of *Moch v. Market St. National Bank,* 107 Fed. 897, deserves attention. The exact words of the opinion are: "The question presented by this appeal is whether the liability of a bankrupt indorser of commercial paper whose liability did not become absolute until after the filing of the petition in bankruptcy, may be proved against his estate after such liability has become fixed, and within the time limited for proving claims."

The court held it might because the liability of an indorser is within the very words of section 63a (4); and section 63a (1) did not qualify section 63a (4). It is to be seen that the *Moch* case only held that it is when the liability becomes fixed within the time allowed for proving claims that it is provable against the bankrupt indorser. The court asks whether the claim may be proved after the liability has become fixed *and* within the period allowed for proving claims. If the liability does not become fixed until after the period allowed for proving claims is past, it would be a logical impossibility to prove the claim after the liability has become fixed and within the period allowed.

The court in the instant case states "leading text writers have stated that the liability of an indorser, upon a note falling due after the petition, is provable under section 63a (4)" the court cites 2 *Remington on Bankruptcy* (3d Ed.), Sec. 777. However, this citation does not support the court's statement unqualifiedly. Remington construes most of the decisions in point as adding the qualification that the liability becomes fixed and absolute within the period limited for proving claims. See for a statement of the rule with the same qualification *Gilbert's Collier on Bankruptcy* 912, and 2 *Collier on Bankruptcy* (12th Ed.) 963.

Perhaps a great deal of the confusion on this subject can be attributed to loose constructions of cases. The *Moch* case is cited frequently, but often only part of the actual decision is given as the holding of that case. See for an example the last paragraph of the opinion in *In re Philip Semmer Glass Co.*, 135 Fed. 77. An interesting case, which is cited by the court in the decision now being considered, is *In re Buzzini*, 183 Fed. 827. That case held that the holder of a note might prove it against the bankrupt indorser who had waived presentation and notice of protest, though the note would not be due for more than a year after the adjudication in bankruptcy. The court in that case said: "I can find no authority for the proposition that granted an obligation is absolutely owing, it makes the least difference when it is payable, and section 63a (1) is expressly to the contrary. The time when the contingency of the claim is to be determined the statute (Bankruptcy Act) fixes at the time of the petition filed section 63a (1); and if the claim be absolutely owing, then there appears to be no law for disallowing it because the paymentis delayed." It was held that the effect of the indorsers waiver of presentation and notice of protest was to relieve the obligation of the usual conditions and to make it an absolute obligation to pay the sum on the day fixed. *In re Buzzini* is thus distinguishable from the principal case, and distinguishable on a point of decisive importance. There was no waiver in the principal case. Therefore the indorser's liability was not unconditional and "an absolute obligation to pay the sum on the day fixed." The decision in *In re Buzzini* was decided under 63a (1). But the present case cannot be brought under 63a (1) because the debt was not absolutely owing at the time of the filing of the petition. It must be decided under 63a (4). In the absence of such waiver as was present in the *Buzzini* case, the liability of the indorser on a negotiable note not maturing until some time after the filing of the petition in bankruptcy is not a debt absolutely owing at the time of the filing of the petition. It is a contingent liability. *In re*

Mullings Clothing Co., supra, stated that a contingent claim was one as to which it remains uncertain at the time of the filing of the petition whether or not the bankrupt will ever become liable to pay it. 2 Rem. sec. 775 (3rd Ed.) states that the test as to whether a claim is contingent is this: "Have all the facts necessary to be proved to fasten liability already occurred? If so, the claim is not contingent." The indorser's liability is contingent on the maker's default.

Do the surety bond cases afford a sound basis for the principal case? The language of Remington in 2 Rem. (3rd Ed.), sec. 779 indicates that they do not. "Thus, even where the surety pays his principal's debt after the principal has been adjudged bankrupt, the surety holds a claim for indemnity that had its origin before the bankruptcy and is therefore a provable and dischargeable debt. This rule has for its basis the peculiar provisions of the act permitting proof of claims in the name of the creditor by sureties and others secondarily liable therefor even before payment by the sureties where the creditor fails or refuses to make the proof himself; and also subrogating *pro tanto* such persons, thus secondarily liable, to the creditors dividends insofar as such persons shall discharge the obligation (sec. 57i) making, in short, such persons thus secondarily liable quasi owners of the claims, hence qualified creditors." Again in section 776 the author says "the statute, by force of its special provisions allowing proofs by those secondarily liable in the name of the creditors, places such persons, *sub modo,* in the shoes of the creditor, though their own obligation is contingent. By virtue of the statutory provisions those secondarily liable to a creditor are made to stand in the creditor's shoes."

It is difficult to see how *Central Trust Co. v. Chicago Auditorium, supra,* relied on by the court aided it in the present case. That case dealt with an anticipatory breach of contract which was caused by the filing of the petition in bankruptcy. The court held the claim might be proved for damages covering the entire life of the contract, notwithstanding the party proving had the right to cancel the contract on a stated notice, that provision not being reciprocal. The court said: "The obligation of the bankrupt was clear and unconditional. The right reserved to the Auditorium Association to cancel its privileges was reserved for its benefit, not that of grantee of those privileges (bankrupt). * * * It is true we have held debts provable under section 63a (4) include only such as existed at the time of the filing of the petition. But it would be an unnecessary and false nicety to hold that because it was the act of filing the petition that wrought the breach, therefore there was no breach at the time of the filing of the petition."

It would seem that in holding provable the claims against the indorser on notes not due until after the period allowed for proving claims, the Supreme Court has done nothing inherently inconsistent with the bankruptcy act. Due to the unfortunate absence of any specific reference to contingent claims in the section dealing with provability of claims, the courts must, under the guise of interpretation, legislate to supply the deficiencies of the act. But it appears that the Supreme Court chose to rely on previous decisions and that it reached the result through a dubious construction of cases, especially the Moch case. S. K.