Future Claims in Bankruptcy: A Utility Driven Marriage

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**Abstract**

“Mass torts” appeared in the legal spotlight over the last couple of decades due to special, legal and non-legal, circumstances. Closely afterwards, the US Bankruptcy Code widened the definition of claims, intending to make it as broad as possible. Latent tort injuries, those who were not to appear until after the resolution of the bankruptcy case, were now susceptible of being interpreted as claims. As a result interested parties seeking to invest in the troubled business couldn’t accurately evaluate what the potential cost of the successor liability doctrine might be and even people not yet injured could be potentially involved in a bankruptcy proceeding, regardless of being unaware of it. This note intends to shed light over the inescapable upper limit of recovery presented by the debtor’s assets in addressing the “futures problem” in bankruptcy and the social welfare diminution of excluding them.

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1. Introduction

“Mass torts”\(^1\) appeared in the legal spotlight over the last couple of decades due to special, legal and non-legal, circumstances. As for legal causes, implementation of strict products’ liability rules in the 1960’s\(^2\), recognition of new categories of compensable harm\(^3\), increased quantity of awards\(^4\), appearance of flexible class actions standards\(^5\) and development of expertise by legal professionals, could be cited as some of the more relevant examples. The non-legal roots developed partly from economies of scale and partly from scientific discoveries. Economies of scale permitted products to reach large number of people, a portion of whom ultimately manifested injuries due to the same causal process over an extended period of time, while scientific discoveries permitted to identify patterns leading to those common sources of harm\(^6\). As business failure is a natural component of economic and legal cycle, it was just a matter of time until the mass tort development faced the bankruptcy conundrum.

That time arrived in the early 1980’s, when the first mass tort bankruptcy cases hit the bankruptcy decks, making it clear that mass tort claimants were competing over limited or insufficient funds\(^7\) with other creditors who had higher priority. Casually or not, it was also the time when a fresh US Bankruptcy Code began to be applied, after one of the biggest reforms in the history of the US bankruptcy system\(^8\). The new code advanced solutions to some problems, as eliminating hurdles presented by the old definition of "acts of bankruptcy", and opened the gate for new challenges. One of the later arose out of the novel definition of claims. Under the former Bankruptcy Act, tort claims were usually excluded from the proceedings because they were “unprovable”\(^9\). As a result, the victims’ causes of action were not discharged\(^10\). The Bankruptcy Code widened the definition of claims, intending to make it as broad as possible. Latent tort injuries, those who were not to appear until after the resolution of the bankruptcy case, were now susceptible of being interpreted as claims.

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1 According to Professor Peter H. SCHUCK the term mass tort arose after 1969. See Peter H. SCHUCK (1995), pp. 945-947.
2 For a historical account of the development of this standard see George L. PRIEST (1985), p. 461.
3 See Peter SCHUCK (1992), p. 574, where the author refers to compensation for the fear of future injury, for medical monitoring costs and for non-impairing conditions.
5 See Richard EPSTEIN (2003), p. 497, citing that “In 1966, the Federal Rules of Civil Procedure made a conscious effort to liberalize the scope of the class action by adopting a posture that, at bottom, asks whether ‘the questions of law or fact common to the members of the class predominate over any questions affecting only individual members.’”
6 See David ROSENBERG, pp. 217-8, stating “Epidemiological studies can predict (with increasing accuracy over time) the rate of cancer incidence in the exposed population attributable to the toxic substance in question”.
7 See Anthony J. SCIRICA, p. 1859.
8 The Bankruptcy Reform Act of 1978 established United States Bankruptcy Courts in each federal judicial district. The reform act also revised and modified Title 11 of the U.S. Code, which contained the substantive and procedural laws of Bankruptcy reorganization.
9 Section 63(a) of the old Bankruptcy Act considered contingent and unliquidated claims not to be comprised by the definition of claims.
Therefore, many individuals who were seeking relief for their injuries, and even the ones who were not, had to deal with liquidation and reorganization proceedings.\footnote{See Charles Jordan Tabb (1997), p. 475.}

As a result of these developments, new problems were faced by both regular and new players in the insolvency field: for example, the bankruptcy courts had to interpret the code in a way that could be consistent with the new rights and duties of the parties, the debtors and both voluntary and involuntary creditors had now an increased dose of uncertainty about the outcome of their cases under the new provisions\footnote{For example, a significant departure from the Bankruptcy Act was the introduction of the definition of claims, which is an essential part of this paper.}, interested third parties seeking to invest in the troubled business couldn’t accurately evaluate what the potential cost of the successor liability doctrine might be and even people not yet injured could be potentially involved in a bankruptcy proceeding, regardless of being unaware of it. Those new bankruptcy provisions brought to the discussion table new arguments and objectives, which tended to be seen as weakening the position of tort claimants. People with latent or non-manifested injuries (usually referred as future claimants in bankruptcy lingo) appeared to be taking the biggest hit, as their rights could be virtually precluded not only at a substantive level, but also at a procedural one\footnote{Tort victims faced the possibility of getting just a few cents for their dollars of credit if their credits where finally discharged while not being able to sue the debtor.}

Many reorganization proceedings were filed because of the economic and financial situation of the debtor. Allegedly, others have been filed because debtor’s counsel considered it the best way to handle present and future pressures from creditors\footnote{Being in a no win situation, as the elements of liability had already been proven in other cases and the companies only could wait for defendants to sue them, arguably they tried the bankruptcy gamble to see if they could shield themselves, even taking a big hit, from even greater liability.}. Moreover, transaction costs (namely searching costs, litigation expenses, free riders costs and hold outs) were a prime concern for debtors. As Professor Elisabeth Gibson has stated “When a defendant faces thousands of claims of a similar nature, even a successful defense of the claims may cost more than the company can afford.”\footnote{See Elisabeth Gibson (2000), p. 7.} Thus, either as prevention or as a result of the demands the company faces, filing for bankruptcy\footnote{Except as expressly manifested, in the present comment I will use the term bankruptcy to encompass both liquidation and reorganization proceedings.} began to be seen as the one of the various available solutions to, from a policy point of view, put the debtor assets at the best possible use and distribute proceeds in the fairest possible way, while eliminating some transactional costs, or just shield assets from creditors, from a debtor’s optic.

