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**Ancillary Litigation – Personal Injury/Employment Discrimination/
Workers’ Compensation/Social Security Disability**

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A. Introduction

Frequently, a consumer debtor with an active bankruptcy case will have a civil claim or cause of action for damages against another party. Whether the debtor pursues a settlement against the opposing party’s insurance company or files a lawsuit, it is likely that the debtor’s claim, if successful, will have an impact upon the bankruptcy estate.

Although this situation may arise often, there is no simple approach to handling the debtor’s civil claim while he or she is in bankruptcy. Nonetheless, it is very important for the debtor to make the required disclosures and follow proper procedure to preserve the claim or cause of action for the debtor’s benefit or for the bankruptcy estate’s benefit or both.

This presentation focuses on the intersection of bankruptcy law with a consumer debtor’s civil claim or cause of action. It seeks to identify some of the common issues that should be addressed, such as whether the claim is property of the estate, who can pursue the claim, and what happens to any recovery. There is no pat answer to the issues presented, and this presenter recommends that counsel become familiar with local practice and procedure to determine the most prudent course of action for your client when this situation arises.

B. Property of the Estate

When a debtor has a claim or cause of action, one of the initial questions is whether this claim or cause of action is property of the bankruptcy estate. The statutes that govern are 11 U.S.C. §§ 541 and 1306.

“Whether arising before or after the petition, a Chapter 13 debtor’s causes of action are property of the estate.” Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 47.7, at ¶ 1, Sec. Rev. May 21, 2004, www.ch13online.com.

In a Chapter 13 case, the property of the estate includes causes of action that arise after the commencement of the case and until the case is closed, dismissed or converted. See In re Fleet, 53 B.R. 833, 838 (Bankr. E.D.Pa. 1985). The debtor must disclose any litigation likely to arise in a nonbankruptcy context. See Hay v. First Interstate Bank of Kalispell, N.A., 978 F.2d 555, 557 (9th Cir. 1992). If the debtor is not knowledgeable of all the facts giving rise to a civil action before the filing of his or her petition and the financial schedules, the debtor must amend those schedules when he or she becomes aware of the existence of the action because it is an asset of the bankruptcy estate.

Donato v. Metropolitan Life Ins. Co., 230 B.R. 418, 421 (N.D. Cal. 1999). It is a widely accepted premise that a debtor’s pre-petition and post-petition causes of action are property of the estate.

This is true even if there is a delay between the time that the claim or cause of action arose and the time that the debtor learns or discovers that he or she has such a claim. Although questions of notice and the debtor’s knowledge of such a claim do not typically determine property of the estate issues, these questions can have a significant impact upon judicial estoppel arguments, which will be discussed later.

“...[T]he message is clear: Don’t take chances with the (non)disclosure of cause of action in Chapter 13 cases. The possibility that a pre- or postpetition cause of action will be property of the Chapter 13 estate should inspire debtor’s counsel to carefully explain to debtors the need to reveal any potential actions that arose before the petition or that arise during the Chapter 13 case. Counsel should always amend the schedules and statement to reveal an omitted cause of action, reopening a closed Chapter 13 case, if necessary, to add the missing

information.” Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 47.7, at ¶ 7, Sec. Rev. May 21, 2004, www.ch13online.com.

C. Standing to Sue

Another issue in the Chapter 13 arena concerns which parties have standing to sue. While it is widely accepted that a Chapter 7 Trustee maintains exclusive control over estate assets including a debtor’s cause of action, the premise is more complicated in a Chapter 13 case.

“11 U.S.C. § 1303 gives the debtor in a Chapter 13 case, exclusive of the trustee, the rights and powers of a trustee under several subsections of § 363. By this cross-reference, § 363(b) and (d) permit the debtor in a Chapter 13 case to use, sell or lease property of the estate. A debtor’s cause of action becomes property of the Chapter 13 estate under §§ 541 and 1306.” Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 54.1, at ¶ 2, Sec. Rev. May 24, 2004, www.ch13online.com.

