CASENOTES

An Analysis of *In re Piper Aircraft Corporation*

In *In re Piper Aircraft Corp.*,[1] the Eleventh Circuit Court of Appeals determined when future claimants hold claims within the meaning of section 101(5) of the United States Bankruptcy Code (the "Bankruptcy Code").[2] Piper Aircraft Corporation[3] filed for bankruptcy and attempted to reorganize under Chapter 11 of the Bankruptcy Code.[4] Because many Piper aircraft were operational at the time of the filing,[5] it was

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1. 58 F.3d 1573 (11th Cir. 1995).
2. *Id.* at 1573. The Bankruptcy Code defines "claim" 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; or (B) 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, legal, equitable, secured, or unsecured.

11 U.S.C. § 101(5) (1978). Determining when a claim arises is important because only holders of claims (and equity interests) are entitled to participate in distributions made under a confirmed Chapter 11 reorganization plan.

3. Piper Aircraft Corporation designs, manufactures, and sells general aviation aircraft and associated spare parts.
4. 58 F.3d at 1575.
5. Approximately 50,000 to 60,000 Piper Aircraft are still operational in the United States. *Id.*

a statistical certainty that individuals would be injured in accidents after confirmation of the reorganization plan, but arising out of or relating to products manufactured, sold, designed, or distributed by Piper prior to confirmation.[6] The bankruptcy court appointed a Legal Representative to protect the interests of these future claimants[7] in the Piper case.[8] The Legal Representative filed a proof of claim on behalf of the future claimants in an amount exceeding one-hundred million dollars.[9] The Official Committee of Unsecured Creditors and Piper objected to the claim on grounds that the future claimants did not hold claims within the meaning of section 101(5) of the Bankruptcy Code.[10] The bankruptcy court held that future claimants did not hold claims because there was no prepetition exposure to specific identifiable defective products and because there was no prepetition relationship between the debtor and the broadly defined class of future claimants.[11] The Legal Representative appealed. The district court affirmed, holding that future claimants did not have claims absent some prepetition exposure to a defective product.[12] The Legal Representative appealed to the Eleventh Circuit. The Eleventh Circuit affirmed the district court's holding but formulated a new test to determine when future claimants hold claims.[13] The court held that a claim is established only when (1) there is a preconfirmation relationship between an identifiable claimant and the debtor, and (2) the basis for the liability arises out of the debtor's prepetition conduct.[14]

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6. *In re* Piper Aircraft Corp., 162 B.R. 619, 621 (Bankr. S.D. Fla. 1994).

7. The court defined the class of future claimants to include:

> All persons, whether known or unknown, born or unborn, who may, after the date of confirmation of Piper's Chapter 11 plan of reorganization, assert a claim or claims for personal injury, property damages, wrongful death, damages, contribution and/or indemnification, based in whole or in part upon events occurring or arising after the Confirmation Date, including claims based on the law of product liability, against Piper or its successor arising out of or relating to aircraft or parts manufactured and sold, designed, distributed or supported by Piper prior to the Confirmation Date.

Id. at 621.

8. 58 F.3d at 1575.

9. *Id.* The claim was based on statistical assumptions regarding the number of persons likely to suffer, after the confirmation of a reorganization plan, personal injury or property damage caused by Piper's pre-confirmation manufacture, sale, design, distribution, or support of aircraft and spare parts. *Id.*

10. *Id.*

11. 162 B.R. at 627.

12. *In re* Piper Aircraft Corp., 168 B.R. 434, 439 (S.D. Fla. 1994).

13. 58 F.3d at 1577. This new test is known as the "*Piper* Test."

14. Specifically, the court held:

When Congress promulgated section 101(5), it intended to define "claim" more broadly than the term was defined under prior bankruptcy law.[15] The former Bankruptcy Act of 1898 defined "claim" very narrowly. Under the Act, a claim had to be both "proved" and "allowed" to be treated under and bound by a reorganization plan.[16] Because of this narrow definition, a debtor was prevented from treating in its plan certain contingent claims that were not "provable" at the time of reorganization. This limitation allowed such claims to be asserted against a reorganized debtor.[17] Two consequences of this narrow definition of "claim" contravened established bankruptcy policy: first, it allowed similarly situated creditors to be treated differently, and second, it often led to the failure of the reorganization process.[18] The legislative history of section 101(5) reflects Congressional intent in revising the definition of claim: "By this broadest possible definition . . . this bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court."[19] Since the enactment of the Bankruptcy Code, virtually all courts have agreed that the definition of claim should be an expansive one.[20] What has not been agreed upon is how far this definition should be expanded.[21] Three important theories have emerged to help answer this question: the Accrued State Law Claim Test, the Conduct Test, and the Prepetition Relationship Test. The Accrued State Law Claim Test, the narrowest interpretation of claim, provides that there is no claim for bankruptcy purposes until a cause of action has accrued under state

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> An individual has a § 101(5) claim against a debtor manufacturer if (i) events occurring before confirmation create a relationship, such as contact, exposure, impact or privity between the claimant and the debtor's product; and (ii) the basis for the liability is the debtor's prepetition conduct in designing, manufacturing and selling the allegedly defective or dangerous product. The debtor's prepetition conduct gives rise to a claim to be administered in a case only if there is a relationship established before confirmation between an identifiable claimant or group of claimants and that prepetition conduct.