The debate over the correct breadth of the definition of claims in bankruptcy has been profuse. This note intends to shed light over the inescapable upper limit of recovery presented by the debtor’s assets in addressing the “futures problem” in bankruptcy and the social welfare diminution of excluding them. Section II will focus on defining the mass torts concept, the problems it entails and the need to address those problems with collective litigation tools. Section III.A will introduce basic
bankruptcy concepts as a way to induce the debate on the definition of claims and its problems. Section III.B will add the time dimension to the discussion. Section IV.A will explain why excluding future claims form the bankruptcy proceedings is a waste of resources. Section IV.B will acknowledge the problems of dealing with future claims in the bankruptcy setting. Section V will offer some concluding remarks.

2. Mass torts

As afore mentioned, mass tort litigation is a contemporary phenomenon. Sophisticated science (new theories and research methods) made possible for both society and, hence, plaintiffs, to trace chains of causation that earlier knowledge wouldn’t permit\(^\text{17}\). In addition, massive amounts of information are readily available for society to use or misuse thanks to technological advances, such as the Internet. Consequently, the number and complexity of tort causes of action has increased, and should keep on growing, as the incentives that propel the expansion remain unaltered\(^\text{18}\).

There is no statutory definition of what mass tort means. Far from regarding this as a flaw, the Report on Mass Tort Litigation considers that a precise definition of mass tort is unnecessary\(^\text{19}\). Generally speaking, mass torts are civil wrongs involving numerous plaintiffs suing a few, common defendants in state or federal court for an action arising from a single accident or exposure to some product or substance.\(^\text{20}\) The concept is purposely broad just to stress the idea of many people having a similar causal problem and searching for an answer from the same respondents, in contrast to any particularities that may differentiate them.\(^\text{21}\)


\(^{18}\) See Elisabeth Warren and Jay Westbrook (2001), p. 756. Among the incentives we can find the awards given by juries and judges throughout the country, which lead interested lawyer/entrepreneurs to keep investing in bringing suits against solvent defendants. In the words of the Report on Mass Tort Litigation “...enormous attorneys fees, often in the millions of dollars, ... causes the process to generate it's own momentum”. See the Report of the Advisory Committee on Civil Rules and the Working Group on Mass Tort to the Chief Justice of the United States and to the Judicial Conference of the United States, February 15, 1999, p. 4.


There are different ways of categorizing mass torts. A common one concentrates on the source of the harm (which permits to intuitively recognize the ability to reduce transaction costs by treating them together) and consists of three groups. First, mass disaster torts are the ones arising out of a single accident where many people are injured. An example of such a situation could be a train crash or a fire in a closed facility. Second, mass toxic or environmental torts, generally come about due to contaminated materials being released the environment, which sooner or later affect public health. Finally, defective products constitute the third category of mass torts. Vast amounts of products sold into the market (ranging from tires to breast implants), may harm numerous persons out of similar design defects.

When mass tort cases come up, serious limitations in the way to manage and adjudge them are exposed. According to Professor Vairo “The traditional tort litigation model of one plaintiff against one defendant is being altered by efforts to address tortuous conduct affecting many apparent victims through litigation involving multiple plaintiffs and often multiple defendants in courts all over the United States.” Among the reasons mentioned by Professor Vairo to defend his position are the expensiveness of litigation, the potential unfairness among similarly situated tort victims and the dilution of debtor’s assets.

Put in other way, mass tort litigation basically tries to address three different problems that tort victims’ face through some type of accumulation of claims mechanism. First, mass tort litigation intends to accomplish optimal deterrence of tortuous activity. As many victims suffer small injuries that by themselves could not entice lawyers (or even the victims themselves) to invest in legal action, firms won’t ever have to pay for those damages, therefore externalizing them. As a result, firms provide an inefficient level of precaution and activity, with its correlation of loss of social welfare. By permitting those tort victims to aggregate their similar claims into a single litigation, economies of scale modifies this uneven scenario making it economically possible for victims to pursue their rights. Hence, externalization of firm costs is avoided and a greater degree of social welfare is achieved.

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22 Some classifications have been made according to the value of the claims [see John C. Coffee, Jr. (1995), p. 1351], others regarding the proximity of harm occurrence [see John C. Coffee, Jr. (1995), p. 1424]; and a third type focused on the “maturity” of the claim [see Francis E. McGovern (1989), p. 659].
23 See Geoffrey C. Hazard, Jr. (2000), pp. 1901-03, where he describes different types of mass torts.
24 Basically, any event that can be easily individualized and where the effects arising out of it can also be fairly simple to establish.
25 For example, a massive chlorine release as a result of a tank leak in a car carrying chlorine as a result of transportation, as experienced by Norway shores;
26 Georgene Vairo, p. 93.
27 Georgene Vairo, p. 93-94.
28 See Note: Locating Investment Asymmetries and Optimal Deterrence in the Mass Tort Class Action, pp. 2669-70.
30 Looking at one of the devices to help solve this lack of incentive problem, the Supreme Court held in Amchem Products Inc. v. Windsor that the central purpose of the class action “is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action
As a way to help achieve optimal deterrence, Professor ROSENBERG captains the idea of obtaining early judgments. Professor ROSENBERG notes that they could thwart “firms from using long latency periods to become judgment proof or otherwise evade the bulk of the claims”32. This proposal has not been the only way to approach the important goal of preventing liability shirking33 and most likely places a control burden on unfitted agents (as the persons with less information are supposed to control the debtor34).

Second, as a byproduct of claim aggregation, a proxy for internalization of costs by individual members of society is accomplished. By allowing claim collectivization the public good problem which optimal deterrence turns out to be is diminished.35 As every member in the community benefits from optimal deterrence, spreading the cost of enforcing that optimal deterrence through the many mass tort victims tends to partially achieve a societal internalization of those costs36.

Third, the mass tort litigation model intends to address investment asymmetries among the parties37. Under the traditional litigation model, a defendant immediately gains the ability to exploit some advantages of scale by investing in her defense38. The reason lies in that both parties will have to prepare for litigation without the particular tort victim being able to spread his legal costs across other, similar claims as the tort feasor will. Therefore, the tort feasor will be able to invest in his defense relatively more, diminishing the success chances of individual tort victims. As has been noted “The defendant’s favorable investment economies in litigation lead to a decrease in its aggregate expected liability, meaning that ex ante it will invest less in taking precautions than it would have invested had it not been able to exploit these litigation investment advantages ex post”39.

solves this problem by aggregating the relatively paltry potential recoveries into something worth someone’s (usually an attorney’s) labor”, see 521 US 591, p. 617 (1997)

31 Must be noted that optimal deterrence is only theoretically achieved, as inherent managers and company and industry incentives coupled with time, distort the efficacy of a model presenting deterrence as a function prevention costs, probability of damaging people, total damage and probability of having to pay. See Note: Tort as a Debt Market: Agency Costs, Strategic Debt, and Borrowing Against the Future, 115 Harv. L. Rev. 2294, 2002.