At present, there appear to be primarily two case law positions on the issue of who has standing to pursue a claim or cause of action that is property of the estate in a Chapter 13 case:

(1) The debtor is the real party in interest who has standing to sue and employ counsel. See *Crosby v. Monroe County*, 394 F.3d 1328, 1331 (11th Cir. 2004); *Bennett v. Flagstar Bank*, 2011 U.S. Dist. LEXIS 141066 (S.D. Ga. December 8, 2011); *Looney v. Hyundai Motor Manufacturing Alabama, LLC*, 330 F.Supp.2d 1289 (M.D. Ala. 2004); *Autos, Inc. v. Gowin*, 244 Fed.Appx. 885, 888-90 (10th Cir. 2007); *Cable v. Ivy Tech State College*, 200 F.3d 467, (7th Cir. 1999); *Olick v. Parker & Parsley Petroleum Company*, 145 F.3d 513, (2d Cir. 1998); *Maritime Elec. Co., Inc. v. United Jersey Bank*, 959 F.2d 1194, 1209 n. 2 (3d Cir. 1991).

(2) The debtor and the trustee have concurrent power and capacity to sue as to nonbankruptcy federal and state law claims. See *In re Griner*, 240 B.R. 432 (Bankr. S.D. Ala. 1999); *Nettles v. State Farm Fire and Cas. Co.*, Slip Copy, 2011 WL 2462556 (M.D. Ga. June 17, 2011).

The trustee may have standing, if he or she chooses, to step into the debtor's shoes and sue when the debtor has been judicially estopped from pursuing the claim. However, in both of the following cases cited, the complaints were ultimately dismissed. See *Smith v. Cumulus Broadcasting, LLC*, Slip Copy, 2011 WL 3489820 (D.S.C. August 8, 2011); *Wright v. Guess*, 2010 WL 348377 (D.S.C. January 25, 2010).

The majority position is that a Chapter 13 debtor retains standing to pursue his or her pre-petition claims and causes of action, and the trustee's participation is generally not needed to protect the bankruptcy estate's interests in the litigation.

D. Required Pleadings and Disclosures by the Debtor

11 U.S.C. § 521(a)(1)(B)(i) requires the debtor to file a schedule of assets unless the court orders otherwise. This includes assets such as claims and causes of action, and potential claims and causes of action. However, the Bankruptcy Code and Rules do not specifically designate where in the petition such claims should be listed.

In this presenter's experience, assets such as claims and causes of action are frequently listed on Schedule B of the petition, Schedule C of the petition if the debtor is entitled to an exemption, and the Statement of Financial Affairs. However, local practice and procedure may determine that the debtor's claim should be listed as an asset elsewhere in the debtor's petition.

In many jurisdictions, it may also be appropriate for the debtor to provide for the claim or cause of action in the Chapter 13 plan or amended plan, depending upon the Chapter 13

Trustee's position and previous rulings by the court. An example of such plan or amended plan language may include providing for continuation of the cause of action by the debtor and that any non-exempt recovery shall be paid to the Trustee for the benefit of the Chapter 13 case.

E. Required Pleadings and Disclosures by Professional Persons Including Plaintiff's Counsel

11 U.S.C. § 329(a) requires any attorney representing a debtor to file with the Bankruptcy Court a statement of the compensation paid or agreed to be paid, if either was made after one year before the date of the filing of the petition. Section 329(b) also provides that the Bankruptcy Court may cancel any such agreement or order the return of any such payment if the compensation exceeds the reasonable value of the services.

Federal Rule of Bankruptcy Procedure 2016 addresses the compensation requests of entities such as attorneys or other professional persons. Rule 2016(a) requires the professional person to file an application with the Bankruptcy Court to seek compensation for services or reimbursement of expenses from property of the bankruptcy estate. Rule 2016(b) requires every attorney for a debtor to file the statement of compensation required by § 329 and transmit it to the United States Trustee (or Bankruptcy Administrator where applicable). The attorney must also disclose any fee sharing or fee sharing agreements.