Id. at 1577.

15. 162 B.R. at 622.

16. *Id.*

17. *Id.*

18. *Id.*

19. H.R. Rep. No. 95th Cong., 2d Sess. 309, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6266.

20. 162 B.R. at 623 (citing *In re Robinson*, 776 F.2d 30 (2d Cir. 1985)); *see also In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993).

21. 162 B.R. at 623.

law.[22] In *In re Frenville*,[23] the Third Circuit Court of Appeals applied the Accrued State Law Claim Test and held that an indemnification claim against the debtor arising after the petition date was not a claim under section 101(5).[24] The issue before the court was whether the automatic stay provision of section 362(a) of the Bankruptcy Code[25] applied when the debtor's acts forming the basis of the suit occurred prepetition but the actual cause of action could not be asserted until postpetition.[26] Under New York law, a suit for indemnification could be commenced only at or after the time the party seeking relief serves an answer.[27] Because the suit for which the party was seeking relief was filed fourteen months after the filing of the bankruptcy petition, the court found there was no prepetition claim subject to the automatic stay.[28] The court found that the automatic stay provision was not applicable because the "claim" for indemnification could not have been commenced before the filing of the bankruptcy petition.[29] Additionally, the court found the party had not met the requirement that one have a "right to payment"[30] necessary to sustain a claim under the Code.[31] According to New York law, a right to payment does not arise in a claim for indemnification until the party seeking indemnification has made the payment for which it seeks relief.[32] The court found its holding was in keeping with Congressional policy that only those claims that arise prepetition can be discharged.[33] However, *Frenville* and its progeny have been criticized as ignoring the intent of Congress to define claims broadly in the bankruptcy context.[34] State law and federal nonbank-

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22. *Id.* at 624.
23. 744 F.2d 332, 332 (3d Cir. 1984).
24. *Id.* at 338.
25. The automatic stay provision provides that:

> (a) Except as provided in subsection (b) of this section, a petition filed under sections 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.

11 U.S.C. § 362(a)(1) (1978).
26. 744 F.3d at 333.
27. *Id.* at 335.
28. *Id.* at 335-36.
29. *Id.* at 334.
30. *See supra* note 2 (providing the definition of claim according to U.S.C. § 101(5)).
31. 744 F.2d at 336.
32. *Id.* at 337.
33. *Id.* at 337-38.
34. 162 B.R. at 624.

ruptcy law do not override the bankruptcy policies of an equitable distribution to creditors and a fresh start to the debtor.[35] For these reasons, all courts outside the Third Circuit that have considered the Accrued State Law Claim Test have rejected it.[36] Courts have been more receptive to the Conduct Test, although some courts have found this test provides too broad of a scope in some situations.[37] Under this test, a right to payment arises when the conduct giving rise to the alleged liability occurs.[38] The leading case describing and adopting the Conduct Test is *In re A.H. Robins Co.*[39] In this case, the Fourth Circuit Court of Appeals considered when a claim based upon the prepetition insertion of a Dalkon Shield[40] arises if the claimant's injury is not manifested until postpetition.[41] The court explained that if the claim arose upon insertion of the device, it would be considered a claim under the Bankruptcy Code, and its prosecution would be stayed.[42] But if the claim arose when injury became apparent, it could not be a claim for bankruptcy purposes, and the automatic stay would not apply.[43] The Fourth Circuit categorized the claim before it as "contingent"; that is, the claim arose prepetition when the device was inserted, with the right to payment contingent upon the manifestation of a future injury.[44] Because contingent claims are treatable in a reorganization plan, a claim arising from prepetition insertion of a Dalkon Shield with injury manifested postpetition would be dischargeable in the plan. The court based its decision on: (1) a literal reading of the Code's definition of claim,[45] (2) the Congressional intent that "claim" be given a broad interpretation,[46] and (3) the district court's equitable power to assure the orderly conduct of the reorganization process.[47] The courts that have concluded the Conduct Test defines claim too broadly have

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35. *Id.*

36. *Id.* (citing *In re A.H. Robins*, 63 B.R. 986 (Bankr. E.D. Va. 1986); *In re Edge*, 60 B.R. 690 (Bankr. M.D. Tenn. 1986); *In re Johns-Mansville Corp*, 57 B.R. 680 (Bankr. S.D.N.Y. 1986)).