32 See David ROSENBERG, p. 234.

33 Avoiding long-term insolvency problems has been proposed through different legal mechanism. See for example Note, Switching Priorities: Elevating the Status of Tort Claims in Bankruptcy in Pursuit of Optimal Deterrence (2003), H116 Harv. L. Rev. 2541H (proposing that tort claims have priority over secured and secured creditors’ ones); also see Henry HANSMANN & Reinier KRAAKMAN (1991), p. H1879H (helping to achieve unlimited shareholder liability to prevent cost externalization by firms).

34 For example, consumer tort victims usually have no idea of the economic solvency, in terms net worth, of the tort feasor.

35 See David ROSENBERG (1994), p. 901; also see Steven SHAVELL,“The Social Versus the Private Incentive To Bring Suit in a Costly Legal System”, 11 J. Legal Stud. 333, 339.

36 The internalization is not complete as victims possessing a legal claim virtually serve as agents for the whole society helping achieve optimal deterrence, while not earning a premium for a service that potentially benefits everybody.

37 See Note: Locating Investment Asymmetries and Optimal Deterrence in the Mass Tort Class Action, pp. 2672-74.


39 See Note: Locating Investment Asymmetries and Optimal Deterrence in the Mass Tort Class Action, p. 2674.
Different procedural aggregation tools were established to try to accommodate the mass tort litigation needs. Multidistrict litigation (28 USC 1407), consolidation of claims (Rule 42 of Federal Rules of Civil Procedure), permissive joinder (Rule 20 of Federal Rules of Civil Procedure), class actions (Rule 23 of Federal Rules of Civil Procedure); collateral estoppel and private case management consortia are among the alternatives used while dealing with mass tort litigation.

In addition to these procedural devices, punitive damages should serve as another avenue for bringing about the same results. As pointed out by Professors Shavell and Polinsky, punitive damages basically should operate to achieve only optimal deterrence of injurers. This conclusion is strongly contested by scholars while courts have an eclectic view of punitive damages objectives, making it difficult to place punitive damages in the same category as the procedural aggregation solutions.

All these procedural options have been criticized due to their shortcomings. According to Professor Roger Cramton there are three main problems as a result of mass tort litigation: 1) proof of causation is difficult because of long latency periods (which contrast with prompt and usually definitive solutions); 2) determining which of the individual actors and factors caused the injury (considering the distinctiveness of each of the aggregate cases); and 3) complexity of providing individualized justice to each and every claimant. In addition, statutes of limitations provide an important hurdle, as latency periods may be long enough as to preclude some actions, even though the injury didn’t yet materialized.

Although bankruptcy has not been originally devised to address the mass tort problem, some counseling lawyers and academics have proposed it as another possible answer to the mass tort quandary. In 1982, the Johns-Manville Corporation became the first “giant” corporation to invoke Chapter 11 of the Bankruptcy Code to resolve its load of asbestos claims. The breaking ground case

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40 Limited to situations in which parties pursue their rights “in respect of or arising out of the same transaction, occurrence or series of transactions and occurrences”. See Federal Rules of Civil Procedure 20 (a). For consideration of the shortcomings of this possibility, see Richard Epstein (2003), p. 486.
42 For another discussion of the alternative aggregation of claims possibilities see Elizabeth Cabraser (2005), p. 1475.
43 See Mitchel Polinsky and Steven Shavell (1998). Although the authors only consider punitive damages under the traditional “day in court” model of litigation, the objectives that they champion for punitive damages to pursue are basically the same as the ones pointed in this section, namely, to avoid externalization of costs to have the optimal level of torts. Investment asymmetries are not tailored under their analysis, but could be seen as a refinement of it. It should be noted though, that claimants are clearly not indifferent from choosing either some sort of claim aggregation or punitive damages, as the award is not distributed in the later and it is in the former.
44 See e.g. Pac. Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 19 (1991), stating “It is true, of course, that under Alabama Law, as under the law of most States, punitive damages are imposed for purposes of retribution and deterrence”.
46 See Linda Mullenix, pp. 1927-1928.
47 See, for example, Alan N. Resnick (2000); See Mark J. Roe (1984).
opened the gate to numerous other corporations in the asbestos and other industries to explore the chapter 11 solution.

3. Mass Tort within Bankruptcy

3.1. The Setting

In a broad sense, bankruptcy can be understood as a mechanism designed to avoid common pool problems, in order to maximize the value of the estate for the residual owners.\(^{48}\) Under this view, a widespread filing of lawsuits by single creditors against the debtor would deplete debtor’s assets (the common pool), as the debtor would spend everything in defending his assets against the upcoming claims. A bankruptcy proceeding serve as a way to stop the “grab race” to the assets problem\(^{49}\), placing them to the best use.

In order to accomplish its objective, Bankruptcy Law is structured under three main characteristics. First, bankruptcy proceedings provide for a mandatory way of dealing with insolvency matters. As a result, every player in the bankruptcy game gets subject to the judicial control over the process. Hence, no creditor can opt out, ideally averting any possibility of creditors using their bargain power to obtain more than they relatively are entitled to.

Second, the bankruptcy proceeding is often referred to as a universal one.\(^{50}\) As such, it encompasses both every asset and liability of the debtor, having minor exceptions in different states.\(^{51}\) Therefore, creditors remain assured that no other avenue to get paid exists, signaled by the "automatic stay" clause\(^{52}\), and that every asset pertaining to the debtor will be in the distribution scheme (and hence ex ante justice will reign), reassured by the "strong arm" clause\(^{53}\).

Third, the decisions made in the proceedings are intended to be final\(^{54}\): once a payment plan is established, the old debts disappear and they are replaced by new creditor rights on the assets. The debtor obtains a bankruptcy discharge if he successfully completes the reorganization plan or

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\(^{48}\) This is the dominant view of bankruptcy theory that follows the seminal work of Professor Thomas Jackson and Douglas Baird. See Thomas H. Jackson (1986). See also Douglas Baird and Thomas Jackson (1984). Other theories contending the approach of the creditor’s bargain theory are Professor Donald R. Korobkin, utilizing a Rawlsian approach to bankruptcy aims; P. Shuchman (1973), focusing on the moral worthiness of debt and its size; and, Elizabeth Warren (2005), p. 811, considering the theory as one of eclectic values. For a complete account of the different bankruptcy theories, see Vanessa Finch (2002), pp. 33-42.

\(^{49}\) See Legal Department International Monetary Fund (1999), Orderly and Effective Insolvency Procedures. Key Issues, pp. 18-25.

