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Straddle Obligations Under Prepetition Contracts – Prepetition Claims, Postpetition Claims or Administrative Expenses

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STRADDLE OBLIGATIONS UNDER PREPETITION CONTRACTS: PREPETITION CLAIMS, POSTPETITION CLAIMS OR ADMINISTRATIVE EXPENSES?

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The Bankruptcy Code[1] ("the Code") divides the universe of claims into two basic categories—those that arise at or before the order for relief concerning the debtor,[2] and those that do not—and treats each class very differently. Prepetition claims that are not granted priority treatment[3] receive their proportionate share of a liquidation of assets, or at least that amount through a plan of reorganization. The result for the creditor is often a minimal recovery. Postpetition obligations that constitute administrative expenses are entitled to priority treatment,[4] perhaps mandating payment in full.

Administrative expenses are addressed by § 503 of the Code. Section 503(b) directs that certain administrative expenses be allowed, including those enumerated in nine listed categories.[5] The first of those categories is "the actual, necessary costs and expenses of preserving the estate," including certain wage and tax claims.[6]

When a debtor, whether an individual or entity, commences a case under the Code, invariably the debtor has prepetition contracts giving rise to a right to payment after the filing is made. Unfortunately, these "straddle" obligations do not fall neatly into one of the two categories of claims. The party asserting the claim invariably seeks to label it as an administrative expense under § 503(b), the contours of which are far from clear. Judges who conclude that these contractual claims are not administrative expenses often leap erroneously

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1 Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1532 (2006)).

2 *See* 11 U.S.C. § 101(10)(A) (2006) (defining a "creditor" as an entity that has such a claim against the debtor).

3 *See id.* § 507(a) (granting priority to certain claims and expenses).

4 *See id.* § 507(a)(2). Although the Code confers a second priority position to administrative expenses, if the debtor has no domestic support obligations, administrative expenses will be paid first.

5 *Id.* § 503(b).

6 *Id.* § 503(b)(1)(A)–(B).

to the conclusion that they must, therefore, be prepetition claims even if they arose postpetition.

I will begin this article in Part I by reviewing the reasons it is important to classify obligations as prepetition or postpetition under the Code. In Part II, I will look at cases in which courts have attempted to develop tests for distinguishing between these categories, and conclude that certain obligations of the debtor under prepetition contracts constitute postpetition obligations. Part III looks at the concept of the administrative expense, which is limited to postpetition claims but does not embrace all of them. In particular, I will examine the Supreme Court's decision in *Reading Co. v. Brown*,[7] which expanded the concept of administrative expense to include certain postpetition obligations that do not benefit the debtor's estate. Finally, in Part IV I will suggest that an appropriate application of *Reading* requires that postpetition straddle obligations under prepetition contracts should be classified as an administrative expense when they are subject to discharge in the bankruptcy case, or if the holder will have no recourse to the debtor after the case is over because the debtor's entire estate is liquidated.

I. PREPETITION OR POSTPETITION: WHY DOES IT MATTER?

The starting point for establishing rights and duties of the debtor and its creditors under the Code is the definition of a claim in § 101(5).[8] If an entity has a claim against the debtor arising or deemed to arise before the order for relief, that entity is defined as a creditor under § 101(10)(A).[9] Only a creditor or an indenture trustee may file a proof of claim under § 501(a).[10] Once filed, that claim is deemed allowed unless a party in interest objects to it.[11] If objection to a claim is made, the court resolves the objection and allows it to the extent to that it is properly asserted.[12]

In a chapter 7 liquidation, property of the estate is distributed in payment of allowed claims in the order specified in § 726.[13] In a chapter 11

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7 Reading Co. v. Brown, 391 U.S. 471 (1968).
8 11 U.S.C. § 101(5).
9 *Id.* § 101(10)(A).
10 *Id.* § 501(a).
11 *Id.* § 502(a).
12 *See id.* § 502(b) (describing grounds for disallowing claims).
13 *Id.* § 726.

reorganization, a plan of reorganization must designate classes of claims,[14] must specify any class of claims that is not impaired under the plan,[15] must specify the treatment of any impaired class of claims,[16] and generally must treat all claims within a particular class in the same way.[17] In addition, a plan of reorganization cannot be confirmed unless it satisfies the requirements of § 1129(a) and (b),[18] which include provisions protecting classes and holders of claims.[19]

The Code provides for the payment of one type of obligation that does not constitute a claim in a bankruptcy case. Section 507(a) grants priority to certain "*expenses* and claims."[20] The "expenses" to which it refers must be those "administrative expenses allowed under section 503(b)."[21] The description of administrative expenses in § 503(b) includes various obligations, whether incurred by the debtor or other parties, which Congress has allocated to the debtor on a priority basis.[22] With only two exceptions,[23] the expenses itemized in § 503(b) arise after a bankruptcy petition is filed (i.e., they are postpetition expenses) and the entity to whom the debtor owes payment would not constitute a "creditor" with a "claim." Unlike § 501, which provides for the filing of a proof of claim by a creditor, § 503 allows any "entity" to file a request for payment of an administrative expense.[24] Thus, the Code explicitly

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[14] *Id.* § 1123(a)(1).

[15] *Id.* § 1123(a)(2).

[16] *Id.* § 1123(a)(3).

[17] *Id.* § 1123(a)(4).

[18] *Id.* § 1129(a)–(b).

[19] *See id.* § 1129(a)(7)–(10), (a)(15), (b)(1).

[20] *Id.* § 507(a) (emphasis added).

[21] *Id.* § 507(a)(2). No other subparagraph of § 507(a) refers to "expenses."

[22] *Id.* § 503(b) (including (1) actual, necessary costs of preserving the estate; (2) compensation and reimbursement of a trustee, a consumer privacy ombudsman, an examiner, a patient care ombudsman, or a court-appointed professional person; (3) actual, necessary expenses of certain creditors, custodians, and members of creditors' committees and compensation for professional services by an attorney or accountant to such an entity; (4) reasonable compensation to certain indenture trustees; (5) fees and mileage; (6) two years of post-rejection monetary obligations under a previously-assumed nonresidential real property lease; (7) actual, necessary costs in connection with closing a health care business; and (8) value of goods received by the debtor within twenty days before commencement of the case).

[23] *See id.* § 503(b)(3)(A) (granting administrative expense status for the actual, necessary expenses of a creditor who files a petition in an involuntary case); *id.* § 503(b)(9) (granting administrative expense status to "the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business"). This latter paragraph was inserted in the most recent amendments to the Code. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005). It should more appropriately have been inserted in § 507, which establishes priorities among claims.

[24] 11 U.S.C. § 503(a).

distinguishes between prepetition claims for which a proof of claim may be filed, and postpetition administrative expenses for which payment may be sought but no proof of claim filed.

This distinction is also critical when property of the estate is distributed in a chapter 7 liquidation, or when a plan of reorganization is prepared and confirmed. Under § 726(a)(1), payment of priority claims under § 507 precedes any distribution to general unsecured claims.[25] In a reorganization under chapter 11, a plan of reorganization may not be confirmed unless priority claims, including administrative expenses, receive the treatment guaranteed them by § 1129(a)(9).[26]

Thus, the Code provides different procedural steps for seeking payment of prepetition "claims" and postpetition "administrative expenses," as well as different substantive rights upon a liquidation or reorganization of the debtor. Courts often resolve disputes over classification of claims when an entity seeks payment of an administrative expense that the debtor believes is properly characterized as a prepetition claim.[27]

The distinction between prepetition claims and postpetition administrative expenses is important in other contexts as well. A filed bankruptcy petition operates as a stay of any action or proceeding against the debtor that "was or could have been commenced before the commencement of the case . . . or to recover a claim against the debtor that arose before the commencement of the case."[28] If the claim against the debtor is not a prepetition claim, the automatic stay does not preclude its assertion against the debtor[29] (although the holder of

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[25] *Id.* § 726(a)(1). Surprisingly, § 726(a)(1) refers only to "claims of the kind specified in . . . section 507" and not to "expenses and claims" as § 507 describes them. Because administrative expenses are not otherwise covered by § 726(a), one must assume that the omission is not intentional.

[26] *See id.* § 1129(a)(9)(A) (requiring, among other things, that administrative expenses be paid cash equal to the allowed amount of the claim on the effective date of the plan). Again, Congress uses the word "claim" to refer to administrative expenses in § 1129(a)(9)(A), although § 507(a) distinguishes between a "claim" and an "expense."

[27] *See, e.g.*, NLRB v. Walsh (*In re* Palau Corp.), 18 F.3d 746 (9th Cir. 1994); United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997 (2d Cir. 1991); Gonzalez v. Gottlieb (*In re* Metro Fulfillment, Inc.), 294 B.R. 306, 312 (B.A.P. 9th Cir. 2003); *In re* Merry-Go-Round Enter., Inc., No. 94-50161-SD, 1999 WL 33457180, at *1 (Bankr. D. Md. Dec. 21, 1999); Kapernekas v. Cont'l Airlines, Inc. (*In re* Cont'l Airlines, Inc.), 148 B.R. 207 (D. Del. 1992).

[28] 11 U.S.C. § 362(a)(1). Other provisions of the automatic stay also turn on whether the act relates to a claim arising before the commencement of the case. *See id.* § 362(a)(5)–(7).

[29] *See, e.g.*, College Pharmacy, Inc. v. Ruth, No. 06-cv-00540-WYD-BNB, 2006 WL 3618314, at *1 (D. Colo. Dec. 11, 2006); Larami Ltd. v. Yes! Entm't Corp., 244 B.R. 56, 58 (D.N.J. 2000); Danzig Claimants v.

the claim may not seek to recover from property of the estate).[30] When characterization of the claim is necessary to determine whether the automatic stay bars some action, the court may have to resolve the dispute.[31]

Filing the bankruptcy petition also creates an "estate" comprised of certain types of property, including "all legal or equitable interests of the debtor in property as of the commencement of the case."[32] Courts may have to determine whether a claim held by the debtor was a prepetition claim (and thus part of the bankruptcy estate) or a postpetition claim (and therefore not subject to bankruptcy court administration).[33] For example, although the automatic stay precludes creditors from offsetting debts they owe the debtor against other claims filed against the debtor,[34] if a creditor obtains relief from the stay, § 553 recognizes that creditor's right to offset a prepetition debt owed to the debtor "against a claim of such creditor against the debtor that arose before the commencement of the case."[35] Courts often must determine whether the claim against which a setoff is proposed is prepetition (in which case the setoff is permissible) or postpetition (in which case no setoff may be made).[36]

The prepetition versus postpetition distinction is relevant in still other contexts. Sometimes the court must determine whether litigation between the

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Grynberg (*In re* Grynberg), 113 B.R. 709, 711–12 (Bankr. D. Colo. 1990), *aff'd*, 143 B.R. 574 (D. Colo. 1990), *aff'd*, 966 F.2d 570 (10th Cir. 1992).

