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Evidentiary Support Needed for Successful Proof of Claim Against Affiliated Debtors

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Evidentiary Support Needed for Successful Proof of Claim Against Affiliated Debtors

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Introduction

According to title 11 of the United States Code (the "Bankruptcy Code) and the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), a debtor must file schedules of the debtor's assets and liabilities.[1] A debtor's schedules would include a list of all known claims against the debtor and list the claims as disputed, contingent or unliquidated.[2]

If an entity believes they have a claim against the debtor that the debtor has not included on a schedule, or the claim is disputed, contingent, or unliquidated, that party can file a proof of claim.[3] A proof of claim in a bankruptcy case is the creditor's statement as to the amount and character of their claim.[4] A claimant will file the claim for purposes of distributions and voting on the reorganization plan.[5]

There are certain situations when a claimant must file multiple proofs of claim and there are certain situations when a creditor should not. Part I of this article deals primarily with the procedural nature of filing a proof of claim. Part II examines who has the burden of proof when a

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[1] *See* Fed. R. Bankr. P. 1007.
[2] *See In re* Brokovich, 544 B.R. 117, 124 (Bankr. W.D. Pa. 2016); Fed. R. Bankr. P. 3003.
[3] *See* Fed. R. Bankr. P. 3003(c). The Bankruptcy Code defines a claim, among other things, as either a "right to payment, whether or not such right is reduced to judgment, liquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(5)(A) (2012).
[4] *See In re* Padget, 119 B.R. 793, 797 (Bankr. D. Colo. 1990).
[5] *See* Fed. R. Bankr. P. 3003(c).

claimant files a proof of claim. Part III concludes by analyzing whether a claimant should file a proof of claim against multiple debtors in a bankruptcy proceeding for affiliated companies.

I. A Proof of Claim can Constitute Prima Facie Evidence of the Validity and Amount of the Claim

"A creditor or an indenture trustee may file a proof of claim."[6] Bankruptcy Rule 3001(f) states that "a proof of claim filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.[7] However, section 502(a) of the Bankruptcy Code allows any party in interest to object to the claim.[8] In a bankruptcy chapter 11 case, any creditor, equity security holder or indenture trustee may file a proof of claim, and object to a proof of claim filed by another.[9]

If a claimant properly files a proof of claim pursuant to section 501, which includes filing the claim on time, absent an objection to the claim, the court will allow the claim and the proof of claim constitutes prima facie evidence of the claim.[10] Additionally, to properly file a proof of claim, the claimant must allege sufficient facts to support the claim.[11] If a claimant fails to establish facts or meet the conditions necessary to support the claim, there is no prima facie validity.[12]

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[6] 11 U.S.C. § 501(a) (2012).
[7] Fed. R. Bankr. P. 3001(f).
[8] *See* 11 U.S.C. § 502(a) (2012).
[9] *See* Fed. R. Bankr. P. 3003(c).
[10] *See* Capt. Hani Alsohaibi v. Arcapita Bank B.S.C. (*In re* Arcapita Bank B.S.C.), 508 B.R. 814, 817 (Bankr. S.D.N.Y. 2014).
[11] *See In re* Allegheny Int'l, Inc., 954 F.2d 167, 173 (3d Cir. 1992).
[12] *See In re* Svendsen, 34 B.R. 341, 342 (Bankr. D.R.I. 1983).

II. There is a Shifting Burden of Proof Which is Initially on the Objecting Party to a Proof of Claim

If a party objects to a proof of claim, there are shifting burdens which play a "key role" in the court's determination of whether the claim will be allowed.[13] Once a party properly files a proof of claim, any other party which objects has the first burden of proof.[14] The objecting party must negate the prima facie validity of the claim and must do so by offering enough evidence to refute one of the "allegations essential to the claim's legal sufficiency."[15] Therefore, if the objecting party cannot provide enough evidence, the claim will keep its prima facie validity.

If the objecting party can negate the claim, the burden shifts back to the claimant and the claimant must then prove, by a preponderance of the evidence, that under applicable law the bankruptcy court should allow the claim.[16]

III. What Constitutes Sufficient Evidence to Support a Proof of Claim Against Affiliated Companies

A. Claimants do not Need to File Multiple Claims in a Substantively Consolidated Case

A bankruptcy court will generally consolidate cases where, "the debtor's assets are so scrambled that unscrambling them is cost, time and energy prohibitive or creditors already perceive the debtors as simply a single unit and deal with them so."[17] In determining whether to consolidate a case, a court considers two factors: "(i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' ... or (ii)

[13] *See In re* Smith & Morris Holdings, LLC, 575 B.R. 637, 638 (Bankr. M.D. Pa. 2017); *quoting In re* Sydnor, 571 B.R. 681, 683 (Bankr. E.D. Pa. 2017).
[14] *See id.*
[15] *See In re* Smith, 575 B.R. at 638, *quoting In re* Henry, 546 B.R. 633, 634 (Bankr. E.D. Pa. 2016).
[16] *See In re* Oneida, Ltd., 400 B.R. 384, 389 (Bankr. S.D.N.Y. 2009).
[17] *In re* Reserve Capital Corp., No. 03-60071, 2007 WL 880600, at *4 (Bankr. N.D.N.Y. Mar. 21, 2007).