\(^{50}\) See Legal Department International Monetary Fund, Op. Cit., pp. 16-25.

\(^{51}\) For the federal exceptions, see 11 USC § 523(a).

\(^{52}\) See 11 U.S.C., section 362.

\(^{53}\) See 11 U.S.C., section 544.

\(^{54}\) This statement addresses the substantial side of bankruptcy theory, not any “res judicata” analysis.
completely liquidates his assets. In this case, the Bankruptcy Code releases the debtor from liability for all "claims" that arise before the order of relief in a Chapter 7 case, or that arise before a Chapter 11 plan is confirmed. There are some minor exceptions to this rule concerning special needs situations or systematic requirements, as obligations arising out of alimony, student loans or money obtained through actual fraud, for example, don’t get discharged.

The discharge provision is one of the most important in the bankruptcy field. It provides for the necessary incentives to avoid risk-shifting problems (as it allows the entity which comes out of the bankruptcy proceeding to suffer and benefit from the actions that it undertakes and a fresh start to individual debtors, a principal part of the bankruptcy objectives). As important as the reasoning behind the discharge provision is what its practical boundaries are. Those boundaries are set by the definition of a claim in section 101 (5) of Title 11, because in order for an obligation to be discharged it must constitute a claim according to the provisions of the Bankruptcy Code.

The definition of claim is very broad. The main idea behind such broadness resides within the very essence of the bankruptcy proceeding, as it is meant to be universal and final proceeding (as all the assets will be apportioned among the creditors according to their respective priorities and anything that is left out potentially will generate an unfair situation among the residual owners). Despite the clear intention of Congress in adopting such a definition of claim, and perhaps due to the Supreme Court decision in "Pennsylvania Department of Public Welfare v. Davenport", the interpretation of the definition of claims has been far from univocal.

55 See 11 USC § 727, § 1141, § 1228 and §1328
56 See 11 USC § 523(a), referring to 19 exceptions to the discharge rule.
58 Charles Jordan TABB considers that there are three main effects of a claim: a) “only claims may be paid in the bankruptcy distribution”; b) “only claims are discharged”; and c) “the holder of a claim is stayed during the case from taking any action to collect its claim from the estate or from the debtor.” See Charles JORDAN TABB (1997), p. 467.
59 See 11 USC 101(5), which defines a 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[0];…”
61 See In re Asbestos Litig. (Flanagan v. Ahearn), 90 F.3d 963 (5th Cir. 1996), vacated, 117 S. Ct. 2503 (1997), noting that the new Bankruptcy Code “by this broadest possible definition, and by the use of the term throughout Title 11… contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court”.
62 See 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 22 C.B. C. 2d 1067, 1990. In page 558, the Supreme Court States “A ‘debt’ is defined in the code as a “liability on a claim”, § 101(12), a ‘claim’ is defined in turn as a ‘right to payment’, § 101(5), and a ‘right to payment’ we have said, ‘is nothing more nor less than an enforceable obligation’”, which is an interesting result, as the Bankruptcy Code also qualifies as a claim non enforceable obligations.
63 As I will refer to in the next section, the definition of claims has been the reason for three conflicting Court of Appeals decisions.
Once compared, the bankruptcy core characteristics resemble greatly the main features of most sophisticated aggregation solutions to mass tort litigation\(^{64}\). Whether or not this is the case, and without penetrating the debate concerning the social efficiency or strategic meaningfulness of using the bankruptcy vehicle to cope with the mass tort problem, Bankruptcy Law inescapably has to deal with some of the same problems as those aggregation solutions. The next section will attempt to show one of those common problems, “the futures” and how it is dealt with under the Bankruptcy Code.

### 3.2. Futures Problem: The Time dimension

At least until the Supreme Court decision in *Amchem Products Inc. v. Windsor*\(^{65}\), aggregation mechanisms, including bankruptcy, had to deal with the so called “futures problem”. According to Circuit Judge Diane P. WOOD “…a “futures” claim is one based on an event that has already occurred (such as exposure to a toxic material), but whose consequences will not become clear enough to support a legal claim until some time after the statute of limitations (measured from the date of the event) has expired.”\(^{66}\) Besides the situation presented by Judge WOOD, i.e. when statute of limitations doesn’t follow the “discovery rule”\(^{67}\), statutes of repose\(^{68}\) or the debtor turning judgment proof cause the same inequitable result.

Under the traditional scheme, tort victims do not have to worry about when their injuries arise, because when they notice the damage, they’ll be able to sue in order to get fully compensated. Once insolvency enters the picture\(^{69}\), how to achieve justice for those people with latent harm has divided the courts. As skewed above, the definition of claims in bankruptcy has been chosen as the battlefield to settle this dispute. As no Supreme Court decision on the topic has been taken yet, three conflicting standards are being applied in the United States: the conduct test; the relationship test; and, the fair contemplation test.

The conduct test is considered to be the broadest of all of them. According to the 4\(^{th}\) Circuit in *Grady v. A. H. Robins Co.*\(^{70}\), a claim for bankruptcy purposes arises when a debtor’s tortuous conduct occurs,

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\(^{64}\) Many claims brought together, economies of scale providing cheaper litigation costs, investment asymmetries being dealt with in the same manner as with class actions plus no opting out possibility. Indeed, H. NEWBERG has qualified bankruptcy as “statutory class actions”. See H. NEWBERG (1985).

\(^{65}\) See 117 S. Ct. 2231 (1997).


\(^{67}\) The discovery rule states that a “cause of action accrues when the plaintiff knows or through the exercise of due diligence should have known of the injury”. See *Burns v. Bell*, 409 A.2d 614, 617 (D.C. 1979). The traditional rule on the contrary considers that “the cause of action accrues at the time of the invasion of [the plaintiff’s] body”. See Steinhardt v. Johns-Manville Corp., 430 N.E.2d 1297, 1299 (N.Y. 1981).

\(^{68}\) Those who block any suit after a certain number of years. See Kan. Stat. Ann. 60-513 (1977)

\(^{69}\) As well as the other time dimension problems, but as this note focuses on bankruptcy, I’ll leave the rest for further study.

\(^{70}\) *Grady v. A. H. Robins Co.*, 839 F.2d 198.
whether or not an injury is manifested at that time\textsuperscript{71}. Therefore, the only fact required is that a debtor have, for example, dumped toxic materials into the sewer, or that he sold his defective product. The test is fairly easy to apply and is the one that the majority of the debtor managers want to use, as the discharge is going to be the broadest\textsuperscript{72}. Precisely this is the critique that falls on it. Critics regard this test as an unfair solution, as people who are unaware of the future damage they will suffer or, even if they fear being injured, may have no idea that a bankruptcy proceeding is pending, still will get their future credits discharged\textsuperscript{73}.

