Scheduling and Protecting Personal Injury and Other Causes of Action in Bankruptcy Cases

by Angela Scolforo, Mark C. Leffler, and Emily Fort

Imagine a client who has a claim for damages arising out of an auto collision. The client was rear-ended, and liability is clear. The accident happened one year and eleven months ago. Thankfully, the client is organized with medical records and evidence of damages, so you quickly draft your complaint and file suit. Congratulations! You have tolled the two-year statute of limitations of Va. Code Ann. § 8.01-243. Or have you?

After serving the complaint, defense counsel calls you and asks, "Did your client tell you about his bankruptcy?" Your helpful opposing counsel then informs you that your client filed a Chapter 7 bankruptcy one month after the auto accident and, further, that your client never disclosed the cause of action in his bankruptcy schedules. You call your client, who innocently explains he never told you about his bankruptcy and never told his bankruptcy lawyer about the accident because he didn't think his personal injury claim and his financial woes were connected.

What is the next step? No one wants to be the personal injury lawyer or the bankruptcy lawyer in this scenario, but those who represent debtors in bankruptcy or plaintiffs in civil litigation need to know that filing for bankruptcy can drastically impact a plaintiff's claim arising from many causes of action such as personal injury, wrongful death, and wrongful termination or discrimination.

In navigating this less-than-ideal hypothetical situation, four overarching factors will guide the analysis: disclosure, standing, exemptions, and good faith/income considerations that arise in a Chapter 13.

Disclosure

Your client's first mistake was failing to tell his bankruptcy lawyer about the claim for damages arising from the auto collision. Simply put, a debtor in bankruptcy has a duty to disclose all property interests, including any cause of action.[1]

The cause of action is property of the estate if it arises before the bankruptcy is filed, and—in a Chapter 13 case—property interests acquired by the debtor postpetition also are part of the bankruptcy estate pursuant to 11 U.S.C. § 1306. Therefore, a debtor's duty to disclose is ongoing:[2] if a debtor "acquires or becomes entitled to acquire any interest in property," the debtor must file a supplemental schedule within fourteen days "after the information comes to the debtor's knowledge …."[3]

Of course, a debtor who intentionally withholds information about such an interest may be prosecuted criminally pursuant to 18 U.S.C. § 152. However, even the debtor's *unintentional* failure to disclose a cause of action can preclude the debtor from pursing the claim. In the hypothetical, your client did not disclose the claim for damages in his bankruptcy schedules. When he filed schedules without disclosing his interest in the cause of action, he was swearing under penalty of perjury that he had no claim for damages. The debtor's oversight, which serves as an admission against his own interests, may be grounds to judicially estop him from pursuing any recovery.

Kimberlin v. Dollar General Corp, 520 Fed. Appx. 312 (6th Cir. 2013) shows how strictly the duty to disclose is enforced. Kimberlin worked for Dollar General for nine years in a distribution center until her termination—which she attributed to retribution for having filed a complaint against her supervisor. She was fired forty-one days prior to making her final payment to the Chapter 13 trustee, and she did not amend her schedules during that time to disclose a cause of action for unlawful termination. Her Chapter 13 plan paid unsecured creditors a dividend of only 3 percent of their claims.

Approximately one year after Kimberlin received her discharge, she filed suit against Dollar General, alleging unlawful termination. The court held that judicial estoppel barred Kimberlin from pursuing the lawsuit because, if Kimberlin had notified the court of her potential claim within the forty-one day period, the bankruptcy court could have modified her plan to increase the creditors' recovery.[4] In analyzing cases similar to Kimberlin, courts in the Fourth Circuit have emphasized that the entry of a discharge in the bankruptcy may be a pre-condition of judicial estoppel.[5]

Standing

Recall that, in the hypothetical, your client filed his personal injury suit within the two-year statute of limitations (and *after* filing a Chapter 7 bankruptcy with less-than-stellar schedules). We asked whether, by filing the personal injury suit, the debtor tolled the statute of limitations found in Va. Code Ann. § 8.01-243.

Unfortunately, the answer is "no." Your client lacked standing to file the suit. A Chapter 7 debtor may only pursue a cause of action if: (i) the trustee abandons the cause of action after notice and a hearing pursuant to 11 U.S.C. § 554(c), or (ii) the "properly scheduled" cause of action is "not otherwise administered at the time of [the bankruptcy case] closing," and is therefore abandoned back to the debtor when the bankruptcy case is closed.

Your client had no standing when you filed the lawsuit because the claim was not properly scheduled and, therefore, it had not been abandoned back to him by the trustee. Only the Chapter 7 trustee has standing to pursue a cause of action.[6] However,

because the cause of action was not properly scheduled, the trustee was unaware of the need to file a suit in order to toll the statute of limitations.