37. *Id.* at 625.

38. *Id.* at 624.

39. 839 F.2d 198 (4th Cir. 1988).

40. The Dalkon Shield is an intrauterine contraceptive device, the production of which was discontinued in 1974 because of mounting concerns about its safety. *Id.* at 199.

41. *Id.*

42. *Id.* *See supra* note 25 (defining the "automatic stay" provision of the Bankruptcy Code).

43. 839 F.2d 199.

44. *Id.* at 202-03.

45. *Id.*

46. *Id.*

47. *Id.*

recognized claims only for those individuals with some type of established prepetition relationship with the debtor.[48] These courts have applied the Prepetition Relationship Test, which requires some prepetition relationship such as contact, exposure, impact, or privity between the debtor's prepetition conduct and the claimant.[49] In *In re Pettibone Corp.*,[50] the debtor had been sued for injuries sustained by the operator of a forklift that had been designed and manufactured prepetition.[51] The claimant was hired by his employer and had sustained his injury postpetition; thus, the claimant had no prepetition contact with either the debtor or the forklift.[52] The Bankruptcy Court for the Northern District of Illinois found that because the claimant's injury occurred postpetition without any prepetition relationship or exposure to tie him to the debtor, there could be no claim as of the petition date.[53] Because the injury could not be tied to some type of prebankruptcy privity, contact, impact, or hidden harm, the claimant did not hold a claim for bankruptcy purposes.[54]

In *In re Piper Aircraft Corp.*, the Eleventh Circuit Court of Appeals summarily rejected the application of the Accrued State Law Claim Test and agreed with the "majority of courts [that have rejected this test] as imposing too narrow an interpretation of the term claim."[55] The court also rejected the Legal Representative's request that it apply the Conduct Test and instead, chose to modify the Prepetition Relationship Test used by the district court.[56] The Eleventh Circuit agreed with the district court's finding that the Conduct Test created too broad of a scope for a claim.[57] It rejected the Conduct Test because the court believed

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48. 58 F.3d at 1577 (citing *In re Jenson*, 995 F.2d 925 (9th Cir. 1993); *In re Chateugay Corp.*, 944 F.2d 997 (2d Cir. 1991); *In re Correct Mfg. Co.*, 167 B.R. 458 (Bankr. S.D. Ohio 1994)).

49. *Id.*

50. 90 B.R. 918 (Bankr. N.D. Ill. 1988).

51. *Id.* at 919.

52. *Id.* at 920.

53. *Id.* at 932-33.

54. *Id.* at 931.

55. 58 F.3d at 1576 n.2 (citing *In re A.H. Robins*, 839 F.2d 198; *In re Black*, 70 B.R. 645 (Bankr. D. Utah 1986); *Acevedo v. Van Dorn Plastic Mach. Co.*, 68 B.R. 495 (Bankr. E.D.N.Y. 1986); *In re Edge*, 60 B.R. 690 (Bankr. M.D. Tenn. 1986); *In re Johns-Manville Corp.*, 57 B.R. 690 (Bankr. S.D.N.Y. 1986); *In re Yanks*, 49 B.R. 56 (Bankr. S.D. Fla. 1985)).

56. *Id.* at 1577.

57. *Id.* The district court distinguished *Piper* from those cases in which courts found claims arose when conduct giving rise to the alleged liability occurred. Each of those cases involved (1) a wrongful prepetition act by the debtor, (2) a prepetition exposure or contact with the defective product by the future claimant, and (3) an injury manifested postpetition by the future claimant as a result of that prepetition conduct. 168 B.R. at 438. In applying these factors to *Piper*, the district court noted there was no evidence in the record of a

its application would enable anyone to hold a claim against Piper by virtue of potential future exposure to any aircraft in the existing fleet.[58] The court noted that even those cases that applied the Conduct Test required some form of prepetition relationship.[59] Although the definition of claim is to be interpreted broadly, the court refused to extend the scope of a claim to include unidentified individuals with no discernible prepetition relationship to Piper.[60] The Eleventh Circuit found the use of the Prepetition Relationship Test to be more consistent with the purposes and goals of the Bankruptcy Code than the Conduct Test. However, it found the district court's use of the Prepetition Relationship Test to be unnecessarily restrictive in mandating that the class of claimants be limited to those who could be identified prior to the filing of the petition.[61] The court modified the Prepetition Relationship Test to include those claimants with injuries occurring postpetition but preconfirmation, provided that the injuries were caused by the debtor's prepetition conduct.[62] By changing the focal point of the analysis from the petition date to the confirmation date, the Eleventh Circuit's *Piper* Test now encompasses all claimants who can be identified preconfirmation. In the court's opinion, this change is consistent with the policies underlying the Code.[63] In applying this new *Piper* Test, the court found that the future claimants failed to meet the minimum requirements necessary to hold a claim.[64] There was no preconfirmation exposure to a specific identifiable defective product nor was there any other preconfirmation relationship between Piper and the broadly defined class of future claimants.[65] Because of this lack of preconfirmation connection between Piper and the future claimants, the court ruled the future claimants did not have section 101(5) claims arising out of Piper's prepetition design, manufacture, sale, and distribution of an allegedly defective product.[66]