[30] 11 U.S.C. § 362(a)(3)–(4). *See, e.g.*, *In re* Jemison, No. 07-40761, 2007 WL 2669222, at *2 n.7 (Bankr. N.D. Ala. Sept. 6, 2007); Fazio v. Growth Dev. Corp. (*In re* Growth Dev. Corp.), 168 B.R. 1009, 1017 (Bankr. N.D. Ga. 1994).

[31] *See, e.g.*, Gordon v. Hines (*In re* Hines), 147 F.3d 1185, 1191 (9th Cir. 1998); Avellino & Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332, 337 (3d Cir. 1984); Frederick v. Fed.-Mogul, Inc., No. 06-11549-BC, 2007 WL 551591, at *2 (E.D. Mich. Feb. 21, 2007); Phillips v. Rapides Primary Health Care Ctr., No. 05-1551-A, 2006 WL 2264983, at *6–*7 (W.D. La. Aug. 7, 2006); *In re* Hawk, 314 B.R. 312, 316 (Bankr. D.N.J. 2004).

[32] 11 U.S.C. § 541(a)(1).

[33] *See, e.g.*, Burgess v. Sikes (*In re* Burgess), 438 F.3d 493 (5th Cir. 2006) (finding crop disaster relief payment not property of the estate); Gehrig v. Shreves (*In re* Gehrig), 491 F.2d 668, 672 (8th Cir. 1974) (holding postpetition tax refund was not property of estate); *In re* Jones, 337 F. Supp. 620, 624 (D. Minn. 1971) (finding postpetition tax refund to be property of the estate to the extent allocable to prebankrutpcy earnings); Ellwanger v. Budsberg (*In re* Ellwanger), 140 B.R. 891, 897–98 (Bankr. W.D. Wash. 1992) (finding legal malpractice claim was estate property).

[34] 11 U.S.C. § 362(a)(7).

[35] *Id.* § 553(a).

[36] *See, e.g.*, Gordon Sel-Way, Inc. v. United States (*In re* Gordon Sel-Way, Inc.), 270 F.3d 280, 289–91 (6th Cir. 2001); United States v. Gerth, 991 F.2d 1428, 1435 (8th Cir. 1993); Sherman v. First City Bank of Dallas (*In re* United Scis. of Am., Inc.), 893 F.2d 720, 724 (5th Cir. 1990); CDI Trust v. U.S. Elecs., Inc. (*In re* Commc'n Dynamics, Inc.), 382 B.R. 219, 230–34 (Bankr. D. Del. 2008); *In re* Gibson, 308 B.R. 763, 769–70 (Bankr. N.D. Tex. 2002); Roberds, Inc. v. Lumbermen's Mut. Cas. Co. (*In re* Roberds, Inc.), 285 B.R. 651, 656–59 (Bankr. S.D. Ohio 2002).

debtor and a creditor is a core proceeding[37] or noncore. If a proceeding is noncore but is related to a bankruptcy case, the bankruptcy judge may only hear the proceeding, not hear and determine it.[38] In addition, noncore proceedings involving personal injury tort or wrongful death claims against the estate are not subject to mandatory abstention.[39] A proceeding based on a cause of action that arises postpetition is likely to be a core proceeding, whereas a cause of action arising prepetition is not. Therefore, identifying when a claim arises may be critical in this context as well.[40]

If the debtor receives a discharge in the bankruptcy case,[41] that discharge operates as a permanent injunction against future acts to collect any discharged "debt"[42] (defined as "liability on a claim").[43] The "debts" that are discharged by the operative provisions of the Code are generally limited to prepetition debts.[44] As a result, courts are often asked to determine whether a claim is prepetition or postpetition in order to define the scope of the discharge.[45]

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[37] *See* 28 U.S.C. § 157(b)(2) (2000) (defining "core" proceedings).

[38] *Id.* § 157(c)(1).

[39] *Id.* § 157(b)(4).

[40] *See, e.g.*, WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp., 75 F. Supp. 2d 596, 609–11 (S.D. Tex. 1999); Burger Boys, Inc. v. S. Street Seaport L.P. (*In re* Burger Boys, Inc.), 183 B.R. 682, 686–87 (S.D.N.Y. 1994); Germain v. Conn. Nat'l Bank (*In re* O'Sullivan's Fuel Oil Co.), 88 B.R. 17 (D. Conn. 1988).

[41] Only individuals are entitled to a discharge in a chapter 7 case under 11 U.S.C. § 727(a)(1). Discharge may also be granted under § 944 to municipal debtors, § 1141 in reorganization cases, § 1228 to family farmers or fishermen with regular income, and § 1328 to individuals with regular income. For eligibility requirements for the various chapters of title 11, see 11 U.S.C. § 109.

[42] 11 U.S.C. § 524(a)(2) (2006).

[43] *Id.* § 101(12).

[44] *See id.* § 727(b) (stating that a discharge under § 727(a) "discharges the debtor from all debts that arose before the date of the order for relief"); *id.* § 1228(a) (stating that discharge covers "all debts provided for by the plan allowed under section 503"); *id.* § 1328(a) (providing that discharge covers "all debts provided for by the plan or disallowed under section 502"). Confirmation of a chapter 11 plan of reorganization discharges a debtor from "any debt that arose before the date of such confirmation." *Id.* § 1141(d)(1)(A).

[45] *See, e.g.*, Boeing N. Am., Inc., v. Ybarra (*In re* Ybarra), 424 F.3d 1018, 1026 (9th Cir. 2005); Bethea v. Robert J. Adams & Assocs., 352 F.3d 1125, 1127 (7th Cir. 2003); Ocean Marine Servs. P'ship No. 1 v. Digicon, Inc. (*In re* Digicon, Inc.), 71 F. App'x 442, 2003 WL 21418127, at *8 (5th Cir. June 11, 2003); Big Yank Corp. v. Liberty Mut. Fire Ins. Co. (*In re* Water Valley Finishing, Inc.), 139 F.3d 325, 329 (2d Cir. 1998); Teichman v. Teichman (*In re* Teichman), 774 F.2d 1395, 1398 (9th Cir. 1985); Wright v. Centennial Healthcare Corp., 383 B.R. 355, 357 (D.D.C. 2008); Chateau Cmtys., Inc. v. Miller, 252 B.R. 121, 123 (E.D. Mich. 2000), *aff'd*, 282 F.3d 874 (6th Cir. 2002); *In re* Clarkson, 377 B.R. 283, 288–89 (Bankr. W.D. Wash. 2007); Covey v. Hackett (*In re* Roadrunner Delivery, Inc.), No. 07-80773, 2007 WL 4553068, at *2 (Bankr. C.D. Ill. Dec. 19, 2007); Varble v. Chase (*In re* Chase), 372 B.R. 133, 141–42 (Bankr. S.D.N.Y. 2007); *In re* Browne, 358 B.R. 139, 144–45 (Bankr. D.N.J. 2006); *In re* Cleveland, 349 B.R. 522, 528–31 (Bankr. E.D. Tenn. 2006); *In re* MCI, Inc., No. 02-13533 (AJG), 2006 WL 544494, at *3 (Bankr. S.D.N.Y. Jan. 27, 2006); Cramer v. Cramer (*In re* Cramer), No. 02-40192-7, 2003 WL 23777742, at *4 (Bankr. D. Kan. Dec. 11, 2003); *In re* Aschtgen, No. 01-01348-D, 2002 WL 1842444, at *4 (Bankr. N.D. Iowa July 16, 2002); Stone St. Servs.,

For these reasons (among others),[46] it matters greatly whether the claim against the debtor constitutes a prepetition claim or a postpetition claim. In most cases, the proper category is easy to determine. But when disputes arise with respect to straddle obligations, courts have struggled to find an adequate test of when a claim "arose."

II. DISTINGUISHING PREPETITION CLAIMS FROM POSTPETITION CLAIMS

The definition of claim in the Code is extremely broad, and expressly includes obligations that are "contingent" and "unmatured."[47] But the Code does not define what it means by a "contingent" or "unmatured" claim. Courts have often quoted the legislative history of the Code,[48] which indicates that the concept of claim is to be given the "broadest possible definition," permitting "all legal obligations of the debtor, no matter how remote or contingent" to be dealt with in the bankruptcy case."[49]

However, when a party is injured by prepetition conduct of a debtor, but the harm becomes apparent only after a bankruptcy discharge has been granted, that party's due process rights may be violated by an interpretation of the definition of claim that precludes the injured party from seeking any

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Inc. v. Granati (*In re* Granati), 271 B.R. 89, 94 (Bankr. E.D. Va. 2001); Riverwood Int'l Corp. v. Olin Corp. (*In re* Manville Forest Prods. Corp.), 225 B.R. 862 (Bankr. S.D.N.Y. 1998), *aff'd*, 209 F.3d 125 (2d Cir. 2000); Beeter v. Tri-City Prop. Mgmt. Servs., Inc. (*In re* Beeter), 173 B.R. 108, 116–22 (Bankr. W.D. Tex. 1994).