whether the affairs of the debtors are so entangled that consolidation will benefit all creditors."[18] The proponent only needs to satisfy one of the factors.[19]

The purpose of consolidation, however, is to "ensure the equitable treatment of all creditors."[20] When the court consolidates a case, the court treats the separate entities as if they merged into a single debtor.[21] Therefore, the court treats separate claims against the previous separate debtors as claims against the consolidated debtor.[22] The separate debtors' assets are collected and "pooled together" and the claims against all the debtors would be satisfied from that one pool of assets.[23] Therefore, in a case where the debtors are substantively consolidated, there would be no need to file claims against the multiple debtors.

B. Filing a Proof of Claim against each Debtor is required in a Jointly Administered Case

When a company and its affiliates file for bankruptcy, the courts can jointly administer the cases.[24] A joint administration of a bankruptcy case does not result in the same "molding of the estates as substantive consolidation."[25] Joint Administration is a procedural tool used by the courts for administrative matters, such as providing notice to creditors.[26] It does not create the same rights for the creditors as consolidation does because it does not merge the assets of the debtors into one surviving estate.[27] Therefore, when asserting a claim against affiliated entities in a jointly administered claim, it is necessary to file a proof of claim against each debtor in each separate case.[28]

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[18] *Id.*
[19] *See id.*
[20] *Id.* at *3.
[21] *See In re* Genesis Health Ventures, Inc., 402 F.3d 416, 423 (3d Cir. 2005).
[22] *See id.*
[23] *See In re Reserve Capital Corp.,* 2007 WL 880600, at *3.
[24] *See In re* Select Tree Farms, Inc., 568 B.R. 1, 3 (Bankr. W.D.N.Y. 2017).
[25] *See* Reider v. Fed. Deposit Ins. Corp. *(In re* Reider*),* 31 F.3d 1102, 1109 (11th Cir.1994).
[26] *See id.*
[27] *See id.*
[28] *See In re* Gianulias*,* No. BAP CC-12-1194-PADKL, 2013 WL 1397430, at *1 (B.A.P. 9th Cir. Apr. 5, 2013).

In *In re Gianulias*, a real estate developer served as the guarantor for the corporation he created.[29] Both the real estate developer and the corporation filed for bankruptcy and the court converted the cases to chapter 11 and ordered them jointly administered.[30] The court later consolidated the cases, but prior to that, creditors filed proofs of claims against only the developer and not the corporation.[31] One of the creditors later claimed entitlement to claims in both cases because the cases were jointly administered at the time the proof of claim was filed.[32] However, the court noted that in a joint administration, a claim filed by a creditor in one case is treated separately from a claim filed in the other case.[33] Moreover, if a creditor files separate proofs of claim, they must ensure they have sufficient evidence to support those claims and be able to prove them by a preponderance of the evidence.[34]

At each stage of the claim resolution process, the court will not allow the claim absent sufficient supporting evidence. For example, the objector does not satisfy his burden just by filing an objection.[35] Consequently, if an objecting party does not provide enough evidence to overcome the prima facie validity, the claim will retain its validity. If the objecting party provides substantial evidence, the claim loses its presumptive validity.[36]

When claimants file proofs of claims, including those who file against multiple debtors in a jointly administered case, a claimant should not file a proof of claim unless they can prove they have sufficient evidence to support their claims. The claimant needs to have evidence sufficient

[29] *See id.*
[30] *See id.*
[31] *See id.* at 2.
[32] *See id.* at 4.
[33] *See id.* at 6.
[34] *See In re* Int'l Wireless Commc'ns Holdings, Inc., 257 B.R. 739, 742 (Bankr. D. Del. 2001).
[35] *See In re* Lanza, 51 B.R. 125, 127 (Bankr. D. N.J. 1985).
[36] *See In re* Hemingway Transp. Inc. v. Kahn (*In re* Hemingway Transp.), 993 F.2d 915, (1st Cir. 1993).

to satisfy a preponderance of the evidence, which is evidence that is more convincing than the evidence of the objecting party.[37]

For example, in *In re Jones & McClain, LLP*., the claimants met their initial burden by filing proofs of claim for severance pay and unused vacation time.[38] The Trustee objected to the claims by refuting the existence of the contract which the claimants based their claim on.[39] The burden then shifted to the claimants to prove the validity of their claim by a preponderance of the evidence.[40] The claimants met this burden through their oral testimony as to representations made to them by one of the attorneys regarding their benefits and compensation and the firm's employment policies.[41] The claimants further supported their claim for unused vacation pay through written correspondence which stated, "my policy was always that vacation was earned in the prior year. Any departing employee received their unused vacation time for the year in cash, unless . . . fired for willful misconduct."[42] The court determined the claimant's testimony along with the written admission was sufficient to meet the claimants burden.[43]

C. Court will Disallow a Claim Due to Lack of Evidentiary Support

In *In re Nortel*, a Delaware bankruptcy court held that a former officer of a debtor could not recover on his claim for his "Special Pension Arrangement" absent evidence of having worked for the debtor.[44] A former President and CEO filed a claim in the amount of $2,278,679 against both a Canadian and United States debtor. The former officer had entered into a retention agreement, which provided for a "Special Pension Arrangement," with Nortel Networks

[37] *See* Tracey v. Internal Revenue Service, 394 B.R. 635, 639 (B.A.P. 1st Cir. 2008).

