By Donald R. Lassman

A Debtor's Dilemma: Undisclosed Claims

Donald R. Lassman
Law Office of Donald R. Lassman
Needham, Mass.

Donald Lassman is a sole practitioner in Needham, Mass., concentrating in bankruptcy, insolvency and business reorganization.

Undisclosed claims — rights to payment that a debtor becomes aware of after a bankruptcy case is filed and that were not included on Schedule A/B as originally filed[1] — can present many challenges for debtor's counsel. The increasing prevalence of medical procedures whose consequences might be unknown or unknowable until many years after the procedure is performed, as evidenced by the proliferation of mass tort claims, is requiring debtor's counsel to confront the problems posed by undisclosed claims with increasing frequency. Moreover, many debtors are understandably confused by solicitations from law firms seeking to represent their interests in pending complex litigation.

The better practice is to avoid the problems posed by undisclosed claims by carefully questioning the debtor prior to the case filing about any injuries or accidents that they have suffered, any medical procedures that they have undergone, any claims that they have against third parties, or any correspondence that they have received referencing claims that might be brought on their behalf. Debtor's counsel should also remind debtors that after a case is filed, they must immediately notify counsel regarding any correspondence or offers of payment that they may receive relating to a claim.[2] However, these precautionary steps will not always work. This article identifies the issues that debtor's counsel must consider when determining how to address undisclosed claims, and presents a guide for resolving those issues designed to minimize harmful consequences to debtors.

Is the Claim Property of the Estate?

When analyzing how to address an undisclosed claim, the first step must be to determine whether the claim is property of the bankruptcy estate. Section 541 of the Bankruptcy Code broadly defines "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case." Bankruptcy trustees typically assert that any connection with the pre-filing period is sufficient to bring the claim within the ambit of estate property. Because a debtor's property interests are determined by reference to state law,[3] the correct analysis focuses on whether the claim is "sufficiently rooted in the prebankruptcy past, and so little entangled with the bankrupts' ability to make an unencumbered fresh start, that it should be regarded as property of the estate."[4] In *Segal*, the U.S. Supreme Court held that a tax refund received by the debtor after its bankruptcy case was filed was property of the bankruptcy estate because the debtor had an interest in the refund when the case was filed, and a postponement of payment of the refund until after the bankruptcy case was filed does not change the result.

When determining whether a claim is property of the estate, courts examine whether all of the elements of a viable claim are present on the petition filing date. In *In re Ross*,[5] a chapter 7 trustee filed a motion to re-open a closed case in order to administer a post-closing settlement offered to the debtor in connection with a device implanted prior to the petition filing date. The trustee asserted that any cause of action relating to the device that accrued *at any time* after the bankruptcy case was filed was property of the estate.[6] The debtor opposed the motion, asserting that she had yet to suffer any injury from the device and that the settlement proceeds therefore did not constitute property of the estate. The *Ross* court found in the debtor's favor and denied the trustee's motion to reopen, finding that the tort settlement proceeds were not property of the estate because the debtor had not yet been harmed; therefore, all the elements of the tort claim were not yet present at the time of the filing.[7] Debtor's counsel must carefully analyze whether an undisclosed claim is property of the estate and not assume that because an element of a claim might have accrued pre-petition, the claim is property of the bankruptcy estate subject to administration by the case trustee.

1 The scope of this article extends to cases in which the debtor becomes aware of a claim and/or its value after the bankruptcy petition has been filed. This article does not address cases in which the debtor has refused or otherwise willfully failed to disclose assets.

2 In many cases, debtor's counsel will first learn of a claim from the case trustee, who in turn was most likely alerted to the claim by counsel prosecuting the claim on the debtor's behalf and seeking to determine whether the claim was listed on the debtor's Schedule A/B and abandoned by the trustee or, if the claim was not listed, whether the trustee is going to assert an interest in the claim.

3 *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979).

4 *Segal v. Rochelle*, 382 U.S. 375, 379, 86 S. Ct. 511, 15 L. Ed. 2d 428 (1966).

5 *In re Ross*, 548 B.R. 632, 635 (Bankr. E.D.N.Y. 2016).