[46] *See, e.g.*, Rochez Bros., Inc. v. Sears Ecological Applications Co. (*In re* Rochez Bros., Inc.), 326 B.R. 579 (Bankr. W.D. Pa. 2005) (distinguishing between prepetition and postpetition claims for purposes of applying § 549(a)); *In re* Learningsmith, Inc., 253 B.R. 131, 134 (Bankr. D. Mass. 2000) (distinguishing between prepetition and postpetition claims for purposes of applying § 365(d)(3)); Taca Int'l Airlines, S.A. v. Pan Am World Airways, Inc. (*In re* Pan Am Corp.), 177 B.R. 1014, 1016–17 (Bankr. S.D. Fla. 1995) (holding 28 U.S.C. § 1409(e) venue provision was met because causes of action were postpetition).

[47] *See* 28 U.S.C. § 101(5)(A) (2000) (defining "claim" to include a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured"). *See generally* Bonnie Kay Donahue & Bryan D. Graham, *Definition of a Claim*, 9 J. BANKR. L. & PRAC. 275, 276–78 (2000) (providing historical perspective on change from Bankruptcy Act to Bankruptcy Code).

[48] *See, e.g.*, Johnson v. Home State Bank, 501 U.S. 78, 86 (1991); Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 558 (1990); United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997, 1003 (2d Cir. 1991); Grady v. A.H. Robins Co., 839 F.2d 198, 200 (4th Cir. 1988); *In re* M. Frenville Co., 744 F.2d 332, 336 (3d Cir. 1984); *In re* Grynberg, 113 B.R. 709, 711 (Bankr. D. Colo. 1990), *aff'd*, 143 B.R. 574 (D. Colo. 1990), *aff'd*, 966 F.2d 570 (10th Cir. 1992).

[49] *See, e.g.*, H.R. REP. NO. 95-595, at 309, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266; S. REP. NO. 95-989, at 21–22, *reprinted in* 1978 U.S.C.C.A.N. 5785, 5807–08.

recovery.[50] Many courts[51] and scholars[52] have examined the problem of prepetition conduct by the debtor giving rise to postpetition injuries, particularly in the context of mass torts and environmental damages.

Courts have also developed various tests for determining when a claim accrues for purposes of applying the bankruptcy definition of "claim." One test looks to when an injured party has a cause of action under applicable state law (sometimes called the "accrual test" or the "payment test").[53] A second test focuses on when the conduct giving rise to the claim occurs (the "conduct test").[54] A third test characterizes a claim as prepetition if prepetition conduct by the debtor is coupled with a specific and identifiable prepetition relationship between the debtor and the claimant (the "relationship test").[55] A fourth test looks to when the claimant had a "fair contemplation" that a claim exists.[56]

No matter what test courts use in attempting to determine whether the unknown future claimant has a "claim" cognizable in bankruptcy, they

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[50] *See, e.g.*, *In re Chateaugay*, 944 F.2d at 1003; Hexcel Corp. v. Stepan Co. (*In re* Hexcel Corp.), 239 B.R. 564, 570–72 (N.D. Cal. 1999); Corman v. Morgan (*In re* Morgan), 197 B.R. 892, 900 (N.D. Cal. 1996); Kewanee Boiler Corp. v. Smith (*In re* Kewanee Boiler Corp.), 198 B.R. 519, 528–29 (Bankr. N.D. Ill. 1996); Waterman S.S. Corp. v. Aguiar (*In re* Waterman S.S. Corp.), 141 B.R. 552 (Bankr. S.D.N.Y. 1992), *vacated on other grounds*, 157 B.R. 220 (S.D.N.Y. 1993).

[51] *See, e.g.*, *In re* UNR Indus., Inc., 20 F.3d 766 (7th Cir. 1994); Lemelle v. Universal Mfg. Corp., 18 F.3d 1268 (5th Cir. 1994); *In re Chateaugay*, 944 F.2d at 1003–05; *In re Hexcel*, 239 B.R. at 567–70; Epstein v. Official Comm. of Unsecured Creditors (*In re* Piper Aircraft Corp.), 168 B.R. 434 (S.D. Fla. 1994), *aff'd*, 58 F.3d 1573 (11th Cir. 1995).

[52] *See, e.g.*, Laura B. Bartell, *Due Process for the Unknown Future Claim in Bankruptcy—Is This Notice Really Necessary?*, 78 AM. BANKR. L.J. 339 (2004); Gregory A. Bibler, *The Status of Unaccrued Tort Claims in Chapter 11 Bankruptcy Proceedings*, 61 AM. BANKR. L.J. 145 (1987); Jeffrey Davis, *Cramming Down Future Claims in Bankruptcy: Fairness, Bankruptcy Policy, Due Process, and the Lessons of the Piper Reorganization*, 70 AM. BANKR. L.J. 329 (1996); Kathryn R. Heidt, *Products Liability, Mass Torts and Environmental Obligations in Bankruptcy*, 3 AM. BANKR. INST. L. REV. 117 (1993); Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846 (1984); J. Maxwell Tucker, *The Clash of Successor Liability Principles, Reorganization Law, and the Just Demand That Relief be Afforded Unknown and Unknowable Claimants*, 12 BANKR. DEV. J. 1 (1995); Frederick Tung, *Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy*, 49 CASE W. RES. L. REV. 435 (1999).

[53] *See* McSherry v. Trans World Airlines, Inc., 81 F.3d 739, 740–41 (8th Cir. 1996); *In re M. Frenville Co.*, 744 F.2d at 337; *In re* Aschtgen, No. 01-01348-D, 2002 WL 1842444, at *3 (Bankr. N.D. Iowa July 16, 2002).

[54] *See, e.g.*, Watson v. Parker (*In re* Parker), 313 F.3d 1267, 1269 (10th Cir. 2002); Grady v. A.H. Robins Co., 839 F.2d 198, 203 (4th Cir. 1988); *In re Waterman S.S.*, 141 B.R. at 552; Roach v. Edge (*In re* Edge), 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986).

[55] *See, e.g.*, *Lemelle*, 18 F.3d at 1268; *In re* Pan Am. Hosp. Corp., 364 B.R. 839, 843 (Bankr. S.D. Fla. 2007); Rides, Inc. v. Chance Indus., Inc. (*In re* Chance Indus., Inc.), 367 B.R. 689, 703 (Bankr. D. Kan. 2006); *In re* Piper Aircraft Corp., 162 B.R. 619, 621 n.1 (Bankr. S.D. Fla. 1994).

[56] *See, e.g.*, Zilog, Inc. v. Corning (*In re* Zilog, Inc.), 450 F.3d 996, 1001–02 (9th Cir. 2006); Cal. Dep't of Health Servs. v. Jensen (*In re* Jensen), 995 F.2d 925, 930 (9th Cir. 1993).

generally have little problem concluding that those who have entered into prepetition contract with the debtor (and therefore have an opportunity to present their claims in the bankruptcy case) have cognizable claims.[57] So long as the contract and the obligations it imposes do not straddle the bankruptcy filing, courts have little trouble characterizing the obligations. If both execution of the contract and its breach by the debtor occur prepetition, courts agree that the breach gives rise to a prepetition claim. Courts also agree that any obligations arising under a contract or lease entered into after the filing of the bankruptcy petition constitute postpetition obligations of the estate.[58]

But what is the proper analysis when the contract exists prior to the bankruptcy filing, but some or all of the breached obligations were to be performed postpetition? Because all obligations under a contract to which the debtor legally commits itself prior to a bankruptcy filing flow inexorably from that prepetition act of the debtor, the simplest approach to the characterization issues would be to label all obligations that flow from such a prepetition contract or lease as themselves prepetition obligations, even if performance of those obligations occurs after the bankruptcy filing. Some courts have therefore stated categorically that all obligations arising under a prepetition contract (as opposed to a postpetition transaction) constitute prepetition claims, without regard to when they are to be performed.[59]

In some cases that statement is true. For instance, if those obligations arise under an "executory contract" or "unexpired lease," § 365 of the Code allows the trustee to "assume or reject" the underlying contract or lease.[60] To assume the contract or lease, the trustee must "cure[ ], or provide adequate assurance that the trustee will promptly cure" any default (other than certain specified defaults), "compensate[ ] or provide adequate assurance that the trustee will

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[57] *See, e.g.*, Georgetown Steel Co. v. Capital City Ins. Co. (*In re* Georgetown Steel Co.), 318 B.R. 313, 328 (Bankr. D.S.C. 2004); *In re* Dixon, 295 B.R. 226, 231 (Bankr. E.D. Mich. 2003); *In re* Roberds, Inc., 285 B.R. 651, 657 (Bankr. S.D. Ohio 2002); *In re* Russell, 193 B.R. 568, 571–72 (Bankr. S.D. Cal. 1996).

[58] *See, e.g.*, Ben Cooper, Inc. v. Ins. Co. of Penn. (*In re* Ben Cooper, Inc.), 896 F.2d 1394, 1399 (2d Cir. 1990), *vacated*, 498 U.S. 964 (1990), *reinstated*, 924 F.2d 36 (2d Cir. 1991); Arnold Print Works, Inc. v. Apkin (*In re* Arnold Print Works, Inc.), 815 F.2d 165, 168 (1st Cir. 1987); *In re M. Frenville Co.*, 744 F.2d at 336–37; Kenston Mgmt. Co. v. Lisa Realty Co. (*In re* Kenston Mgmt. Co.), 137 B.R. 100, 105–06 (Bankr. E.D.N.Y. 1992).

[59] *See, e.g.*, Abercrombie v. Hayden Corp. (*In re* Abercrombie), 139 F.3d 755, 758 (9th Cir. 1998); Park Nat'l Bank v. Univ. Ctr. Hotel, Inc., No. 1:06-cv-00077-MP-AK, 2007 WL 604936, at *7 (N.D. Fla. Feb. 22, 2007); PBGC v. LTV Corp. (*In re* Chateaugay Corp.), 87 B.R. 779, 796 (S.D.N.Y. 1988), *aff'd on other grounds*, 875 F.2d 1008 (2d Cir. 1989), *rev'd*, 496 U.S. 633 (1990); *In re* Griffin, 313 B.R. 757, 762 (Bankr. N.D. Ill. 2004); *In re* Caldor, Inc.-NY, 240 B.R. 180, 192 (Bankr. S.D.N.Y. 1999).