The relationship test, established by the 11\textsuperscript{th} Circuit \textit{In re Piper Aircraft Corp.}\textsuperscript{74}, shares the same basic idea as the conduct test, but tries to limits some extreme results by adding another requirement. According to Professor Alan RESNICK’S view of the relationship test, “a claim arises for bankruptcy purposes when the debtor has engaged in the conduct giving rise to liability and there is contact, privacy of contract, or another relationship between the claimant and the debtor.”\textsuperscript{75} Therefore, the court found that a tort claim for defective product arising out of a jet crash (sold by the debtor before filing for bankruptcy), some years after the reorganization plan was approved was not discharged under Piper’s bankruptcy proceeding.

The last standard is the “fair contemplation test”, established by the 9\textsuperscript{th} Circuit \textit{In re Jensen}.	extsuperscript{76} According to Professor RESNICK “a claim does not arise for bankruptcy purposes until the debtor’s tortuous conduct occurs and the potential existence of the claim could have been reasonably contemplated by the parties.”\textsuperscript{77} It should be highlighted that this interpretation of \textit{In re Jensen} is not universal. For example, Professor TABB reads the decision as utilizing the relationship test in environmental mass torts.\textsuperscript{78} This decision tries to work as much as possible to protect future tort victims but if correctly interpreted by Professor RESNICK, bankruptcy goals would probably not be achieved using it, because of the lack of comprehensiveness that such a standard brings into the insolvency proceeding\textsuperscript{79}.

The differences presented in the opinions lie over highly valuable policy objectives. Inside an insolvency scenario, conflict of goals emerge when one tries to both achieve the bankruptcy aims of fair distribution and efficient use of assets, and protect the right of those future claimants under state


\textsuperscript{72} If the debtor manages to keep directing the business or even has a residual participation on it, he will want to maximize the certainty of liabilities and their amount to try to obtain part of the reorganization benefits

\textsuperscript{73} See, for example, Richard I. KILPATRICK and Thomas J. SALERNO (1995), p. 10.

\textsuperscript{74} \textit{In re Piper Aircraft Corp.}, 58 F. 3d 1573.

\textsuperscript{75} See Alan N. RESNICK (2000), p. 2071.

\textsuperscript{76} \textit{In re Jensen}, 995 F. 2d 925.


\textsuperscript{79} See below Section IV.A
tort law.\textsuperscript{80} Under a traditional litigation view\textsuperscript{81}, Bankruptcy focuses on distributive issues, while Tort Law concentrates on corrective justice\textsuperscript{82} (consequently protecting the right of a victim to bring her claims in order to repair the damage done by tortfeasors is imperative). Put in the words of Professor RABIN “a tension between our continuing impulse to do individual justice and a more modern compensation-driven conception of collective justice”.\textsuperscript{83} The intent to strike a balance is evident under the JENSEN and PIPER decisions.

As if the difficulty of solving the preceding problem didn’t suffice, constitutional due process rights of the future claimants must be brought into the scenario. The first problem consists on how to provide future (unknown) claimants with adequate notice or the opportunity to be heard in any trial where their rights are at stake.\textsuperscript{84}

Naturally, if future claimants most likely don’t know that they have latent diseases, even worst is the chance of realizing that their future rights are being ascertained. Therefore, with no participation the possibility of a proper defense appears to be lessened. If, in addition, later in the future when they realize that they have been injured, they cannot sue the debtor, a violation of the constitutional right to due process, established in the Fifth Amendment, could be manifested.\textsuperscript{85} The next section will show how to decide on a standard juggling with these values.

4. Developing an answer

4.1. Creditor’s strategic reaction

The bankruptcy design potentially can include future claims due to its fresh start aspiration. Now, as for the future claimants, the logical way to include them relies on the fact that, to some extent, they have already been damaged by the unnecessary exposure to the risk of harm.\textsuperscript{86} Therefore they have an economic right to be made whole that bankruptcy should protect.


\textsuperscript{81} By a traditional litigation view, I mean one derived out the Aristotelian concepts of justice. See Aristotle “Nicomachean Ethics”, in Jonathan BARNES (1984), ed. 2, pp. 1729, 1781-97.

\textsuperscript{82} See Kevin M. WARSH (1995), p. 678, considering that “The law requires the wrongdoer to make the victim "whole."”. Also see Fowler v. Harper, FLEMING JAMES, Jr. & Oscar S. GRAY (1986), p. 490, quoting “The cardinal principle of damages in Anglo-American law is that of compensation of the injury caused to plaintiff by defendant’s breach of duty”.


\textsuperscript{84} See Ralph R. MABEY and Jamie ANDRA GARVIN (1993), pp. 775-776.


\textsuperscript{86} See Claire FINKELSTEIN (2003), pp. 967-969.
In the same way as anybody is better off by having a ticket to win the lottery than by not having it (ceteris paribus), anybody who has been exposed to a toxic material is worst off than someone who has not been exposed to it. In this sense, the lottery ticket holder or the person exposed to a risk has a valuable economic right, namely a chance to win the lottery and a chance to recover contingent damages, respectively.\footnote{This possibility correlates the chance of being damaged.} This is the idea lying under probability statements.\footnote{See Michael D. Resnik (2000), pp. 47-48.}

Having this in mind, let’s consider how to value a distressed business outside and then inside bankruptcy. If $Y$ is the value of the business outside bankruptcy we could have

$$Y = AV - \alpha PC - \beta FC$$

where $AV$ is the present value of assets, $PC$ is the value of the present claims (those which do not arise out of latent injuries) and $FC$ is the present value of future claims. The modifiers $\alpha$ and $\beta$ correspond to the weighted average probability of losing the lawsuits were the company is asked to pay for the present and future claims respectively and are between 0 and 1. Valuation experts may disagree on which standard to use, for example the “market comparison approach”, the “comparable transaction” or the “discounted cash flow”, but they inevitably will use one of those to capture the value of the business.\footnote{For an account of these methodologies see Peter Pantaleo & Barry Ridings (1996); Kerry O’Rourke (2005), pp. 419-24.} Naturally afterwards they will deduce the value of the present and expected debt to arrive to their estimate.