[38] *See In re* Jones & McClain, LLP v. Michel (*In re* Jones & McClain, LLP), 409 B.R. 322, 327 (Bankr. W.D. Pa. 2009).
[39] *See id.*
[40] *See id.*
[41] *See id.* at 326.
[42] *Id.*
[43] *See id.* at 327.
[44] *In re* Nortel, No. 09-10138(KG), 2017 WL2656520, at *1 (Bankr. D.Del. 2017).

Corporation ("NNC") and Nortel Networks Limited ("NNL"), two Canadian debtors. The former officer also entered into a termination agreement with the Canadian debtors and Nortel Networks, Inc. ("NNI"), a United States debtor.[45] The Canadian debtors objected to the former officer's claim, but then represented that they would withdraw their objection if the bankruptcy court disallowed the claim against the United States debtor.[46]

The *In re Nortel* decision turned on a lack of evidence. The claimant did not provide the court with an explanation as to why the termination agreement included NNI.[47] The court speculated it was because NNI is the principal U.S. operating subsidiary of the Canadian debtors and the claimant is a U.S. citizen, but this speculation lacked evidentiary support.[48] The evidence, including the terms of the retention agreement, reflected that the former officer was an employee of NNC and NNL, not of NNI. Further, the debtors also provided a letter which explicitly stated how the claimant was going to receive his pension benefits from Canada.[49] The court determined NNC and NNL employed the claimant, that the claimant worked as President and CEO of NNC and NNL, and that the pension payments came from Canada.[50] The claimant, however, did not have a relationship to NNI. Accordingly, the court concluded only the Canadian debtors had obligations to the claimant.[51]

Further, in *In re Carolina Tobacco Co*., a company filed for chapter 11 bankruptcy.[52] The debtor filed its schedules, which included the company's liabilities.[53] Several creditors objected to the claim, arguing that the claim was a not a debt of Carolina Tobacco Company, but was

[45] *See id.*
[46] *See id.* at 1.
[47] *In re Nortel*, 2017 WL2656520, at *3.
[48] *See id.*
[49] *See id.*
[50] *See id.*
[51] *See id* at 4.
[52] *See In re* Carolina Tobacco Co., 375 B.R. 602, 603 (Bankr. D. Or. 2007).
[53] *See id.*

instead a debt of Tideline, an affiliated company of Carolina Tobacco Company.[54] The court concluded there was no credible evidence to prove the claim was a debt of Carolina Tobacco Company.[55] There was sufficient evidence provided to overcome the prima facie validity of the claim.[56] This included the basis and explanation of the claims, which changed multiple times over the course of the case.[57] Additionally, there was fabricated documentary evidence, and a promissory note referred to the obligation as belonging to Tideline instead of Carolina Tobacco Company.[58]

In *In re Outer Banks Ventures, Inc*., a creditor filed a claim which was presumptively valid when filed.[59] The debtor filed an objection to the claim which provided evidence establishing that the creditor made calculation errors in determining the interest component of the claim and rebutted the claim's presumptive validity.[60] The court found that the creditor's prior testimony expressing his confidence in his own calculations of the debt, which he based off his personal interpretation of documents, was insufficient to meet the preponderance of evidence burden.[61] The court further found that the creditor had no authority for the imposition of late fees and default interest on a claim that was not supported by sufficient evidence.[62] Accordingly, the court allowed the debtor's objection to the claim.[63]

Conclusion

If there are affiliated companies, a claimant should not file a proof of claim against multiple debtors unless that claimant has sufficient evidence to prove each claim. If the debtor,

[54] *See id.*
[55] *See id.*
[56] *See id.* at 608.
[57] *See id.*
[58] *See id.*
[59] *See In re* Outer Banks Ventures, Inc., 572 B.R. 604, 612 (Bankr. E.D.N.C. 2017).
[60] *See id.*
[61] *See id.* at 616.
[62] *See id*. at 621.
[63] *See id.*

or another party objects to the claim, that party would need to provide sufficient evidence to overcome the claim. If the party, which is usually the debtor, can fulfill their burden of proof, the claimant will need to provide sufficient evidence to overcome the objection. If they are unable to do that, they will lose. Therefore, if the creditor does not believe it can provide the evidence, it should not waste their time and expense attempting to file claims against multiple debtors. More importantly, a claimant who files a claim with no evidentiary support could face sanctions based on the time spent reviewing the claim and any opposing motions.[64]

[64] *See* Cedar Tide Corp., v. Mintz, (*In re* Cedar Tide Corp.) 164 B.R. 808, 818 (E.D.N.Y. 1994).