[60] 11 U.S.C. § 365(a) (2006).

promptly compensate" the nondebtor party to the contract or lease for any actual pecuniary loss caused by the default, and "provide[ ] adequate assurance of future performance under such contract or lease."[61]

In assuming the contract or lease, the trustee is effectively electing to convert existing obligations under the contract or lease into postpetition obligations of the estate. Such postpetition obligations are entitled to administrative expense priority under § 503(b)(1), even if those obligations were originally incurred prior to the filing.[62] Thus, the assumption of an executory contract or unexpired lease transforms straddle obligations into postpetition obligations giving rise to claims equal in priority to those incurred under any new contract or lease to which the trustee becomes bound during the bankruptcy case.[63]

If the trustee rejects an executory contract or unexpired lease that has not previously been assumed, § 365(g) mandates a very different treatment of the debtor's obligations. Even if the debtor's obligations required performance after the filing of the bankruptcy petition—unless the Code requires such performance during the bankruptcy case[64] (in which case a failure to perform would constitute a postpetition breach)[65]—any breach occasioned by the failure of the debtor to perform under that rejected contract or lease is treated as occurring "immediately before the date of the filing of the petition."[66] In this way, all straddle obligations of the debtor under a contract or lease are transformed by rejection into prepetition obligations giving rise to a prepetition claim by the injured party.[67]

The only postpetition obligations under a rejected executory contract that are not transformed into prepetition claims upon rejection are those arising

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[61] *Id.* § 365(b)(1).

[62] *But see* United States v. Gerth, 991 F.2d 1428, 1432–33 (8th Cir. 1993) (holding that debtor's assumption of executory contract does not change prepetition obligations into postpetition obligations for purposes of set-off).

[63] *See, e.g.*, Adelphia Bus. Solutions, Inc. v. Abnos, 482 F.3d 602, 606 (2d Cir. 2007); Nostas Assocs. v. Costich (*In re* Klein Sleep Prods., Inc.), 78 F.3d 18, 28 (2d Cir. 1996); *In re* El Paso Refinery, L.P., 220 B.R. 37, 41 (Bankr. W.D. Tex. 1998).

[64] *See* 11 U.S.C. § 365(d)(3) (requiring timely performance by debtor under unexpired lease of nonresidential real property until lease is assumed or rejected).

[65] *See, e.g.*, *In re* Atl. Container Corp., 133 B.R. 980, 990–91 (Bankr. N.D. Ill. 1991).

[66] 11 U.S.C. § 365(g)(1).

[67] *See id.* § 502(g)(1). *See also* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531 (1984); COR Route 5 Co. v. Penn Traffic Co. (*In re* Penn Traffic Co.), 524 F.3d 373, 378 (2d Cir. 2008); *In re* AppliedTheory Corp., 312 B.R. 225, 235 (Bankr. S.D.N.Y. 2004); *In re El Paso Refinery*, 220 B.R. at 41.

from postpetition performance by the nondebtor party to the contract. To the extent that the nondebtor party performs under the contract after the bankruptcy filing, the debtor has an obligation to pay the nondebtor party an amount representing the reasonable value of that performance to the estate as an administrative expense claim.[68] This claim will not necessarily be the same as the contractual amount payable for that performance because the performance may not benefit the estate to that extent.[69] When the contract is rejected, any contractual amount owing in excess of the amount actually paid would become part of the prepetition unsecured claim created by rejection.

Characterization of claims under executory contracts and leases as prepetition or postpetition is therefore dictated by the provisions of the Code. But not all contracts giving rise to straddle obligations of a debtor fall within the parameters of § 365 because not all contracts can be characterized as "executory."[70] Moreover, even for those executory contracts and leases, disputes may arise that require characterization of obligations created by the contract or lease as prepetition or postpetition obligations. Courts differ on the proper resolution of such disputes, as they struggle to determine which, if any, of the obligations under these contractual undertakings of the debtor should be deemed obligations of the estate.

Much of the confusion over the treatment of straddle obligations based on prepetition contracts stems from the difficulties in defining "contingent" rights to payment included in "claims" under the Code. In the much-quoted opinion *United States v. LTV Corp.*,[71] the court characterized the word "contingent" in the context of a contractual claim to mean "obligations that will become due upon the happening of a future event that was 'within the actual or presumed contemplation of the parties at the time the original relationship of the parties was created.'"[72]

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[68] *See, e.g.*, *Bildisco*, 465 U.S. at 531; Am. Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A., 280 F.2d 119, 124 (2d Cir. 1960); *In re* Heritage Leasing Corp., No. C/A 96-75946-W, 1998 WL 2016851, at *7 (Bankr. D.S.C. Sept. 17, 1998); *In re* Cole, 189 B.R. 40, 47 (Bankr. S.D.N.Y. 1995).

[69] *See, e.g.*, *In re AppliedTheory Corp.*, 312 B.R. at 239.

[70] *See, e.g.*, Potter v. CNA Ins. Cos. (*In re* MEI Diversified, Inc.), 106 F.3d 829, 832 (8th Cir. 1997); *In re* Beeter, 173 B.R. 108, 116 (Bankr. W.D. Tex. 1994).

[71] United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997 (2d Cir. 1991).

[72] *Id.* at 1004 (quoting *In re* All Media Props., Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd mem.*, 646 F.2d 193 (5th Cir. 1981)). The court in *All Media Properties* was not interpreting the word "contingent" as used in the definition of "claim." Rather, the court was determining whether the claims held by petitioning creditors in an involuntary bankruptcy were "contingent as to liability" which would disqualify them under 11 U.S.C. § 303(b)(1). *In re All Media Props.*, 5 B.R. at 132.

The problem with this formulation stems not from what it contains, but from what it omits. Contingent contractual obligations are, as the *LTV Corp.* language suggests, those obligations that become due in the future, after the signing of the contract to which they relate. It is also true that the obligations become payable upon the occurrence of a future event. But what the language does not address is the nature of that contemplated future event.

When a prepetition contract gives rise to postpetition payment obligations, there are three possible reasons for the straddle. First, the nondebtor party to the contract may have fully performed prior to the filing date (as by supplying goods or services to the debtor), and the debtor had not performed its obligations prepetition (either because the payment obligation was not yet due, or because the debtor defaulted). Here there is no contingent claim. If there are no further obligations on the part of the nondebtor party, the contract is not executory, and the nondebtor party simply holds a prepetition claim that arose at the time of the performance.

Note that I suggest the claim arose at the time of the performance, not at the time the contract was executed. If the nondebtor party never performed its obligations (e.g., never delivered the goods or services to the debtor), the debtor would never have an obligation to pay the nondebtor. Indeed, the debtor may have a claim against the nondebtor for breach of the contract. A prepetition contract that was unperformed on both sides at the time of the bankruptcy filing creates no right to payment until either one of two things occurs: (1) postpetition performance occurs (in which case the failure to pay would constitute a postpetition breach); or (2) the contract is rejected by the debtor (creating an anticipatory breach), in which case the rejection is treated as a prepetition claim by reason of the Code.

A second reason a prepetition contract may create straddle obligations is that the nondebtor party to the contract has a legal obligation to perform postpetition (such as providing goods or services), and the debtor has an obligation to make payment postpetition when performance is rendered. In this situation, the contract is executory. Any prepetition performance under a prepetition contract creates a prepetition claim, even if postpetition performance is also to be rendered.[73] With respect to postpetition

[73] *See, e.g.*, *In re* Hines, 147 F.3d 1185, 1188 (9th Cir. 1998); *In re* Collins & Aikman Corp., 384 B.R. 751, 761 (Bankr. E.D. Mich. 2008); Lubit v. Chase (*In re* Chase), 372 B.R. 125, 127 (Bankr. S.D.N.Y. 2007). Problems sometimes arise when a debtor's obligation to make payment relates both to prepetition and postpetition services, such as bonuses, vacation pay, or severance payments under an employment contract.

performance, the contract creates no right to payment until either the nondebtor party performs or the contract is rejected by the debtor. Because there cannot be a "claim" unless there is a right to payment,[74] the claim against the debtor cannot be characterized as a contingent "claim" when the contingency is the future performance by the nondebtor party that gives rise to the right to payment.[75] When that performance occurs postpetition, the claim is also postpetition.[76]

Courts have implicitly recognized that such claims are postpetition in nature. If the nondebtor party under a prepetition contract performs after the filing, and the performance benefits the estate, all courts recognize that the nondebtor party may seek compensation on an administrative expense basis.[77] Because administrative expenses must be postpetition claims,[78] courts are

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To the extent the claim represents compensation for prepetition services (without regard to when it becomes payable), courts characterize the claim as prepetition. *See, e.g.*, Lasky v. Phones For All, Inc. (*In re* Phones For All, Inc.), 288 F.3d 730, 732 (5th Cir. 2002); Isaac v. Temex Energy, Inc. (*In re* Amarex, Inc.), 853 F.2d 1526, 1531 (10th Cir. 1988); Lines v. Sys. Bd. of Adjustment No. 94 Bhd. of Ry. Airline & S.S. Clerks (*In re* Health Maint. Found.), 680 F.2d 619, 621 (9th Cir. 1982); Cramer v. Mammoth Mart, Inc. (*In re* Mammoth Mart, Inc.), 536 F.2d 950, 955 (1st Cir. 1976); *In re AppliedTheory Corp.*, 312 B.R. at 244. *But see* Rodman v. Rinier (*In re* W.T. Grant Co.), 620 F.2d 319, 321 (2d Cir. 1980); Zelin v. Unishops, Inc. (*In re* Unishops, Inc.), 553 F.2d 305, 308 (2d Cir. 1977); Straus-Duparquet, Inc. v. Local Union No. 3 Int'l Bhd. of Elec. Workers, 386 F.2d 649, 651 (2d Cir. 1967) (holding severance pay is earned at time of termination and constitutes administrative expense). This concept has also been extended to deny administrative expense treatment to withdrawal liability and claims for unfunded benefits or termination premiums under prepetition pension plans to the extent that the consideration giving rise to such liability was prepetition services of the employees. *See, e.g.*, PBGC v. Skeen (*In re* Bayly Corp.), 163 F.3d 1205, 1211 (10th Cir. 1998); PBGC v. CF&I Fabricators of Utah, Inc. (*In re* CF&I Fabricators of Utah, Inc.), 150 F.3d 1293, 1297–98 (10th Cir. 1998); Trs. of Amalgamated Ins. Fund. v. McFarlin's, Inc., 789 F.2d 98, 101–02 (2d Cir. 1986); *In re* Finley, Kumble, Wagner, Heine, Underberg, Manley, Meyerson & Casey, 160 B.R. 882, 891 (Bankr. S.D.N.Y. 1993). But when the compensation is earned for postpetition actions by the debtor or the employee, it is treated as a postpetition claim. *See, e.g.*, *In re* Beverage Enters. Inc., 225 B.R. 111, 116 (Bankr. E.D. Pa. 1998). *Cf.* Mass. Div. of Employment & Training v. Boston Reg'l Med. Ctr., Inc. (*In re* Boston Reg'l Med. Ctr., Inc.), 291 F.3d 111, 125–26 (1st Cir. 2002) (allowing administrative expense status to payments in lieu of contributions to state unemployment compensation fund only to the extent based on postpetition work by employees).

