When the PI plaintiff files bankruptcy but fails to schedule the lawsuit

A situation to be avoided for sure; here are the likely consequences

By David Cook

Confronting monstrous medical bills and the loss of income, the plaintiff files bankruptcy to squelch haranguing collection calls and pesky lawsuits. Bankruptcy discharges the medical bills (unless secured by a lien on the personal-injury lawsuit) and enhances the recovery due plaintiff. *Local Loan Co. v. Hunt* (1934) 292 U.S. 234 offers the plaintiff a "fresh start" by freeing the plaintiff (as debtor) from the financial drain caused by the catastrophic injury.

Personal misfortune and financial pain make up the personal-injury and bankruptcy cocktail. In filing bankruptcy, the debtor must list the personal-injury lawsuit ("PI lawsuit") as an asset in the bankruptcy schedules [Schedule B Nos. 21 & 35] and statement of affairs [No. 4 - "List all suits and administrative proceedings to which the debtor is or was a party within year."] ("Scheduling" includes disclosing the PI lawsuit in the schedules and statement of affairs) (See *Wood v. Premier Capital, Inc.* (*In Re Wood*) (1st Cir. BAP 2003) 291 B.R. 219, 226.) More than a few times, the debtor declines to schedule the PI lawsuit in the bankruptcy. The bankruptcy case is concluded, and the creditors and the trustee miss the PI lawsuit. On the other hand, the insurance company lawyers don't make this error.

What happens next? Let's see who is the winner and who is the loser.

Who owns the PI lawsuit upon the filing of the bankruptcy?

Upon the filing of a bankruptcy by the PI plaintiff, title to PI lawsuit vests in the bankruptcy trustee, ousting the plaintiff as the party in interest. Bankruptcy ejects the plaintiff as the party and inserts the bankruptcy trustee as the actual owner of the lawsuit itself. (See *Matter of Geise* (7th Cir. 1993) 992 F.2d 651, 655; also *Cottrell v. Schilling* (6th Cir. 1989) 876 F.2d 540, 542-43; *Sierra Switchboard Co. v. Westinghouse Electric Co.* (9th Cir. 1986) 789 F.2d 705, 709; *Tignor v. Parkinson* (4th Cir. 1984) 729 F.2d 977, 980.) Plaintiff's counsel, therefore, has a new client or, maybe, an adverse competitor. Moreover, plaintiff's counsel forfeits control and ownership of the PI lawsuit. Given that bankruptcy excises the debtor from the recovery, temptation entices the debtor to conceal the lawsuit from the bankruptcy.

As a result of the bankruptcy, the debtor as the plaintiff debtor lacks standing to prosecute the PI lawsuit, leading to a potential dismissal unless the court grants leave to substitute in the bankruptcy trustee and continue the prosecution of the case. (See *Cloud v. Northrop Grumman Corp.* (1998) 67 Cal.App.4th 995, 1004-1010 [See cases in next section].) The trustee may abandon the PI lawsuit if, e.g., the debtor could claim a 100 percent exemption. That depends upon the exact nature of the damages sought and the breadth of the exemption. (See *Harris v. St. Louis Univ.* (E.D. Mo. 1990) 114 B.R. 647, 648) An exemption might conceptually revest the estate in the hands of the plaintiff. (See *Haaland v. Corporate Management, Inc.* (S.D.Cal. 1989) 172 B.R. 74 (discussing personal injury exemption set forth in Code of Civil Procedure section 704.140).) That might work, maybe.

Given the time-sensitive nature of personal injury actions and the risk of a dismissal, standing becomes a crisis. A dismissal for lack of standing could be catastrophic if the statute of limitations passes. (See, e.g., *Bostanian v. Liberty Savings Bank* (1997) 52 Cal.App.4th 1075, 1079 (although Chapter 11 debtor-in-possession has standing to sue, Chapter 7 debtor lacks such standing); also *In re Louden* (E.D.Ky. 1989) 106 B.R. 109 (since there is no debtor-in-possession in Chapter 7 case, debtor has no standing to sue).)

What happens if the debtor fails to disclose this asset?

The failure to schedule the PI lawsuit may be fatal. The trial court can dismiss the personal injury action, exonerating the defendant of any civil liability, no matter how egregious (such as wrongful death or horrible bodily injury). Can this happen? Maybe. If not, the case is wrested from the plaintiff and handed to the trustee.

The seminal case is *Oneida Motor Freight, Inc v. United Jersey Bank* (3rd Cir. 1988) 848 F.2d 414. In *Oneida,* the debtor filed a Chapter 11 and did not schedule a potential lender liability claim against the bank, nor raise any issue of set-off against the bank's claim (*Id*. at 417) and settled, providing for payment to the bank (*Id.* at 415). The bankruptcy filings failed to disclose the lender liability claim against the bank. Post-confirmation, the debtor filed a lender liability against the bank, which the court dismissed on the grounds of estoppel (*Id.* at 416, *fn*. 2, and 420).

