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KIRKLAND ALERT

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Third Circuit Overrules Long-Criticized *Frenville* Decision; Redefines When "Claim" Accrues for Future Claimants

In a significant *en banc* decision issued on June 2, 2010, *Jeld-Wen, Inc. (f/k/a Grossman's Inc.) v. Van Brunt* (*In re Grossman's, Inc.)*, Ch. 11 Case No. 09-1563 (3d Cir. June 2, 2010), the U.S. Court of Appeals for the Third Circuit reversed itself and joined with other circuit courts in holding that that "a 'claim' under section 101(5) of the Bankruptcy Code arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury which underlies a 'right to payment' under the Bankruptcy Code." Specifically, the Third Circuit in *Jeld-Wen* overturned the court's 1985 decision in *Avellinot & Beines v. M. Frennville Co*. (*In re M. Frenville*), which looked instead to the time when a right to payment accrues under state law to determine when a "claim" arose.[1]

The time when a claim arises under the Bankruptcy Code is significant because only "claims" are administered by the bankruptcy court and only "claims" are discharged upon confirmation of a plan of reorganization. Additionally, only suits that implicate "claims" are affected by the automatic stay upon the commencement of a bankruptcy case under section 362 of the Bankruptcy Code.

Applying the new test to *Jeld-Wen's* facts means that the claim "arose sometime in 1977, the date that Mary Van Brunt alleged that Grossman's product exposed her to asbestos" rather than in 2006, when Mrs. Van Brunt developed mesothelioma.[2] Mrs. Van Brunt purchased certain asbestos-containing home improvement products from a Grossman's lumber retailer sometime in 1977.[3] In the intervening period between Mrs. Van Brunt's purchase and the appeal to the Third Circuit, the retailer filed for bankruptcy, a plan of reorganization was filed and confirmed, and all of the debtor's stock was sold to a third party, Jeld-Wen, Inc.[4] About ten years after the Grossman's bankruptcy case confirmation, Mrs. Van Brunt developed mesothelioma and she commenced suit against Grossman's successor in interest, Jeld-Wen, Inc.[5] Jeld-Wen itself moved to re-open the bankruptcy case and filed an adversary proceeding to determine that Mrs. Van Brunt's liability claim had been discharged in the bankruptcy case and that she was barred from otherwise bringing suit.[6]

Lower Courts' Decisions

Relying on *Frenville*, the bankruptcy court held that the confirmation order did not bar Mrs. Van Brunt from bringing her product liability claim against the retailer because, under state law, her asbestos personal injury cause of action did not arise until the injury manifested itself, which was many years after the effective date of the plan.[7] The bankruptcy court rejected Jeld-Wen's argument that her claims arose when the acts giving rise to the claim were performed, namely, the sale of goods to Mrs. Van Brunt in 1977.

The district court affirmed the substance of the lower court's decision, noting that it was "compelled" to do so by *Frenville*'s binding precedent.[8]

The Third Circuit noted that the lower courts had "correctly applied" the *Frenville* "accrual test," which states that "the existence of a valid claim depends on: (1) whether the claimant possessed a right to payment; and (2) when that right arose" as determined by reference to the relevant non-bankruptcy law.[9]

In re Frenville

In *Frenville*, the Third Circuit held that the automatic stay did not bar an accounting firm's suit against the debtor.[10] A group of banks that loaned money to Frenville sued Frenville's accounting firm, A&B, for negligently and recklessly preparing the debtor's financial statements. After the commencement of the suit by the lender-banks and relying on its common law indemnification rights, A&B sought to implead the debtor as a third party defendant in the non-bankruptcy suit against it, and also commenced an adversary proceeding in the bankruptcy case against the debtor.[11]

Looking to the applicable New York state law to determine whether A&B's cause of action was stayed by section 362 of the Bankruptcy Code, the Third Circuit concluded that because the cause of action *could* not have arisen until the banks actually sued A&B (which occurred 14 months after the petition date), A&B did not have a right to payment against the debtor until that time, and, accordingly, did not hold a "claim."[12] The *Frenville* court came to this conclusion notwithstanding the language in the Bankruptcy Code that states that a "claim" includes those rights to payment that are contingent, unmatured, or unliquidated.[13] Thus, the court concluded A&B's claim was exclusively post-petition and was unaffected by the automatic stay.[14] The result of this decision, of course, is that A&B was permitted to proceed against the reorganized debtor for conduct that occurred before the bankruptcy petition was filed.