[74] 11 U.S.C. § 101(5)(A) (2006).

[75] *See, e.g.*, *In re Hines*, 147 F.3d at 1191; Knutson v. Tredinnick (*In re* Tredinnick), 264 B.R. 573, 577 (B.A.P. 9th Cir. 2001); *In re* Chase, 372 B.R. at 133 (holding that fees for services performed postpetition under prepetition agreement do not constitute contingent prepetition claims). *But see In re* New Power Co., 313 B.R. 496, 508 (Bankr. N.D. Ga. 2004) (characterizing postpetition attorneys' fees as a contingent claim); *In re* Talk City, Inc., 281 B.R. 132, 142 (Bankr. D. Mass. 2002) (holding claim for costs of turning over assets to debtor postpetition as required by prepetition contract was prepetition claim).

[76] *See, e.g.*, *In re* Camellia Food Stores, Inc., 287 B.R. 52, 52–58 (Bankr. E.D. Va. 2002).

[77] *See infra* Part III.

[78] *See, e.g.*, Kadjevich v. Kadjevich (*In re* Kadjevich), 220 F.3d 1016, 1019–20 (9th Cir. 2000); United Trucking Serv., Inc. v. Trailer Rental Co. (*In re* United Trucking Serv. Inc..), 851 F.2d 159, 161 (6th Cir.

necessarily concluding that claims created by the nondebtor's postpetition performance under a prepetition contract that benefit the estate are postpetition claims. Whether performance benefits the estate or not has no bearing on when a claim arises. Therefore, if postpetition performance of a prepetition contract creates a postpetition claim against the debtor in the case of administrative expenses, it must also do so when the claim cannot be so characterized.

Statutory language also supports this characterization. If the prepetition contract is rejected by the debtor, the Code requires that the breach be treated as a prepetition claim.[79] Congress's directive in § 502(g)(1) that such a claim be treated "the same *as if* such claim had arisen before the date of the filing of the petition"[80] implies that, in the absence of this language, the claim would otherwise be a postpetition claim, arising at the time of the breach by the debtor.

A third reason straddle obligations arise is because, although the nondebtor party has fully performed its obligations before the filing, the debtor's obligations come due after filing because of some contingency specified in the prepetition agreement (other than performance by the nondebtor party). For example, suppose the nondebtor party has a contractual right to receive a severance payment upon termination of his or her employment and termination occurs postpetition. If the severance arrangement were part of an executory contract and the potential burden of the contract outweighed its benefits, the trustee could reject the contract and transform the severance claim into a prepetition claim.[81] But if the contract is not executory, the termination should still result in a prepetition claim.[82] If no postpetition action on the part of the nondebtor party to the contract is required to give rise to liability, the claim

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1988); *In re Mammoth Mart, Inc.* 536 F.2d at 950; McMillan v. LTV Steel Co., No. 1:06CV00850, 2007 WL 2838975, at *7–8 (N.D. Ohio Sept. 26, 2007); *In re* Baldwin-United Corp., 43 B.R. 443, 453 (S.D. Ohio 1984).

[79] *See* 11 U.S.C. § 502(g)(1).

[80] *Id.* (emphasis supplied).

[81] *See, e.g.*, *In re* Dornier Aviation N. Am. Inc., No. 02-82003-SSM, 2002 WL 31999222, at *2 (Bankr. E.D. Va. Dec. 18, 2002).

[82] *See, e.g.*, Mason v. Official Comm. of Unsecured Creditors (*In re* FBI Distribution Corp.), 330 F.3d 36, 47–48 (1st Cir. 2003); *In re Dornier Aviation*, 2002 WL 31999222, at *6–7 (stating that severance claims under prepetition agreements are always prepetition claims). *But see* Frederick v. Fed.-Mogul, Inc., No. 06-11549-BC, 2007 WL 551591, at *2 (E.D. Mich. Feb. 21, 2007) (characterizing as postpetition claim breach of prepetition contract requiring compensation to inventor if debtor used invention commercially).

should be a prepetition claim even if postpetition action by the debtor in possession or trustee causes it to become payable.[83]

The event triggering liability need not be an action by the debtor in possession or trustee. For example, a prepetition contract may require the debtor to indemnify the nondebtor party in the event of actions taken by third parties. When those third parties take such actions after the filing, the contract parties have already negotiated prepetition to place the risk of such actions occurring upon the debtor. Because this indemnification obligation does not stem from the nondebtor party's postpetition performance, the claim for this obligation seems appropriately labeled a prepetition contingent claim arising when the contract is executed.[84]

Following the congressional mandate to interpret the definition of claim broadly, courts have failed to distinguish between these various types of contingencies. Many courts have interpreted the word "contingent" to embrace contractual obligations that are dependent on the nondebtor party's future performance, rather than confining that concept to circumstances beyond that party's control: what one court dubbed an "extrinsic event."[85]

I suggest a better approach. If the event creating a right to payment constitutes an act by a nondebtor party, there is no "claim" within the meaning of the Code until that nondebtor party performs that act. If that party performs after the bankruptcy petition is filed, the claim such performance creates is a postpetition obligation. On the other hand, if the debtor's obligation to pay is

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[83] *See, e.g.*, Oneida Ltd. v. PBGC (*In re* Oneida Ltd.), 383 B.R. 29, 38 (Bankr. S.D.N.Y. 2008) (concluding that premium payable upon postpetition termination of prepetition pension plan constitutes prepetition contingent claim); *In re* Chateaugay Corp., 102 B.R. 335 (Bankr. S.D.N.Y. 1989) (finding claim for indemnification triggered by actions taken by the debtor in possession to be prepetition claim). This situation should be distinguished from an obligation under a prepetition contract to pay legal expenses incurred as a result of litigation initiated by the trustee or debtor in possession after the filing. In that situation, action by the nondebtor party (in defending the lawsuit) is required as a precondition to the claim, and the claim should be deemed to be postpetition. *See, e.g.*, Total Minatome Corp. v. Jack/Wade Drilling, Inc. (*In re* Jack/Wade Drilling, Inc.), 258 F.3d 385, 389 n.3 (5th Cir. 2001).

[84] *See, e.g.*, Woburn Assocs. v. Kahn (*In re* Hemingway Transp., Inc.), 954 F.2d 1, 9 (1st Cir. 1992); Employees' Ret. Sys. v. Osborne (*In re* THC Fin. Corp.), 686 F.2d 799, 802–04 (9th Cir. 1982); *In re* Highland Group, Inc., 136 B.R. 475, 481 (Bankr. N.D. Ohio 1992). When a postpetition event triggers liability of the nondebtor party to the estate under a prepetition contract, the claim of the estate against the nondebtor should also be characterized as a prepetition claim. Some courts disagree, however. *See, e.g.*, W. Elecs., Inc. v. Nat'l Union Fire Ins. Co. (*In re* W. Elecs., Inc.), 128 B.R. 900, 903–04 (Bankr. D.N.J. 1991) (concluding that claim against insurance company for postpetition loss was postpetition core proceeding).

[85] *See In re* All Media Props., Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd mem.*, 646 F.2d 193 (5th Cir. 1981).

triggered by a future event not requiring any act by the nondebtor party, the claim should arise when the consideration for that obligation is provided to the debtor, not when the future event occurs. When the debtor received consideration prepetition, the obligation of the debtor to pay should constitute a "claim" arising prepetition, even if the event triggering the right to payment occurs postpetition.[86]

A prepetition contract claim, like all other prepetition claims, may be asserted through a proof of claim filed under § 501 and will share in any distribution with other unsecured prepetition claims of the debtor. If, however, the contract claim is postpetition, its treatment may depend on whether it can be characterized as an administrative expense: the topic to which we now turn.

III. ADMINISTRATIVE EXPENSES V. POSTPETITION CLAIMS

Even if straddle obligations under prepetition contracts are properly characterized as postpetition claims (rather than as contingent prepetition claims), that does not necessarily mean they must also be administrative expenses under § 503(b). Section 503(b) directs the court to allow "administrative expenses, . . . including" certain enumerated categories.[87] The first of these categories is "the actual, necessary costs and expense of preserving the estate including" certain wages, taxes, fines and penalties.[88]

Because of the priority given to administrative expenses, courts tend to interpret the language narrowly, requiring that the claimant seeking to establish entitlement to administrative expense treatment establish two things.[89] First,

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[86] *See, e.g.*, *In re* Jartran, Inc., 732 F.2d 584, 587 (7th Cir. 1984); *In re* Baths Int'l, Inc., 25 B.R. 538, 540–41 (Bankr. S.D.N.Y. 1982), *aff'd*, 31 B.R. 143 (S.D.N.Y. 1983) (concluding that claim for advertising fees was prepetition claim when ad was placed prepetition, but not published by third party publisher until after filing).

[87] 11 U.S.C. § 503(b) (2006).

[88] *Id.* § 503(b)(1). *See generally* David M. Reeder, *The Administrative Expense Priority in Bankruptcy—A Survey*, 36 DRAKE L. REV. 135, 136–38 (1986–1987) (reviewing the history of and policy behind the administrative expense).