Oneida kicks off a series of cases holding that failure to schedule or disclose the claim (against the tortfeasor) in the bankruptcy constituted judicial estoppel barring any relief. (See *Billmeyer v. Plaza Bank of Commerce* (1995) 42 Cal.App.4th 1086, 1092 (fn. 2) (dismissal of lender liability claim for the failure to disclose); *Matter of Baudoin* (5th Cir. 1993) 981 F.2d 736 (lender liability claim); *Hay v. First Interstate Bank of Kalispell, N.A.,* (9th Cir. 1992) 978 F.2d 555, 557 (lender liability action barred but left open rights of creditors); *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.* (3rd Cir. 1996) 81 F.3d 355 (estoppel applied in favor of non creditor defendant if the claim was not scheduled); *International Engine Parts, Inc. v. Feddersen & Co.* (1998) 64 Cal.App.4th 345 (judicial estoppel in favor of a party who was not a creditor nor a party to the bankruptcy proceeding).)

Other cases abound, including *Maggio v. Schatz* (Cal.App.2d Dist. 2004) 2004 Cal.App. Unpub. LEXIS 9366 (unscheduled), *Hamilton v. Greenwich Investors, XXVI, LLC,* (2011) 195 Cal.App.4th 1602 (unscheduled); *Hamilton v. State Farm Fire & Cas. Co.* (9th Cir. 2001) 270 F.3d 778, 784-786 (unscheduled); *Burnes v. Pemco Aeroplex, Inc.* (11th Cir. 2002) 291 F.3d 1282, 1287-1288 (unscheduled). (See also *M & M Foods, Inc. v. Pacific Amer. Fish Co.* (2011) 196 Cal.App.4th 554, 561-565 (denied confirmation of arbitration award because debtor failed to fully disclose asset in schedules).)

Not every personal-injury plaintiff crumples and some survive the debacle of the unscheduled PI lawsuit. For example, in *Cloud, supra*, the court barred summary disposition at the pleading stage, as follows: "[N]on-disclosure, and nothing more, is all that could be established in this case by a review limited to the plaintiff's complaint plus her bankruptcy filings." (See *Cloud* at 1019-1020, questioning whether non-disclosure was part of a scheme to defraud or innocent error); also *Gottlieb v. Kest* (Cal.App.2d 2006) 141 Cal.App.4th 110 (bankruptcy proceeding did not adjudicate the claim one way or another).)

Dismissal is not preordained but the trustee captures an asset, possibly free of trial counsel absent a valid pre-petition lien. An unscheduled asset belongs to the trustee who may pursue the action for the benefit of the estate. (*Locapo v. Colsia* (D.N.H. 2009) 609 F. Supp.2d 156, *GE HFS Holdings, Inc. v. International Ins. Group* (D. Ma, May 29, 2008) LTC 2008 U.S. Dist LEXIS 4406, *Graupner v. Town of Brookfield* (D. Ma. 2006) 450 F. Supp.2d 119, *Vidal v. Doral Bank Corp.,* (D.P.R. 2005) 363 F. Supp.2d 12) While the claim is preserved, the plaintiff's standing is forfeited. In any event, the PI lawsuit belongs to the trustee who might oust trial counsel who embraces *Fracasee v. Brent* (1972) 6 Cal.3d 784 (measure of attorney's fees due discharged attorney in tort case).

Worse, the plaintiff's omission is an act of dishonesty that gives the defense counsel a WMD: "Did you lie on the bankruptcy schedules?" or "Did you lie in this case?" or "Are you cheating your own doctor who saved your life?" The failure to list the PI lawsuit might bar the debtor's discharge under Bankruptcy Code section 727(a)(4)(A) *et seq*. (See *In Re Harris* (Bankr. D. N.H. 2006) 2006 B.N.H. 26; *Saunders Real Estate Corp. v. Pearlman* (*In re Pearlman*) (Bankr. D.R.I. 2009) 413 B.R. 27.) The failure to list the PI lawsuit may deny viable exemptions. (See *In re Orlando* (Bankr. D. Mass. 2007) 359 B.R. 395; *In re Salvucci* (Bankr. D. Mass, 2006) 339 B.R. 279.) The nightmare culminates in a criminal prosecution under 18 U.S.C. §§ 152 (1),(2) and (3) [false oath].

Nothing good ever comes of failing to disclose a PI lawsuit in the bankruptcy.

The punchline

What should the trial lawyer do? Get a PACER account [access to U.S. court filings] to confirm that the bankruptcy schedules disclose the PI lawsuit and underlying claim. If the schedules fail to disclose the PI lawsuit, communicate with the debtor's bankruptcy counsel, provide a copy of the lawsuit, and advise bankruptcy counsel to amend the schedules that would list the PI lawsuit in the schedules. Delay is the enemy.

Q.E.D.: Kiss-and-tell is better than the kiss of death.


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