In a bankruptcy setting, reorganizations of non-individual debtors present the luxury of simplifying the formula. As a discharge means no successor liability\footnote{For an account of successor liability doctrine see Michael Green (1986).}, any party proposing a reorganization plan to acquire the going concern value of the business, will only need to compute $AV$ to capture it. Once you paid 100% of the value of the assets (assuming the price actually represents the fair value of the assets\footnote{In the secured credit literature there are several articles showing the commonly inadequate price/value ratio in auctions.}), to be asked later for more, in our case for debts arising of future claims, would mean to ask the buyer to take a loss on his investment right form the start\footnote{Under a perfect competition scheme, the efficient use of the assets would only bring a marginal profit, which would be trimmed if future claims are not discharged in the insolvency proceeding}. As logical conclusion, any prudent buyer will only pay $AV - \beta FC$ for the reorganized business. This is expressly against the idea of the Bankruptcy Reform Commission, which intended the bankruptcy proceedings as a mean to maximize the value of a business\footnote{Consistently, the National Bankruptcy Review Commission has proposed to clarify the matter by adopting the definition of future claims in the code and to expressly deal with them in bankruptcy. See Report of the National Bankruptcy Review Commission, October 20, 1997, at http://govinfo.library.unt.edu/nbrc/reporttitlepg.html}. Furthermore, it changes the relative

87 This possibility correlates the chance of being damaged.
89 For an account of these methodologies see Peter Pantaleo & Barry Ridings (1996); Kerry O’Rourke (2005), pp. 419-24.
90 For an account of successor liability doctrine see Michael Green (1986).
91 In the secured credit literature there are several articles showing the commonly inadequate price/value ratio in auctions.
92 Under a perfect competition scheme, the efficient use of the assets would only bring a marginal profit, which would be trimmed if future claims are not discharged in the insolvency proceeding
93 Consistently, the National Bankruptcy Review Commission has proposed to clarify the matter by adopting the definition of future claims in the code and to expressly deal with them in bankruptcy. See Report of the National Bankruptcy Review Commission, October 20, 1997, at http://govinfo.library.unt.edu/nbrc/reporttitlepg.html
position of each of the creditors, as other creditors probably won’t get 100 cents on the dollar, as future claimants will have the chance to.

In a time where mass torts claims driving business into bankruptcy is no longer a surprise, allowing future claims to be outside the definition of bankruptcy, as it is to some extent with the relationship and fair contemplation tests, potentially turns bankruptcy proceedings into a big administrative waste with very small achievement compared to its costs. Let’s assume that a peace meal liquidation (LQ) is less valuable than a reorganization (AV)\(^4\) in terms of the discounted cash flow of the assets in each situation (AV>LQ), therefore requiring having a reorganization. In addition, let’s assume that future claims are not claims under the meaning of the code, hence not discharged under the bankruptcy proceedings.\(^5\) The problem is that if the value of the assets under reorganization is smaller than the value of future claims, AV<βFC, then there is going to be a peace meal liquidation. The reason for this result arises out of successor liability doctrine.

Under successor liability doctrine only 6 scenarios allow courts to impose liability on a successor: a) merger or consolidation of the purchasing and selling corporation; b) de facto merger; c) continuation\(^6\); d) contractual assumption; e) fraud\(^7\); and f) product line theory\(^8\). A liquidation setting presents a person acquiring assets of the estate, which naturally rules out merger or consolidation and de facto merger\(^9\). Assuming there’s no fraud or contractual imposition, successor liability could be imposed only under the continuation or product line exception. In a continuation case three facts must be shown under Turner v. Bituminous Cas. Co.\(^10\): (1) continuation of the seller corporation, in terms of continuity of management, personnel, physical location, assets, and general business operations of the predecessor corporation; (2) the predecessor corporation dissolves as soon as legally and practically possible; and (3) the purchasing corporation assumes those liabilities of the seller necessary for the uninterrupted continuation of normal business operation of the selling corporation.\(^11\) A buyer under a liquidation scheme does not have to assume any debts of the debtor, therefore not complying with prerequisite number 3. Also, it would be in many situations doubtful whether the buyer complies with situation 1.

\(^4\) I am using AV as the value of the assets under reorganization, i.e. the best use of the assets and therefore the most valuable. If reorganization is supposed to achieve its aim, then this is a reasonable assumption.

\(^5\) I am also assuming rationality of the players (debtor, creditors and judge) and knowledge about the value of βFC.


\(^9\) See Michael Green (1986), Op. Cit., where he claims “The de facto merger exception developed to encompass sales of assets for stock that were functionally equivalent to a merger.” “Courts have limited the de facto merger exception to acquisitions in which the predecessors’ assets were acquired in exchange for stock”.


The product line exception was first recognized in *Ray v. Alad Corp.*

In Ray, the Supreme Court of California established a multi-test condition: destruction of plaintiff’s remedies, successor’s ability to spread the original manufacturer’s risk and fairness. Courts require that the acquisition of the business must cause or substantially contribute to the destruction of the plaintiff's remedies to fulfill the first requirement. Hence, a successor who purchases assets at a bankruptcy sale cannot be considered the cause of a plaintiff's lack of remedy against the predecessor (unless extra bankruptcy situations showed that). This was the result in *Nelson v. Tiffany Industries, Inc.*

Consequently, as no successor liability doctrine will apply under the liquidation scenario, creditors are going to be better off by rejecting a reorganization plan when $AV < \beta FC$, as they will be getting a less money out of the reorganization. Easily follows that the creditors will have an incentive to reject any reorganization plan offering to pay $AV$, preferring to put the assets to a less valuable use under liquidation. Hence, the net worth loss will occur, which with the giant corporations that exist today could easily be counted in millions.

Interestingly, this result can be partially extended to the case where even though reorganization value is bigger the value of the future claims ($AV > \beta FC$), the reorganization value minus the liquidation value is smaller than the value of the future claims ($AV - LQ < \beta FC$). The reason for this result is that any time the liquidation value is bigger than reorganization value minus the value of future claims, creditors will prefer the liquidation alternative. Hence, for a business to reorganize (capturing the greatest net worth) you need not only to have a positive net worth arising out of reorganization, but also that the positive net worth is bigger than $LQ$. Otherwise $AV - LQ$ is going to be lost to society.