6 The settlement was offered in exchange for a release of all present and future claims in connection with the device.

7 *See also Ostrander v. Van Dam (In re Mateer)*, 559 B.R. 1 (Bankr. D. Mass. 2016) (malpractice claims asserted against debtor's counsel do not constitute property of bankruptcy estate because although act alleged to be malpractice occurred prefiling, debtor suffered no harm from that act until after bankruptcy case was filed); *Sikirica v. Harber (In re Harber)*, 553 B.R. 552 (Bankr. W.D. Pa. 2016) (personal-injury claim payment was not property of estate where debtor had suffered no injury until after bankruptcy case had been closed).

Addressing Undisclosed Claims in Open Cases

Assuming that a claim is property of the bankruptcy estate, when the claim is discovered *prior* to case closing, the debtor should promptly file amended schedules[8] in accordance with Bankruptcy Rule 1009[9] in order to add the claim as an asset on Schedule A/B and add the appropriate exemption(s) on Schedule C to preserve and retain the value of the claim for the debtor. Voluntarily amending the schedules should substantially minimize the risk of challenges to the debtor's discharge under § 727 (*i.e.*, § 727(a)(2) (concealed property) or § 727(a)(4) (false oath)), and the imposition of criminal sanctions (*i.e.*, 18 U.S.C. § 152 ("Concealment of assets; false oaths and claims; bribery")). Once the schedule amendments are allowed, parties-in-interest and the case trustee have 30 days to object to new exemption claims on Schedule C. However, as a practical matter, *Law v. Siegel*[10] has substantially narrowed the range of challenges to exemption claims absent express statutory support for the challenge, or an exemption that is fictitious or not legitimately available (or subject to limitation) under the applicable exemption statute.[11]

Addressing Undisclosed Claims in Closed Cases

When a claim is first discovered *after* the case has been closed, next steps are more complicated and perilous. First, counsel must locate the client, advise the client of the issues presented and possible outcomes, and determine whether the client is interested in retaining counsel to pursue the matter. In the absence of a provision in the original fee agreement pertaining to case reopening, it might be necessary to negotiate new terms and conditions for retention and file an amended Rule 2016(b) statement disclosing the new terms of retention to the court.[12]

Sorting out the issue of what must be disclosed, to whom and when can present a vexing problem for counsel. While disclosure is always the best practice in a bankruptcy case, the debtor may have a very different view and request that no disclosure be made to the case trustee, particularly if a compelling argument can be made that the claim is not even property of the estate. Counsel must have a careful discussion with the debtor about the critical importance of full disclosure to minimize the risk of discharge revocation under 11 U.S.C. § 727(d)(2),[13] and explain the likelihood that the case trustee will find out about the claim in any event from the lawyers handling the claim. If counsel and the debtor are unable to come to an agreement on the proper approach, counsel may have to decline or withdraw from further representation of the debtor.

Assuming that an agreement is reached on the issue of disclosure and the debtor wants counsel to continue representation, the debtor may file a motion requesting that the case be re-opened[14] and pay the reopening filing fee of $260. Alternatively, the debtor could avoid the filing fee by alerting the case trustee to the existence of the undisclosed claim and requesting that the case trustee (in conjunction with the Office of the U.S. Trustee) seek reopening to administer the claim.

Case reopening is within the bankruptcy court's sound discretion.[15] Once the case has been reopened, the debtor should promptly amend its schedules in order to disclose the claim. However, depending on the law of the jurisdiction in which the case is pending, the process for amending schedules after a case is reopened might be radically different from the amendment process in cases that have not yet been closed. This difference is perhaps best illustrated by *In re Awan*.[16]

In *Awan*, the U.S. Trustee filed a motion to reopen the bankruptcy proceeding in February 2017 to administer an undisclosed personal-injury claim. After the case was reopened, the chapter 7 trustee promptly moved to hire counsel to pursue the claim and filed a motion to approve a settlement of the claim shortly thereafter. After the court had approved the settlement, the debtor filed amended Schedules A/B and C disclosing the personal-injury claim, seeking to exempt the settlement proceeds. The Trustee objected to the exemption claim as untimely under Rule 9006(b)(1), and because the debtor had not shown "excusable neglect"[17] for enlarging the amendment time period as required by that rule.