[89] *See, e.g.*, *In re* FBI Distribution Corp., 330 F.3d 36, 42 (1st Cir. 2003); PBGC v. Sunarhauserman, Inc. (*In re* Sunarhauserman, Inc.), 126 F.3d 811, 816 (6th Cir. 1997); Microsoft Corp. v. DAK Indus. (*In re* DAK Indus.), 66 F.3d 1091, 1094 (9th Cir. 1995); Gen. Am. Transp. Corp. v. Martin (*In re* Mid Region Petroleum, Inc.), 1 F.3d 1130, 1133 (10th Cir. 1993); *In re Jartran*, 732 F.2d at 587; *In re* Mammoth Mart, Inc., 536 F.2d 950, 954 (1st Cir. 1976); *In re* Pinnacle Brands, Inc., 259 B.R. 46, 51 (Bankr. D. Del. 2001); *In re* Cole, 189 B.R. 40, 48 (Bankr. S.D.N.Y. 1995). *See generally* Daniel Morman, *The Legacy of* Reading Co. v. Brown *Administrative Claims Arising from Trustee of DIP Misconduct*, 23 AM. BANKR. INST. J. 1 (Oct. 2004); Bruce H. White & William L. Medford, *Post-Petition Claims and Administrative Expense Priority*, 21 AM. BANKR. INST. J. 24 (June 2002).

the expense must arise from a transaction with the debtor in possession or trustee, not merely one with the prepetition debtor.[90] Second, that transaction must have been beneficial to the debtor in possession or trustee in connection with the operation of the business.[91]

This test certainly embraces the ordinary day-to-day postpetition expenses businesses incur in exchange for beneficial goods or services,[92] even if those goods or services are provided under a prepetition contract.[93] However, problems tend to arise when one of two things occurs. First, although an obligation may be incurred in exchange for postpetition goods or services provided to the debtor, those goods or services may not have benefited the estate. Second, the obligation may be incurred not in exchange for some postpetition goods or services provided to the debtor, but because of some wrongdoing by the trustee or debtor in possession that causes harm to another.

When goods or services are provided to the debtor postpetition under a prepetition contract, courts generally hold that the nondebtor party is entitled to an administrative expense claim only to the extent that the goods or services benefited the estate.[94] If no benefit is provided, no administrative expense claim may be awarded. Presumably, the nondebtor contract party would continue to have a claim based on the contract price of the goods or services. But, as discussed above in Part II, that claim would be a postpetition claim.

The Supreme Court focused on the other scenario in the case of *Reading Co. v. Brown*,[95] decided under the Bankruptcy Act but equally applicable to the

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[90] *See, e.g.*, *In re* Hemingway Transp., Inc., 954 F.2d 1, 5 (1st Cir. 1992); Employee Transfer Corp. v. Grigsby (*In re* White Motor Corp.), 64 B.R. 586, 593 (N.D. Ohio 1986); *In re* Liberty Fibers Corp., 383 B.R. 713, 717–19 (Bankr. E.D. Tenn. 2008); *In re Pinnacle Brands*, 259 B.R. at 51.

[91] *See, e.g.*, *In re Hemingway Transp., Inc.*, 954 F.2d at 5; *In re Liberty Fibers*, 383 B.R. at 719; *In re Pinnacle Brands*, 259 B.R. at 52; *In re Cole*, 189 B.R. at 48.

[92] *See generally* White & Medford, *supra* note 89; Stephen D. Hurd, *Re-Reading* Reading*: "Fairness to all Persons" in the Context of Administrative Expense Priority for Postpetition Punitive Fines in Bankruptcy*, 51 VAND. L. REV. 1459, 1462 (1998).

[93] *See, e.g.*, *In re* MEI Diversified, Inc., 106 F.3d 829, 832 (8th Cir. 1997) (granting administrative expense status to postpetition premiums under prepetition workers' compensation insurance policy); Combs v. Elkins Energy Corp. (*In re* Elkins Energy Corp.), 42 B.R. 576, 578 (Bankr. W.D. Va. 1984) (granting administrative expense status to funds due union health and retirement fund under national wage agreements based on postpetition services).

[94] *See, e.g.*, *In re FBI Distribution Corp.*, 330 F.3d at 43–44; Beneke Co. v. Econ. Lodging Sys., Inc. (*In re* Econ. Lodging Sys., Inc.), 234 B.R. 691, 699 (B.A.P. 6th Cir. 1999); *In re Cole*, 189 B.R. at 40.

[95] Reading Co. v. Brown, 391 U.S. 471 (1968).

concept of administrative expense under the Code.[96] The debtor, which filed for an arrangement under Chapter XI of the Bankruptcy Act, owned an industrial structure. Brown, the receiver, was promptly appointed and was authorized to operate the debtor's business, which consisted of renting that structure. Less than two months later, fire destroyed the building, as well as adjoining properties, one of which was owned by Reading Co.[97] Reading filed a claim in the arrangement for its losses, which it asserted were due to the negligence of the receiver and characterized as administrative expenses. The debtor was subsequently adjudicated a bankrupt, and Reading was denied administrative expense priority treatment for its claim.[98]

Accepting for purposes of its analysis that the negligence of the receiver caused the harm, the Supreme Court rejected the notion that administrative expenses are limited to those "without which the insolvent business could not be carried on," such as those to "suppliers, landlords, and the like" who would not do business with the debtor postpetition in the absence of such priority.[99] Instead, the Court stated that the definition of "administrative expense" must be interpreted in light of its "decisive, statutory objective: fairness to all persons having claims against an insolvent."[100]

Contrasting Reading with other prepetition creditors who hoped to benefit from the debtor's successful reorganization, the Court noted that Reading "had an insolvent business thrust upon it by operation of law."[101] Moreover, in the absence of administrative expense treatment, Reading would have no satisfactory means of asserting a claim against the debtor because the claim would not constitute a prepetition claim provable in the bankruptcy,[102] and a postpetition claim against the postliquidation shell would be meaningless.[103] Therefore, the Court concluded that "tort claims arising during an arrangement

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[96] Section 64a of the Bankruptcy Act provided a first priority to "the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition." Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 544 (repealed 1978). Because the language is so similar to that employed in current § 503(b)(1)(A), courts continue to look to *Reading* to interpret the boundaries of the concept of administrative expenses. *See, e.g.*, Pa. Dep't of Envtl. Res. v. Tri-State Clinical Labs., Inc., 178 F.3d 685, 690 (3d Cir. 1999); *In re* Women First Healthcare, Inc., 332 B.R. 115, 123 (Bankr. D. Del. 2005). *See generally* White & Medford, *supra* note 89.

[97] *Reading*, 391 U.S. at 473.

[98] *Id.* at 474.

[99] *Id.* at 477.

[100] *Id.*

[101] *Id.* at 478.

[102] *Id.* at 479–82.

[103] *Id.* at 479.

[should be treated] as actual and necessary expenses of the arrangement rather than debts of the bankrupt."[104]

Following *Reading*, courts have consistently held that claims arising by reason of postpetition tortious conduct by the trustee or debtor in possession in a chapter 11 case constitute administrative expenses.[105] Some courts have applied *Reading* more broadly; for example, some allow administrative expense treatment of fines or other charges assessed as a result of postpetition violations of law by the debtor.[106] Others have applied *Reading* to find that trademark or patent infringement claims constitute administrative expenses.[107] Courts have also allowed as administrative expenses fees awarded on the basis of the debtor's postpetition bad faith or frivolous litigation.[108] Most courts have declined to extend *Reading* further.[109] Nevertheless the question remains

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[104] *Id.* at 482.

[105] *See, e.g.*, Brutoco Eng'g & Constr. Co. v. Dennis Ponte, Inc. (*In re* Dennis Ponte, Inc.), 61 B.R. 296, 298 (B.A.P. 9th Cir. 1986); *In re* B. Cohen & Sons Caterers, Inc., 143 B.R. 27, 29–30 (E.D. Pa. 1992); *In re* UAL Corp., 386 B.R. 701, 707 (Bankr. N.D. Ill. 2008); *In re* Hayes Lemmerz Int'l, Inc., 340 B.R. 461, 480 (Bankr. D. Del. 2006); *In re* Women First Healthcare, Inc., 332 B.R. 115, 125 (Bankr. D. Del. 2005); *In re* French Creek Millwork, No. 03-1833 DWS, 2005 WL 2857985, at *3 (Bankr. E.D. Pa. Oct. 12, 2005); *In re* Enron Corp., No. 01 B 16034 (AJG), 2003 WL 1562201, at *5 (Bankr. S.D.N.Y. Mar. 17, 2003); *In re* MacDonald, 128 B.R. 161, 164 (Bankr. W.D. Tex. 1991). *But see* Pa. Dep't of Envtl. Res. v. Tri-State Clinical Labs., Inc., 178 F.3d 685, 698 (3d Cir. 1999) (holding criminal fine imposed for postpetition conduct violating waste management act was not an administrative expense because it was not compensatory); Cross v. K.B. Toys, No. 05 C 6137, 2006 WL 2437831, at *5 (N.D. Ill. Aug. 22, 2006) (deciding, without discussion of *Reading*, that postpetition retaliation claim was not administrative expense because it was not incurred to preserve estate).

[106] *See, e.g.*, Texas v. Lowe (*In re* H.L.S. Energy Co.), 151 F.3d 434, 438 (5th Cir. 1998); Cumberland Farms, Inc. v. Fla. Dep't of Envtl. Prot., 116 F.3d 16, 20–21 (1st Cir. 1997); Spunt v. Charlesbank Laundry, Inc. (*In re* Charlesbank Laundry, Inc.), 755 F.2d 200, 202 (1st Cir. 1985); *In re* Metro Fulfillment, Inc., 294 B.R. 306, 312 (B.A.P. 9th Cir. 2003); *In re* Bill's Coal Co., 124 B.R. 827, 830 (D. Kan. 1991). *Cf. In re* Cont'l Airlines, Inc., 148 B.R. 207, 216 (D. Del. 1992) (suggesting that award for postpetition wrongful termination of employee would constitute administrative expense); *In re* Beverage Enters., Inc., 225 B.R. 111, 117 (Bankr. E.D. Pa. 1998) (suggesting that if claim under Worker Adjustment and Retraining Notification Act was not in the nature of "wages" it would still be allowable as administrative expense under *Reading*). *See generally* Susan R. DeSimone, Comment, *The Price of Doing Business: Environmental Criminal Fines and the Administrative Expense Solution*, 17 BANKR. DEV. J. 489 (2001); Hurd, *supra* note 92.