However, 11 U.S.C. § 504(a) prohibits attorneys from different law firms from sharing or agreeing to share compensation or reimbursement received under § 503(b)(2) or § 503(b)(4).

F. Approval of Attorney Employment and Compensation

Aside from the questions regarding the debtor's interests in a civil claim or cause of action, there are equally important questions regarding the employment and compensation of the attorneys who represent the debtor or the trustee in these cases.

11 U.S.C. § 327(e) concerns the employment of a professional person for a special purpose, such as legal representation in a nonbankruptcy cause of action that is property of the bankruptcy estate. Although this statute discusses the trustee's employment of an attorney, the Chapter 13 debtor possesses the rights and powers of a trustee, exclusive of the trustee, pursuant to § 1303. Under the majority position, the debtor should seek approval to employ a special attorney to represent him or her in the nonbankruptcy cause of action. This is accomplished by preparing and filing the appropriate application for review by the Bankruptcy Court that presides over the debtor's Chapter 13 case.

“The proper practice for creditors and trustees is to allow the debtor-in-possession [in a Chapter 13 case] to exercise the powers assigned by §§ 1306(b) and 541, and sue in his own name for the estate.” *Cable v. Ivy Tech State College*, 200 F.3d 467, 474 (7th Cir. 1999).

“In considering whether special counsel to a debtor is required to file an application to be employed, this Court can find very little case law under section 327(e). Applications [by the debtor] to employ special counsel to litigate pre-petition non-bankruptcy causes of action are routine, daily matters that this Court deals with and, it is this Court's belief that, the lack of case law is due to the fact that the requirement to seek court approval of employment is so basic, blatant and fundamental that it has not previously been challenged.” *In re Price*, 2007 WL 1125639, at *6 (Bankr. N.D. Ala. 2007).

11 U.S.C. § 328(a) is a statute that addresses compensation for a professional person employed by a trustee (or arguably a debtor with § 1303 rights and powers). It differs, however, from § 327 because it allows the Bankruptcy Court to pre-approve a professional person's compensation.

Section 328 allows the trustee, with the bankruptcy court's approval, to employ a professional under § 327 "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a fixed or percentage fee basis, or on a contingent fee basis." 11 U.S.C. § 328(a). Even if the trustee and the bankruptcy court pre-approve a professional's compensation pursuant to § 328, the bankruptcy court "may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." *Id.*

In re Citation Corp., 493 F.3d 1313, 1318 (11th Cir. 2007).

The differences between §§ 328 and 330 affect the timing and process of the court's review of fees. For instance, under § 328, the bankruptcy court reviews the fee at the time of the agreement and departs from the agreed fee only if some unanticipated circumstance makes the terms of that agreement unfair.

Id. Based upon the case law, the compensation of attorneys seeking to represent the debtor or the trustee for a special purpose during a Chapter 13 case is rarely approved pursuant to § 328(a). Bankruptcy courts are hesitant to pre-approve attorney fees in personal injury cases until they have had an opportunity to review the results achieved by the attorney. For this reason and others, special attorneys are usually employed pursuant to § 327 and compensation is awarded pursuant to § 330.

Federal Rule of Bankruptcy Procedure 2016(a) states that an entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file an application setting for a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested.

"If the [debtor's] attorney seeks compensation from the Chapter 13 estate, Bankruptcy Rule 2016(a) requires an application for compensation." Keith M. Lundin & William H. Brown,

Chapter 13 Bankruptcy, 4th Edition, § 294.1, at ¶ 2, Sec. Rev. June 17, 2004, www.ch13online.com.

11 U.S.C. § 330 authorizes the Bankruptcy Court to award a professional person employed under § 327 reasonable compensation for actual, necessary services rendered by the professional person and reimbursement for actual, necessary expenses. This statute authorizes the Court to award less than the amount of compensation requested, and is different from the pre-approval of compensation that is available pursuant to § 328.