As the Virginia Supreme Court held in a case involving essentially these facts, standing must exist before filing suit, and filing suit without standing is a "legal nullity"—allowing the statute of limitations to run.[7] In *Kocher*, the court held that the lawsuit at issue was void and did not toll the statute of limitations, because the lawsuit was filed before such relief was granted. The court reached this decision notwithstanding the bankruptcy court reopening the bankruptcy case and granting the debtor leave to amend

the schedules to disclose the cause of action and exempt it without objection.[8]

Imagine the previous scenario with a twist: Your client was a debtor in Chapter 13 bankruptcy instead of Chapter 7. In contrast to Chapter 7, there is no risk for plaintiff's counsel in filing suit for a Chapter 13 debtor, because Chapter 13 debtors retain standing to pursue their own causes of action. As such, a Chapter 13 debtor who files suit tolls the statute of limitations. This was confirmed by the Fourth Circuit in *Wilson v. Dollar General Corp.*, 717 F.3d 337, 339 (4th Cir. 2013), which held that, "because of the powers vested in the Chapter 13 debtor and trustee [pursuant to Bankruptcy Code Sections 1303 and 1306 and Bankruptcy Rule 6009], a Chapter 13 debtor may retain standing to bring his pre-bankruptcy petition claims."

Claiming Exemptions

Let's continue the hypothetical with the debtor in a Chapter 13, rather than a Chapter 7. Your Chapter 13 debtor client had standing and properly scheduled the cause of action. If your client recovers pursuant to the cause of action, will he still have to pay the proceeds to the trustee?

The first step in resolving this issue is asserting the proper exemptions, which he must do in order to have any hope of protecting the proceeds from his creditors. 11 U.S.C. § 522 grants the debtor the power to exempt assets within the time specified in Bankruptcy Rule 1007 (generally fourteen days). Further, Bankruptcy Rule 1009 also allows schedules to be "amended by the debtor as a matter of course at any time before the case is closed" with proper notice. Pursuant to Bankruptcy Rule 9006(b)(1), the debtor can even file a motion and try to amend schedules after the case is closed if "excusable neglect" is proven.[9] If the debtor does not initially schedule the cause of action, he must amend the schedules, and then he is permitted to claim an exemption.[10] Even where the debtor's cause of action accrues postpetition—and even if it was not timely disclosed—the debtor should amend his schedules to fully disclose the claim, accurately value it, and then exempt the highest allowable value. Otherwise, the trustee may retain an interest.[11]

Secondly, as you attempt to obtain the maximum recovery for your client, you must be aware that there may be medical providers who have a "secured" claim, a lien on the proceeds to guarantee their payments. The bankruptcy court in *In re Jones Const. & Renovations, Inc.*, 337 B.R. 579, 586 (Bankr. E. D. Va. 2006), found that "pre-petition assignments are valid, and the proceeds of any assignment that vests rights in the assignee pre-petition are not property of the estate." The district court in *In re Carpenter*, 252 B.R. 905, 913, 916 (E. D. Va. 2000) found that the employer had an equitable lien on the debtor's personal injury settlement proceeds under the terms of the health insurance plan, which is a "security interest" in the proceeds (the "res"), and ordered the debtor to pay the employer the proceeds up to the amount that the debtor received under the plan. A Chapter 13 debtor may need to provide for medical lien creditors as secured claimants in a Chapter 13 plan.

Additional Considerations in Chapter 13

If the debtor plaintiff is in Chapter 13 bankruptcy, he will need good counsel to

determine whether—even if the property is exempt—he may have to pay it to the bankruptcy trustee for the benefit of his creditors. The trustee may assert that the funds constitute income that the debtor must pay into his Chapter 13 plan in order to satisfy the Bankruptcy Code's disposable income or good faith requirements.

Although courts are split on whether Chapter 13 debtors must pledge proceeds of exempt assets to fund their plans as disposable income, debtors in the Fourth Circuit have strong arguments for retaining such proceeds. In *In re Solomon*, 67 F.3d 1128 (4th Cir. 1995), the court refused to require a Chapter 13 debtor to pay the trustee exempt IRA funds because they were exempt, saying, "a debtor's choice to proceed under Chapter 13 [should not] entitle creditors to more than they would receive in Chapter 7 . . . ." However, in contrast to *Solomon*, three other circuit decisions require the debtor to pay over exempt funds to meet disposable income requirements.[12]

Often a compromise is reached between debtors and trustees as to how the proceeds are to be distributed when the debtor recovers money from a cause of action.

In summary, debtors clearly have a duty to disclose any cause of action, and plaintiff's counsel should carefully confirm they have standing to pursue the cause of action before filing suit. One simple way to avoid being the plaintiff's counsel in the first scenario above is to review the federal courts' PACER system for bankruptcy filing histories before accepting the case. Debtor's counsel should carefully guide the debtors in scheduling their assets and asserting their full exemption rights. Failure to disclose or exempt may strip the debtor of his ability to pursue or benefit from the cause of action at all, or may result in the trustee taking the debtor's interest. Then, even if properly disclosed and exempt, there is at least an argument that debtors may have to pay over the proceeds to a Chapter 13 trustee for the benefit of creditors. Plaintiff's civil counsel and bankruptcy counsel will maximize the benefits to their clients—and perhaps even benefit creditors—when they understand the interplay between civil causes of action and bankruptcy.