[107] *See, e.g.*, Caradon Doors & Windows, Inc. v. Eagle-Picher Indus., Inc. (*In re* Eagle-Picher Indus., Inc.), 447 F.3d 461, 464 (6th Cir. 2006); Carter-Wallace, Inc. v. Davis-Edwards Pharmacal Corp., 443 F.2d 867, 874 (2d Cir. 1971); Houbigant Inc. v. ACB Mercantile, Inc. (*In re* Houbigant, Inc.), 188 B.R. 347, 356–57 (Bankr. S.D.N.Y. 1995).

[108] *See, e.g.*, *In re* Met-L-Wood Corp., 115 B.R. 133, 136 (N.D. Ill. 1990); *In re* Am. Preferred Prescription, Inc., 218 B.R. 680, 688 (Bankr. E.D.N.Y. 1998); *In re* Execuair Corp., 125 B.R. 600, 604 (Bankr. C.D. Cal. 1991). *But see In re* Kadjevich, 220 F.3d 1016, 1021 n.4 (9th Cir. 2000) (disapproving of such allowance); *In re* E.A. Nord Co., 78 B.R. 289, 292 (Bankr. W.D. Wash. 1987).

[109] *See, e.g.*, Oregon Dep't of Human Res. v. Witcosky (*In re* Allen Care Ctrs., Inc.), 96 F.3d 1328, 1331 (9th Cir. 1996) (denying administrative expense treatment of postpetition costs incurred by state in closing

whether such a narrow reading is appropriate, and how postpetition claims arising by reason of prepetition contractual obligations should be treated.[110] This may depend on what aspects of *Reading* were critical to the Court's conclusion.

IV. *READING* AND POSTPETITION STRADDLE OBLIGATIONS

There were three key facts that might have been determinative to the Supreme Court's decision in *Reading*. First, the claim arose out of wrongful postpetition conduct by the receiver. Second, the company was engaged in a continuing business at the time the claim arose. Third, the claimant would have had no satisfactory alternative were administrative expense treatment denied. I suggest this third fact was determinative and should guide our analysis of postpetition contract claims created under prepetition contracts, although the first two facts support administrative expense treatment of these debts as well.

When a trustee or debtor in possession breaches a prepetition contract, that breach constitutes a wrongful act for which the Code provides recourse. Although the injured party's recovery in a bankruptcy case is not equivalent to what it could obtain outside bankruptcy, the breach is no less wrongful for that reason. The nondebtor party to the contract, like Reading (the party harmed by the receiver's negligence), was not looking to a successful reorganization to maximize its prepetition recovery with respect to this newly created claim. As in *Reading*, this harm was "thrust upon it."[111]

Consistent with the theme of *Reading* that allows administrative expense treatment of claims arising from the trustee's or debtor in possession's

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nursing home operated by debtor); *In re* Econ. Sys., 234 B.R. 691, 697–98 (B.A.P. 6th Cir. 1999) (refusing to extend *Reading* to postpetition consultant services under prepetition contract); *In re* Unidigital, Inc., 262 B.R. 283, 290 (Bankr. D. Del. 2001) (denying administrative expense claim for cost of removal of leased printer after abandonment by lessee); *In re* Motel Invs. of Christiansburg LLC, 307 B.R. 536, 538–39 (Bankr. W.D. Va. 2004) (declining to award as administrative expense postpetition collection costs incurred as a result of debtor's failure to inform creditor of bankruptcy); *In re* Lazar, 207 B.R. 668, 681 (Bankr. C.D. Cal. 1997) (holding that *Reading* is not applicable to criminal fines for failure to conduct postpetition remediation of prepetition environmental damage).

[110] *Compare In re* Hemingway Transp., Inc., 954 F.2d 1, 7 (1st Cir. 1992) (stating that "we are aware of no authority that the *Reading-Charlesbank* exception encompasses a right to payment originating in a prepetition contract with the debtor") *with In re* Elkins Energy Corp., 42 B.R. 576, 579 (Bankr. W.D. Va. 1984) (holding that royalties due union health and retirement fund under prepetition contract for postpetition services are administrative expenses under *Reading*).

[111] Reading Co. v. Brown, 391 U.S. 471, 478 (1968).

wrongful conduct, courts have allowed administrative expense claims for the failure of a debtor in possession or trustee to repair and maintain property as required by a prepetition lease agreement.[112] A decision by the trustee or debtor in possession not to comply with postpetition obligations under a prepetition contract is made because such noncompliance is presumably more beneficial to the estate than compliance would be. When the estate benefits from a decision to breach a prepetition contract, the harm caused by such breach should give rise to an administrative expense claim.[113]

Similarly, some courts have accorded administrative expense status to attorney's fees awarded under prepetition when the trustee or debtor in possession initiates or pursues postpetition litigation.[114] In these situations, the voluntary action of the trustee or debtor in possession occurs after the filing and results in harm to the nondebtor party. Under *Reading* such harms should be compensable on an administrative expense basis.

It is unclear how important it was to the Supreme Court in *Reading* that the negligence of the receiver occurred while the business was in an arrangement, as opposed to occurring during the period after which it was in bankruptcy.[115]

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[112] *See, e.g., In re* United Trucking Serv., Inc., 851 F.2d 159, 162 (6th Cir. 1988). *But see* Malden Mills Indus., Inc. v. Maroun (*In re* Malden Mills Indus., Inc.), 303 B.R. 688, 707–08 (B.A.P. 1st Cir. 2004) (denying administrative expense claim for costs incurred removing storage banks and debris from leased premises after rejection of lease and abandonment of premises).

[113] *But see* K-4, Inc. v. Midway Engineered Wood Prods., Inc. (*In re* TreeSource Indus., Inc.), 363 F.3d 994, 998 (9th Cir. 2004); *In re* Heritage Leasing Corp., No. C/A 96-75946-W, 1998 WL 2016851, at *3 (Bankr. D.S.C. Sept. 17, 1998) (holding postpetition breach of prepetition lease constitutes prepetition claim).

[114] *See, e.g.*, Shure v. Vermont Indus. Dev. Auth. (*In re* Sure-Snap Corp.), 983 F.2d 1015, 1018–19 (11th Cir. 1993); Irmas Family Trust v. Madden (*In re* Madden), 185 B.R. 815, 818–19 (B.A.P. 9th Cir. 1995); *In re* Hadden, 57 B.R. 187, 190 (Bankr. W.D. Wis. 1986); *In re* Beyond Words Corp., 193 B.R. 540, 546 (N.D. Cal. 1996). *But see In re* Jack/Wade Drilling, Inc., 258 F.3d 385, 390 (5th Cir. 2001) (denying administrative expense treatment to attorneys' fees awarded under prepetition contract to prevailing party in suit brought by chapter 7 trustee when suit was brought in good faith); *In re* Kadjevich, 220 F.3d 1016, 1020 (9th Cir. 2000) (denying attorneys' fees awarded postpetition in prepetition lawsuit based on postpetition misconduct by debtor); *In re* Abercrombie, 139 F.3d 755, 759 (9th Cir. 1998) (disapproving of *Madden*, 185 B.R. at 815); *In re Hemingway Transp.*, 954 F.2d at 9 (denying administrative expense treatment to attorneys' fees awarded under prepetition contract for defending against unsuccessful third party complaint brought by trustee); *In re* Gullone, 301 B.R. 683, 688 (Bankr. D.N.J. 2003) (holding attorneys' fees awarded against debtor in unsuccessful suit for unlawful termination commenced prepetition and pursued postpetition were prepetition claim).

[115] *See, e.g.*, Pa. Dep't of Envtl. Res. v. Tri-State Clinical Labs., Inc., 178 F.3d 685, 692 n.7 (3d Cir. 1999) (suggesting that, because administrative expense claims are also recoverable in liquidations, "this is a distinction without a difference"); Yorke v. NLRB, 709 F.2d 1138, 1143 (7th Cir. 1983) (suggesting that costs incurred in connection with mandatory bargaining with union in connection with termination of operations would be administrative expense because decision to terminate operations was "in the overall interests of the creditors"); *In re* Women First Healthcare, Inc., 332 B.R. 115, 123 (Bankr. D. Del. 2005) (allowing

One can certainly argue that the injuries suffered by Reading and the other adjacent landowners would have been given administrative expense treatment in either case because no other recovery would have been available to them after the debtor was liquidated.

In any event, any distinction between claims incurred in connection with a continuing business and those in connection with a liquidation has been blurred by changes to the Code since *Reading* was decided. Even in a chapter 7 liquidation, a court may authorize the trustee to operate the business of the debtor.[116] Conversely, a chapter 11 plan may provide for the liquidation of the debtor.[117] Businesses are always run in bankruptcy, until a liquidation is completed. Whether a postpetition claim is incurred in connection with continuing a business or liquidating it should be immaterial to its characterization.

Moreover, as in a reorganization, all costs of a liquidation should be borne by a debtor's creditors collectively, rather than the individual postpetition creditor. One of the theories underlying the Code is that a collective approach to outstanding debts will maximize recovery by minimizing transaction costs.[118] Collective action does not eliminate transaction costs entirely. The parties benefiting from the collective action (whether under chapter 7 or chapter 11) should expect to bear the costs of that action, whether incurred in running the business of the debtor or liquidating the estate.[119] Those costs necessarily diminish their recovery, but not to the extent costs inherent in

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administrative expense in connection with liquidation of assets "[s]o long as the activity of the Debtor was in furtherance of its case").

[116] *See* 11 U.S.C. § 721 (2006).

[117] *Id.* § 1123(a)(5)(B).