A further distinction needs to be made concerning who is entitled to $LQ$. If secured creditors are entitled to $\sigma LQ$, with $0 \leq \sigma > 1$, then everybody will be preferring $LQ$, as unsecured creditors would be getting $(1-\sigma)LQ > 0$ instead of a negative value in reorganization. Again this result would put the assets to a poor use under both of our scenarios. On the other hand, when secured creditors are entitled to $LQ$, then unsecured creditors will have an incentive to gamble. First, they may consider

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104 See 778 F.2d 533, 537 (9th Cir. 1985).
105 See 778 F.2d 533, 538 (9th Cir. 1985).
106 I am not taking into account control benefits for some creditors who may want push for reorganization as a way to get those benefits.
asset volatility and may try to delay the reorganization to gain from the real value option.\textsuperscript{108} By waiting they may benefit from a change in the valuation of the assets and obtain some value for their claims. As the managers/ equity holders would also benefit from this scenario\textsuperscript{109}, the company would invest high-risk projects with negative present value but with a great upside that would in turn diminish the total amount received by all the creditors. Second, a coalitional problem may arise in the peace meal liquidation itself. As shown by HOTCHKISS and MOORADIAN\textsuperscript{110}, equity holders and junior creditors may bid in this liquidation over their own valuation (which may inefficiently assign assets) in order to obtain a bigger share. The overbidding scenario is generated because overbidding forces prices up (increasing coalitions’ reward if it losses the auction) and because by paying more it would be partly paying to itself.

It could be argued though, that not discharging future claims would to some extent foster optimal deterrence. Such a position would rely on the fact that the practical effect would be the same as upgrading future claims in bankruptcy.\textsuperscript{111} Such a proposal would be based on imposing control duties over secured creditors, who in theory would be in a better situation than tort victims to monitor and restrict the possibility of the debtor going to tort debt market to finance himself.\textsuperscript{112} Evidently, a non-discharging rule would increase the incentives of the secured creditors to keep the debtor in check. The problem with the reasoning is that, even if reorganization is chosen, creditors won’t find it cost efficient to deal with the uncertainty that future claims provide. For them, it will be much cheaper to control that their credits are not underwater (normal credit procedure) for which they do not have to develop any new technique nor hire specialized product or environment liability experts. So their incentive to control would be non-existent, as they would always get paid under liquidation.

Therefore, if bankruptcy proceedings are intended to maximize the value of the estate, the conduct test should be chosen to deal with future claims. As a result of making creditors choose reorganization (by including future claims in the distribution and discharge process), it also helps provide the right incentives for debtors’ managers’ pre-bankruptcy to timely file for reorganization, which is one of the important objectives of allowing debtor in possession.\textsuperscript{113} In addition, if any other than the conduct test is used, equality of distribution among similarly situated creditors would be broken, as future claimants could potentially receive 100% on the dollar contrasting with the smaller percentage to be received by present tort claimants.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{109} See Bebchuk & H. Chang (1992).
\item \textsuperscript{110} See Edith Hotchkiss and Robert Mooradian (2003).
\item \textsuperscript{111} For a focalized study of such a proposal see Note: Switching Priorities: Elevating the Status of Tort Claims in Bankruptcy in Pursuit of Optimal Deterrence, 116 Harv. L. Rev. 2541.
\item \textsuperscript{112} For an exposition of the tort damages as a debt market see Note: Tort as a Debt Market: Agency Costs, Strategic Debt, and Borrowing against the future, 115 Harv. L. Rev. 2294, 2002, considering that if consumers don’t pay a tort premium on the products they purchase and the seller doesn’t use that money for precautions, they are actually lending money to the seller, which he will have to pay back at the time of the damage awards are entered.
\item \textsuperscript{113} See Elisabeth Warren, Jay L. Westbrook (2001), p. 475, relating to the choice of “carrots or sticks” (incentives or penalties) to timely bring a bankruptcy proceeding.
\end{enumerate}
\end{footnotesize}
4.2. Hurdles to overcome by the conduct test

Obviously, the general implementation of the conduct test won’t come without difficulties. First, estimation of future claims according to Section 502(c) of the Bankruptcy Code can be extremely difficult. Collier on Bankruptcy points that “In estimating a claim, the bankruptcy court should use whatever method is best suited to the particular circumstances”. Courts generally go through the process of hearing expert opinions presented by the parties and published medical information to assess, though in rough estimates, both figures. Once those numbers are achieved, they use the discount probability approach, following the procedure established “In re Xonics Photochemical, Inc.” According to Judge Posner’s Opinion, the courts should multiply the total possible amount of future claimants by the probability of getting injured and the average amount of their future claims. In addition to the valuation model of Xonics, several other ones have been proposed to deal with this difficult issue. Still, the biggest problem to solve is the lack of information available to produce accurate input figures, which turns this undertaking into a truly difficult and uncertain one.

A second obstacle consists on how to provide for adequate representation for the future claimants in order to provide for both due process and adequate control over their claims. The best way courts have found to protect them is to appoint a future claimants representative. In order to do so, future claimants are in a sense paralleled to “incompetents” for the purpose of the Bankruptcy case. This, again, constitutes an imperfect solution but the best available to deal with insolvency. The future claimant representative will be charged with the protection of the future claimants interests being completely independent from any other participant in the proceedings. He votes in the creditor’s decision to approve the plan and helps to estimate the total amount of future claims while giving his projections and the method he uses to arrive at them.

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114 See 11 USC § 502(c), which provides in that “all claims against the debtor be converted into dollar amounts”.
118 See F. Tung (2000). Also see National Bankruptcy Review Commission Bankruptcy: The Next Twenty Years: National Bankruptcy Review Commission Final Report, pp. 331-332: “The use of mass future claims representatives has become readily accepted in the reorganization context under present law, yet nothing in the Code expressly requires representation for mass future claimants or gives any guidance on the parameters of appointing such representatives... The Commission considered this representation an absolute necessity and a fundamental prerequisite to the discharge of mass future claims. A legal representative is essential to represent the interests of classes of holders who were not identified individually during the bankruptcy proceedings.”
120 This representative would be an agent with no direct principal to control him
121 It should be noted that after Amchem Products Inc. v. Windsor, it is self evident the necessity to have different claim representatives for future and present tort claimants (in the case there is a present tort representative under the bankruptcy proceedings). See 117 S. Ct. 2231 (1997). To read about the conflict of interest among different classes of tort victims see John Coffee, Jr. (1995), Op. Cit.
122 How to achieve that the representative effectively works for the future claimants is of extreme importance. In fact, it has been noted that “when the heat of the battle rises in terms of apportioning the assets, the future claimants’ representative has been used more as a mediator than as a party.” [0] See Laura Bartell (2004), p. 365. Also see Roger
A third hurdle is presented by the intricacy of accomplishing equality of distribution among equally situated creditors with inter-temporal differences in their injuries and, hence, claims. Trusts are nowadays the most common way of distribution in bankruptcy cases involving the futures problem. The *Johns-Manville bankruptcy case* used this form of distribution. It consisted of a trust, which divested payments on a “first come first served” basis. This method placed a heavy burden on the initial estimation of the value of the future claims, as, if proven wrong, later claimants may find the fund depleted. Therefore, this way of dealing with the problem favors claimants who settle their claims with the trust first due to the uncertainty on whether the assets of the trust will be sufficient to pay all claims. Ironically, it also provides incentives to a race to the assets, which is one of the purposes of the bankruptcy proceeding in the first place.