Endnotes:

1 11 U.S.C. §§ 521(a)(1)(B)(i) and 541, and F. R. Bank. P. 1007; *see also Wilson v. Dollar Gen. Corp.*, 717 F.3d 337, 342 (4th Cir., 2013); *Kocher v. Campbell*, 712 S.E.2d 477, 479 (Va. 2011); *Canterbury v. J.P. Morgan Acquisition Corp.*, 958 F. Supp. 2d 637 (W.D. Va. 2013) (*quoting Logan v. JKV Real Estate Servs.,* 414 F.3d 507, 512 (4th Cir. 2005)); *Vanderheyden v. Peninsula Airport Comm'n*, 2013 WL 30065 (E.D. Va., 2013).

2 The U.S. District Court in *Vanderheyden* explained the duty to disclose as follows:
… The Fourth Circuit has observed that "[t]he meaning of 'property of the estate' under the Code has been construed 'broadly to encompass all kinds of property, including intangibles [more] specifically, 'property of the estate' under § 541(a) has 'uniformly been interpreted to include causes of action.' … [T]he debtor need not know all the facts or even the legal basis for the cause of action; rather, if the debtor has enough information . . . to suggest that it may have a possible cause of action, then that is a 'known' cause of action such that it must be disclosed … the debtor has an affirmative duty to disclose such assets and liabilities to the bankruptcy court … This duty does not end when the debtor files her bankruptcy petition; it continues through the pendency of the debtor's bankruptcy proceedings, requiring the debtor to update the bankruptcy court as her financial situation changes.
Vanderheyden, is 2013 WL 30065, at *8. (most citations omitted).

3 Fed. R. Bankr. P. 1007(h).

4 *Kimberlin*, 520 Fed. Appx. at *3.

5 *See Collucci v. Tyson Farms*, 2014 WL 6879927 (E. D. Va. 2010) (declining to apply judicial estoppel because there is no reliance until the discharge is entered, even though the debtor filed an employment discrimination complaint prior to filing Chapter 13 and he did not initially list his cause of action); *Royal v. R & L Carriers Shared Services, LLC*, 2013 WL 1736658 (E. D. Va. 2013) (denying judicial estoppel claim in a wrongful termination lawsuit because "[c]ourts have repeatedly emphasized that 'acceptance' in this context means that the bankruptcy court has not merely confirmed the debtor's bankruptcy plan but has also taken the ultimate step of granting the debtor relief (*i.e.,* discharge or repayment)").

6 *Wilson v. Dollar Gen. Corp.*, 717 F.3d 337, 342 (4th Cir. 2013); *Robertson v. Flowers Baking Co. of Lynchburg*, 2012 WL 830097 (W.D. Va. 2012).

7 *Kocher v. Campbell*, 712 S.E.2d 477, 480 (Va. 2011).

8 *Id*. at 481.

9 *See In re Wilmoth*, 412 B.R. 791 (Bankr. E.D. Va. 2009).

10 The Virginia exemption rights relevant to causes of action include Va. Code Ann. § 34-28.1 (personal injury and wrongful death actions); Va. Code Ann. § 34-4 ($5,000 per "householder" ($10,000 if 65 or older) plus $500 per dependent); and Va. Code Ann. § 34-4.1 (another $10,000 for disabled veterans).

11 *In re Webb*, 210 B.R. 266 (Bankr. E.D. Va. 1997) (containing a detailed discussion of Virginia's unique personal injury exemption statute); *In Re Williamson*, 337 B.R. 846 (Bankr. E.D. Va. 2005) (court allowed amendment of schedules to disclose and exempt prepetition personal injury proceeds and the mobile home and van purchased with such proceeds); *In re Walley*, 525 B.R. 320 (Bankr. E.D. Va. 2015) (allowing amendment and exemption of postpetition assets); and *In re Barnett*, Case No. 11-36220-KRH (Bankr. E.D. Va. Feb. 18, 2015) (overruling the Chapter 13 trustee's objection to the debtor's claim of exemption in a post-petition cause of action for personal injury).

12 *See In re Hagel*, 184 B.R. 793 (9th Cir BAP 1995) (Social Security Disability payment are included in determining disposable income, even though exempt); *In re Koch*, 109 F.3d. 1285 (8th Cir. 1997) (debtor required to pay exempt worker's compensation benefits because 11 U.S.C. § 1325(b)(2) defines "disposable income" to mean income not needed for debtor's support and the ability to claim an exemption is an independent issue from whether debtors have the ability to repay their debts); *In re Freeman*, 86 F.3d 478 (6th Cir. 1996) ("[T]he 'projected disposable income' language of section 1325(b) does not expressly or implicitly qualify income by reference to its exempt status under state law" and finding that tax refunds must be paid over as disposable income, even though exempt.).

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