The court held a hearing on the trustee's exemption objection and directed the debtor to file a motion for an extension of time that set forth the circumstances of excusable neglect. The debtor never filed the motion to extend time and instead filed a motion to withdraw the amended Schedule C. The trustee asserted that the debtor's liberal right to amend schedules contained in Rule 1009(a) did not apply in a closed case and that in a closed case, a schedule amendment is only permissible upon a showing of excusable neglect pursuant to Rule 9006(b).

Case law interpreting the application of Rule 1009 to schedule amendments in reopened cases have thus far adopted one of three approaches: (1) Rule 1009 applies in both open and reopened cases (the "broad approach"); (2) Rule 1009 prohibits amendments in reopened cases (the "narrow approach"); or (3) Rule 1009 does not apply in reopened cases, but a schedule amendment might be accomplished under Rule 9006(b)(1) (the "middle

8 The proper manner for amending schedules and whether leave of court is necessary (*i.e.*, schedule amendment by notice or motion) is usually subject to local rules and typically depends on when the amendment is being made during the case.

9 Pursuant to Fed. R. Bankr. P. 1009(a), the debtor may amend schedules "as a matter of course at any time before the case is closed."

10 *Law v. Siegel*, 134 S. Ct. 1188 (2014).

11 *In re Hoover*, 574 B.R. 413 (Bankr. D. Mass. 2017).

12 Local rules for the bankruptcy court should also be consulted in the event that there is a rule addressing the scope of debtor's counsel's obligation to provide representation throughout the course of a bankruptcy case.

13 The question to ask here is whether the time period for bringing a discharge revocation action under § 727(e)(2)(B) runs out when a case is first closed or is resurrected by the reopening until such time as the reopened case is closed.

14 Section 350 provides for case reopening to "administer assets, to accord relief to the debtor or for other cause."

15 *Mendelsohn v. Ozer*, 241 B.R. 502, 506 (E.D.N.Y. 1997).

16 *In re Awan*, 2017 Bankr. Lexis 3177 (Bankr. C.D. Ill. 2017).

17 Determining excusable neglect is a two-step process. The first step is to determine whether the failure was due to neglect, which, in turn, is defined as inadvertence, mistake or carelessness, or intervening circumstances beyond the party's control. The second consideration is whether the neglect is excusable. Courts make this determination through a consideration of all circumstances surrounding the failure to timely act, including a danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether the delay was within the reasonable control of the party seeking the extension, and whether the party seeking the extension has acted in good faith. *See Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 394 (1993); *In re Dollman*, 2017 Bankr. Lexis 3304 (Bankr. D.N.M. 2017).

continued on page 61

from page 15

approach"). The court adopted the middle approach, finding that the debtor's right to amend as a matter of course ended when the case was closed. Further, the court sustained the trustee's exemption objection because the debtor had not requested an extension of time for filing an amended Schedule C, nor attempted to make a showing of excusable neglect as required under Rule 9006(b).[18]

The lesson for debtors is plain. In reopened cases, debtors should face few obstacles to schedule amendments in jurisdictions adopting the broad approach, but should expect to have little success in obtaining approval of schedule amendments in jurisdictions adopting the narrow approach. In courts adopting the middle approach, the burden placed on the debtor to obtain the approval of schedule amendments might be quite substantial and costly, most likely requiring an evidentiary hearing in order to establish the necessary elements of cause and excusable neglect — a proceeding that a debtor might be wholly unable to afford.

Conclusion

Managing undisclosed claims in open and reopened cases is fraught with complexity. Debtor's counsel must carefully think through available options and develop a sound strategy that will preserve the debtor's ability to exempt undisclosed claims, and avoid the possibility of criminal sanctions and jeopardizing the debtor's discharge. abi

18 Although not discussed in *Awan*, in addition to requiring excusable neglect, Rule 9006(b) also requires the party seeking the time extension to "show cause" as to why the extension should be granted. *See Moretti v. Bergeron (In re Moretti)*, 260 B.R. 602, 610 (B.A.P. 1st Cir. 2001) ("In addition to excusable neglect, the Debtor must establish that there is cause to amend. In other words, he must demonstrate that amending the schedules would serve a significant purpose and not be inconsequential.").