Several proposals have been made to ameliorate the intertemporal distribution. Professor Mark Roe proposes to establish a “variable annuity approach”, according to which any funds in the bankruptcy trust are disbursed gradually, so that if any inequality of distribution is being made, it can be adjusted in the future to avoid the major distribution issues. Professor Thomas Smith suggests a “capital market’s approach”, where, through the assignment of a share of the trust fund for each dollar of tort claims to each future tort claimant, lets the capital markets solve any inequality of distribution difficulty by permitting the sale of those shares. Ideally, after an undetermined period of time, when all the claims are gathered, the assets are distributed pro rata to the number of shares.

Yet another model is advocated by Professors’ Listokin & Ayotte. First of all, they propose a percentage fee arrangement for the future claimants’ representative tied to whatever the future claimants are entitled to, in order to provide him with an effective substitute for the lack of monitoring that exists due to the lack of ascertainable principals at the proceeding. Also, they propose to take into consideration the different amount of risk suffered by later claimants compared

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124 See *In re Laguna*, 114 Bankr. 214, 216, where it is considered that one of the principal bankruptcy goals consists on fostering financial rehabilitation and equitable distribution among creditors.

125 See Ralph R. Mabey and Peter A. Zisser, p. 495.


128 As mentioned above, this is one of the main purposes for an insolvency proceeding. Usually this race is referred as the common pool problem.


130 Though it ameliorates the intertemporal distribution problem, inequality will still arise out of this method as the trust may run out of money through this possibility also, adjustment may be needed to the amount paid for each dollar of claim and what early claimants received cannot be brought back to redistribute it again.


132 The biggest problem with this approach is that is it is possible that a tort creditor will sell his shares in a thinly traded market, and hence be ripped of by the big players who control that market. Thence, if there are no perfect capital markets to use, it’s at the most an imperfect solution.

to sooner ones, and assuming that they are risk averse, they advocate for an adjustment of the distribution of money to consider the amount of total risk borne by every future claimant. Though imperfect, the proposed solutions are another step in the quest for equal inter-temporal distribution.

A forth problem comes about with the class proof of claims in bankruptcy. There’s a split at the Federal Court of Appeal Level regarding whether to allow or not class proofs of claims in bankruptcy.¹³⁴ Most likely, if class proof of claims is not allowed, future claimants may even completely miss the bankruptcy procedure, as the debtor won’t have many incentives to expand its creditor list, as that would reduce his chance of conserving equity in the business. Plus, individuals will only have the incentive to file a proof of claim if they have knowledge about their future injury and the prospect of recovery is big enough to overcome the costs of filing it.

A fifth problem concerns the possibility of a sudden flooding of unreal future claims in bankruptcy. As the conduct test is highly prone to welcome future claims, the appearance of extremely insignificant present value claims would present an administrative hurdle (as the estimation of the claims would still be difficult, time consuming and somewhat expensive).

A sixth problem will be provided by debtors who once they have inside information about the possibility of important future claims, will drive into bankruptcy not disclosing all that information. In that scenario, they will try to get a discharge on future claims estimating them below their real level, so that they can still conserve equity in the business. This development is possible as the Bankruptcy Code has a liberal filing scheme where neither financial or balance-sheet insolvency is a prerequisite to file for Chapter 7 or 11.¹³⁵ To which extent this possibility could be prevented is difficult to assess. It would be extremely complicated to subject the portion of the shares that the shareholders obtain under the reorganization plan to future findings about the real degree of the future injuries, as that would impair any dealing in that stock. Furthermore, such a solution would be prone to hindsight errors in reassessing the value of AV-αPC-βFC (which would be what the shareholders would be entitled to). Probably some kind of penalty would work better to induce managers to properly disclose.

¹³⁴ See In re Standard Metal Corporation, 817 F.2d 625 (10th Cir. 1987); Matter of American Reserve Corporation, 840 F.2d 487 (7th Cir. 1988); Michael Guyerson & Darrell Daley (1989); Jay Sanders (1997).

¹³⁵ This is the situation under the U.S. Bankruptcy Code. See 11 USC § 301 and § 303. For a description of the US system see Elisabeth Warren and Jay Westbrook (2005), p. 1199. In other countries, there are stringent requirements to file for bankruptcy. In France there must be a financial crisis. See André Jacquemont (2000), pp. 35-36, expressing that “le passif exigible” (the current debts) must be smaller than the “actif disponibles” (current assets). See also Corinne Saint-Alary-Houin (2001), pp. 202-203. The rational for the American rule resides on giving incentives to the managers of the business (coupled with the debtor in possession rule) to file whenever it is most economically efficient, as they are the ones possessing the best information. See Sergio A. Muro, “Deciding on an Efficient Involuntary Bankruptcy Filing Petition Rule”, at http://lsr.nellco.org/cornell/lps/papers/6/.
5. Conclusion

As it can be seen, the futures problem in bankruptcy is a complex and sometimes emotional one. Conflicting objectives are at stake (i.e. distributive and corrective justice), and a definitive solution needs to be made, which augments the focus and tension on the problem. Any decision on how to address this quandary will impair individual rights to some degree.

Standard Bankruptcy arguments ask for all claims to be included in the bankruptcy proceeding to assure fairness of distribution, fresh start and best use of assets. Hence, the conduct test needs to be the one chosen in order to justly interpret the claims definition of the bankruptcy code. Usually overseen, though, are the players’ incentives to provide for a solution with a high opportunity cost if future claims are not incorporated in the proceeding: choosing liquidation over reorganization.

Definitely there are difficult issues if one supports the conduct test in this scenario: due process can be impaired if not carefully taken care of, a poor estimation of claims may impair the future claimants recovery, distribution could end up being highly unequal among present and future tort victims, future claimants may go unrepresented if class proof of claims are not allowed in the proceedings, the bankruptcy proceeding could be flooded with unreal future claims disrupting the proceedings, and strategic hiding of information could unjustly enrich shareholders at expense of future claimants.

In any case all these hurdles will keep on spurring the futures’ debate. What can’t be avoided are the strategic incentives that the relationship and the fair contemplation test provide for the creditors. Therefore, I believe that the conduct test is a step ahead in the race for an adequate standard to deal with futures’ in bankruptcy.

6. References


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