Section 330 also identifies the relevant factors that the Court must take into account when considering the nature, extent, and value of the professional person's services. These factors include the time spent, the rates charged, whether the services were necessary to the administration of the bankruptcy case or beneficial toward the completion of the bankruptcy case, and whether the services were performed within a reasonable time based upon the complexity, importance, and nature of the problem, issue, or task addressed.

“In determining attorney's fees, a judge must 1) determine the nature and extent of the services rendered; 2) determine the value of those services; and 3) consider the factors laid out in *Johnson v. Georgia Highway Express, Inc.* 488 F.2d 714 (5th Cir. 1974) and explain how they affect the award.” *Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874, 878 (11th Cir. 1990). Federal Rule of Bankruptcy Procedure 2014(a) states that “An order approving the employment of attorneys...or other professionals pursuant to § 327... of the Code shall be made only on application of the trustee or committee.”

However, “...in accordance with *Cable, supra.*, the term ‘trustee’ in 11 U.S.C. § 327(e) is to be read as ‘Chapter 13 debtor.’ That statute is fully applicable to the circumstances addressed by this order, and thus the court's approval of the employment of an attorney to represent the

debtor in this circumstance is necessary, based upon an application *by the debtor* which conforms to the requirements of applicable law, which are primarily stated in Fed. R. Bankr. P. 2014(a).” *In re Jenkins*, 406 B.R. 817, 819-820 (Bankr. N.D. Ind. 2009). See also *In re Price*, 2007 WL 1125639, at *6 (Bankr. N.D. Ala. 2007).

These cases hold that an attorney representing the debtor whose employment has not been approved by the Bankruptcy Court may not seek compensation from the bankruptcy estate.

G. Vesting

Vesting is another issue that may impact the prosecution of a debtor’s nonbankruptcy claim or cause of action.

11 U.S.C. Section 1327(b) states that “except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”

“Given its ordinary dictionary meaning, ‘vesting’ means that property of the estate is ‘put in possession or control of’ the debtor.” Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 230.1, at ¶ 2, Sec. Rev. May 17, 2011, www.ch13online.com.

Although the idea may seem simple enough, the case law splinters on the issue of what vests at confirmation and what remains property of the estate.

The Eleventh Circuit follows the estate transformation approach, whereby pre-petition property that is not necessary for completion of the plan re-vests in the debtor upon confirmation of the plan.

Consideration of the case law and the general concerns of the bankruptcy code assures us that the estate transformation approach, adopted by the bankruptcy courts in the Southern District of Georgia, should be the law of this circuit. We therefore echo the conclusion of the Seventh Circuit and “read the two sections, 1306(a)(2) and 1327(b), to mean simply that while the filing of the

petition for bankruptcy places all the property of the debtor in the control of the bankruptcy court, the plan upon confirmation returns so much of that property to the debtor's control as is not necessary to the fulfillment of the plan.”

In re Telfair, 216 F.3d 1333, 1340 (11th Cir. 2000) quoting *In re Heath*, 115 F.3d 521, 524 (7th Cir. 1997).

While some jurisdictions may vest property in the debtor upon confirmation of the plan, other jurisdictions may delay the vesting of property in the debtor until the Chapter 13 case is dismissed, closed, or converted. For practical purposes, this difference may determine whether the debtor should involve the Chapter 13 Trustee in decisions to employ counsel and prosecute nonbankruptcy claims or causes of action for the benefit of the estate.

However, neither § 1327(b) nor the Court's holding in *Telfair* provides a bright line test for determining whether a claim or cause of action is estate property. As evidenced by the Eleventh Circuit Court's holding in *In re Waldron*, assets acquired by the debtor after confirmation of the plan are property of the estate.

We conclude, based on the plain language of section 1306(a), that Mr. Waldron's claims are property of the estate. Mr. Waldron acquired his claims for underinsured motorist benefits after the commencement of the Waldrons' bankruptcy case but before their case was dismissed, closed, or converted. Section 1306(a) does not mention the confirmation of the debtor's plan as an event relevant to what assets are property of the estate, ...and section 1327(b) does not address assets acquired after confirmation.