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known defective or harmful product. *Id.* Secondly, there were some future claimants who never had, and never will have, a prepetition exposure or contact with an allegedly defective Piper product. *Id.* Finally, the court could not conceive of circumstances in which prepetition exposure to allegedly defective Piper aircraft or parts would result in a prepetition injury that did not manifest itself until postpetition. *Id.*

58. 58 F.3d at 1577.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.* at 1577 n.5.
64. *Id.* at 1588.
65. *Id.* *See supra* note 7 (providing the definition of "future claimant").
66. *Id.*

The problem of how to treat "future" claims is one of the most vexing issues in bankruptcy.[67] While the Bankruptcy Code requires the determination of when a claim arises, it does not address how that determination should be made. The result is that the courts are left to piece together formulations that inevitably evidence the conflict between bankruptcy policy and practicality. The decision in *Piper* implicates two bankruptcy policies. The first policy implicated is the "fresh start" policy. Defining claims broadly permits a "complete settlement of the affairs of a bankrupt debtor and a complete discharge and fresh start" by dealing with all of the legal obligations of the debtor.[68] However, the *Piper* Test enables contingent tort claims to survive the bankruptcy and to be asserted against a reorganized debtor, which denies the debtor the fresh start Congress intended. By adopting a modified version of the Prepetition Relationship Test, the Eleventh Circuit has essentially rewritten the Bankruptcy Code's concept of claim by eliminating the words "contingent," "disputed," "unliquidated," and "unmatured" from section 101(5) and adding the words "prepetition relationship" and "preconfirmation injury."[69] The *Piper* Test limits the scope of a debtor's obligations that can be settled in a bankruptcy case, thereby preventing the debtor from receiving a complete discharge and a fresh start. A reorganized debtor could emerge from bankruptcy only to be forced back in because of surviving claims. However, the Eleventh Circuit, while recognizing that "claim" was intended to be interpreted broadly, found that even a broad definition has its limits.[70] The court stated the scope of a claim cannot be extended to include unidentified and presently unidentifiable individuals with no prepetition relationship to Piper.[71] Apparently, the court concluded it was interpreting, rather than rewriting, the Bankruptcy Code. A second bankruptcy policy implicated by the decision in *Piper* is that similarly situated creditors should be treated equally. Yet, under the *Piper* Test, victims injured by the debtor's same prepetition acts will receive disparate treatment.[72] Those claimants injured by the debtor's prepetition acts who manifest injury postconfirmation may be compensated in full, while those whose injuries manifest themselves preconfirmation will be paid in "bankruptcy

67. Daniel L. Keaton, *Getting A Handle on Late-Manifesting Claims: A Comment*, 72 WASH. U. L.Q. 1095, 1095 (1994).

68. H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977).

69. *See supra* note 2.

70. 58 F.3d at 1577.

71. *Id.*

72. Kathryn R. Heidt, *The Changing Paradigm of Debt*, 72 WASH. U. L.Q. 1055, 1067 (1994).

dollars."[73] This disparity is highlighted when one considers the same situation in the case of a debtor that sells its assets, distributes the sales proceeds to creditors, and then dissolves under state law. Application of the *Piper* Test to those plaintiffs who are injured postconfirmation as a result of the debtor's past acts will not allow them any recovery. These plaintiffs will be unable to recover in bankruptcy because they do not hold claims. Further, they will be unable to recover in the future because there will be no entity from which to recover.[74] The Bankruptcy Court attempted to respond to this concern in its opinion.

> In bankruptcy . . . timing matters . . . . [This] simple truth . . . is evident in numerous provisions of the Bankruptcy Code . . . . Creditor Jones, paid in full 91 days before the petition may keep his money while creditor Smith, paid the very next day, will have to disgorge the entire amount and share in any distributions to unsecured creditors. If timing was irrelevant, then Congress would have allowed the Trustee to reach back indefinitely to recover all prepetition payments made by insolvent debtors.[75]

Thus, the Eleventh Circuit found closure to the bankruptcy process more desirable than providing a fresh start to the debtor and equal treatment to similarly situated creditors.

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73. *Id.*
74. *Id.* at 1068.
75. 162 B.R. at 628, 629 n.16.