[118] *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7–19 (1986); Laura B. Bartell, *Getting to Waiver—A Legislative Solution to State Sovereign Immunity in Bankruptcy after Seminole Tribe*, 17 BANKR. DEV. J. 17, 55–56 (2000); Paul B. Lewis, *Bankruptcy Thermodynamics*, 50 FLA. L. REV. 329, 366 (1998); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 346 (1993).

[119] *But see In re Hemingway Transp.*, 954 F.2d at 5 n.5 (expressing doubt that *Reading* exception is applicable to nonoperating liquidation because "one fundamental justification for the priority is that general creditors stand to benefit from the postpetiton *operation* of the debtor's business, either through the immediate generation of operating profits or through the ultimate reorganization of the debtor as a viable business entity"); *In re* Leroy M. Hull Co., 344 B.R. 466, 469 (Bankr. W.D. Va. 2004) (denying administrative expense claim for improper disposition of property held as bailee when no proof was offered that disposition occurred prior to conversion to chapter 7); *In re* Unidigital, Inc., 262 B.R. 283, 290 (Bankr. D. Del. 2001) (denying administrative expense treatment for claim that did not arise from operation of debtor's business); *In re* Heritage Leasing Corp., No. C/A-96-75946-W, 1998 WL 2016851, at *4 (finding the *Reading* does not apply to chapter 7 liquidations).

individual action would have done. Therefore, the prepetition claimants who share in the distributions from the estate should rightfully bear all costs incurred by the trustee or debtor in possession in achieving that distribution, even if the costs were not incurred in connection with running the business. Postpetition claims under prepetition contracts should be included in these costs.

Finally, the nondebtor party to a prepetition contract that gives rise to a postpetition claim often has no satisfactory alternative to administrative expense treatment. The ideal solution to this problem would be to allow postpetition claimants not qualifying as administrative expense holders to file claims and share in distributions pro rata with prepetition claimants. As Professor Jackson has persuasively argued,[120] this comports most closely with the treatment of comparable claims arising in connection with a nonbankruptcy dissolution or sale. Chief Justice Warren, in his dissenting opinion in *Reading*, also pointed out the injustice of treating tort claimants differently simply because they were injured after the debtor's filing rather than before.[121] One can make the same argument about contract parties; why should a claim created by a prepetition breach of the contract get paid (if at all) as an unsecured prepetition claim while a claim created by a postpetition breach of the same contract gets administrative expense priority? Should not both share pro rata?

The problem with this approach is that the Code currently does not allow it. One holding a postpetition claim is not a "creditor" entitled to file a claim under § 501. Therefore, unless that claimant can qualify as a holder of an administrative expense and request payment under § 503(a), there is no statutory mechanism for the assertion of that claim to share in any distributions.[122]

This would not be a problem if there were an alternative mechanism available to the claimant to seek recovery. And in some cases there is an alternative. If the debtor is an individual in chapter 7, the discharge granted

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[120] *See* Thomas H. Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BANKR. L.J. 399, 424–27 (1986).

[121] *See* Reading Co. v. Brown, 391 U.S. 471, 486 (1968) (Warren, C.J. dissenting).

[122] In a chapter 13 case, postpetition claims may be filed if they are either claims for "taxes that become payable to a governmental unit while the case is pending" of "a consumer debt, that arises after the date of the order for relief under this chapter, and that is for property or services necessary for the debtor's performance under the plan." 11 U.S.C. § 1305(a) (2006). No similar mechanism is provided to holders of postpetition claims in chapter 7 or chapter 11.

under § 727 discharges the debtor only from debts "that arose before the date of the order for relief,"[123] not from postpetition debts. The debtor will continue to exist after the bankruptcy and the postpetition claimant can, without running afoul of the permanent injunction of § 524,[124] seek to recover its claim from the debtor at that time.

However, if the debtor is not an individual and liquidates in a chapter 7 case, the claimant's theoretical ability to sue the postbankruptcy debtor is meaningless. Although the debtor is not granted a discharge of any debts,[125] only a shell will remain after liquidation. This is precisely the scenario the Supreme Court in *Reading* found an unsatisfactory alternative to administrative expense treatment.[126]

If the debtor files under chapter 11, unless the plan of reorganization provides for the debtor's liquidation,[127] the debtor will continue to exist after the bankruptcy, and one might think that the postpetition creditor would therefore have an alternative to recovery in the bankruptcy case in the form of a claim against the reorganized debtor. But confirmation of a plan of reorganization generally discharges the debtor not merely from prepetition debts as in chapter 7, but from "any debt that arose before the date of such confirmation,"[128] which includes any postpetition/preconfirmation debts. These are claims that did not arise "at the time of or before the order for relief concerning the debtor" and are not held by "creditors."[129] As a result, even though postpetition creditors will likely have knowledge of the bankruptcy case,[130] their claims cannot be filed under § 501 of the Code and they cannot share in any distributions. It is no wonder that courts have strained to characterize these postpetition debts as prepetition to avoid denying their holders any recovery at all.

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123 11 U.S.C. § 727(b).

124 *Id.* § 524(a)(2) (enjoining acts to collect debts discharged under § 727).

125 *See id.* § 727(a)(1) (precluding grant of discharge if "debtor is not an individual").

126 *See Reading*, 391 U.S. at 479.

127 *See* 11 U.S.C. § 1141(d)(3)(A).

128 *Id.* § 1141(d)(1)(A).

129 *See id.* § 101(10)(A).

130 *Compare* Sequa Corp. v. Christopher (*In re* Christopher), 28 F.3d 512, 519 (5th Cir. 1994) (holding that claims of postpetition creditor with actual knowledge of bankruptcy could be discharged consistent with due process) *with* Dalton Dev. Project #1 v. Unsecured Creditors Comm. (*In re* Unioil), 948 F.2d 678, 683 (10th Cir. 1991) (holding claims of postpetition creditors without knowledge of bankruptcy were not discharged).

Short of amending the Code to permit such postpetition claims, I believe the policy underlying *Reading* requires a more expansive interpretation of "administrative expense" than has yet been proposed. The test I propose for determining whether a postpetition obligation constitutes an administrative expense is a simple one. In a chapter 11 case, if the postpetition claim is subject to discharge, it should be treated as an administrative expense. In a chapter 7 case, if the debtor is not an individual and is liquidated, the postpetition claim should also be treated as an administrative expense.

It is fundamentally unfair to discharge claims that cannot be asserted in a bankruptcy case.[131] Postpetition/preconfirmation claims not constituting administrative expenses cannot be asserted and are discharged. Therefore, consistent with *Reading*, the claim should be borne by the estate as an administrative expense. Although postpetition claims in a nonindividual debtor's chapter 7 case are not discharged, if the claim cannot be asserted against the debtor after the bankruptcy case is concluded because the debtor has been liquidated (as was true in *Reading*), the claimant has no effective alternative means of recovery and fundamental fairness requires administrative expense treatment.

There is no statutory impediment to such an interpretation. The *Reading* overlay on § 503(b)(1)(A) permits a court to conclude that straddle obligations constitute "the actual necessary costs and expenses of preserving the estate"[132] without regard to any benefit to the estate. Nor do such obligations have to be shoehorned into that category of administrative expense to be allowable. The list of specific administrative expenses provided by § 503(b) of the Code is illustrative, rather than exclusive;[133] § 503(b) begins by directing allowance of administrative expenses "including" those listed.[134] When Congress used "including" in the Code, it intended that the term be construed as "not

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[131] *See* White & Medford, *supra* note 89, at 24 (stating that "[p]articularly difficult is the issue of fundamental fairness in denying administrative expense priority to post-petition claims that do not provide an *actual, necessary cost of preserving the estate*, yet were unavoidable by the claimant"); Hurd, *supra* note 92, at 1485 (suggesting that it would be unfair to discharge postpetition punitive fines in a chapter 11 case, and advocating that they be given administrative expense treatment).

[132] 11 U.S.C. § 503(b)(1)(A).

[133] *See, e.g.*, Varsity Carpet Servs., Inc. v. Richardson, 146 B.R. 881, 884–85 (N.D. Ga. 1992); Pergament v. Maghazeh Family Trust (*In re* Maghazeh), 315 B.R. 650, 654 (Bankr. E.D.N.Y. 2004); *In re* Metro Transp. & Health Referral, Inc., 165 B.R. 832, 833 (Bankr. N.D. Ohio 1994); *In re* Bergin Corp., 77 B.R. 210, 212 (Bankr. E.D. Wis. 1987). *See generally* 4 COLLIER ON BANKRUPTCY ¶ 503.05[1], at 503–23 (Alan N. Resnick & Henry J. Sommer, eds., 15th rev. ed. 2008) (stating that described categories "cannot be considered an exhaustive list of all of the types of claims that are entitled to administrative priority treatment").

[134] 11 U.S.C. § 503(b).

limiting."[135] The obligation of the debtor to satisfy those contractual obligations incurred during a bankruptcy case owing to those who could not otherwise seek recovery warrants administrative expense treatment under § 503(b), whether or not it is incurred in connection with preservation of the estate.

CONCLUSION

A bankruptcy filing is an unwelcome interruption in an ongoing contractual relationship. It rarely occurs at a convenient time. The nondebtor party may not have been paid for its prior performance, and yet it may have an obligation to continue to perform after the filing is made. When the bankruptcy is over, the nondebtor party generally receives far less for that performance than the contract provided.

But the mere fact that a prepetition contract exists is not reason enough to conclude that all contractual obligations incurred by the debtor are also prepetition in nature. Postpetition performance by the nondebtor party gives rise to a postpetition claim, whether or not that claim can be characterized as an administrative expense.

And in most cases, it should be so characterized. The Supreme Court's *Reading* decision indicated that fundamental fairness would be denied to a postpetition claimant who has no means to assert its claim against the debtor. Denial of administrative expense treatment to a postpetition claim renders it uncollectible if it is discharged in chapter 11 or if the nonindividual debtor liquidates in chapter 7. In these situations, in the absence of an amendment to the Bankruptcy Code to permit postpetition claimants to share pro rata with prepetition claimants, postpetition straddle claims should be given administrative expense treatment.

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[135] *Id.* § 102(3).