In re Waldron, 536 F.3d 1239, 1242 (11th Cir. 2008).

Thus, in the Eleventh Circuit, a debtor's claim or cause of action is property of the bankruptcy estate even if the claim arose after confirmation of the plan. For this reason, it is important for plaintiff's counsel to be aware of the pending bankruptcy case and determine the Chapter 13 Trustee's position concerning the nonbankruptcy cause of action.

H. Failure to Disclose – Judicial Estoppel

There can be severe ramifications for a consumer debtor who has an active bankruptcy case and fails to disclose to the Bankruptcy Court that he or she has a claim or cause of action that could result in a recovery. Such nondisclosure may also result in a windfall for the defendant opposing the debtor's complaint in the nonbankruptcy proceeding.

An equitable doctrine known as judicial estoppel seeks to protect the integrity of the judicial process by preventing a party from asserting inconsistent legal positions in different proceedings. For the purposes of the instant presentation, judicial estoppel applies to a consumer debtor who, for example, pursues a nonbankruptcy claim or cause of action but does not disclose it to the Bankruptcy Court or list it in his or her bankruptcy schedules.

“In the Eleventh Circuit, courts consider two factors in the application of judicial estoppel to a particular case...First, it must be shown that the allegedly inconsistent positions were made under oath in a prior proceeding. Second, such inconsistencies must be shown to have been calculated to make a mockery of the judicial system.” *In re Burnes*, 291 F.3d 1282, 1285 (11th Cir. 2002) quoting *Salomon Smith Barney, Inc. v. Harvey M.D.*, 260 F.3d 1302 (11th Cir. 2001).

When the defendant in the nonbankruptcy proceeding moves for dismissal or summary judgment due to the debtor's failure to disclose the lawsuit, it is common for the debtor to claim that he or she was unaware of the duty to disclose the cause of action in his or her bankruptcy petition. However, a recent opinion from the Eleventh Circuit makes it clear that a debtor's duty to disclose assets is a continuing duty that does not end until the bankruptcy case is finished.

“A debtor seeking shelter under the bankruptcy laws has a statutory duty to disclose all assets, or potential assets to the bankruptcy court...The duty to disclose is a continuing one that

does not end once the forms are submitted to the bankruptcy court; rather the debtor must amend [her] financial statements if circumstances change.” *Robinson v. Tyson Foods, Inc.*, 595 F.3d 1269, 1274 (11th Cir. 2010).

In a situation where judicial estoppel prevents the debtor from proceeding with the civil claim or cause of action, the Trustee should not be prejudiced by the debtor’s actions and the Trustee should be able to proceed, if he or she chooses, with the prosecution of the claim.

In this [Chapter 7] case, Parker’s discrimination claim became an asset of the bankruptcy estate when she filed her petition. Reynolds, as trustee, then became the real party in interest in Parker’s discrimination suit. He has never abandoned Parker’s discrimination claim and he never took an inconsistent position under oath with regard to this claim. Thus, Reynolds cannot now be judicially estopped from pursuing it.

Parker v. Wendy’s International, Inc., 365 F.3d 1268, 1272 (11th Cir. 2004). In the *Parker* case, the Chapter 7 trustee was able to successfully intervene as the real party in interest and step into the debtor’s shoes to prosecute the cause of action when the debtor was judicially estopped from doing so. Since the *Parker* case involved a Chapter 7 debtor, the relevant statutes are somewhat different than they would be in a Chapter 13 case. However, it appears that the analysis is similar and an argument can be made for a Chapter 13 Trustee to reach the same result for the benefit of the estate in a Chapter 13 case.

I. Exemptions

Typically, a Chapter 13 debtor will claim some amount exempt for a cause of action that is property of the bankruptcy estate. Although the debtor’s location will likely determine whether state law or bankruptcy law controls the exemptions that are available, there are a few additional points worth considering.