Other Circuits' Standards

In addition to the "accrual test" applied in *Frenville*, other circuits generally have applied one of two other tests to determine when a "claim" arises: (1) the conduct test and (2) the pre-petition relationship test.

Conduct Test. As applied by the Fourth Circuit, the conduct test states that a right to payment, and, therefore, a "claim" for bankruptcy purposes, arises when the debtor's conduct giving rise to the alleged liability occurred.[15] Though this test appears to provide a clearer and more uniform application than the accrual test, it is still imperfect because courts disagree as to which conduct gives rise to a claim. Thus, several courts have rejected the conduct test for another, more narrowly designed standard, the pre-petition relationship test.

Pre-Petition Relationship Test. Under this test, a claim exists if it arises from the debtor's conduct and the claimant also had some pre-petition relationship with the debtor. The requisite relationship is minimal, generally requiring only that the holder of a claim be identifiable to the debtor, but this additional step overcomes many due process concerns. The Eleventh Circuit applies this standard.[16] The Ninth Circuit applies its own version of this test, stating the requirement that a claim be within the "fair contemplation" of the parties at the time of the bankruptcy case, which relies partially on the relationship between the parties pre-petition.[17]

Third Circuit Rationale in *Jeld-Wen*

In *Jeld-Wen*, the Third Circuit concluded that *Frenville* had too narrowly construed "claim," in effect, disregarding the "contingent" and "unmatured" language in the Code's definition of "claim."[18] The *Frenville* accrual test also failed to acknowledge the gap between the time when a "claim" might exist under the Code and when a right to payment could exist under state law (acknowledging that a claim is meant to be broad enough to include situations beyond just those where a right to payment has arisen).[19] The Third Circuit identified "something approaching a consensus across the country" and concluded that "a 'claim' arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a 'right to payment' under the Bankruptcy Code."[20]

Still, even though the court appeared to sharply limit the Van Brunt's claim based on the new formulation and conclusion that the claim arose pre-petition, the Third Circuit declined to decide whether the Van Brunt's claim was discharged by the bankruptcy court's 1997 confirmation order. Such a determination was a question instead for the bankruptcy court on remand based on due process considerations of whether Van Brunt had sufficient notice of the bankruptcy case and its implications.[21]

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1 *Avellinot & Beines v. M. Frennville Co*. (*In re M. Frenville*), 744 F.2d 332 (3d Cir. 1985).

2 *Jeld-Wen, Inc.,* No. 09-1563, slip op. at 18.

[3] *In re Grossman's, Inc.*, 389 B.R. 384, 387 (Bankr. D. Del. 2008).

[4] *Id.* at 386-87.

[5] *Id.* at 387.

[6] *Id.*

[7] *Id.* at 388 ("thus, under New York law, the Van Brunts' claims did not arise until Mary Van Brunt discovered her asbestos related disease").

[8] *In re Grossman's, Inc.*, 400 B.R. 429 (D. Del. 2009) (affirming in all respects except New York warranty claims, for which the four year statute of limitations had expired, since it began running as of the time a product was delivered).

[9] *Jeld-Wen, Inc.*, No. 09-1563, slip op. at 8.

[10] *In re M. Frenville Co.*, 744 F.2d 332, 333 (3d Cir. 1985).

[11] *Id.* at 333-34.

[12] *Id.* at 337.

[13] *Id.*

[14] *Id.*

[15] *See e.g. In re AH Robins*, 839 F.2d 198 (4th Cir. 1988).

[16] *See In re Piper Aircraft Corp.*, 162 B.R. 619 (Bankr. S.D. Fla. 1994).

[17] *See In re Jensen*, 995 F.2d 925 (9th Cir. 1993).

[18] *Jeld-Wen, Inc.*, No. 09-1563, slip. op. at 11.

[19] *Id.*

[20] *Jeld-Wen, Inc.*, No. 09-1563, slip op. at 18.

[21] *Jeld-Wen, Inc.*, No. 09-1563, slip op. at 18, 21. For remand, the Third Circuit suggested certain factors which the bankruptcy court might consider, including: "the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by § 524(g)." *Id.* at 22. The Third Circuit expressed no real view, however, on whether due process had been satisfied.

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