Once the debtor claims an exemption on Schedule C of the petition and serves it properly, the property claimed as exempt is exempt unless a party in interest files an objection within 30 days after the meeting of creditors is concluded or within 30 days after any exemption amendment is filed pursuant to Federal Rule of Bankruptcy Procedure 4003(b). See *Taylor v. Freeland & Kronz*, 503 U.S. 638, 643-644 (1992).

However, an interested party such as a creditor or a trustee need not object to an exemption claimed to preserve the estate's ability to later recover value in the asset beyond the dollar value the debtor expressly declared exempt. See *Schwab v. Reilly*, 130 S. Ct. 2652, 2657 (2010).

In the Eleventh Circuit, bear in mind that the holding of *Schwab v. Reilly* appears to have abrogated the Court of Appeals' holding in *In re Green* concerning the debtor's exemption of an entire but contingent asset. See *In re Green*, 31 F.3d 1098 (11th Cir. 1994).

J. Denial or Termination of Employment Due to an Employee's Bankruptcy

The Bankruptcy Code provides protection to individuals from certain types of employment discrimination based upon a past or present bankruptcy filing.

11 U.S.C. § 525(a) requires that "...a governmental unit may not...deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title..."

11 U.S.C. § 525(b) provides that "No private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title..."

The plain language of § 525(a) states that a *governmental unit* cannot deny employment to someone just because he or she filed a bankruptcy case. However, several Circuit Courts have

entered opinions recently that analyze and clarify § 525(b) as it applies to a *private employer's* allowable decision to deny employment to an individual based upon that individual's bankruptcy filing.

“Federated moved to dismiss Rea’s action, arguing that § 525(b) does not prohibit a private employer from refusing to hire an individual because that individual has claimed bankruptcy.” *Rea v. Federated Investors*, 627 F.3d 937, 939 (3rd Cir. 2010). “The District Court properly declined Rea’s request to read the phrase ‘discrimination with respect to employment’ in § 525(b) as broad enough to encompass discrimination in the denial of employment. Congress did not so provide. Neither will we.” *Id.* at 941.

“Relying on *Leary v. Warnaco, Inc.* 251 B.R. 656, 658 (S.D.N.Y. 2000), Rea asserts that the plain meaning of the prohibition in § 525(b) against ‘discrimination with respect to employment’ is broad enough to encompass discrimination in the denial of employment.” *Id.* at 940.

“We find Rea’s reliance on *Leary* unavailing. *Leary* appears to be the only court to conclude that § 525(b) prohibits private employers from engaging in discriminatory hiring, contrary to overwhelming authority otherwise.” *Id.* at 940.

“We conclude that Congress [in §525(b)] did not prohibit private employers from denying employment to persons based on their bankruptcy status” *In re Burnett*, 635 F.3d 169, 173 (5th Cir. 2011).

The conspicuous difference between the two subsections is that § 525(a), the one applying to government employers, explicitly forbids them from either denying or terminating employment because of a bankruptcy, while § 525(b), the one applying to private employers, forbids them from terminating employment because of bankruptcy but says nothing about denying employment because of it.

Myers v. Toojay's Management Corp., 640 F.3d 1278, 1283 (11th Cir. 2011).

Although the District Court for the Southern District of New York decided in *Leary* that a private employer was prohibited from denying employment based upon an individual's bankruptcy status, the large majority of cases support an employer's ability to do just that – deny employment to an individual based upon his or her bankruptcy filing.

K. Conclusion

The intersection of bankruptcy law with nonbankruptcy claims and causes of action can be somewhat confusing to bankruptcy practitioners and plaintiffs' attorneys alike. However, by focusing on the applicable sections of the Bankruptcy Code, the Bankruptcy Rules, and the prevailing case law, attorneys should be able to determine where the issues are likely to develop and what steps should be taken by your clients to navigate those issues successfully. Hopefully, these materials will serve as a primer for attorneys seeking guidance when a Chapter 13 debtor has a claim or cause of action that is property of the estate and he or she wants to proceed with prosecution of the case without running afoul of the requirements of the Bankruptcy Code or the Bankruptcy Rules.