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So, Your Client Filed Bankruptcy

What You Need To Know

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It's become an all-too-familiar situation. You're in the middle of litigating your personal injury case or, worse, you just wrapped up settlement, only to discover that your client months ago filed a bankruptcy. In an instant, your client's recovery (and your fee) become wholly dependent on a successful negotiation of an unfamiliar process with its own set of judges, rules and procedures. The COVID-19 crisis will increase bankruptcies and the likelihood that clients will seek bankruptcy protection at some point during their lawsuit. It's never been more important to understand how a bankruptcy filing will affect your cases and be prepared to deal with it when it happens. This article outlines the basic aspects of consumer bankruptcy law which impact a client's lawsuit, including disclosure, judicial estoppel and requirements for bankruptcy court approval of your representation and settlement. The article also suggests ways to increase the level of predictability or, if not control over, the client's decision-making process regarding debt management and bankruptcy.

Listing the Claim: The Bankruptcy Estate and Judicial Estoppel.

The moment a bankruptcy petition is filed, all property of the debtor becomes property of the bankruptcy estate. This includes all of the debtor's legal and equitable interests in property as of the commencement of the case and the debtor's property immediately falls under the control of the bankruptcy trustee and ultimately the court. 11 U.S.C. § 541. All means all - real, personal, tangible and intangible; and that includes actual and potential known causes of action (tort or otherwise) existing at the time of the petition, filed or unfiled. 11 U.S.C. § 521. In a Chapter 13 proceeding, property of the estate also includes property acquired post-petition; so any claim arising during the course of the bankruptcy proceeding becomes property of the estate and subject to court control. 11 U.S.C. § 1306(a).

A bankruptcy petition must list all property, including filed or known unfiled claims, held by the debtor. Your client's failure to list filed or potential claims risks criminal penalties and the potential dismissal of those claims by operation of the doctrine of judicial estoppel. Judicial estoppel is an equitable doctrine protects the integrity of the judicial process "by prohibiting parties from deliberately changing positions according to the exigencies of the moment." New Hampshire v. Maine, 532 U.S. 742, 749–50 (2001). The Eleventh Circuit adopts a two-prong test for applying judicial estoppel: (1) an inconsistent statement under oath in a separate proceeding; and (2) an intent to "make a mockery" of the judicial system. See, e.g., Robinson v. Tyson Foods, Inc., 595 F.3d 1269, 1273 (11th Cir. 2010).

Because a bankruptcy petition is a sworn statement in court as to what the debtor owns, filing a lawsuit on a claim not listed in the petition or failing to list a cause of action filed prior to the petition satisfies the first prong. That is the case even if the bankruptcy was dismissed by the time the defendant raises the issue. Kunica v. St. Jean Financial Inc., 233 B.R. 46, 58-59 (Bankr. S.D.N.Y. 1999). But because the second prong requires an intent to deceive, not every failure to list the cause of action is fatal.

The Eleventh Circuit in Slater v. United States Steel Corp., 871 F.3d 1174 (11th Cir. 2017)("Slater II), sitting *en banc*, comprehensively addresses judicial estoppel in the bankruptcy context and in particular the intent element. Slater II relaxed the prior approach which tended to apply automatic dismissal whenever a claim was unlisted. Slater II instead establishes a totality-of-the-circumstances test to determine whether the second prong (intent to "make a mockery of the judicial system) justifies dismissal. The court identified the following factors to be examined under the second prong of the test: Sophistication of debtor; Whether debtor corrected the omission and under what circumstances; Whether debtor (or his attorney) notified the bankruptcy attorney of the claims; Whether the bankruptcy trustee or creditor had actual notice; Whether other lawsuits were disclosed; and the actions taken by bankruptcy Court, or lack thereof.

Slater II provided a welcomed relief from the "gotcha" effect of the prior approach of automatically dismissing virtually any unlisted claim. This new approach gives litigators a fighting chance to take actions to avoid estoppel by taking prompt action after discovering that a client is in bankruptcy and has failed to list the claim. It's worth pointing out, however, the even under this new approach, simply dismissing the bankruptcy will not necessarily avoid the estoppel effects of failing to list the claim. Weakley v. Eagle Logistics, 894 F.3d 1244, 1247 (11th Cir. 2018), cert. denied, 139 S. Ct. 836, 202 L. Ed. 2d 607 (2019).

The Alabama Supreme Court has generally embraced the federal guidance on imposition of estoppel in the bankruptcy context. Ex parte First Alabama Bank, 883 So.2d 1236 (Ala. 2003). See also, Ex parte Jackson Hospital & Clinic, Inc., 167 So.3d 324 (Ala. 2014). However, Alabama cases did not adopt an "automatic" approach and have shown reluctance to dismiss a plaintiff's case outright to create a windfall for the defendant. Middleton v. Caterpillar Indus. Inc., 979 So.2d 53 (Ala. 2014). The Slater II test is more in line with Alabama law and provides needed clarity on when the plaintiff's case is due to be dismissed.[1]

What should you do when you discover that your client failed to list his lawsuit in the bankruptcy petition? While the debtor is required to list all property upon filing the petition, the Bankruptcy Code takes a liberal approach to amendments. The bankruptcy schedules may be amended at any time prior to closure, and this is true with respect to the addition of a listed claim. A claim can be added to the schedule at any point during the proceeding and even after conclusion by reopening the estate for that purpose. At the same time, however, an unexplained delay in amending the schedule will risk estoppel under Slater II's totality-of-the-circumstances test. It's important, therefore, to act quickly to amend the schedule soon after the failure to list is discovered.

Complying with the Bankruptcy Rules: Chapter 7 vs. 13.

The first issue to determine is which chapter of the bankruptcy code your client filed under. Most consumer bankruptcies proceed under either Chapter 7 (liquidation) or Chapter 13 (debt restructuring). While in both proceedings all the debtor's property, including and claim, is held by the estate, there are differences that can affect how your client's claim is treated. In a Chapter 7, the claim belongs to the trustee and not your client. While it's common for the trustee to allow a claim to proceed with the attorney selected by the client, know that the trustee has the right (subject to court approval) to decide whether to proceed, to select the attorney representing the trustee/debtor in the suit and whether to settle. Bankruptcy Rule 6009; See also Koch Refining v. Farmers Union Cent. Exchange Inc., 831 F.2d 1339, 1346-47 (7th Cir. 1987). For this reason, the trustee should kept informed of major developments as the case progresses, especially any contemplated settlement. In a Chapter 13, under which debts deemed allowed are paid over the course of a plan (typically five years), the trustee has a reduced role in managing the estate property. In a Chapter 13, the debtor controls claims filed before and after the petition, including the selection of counsel and resolution, subject only to court approval (see below). Crosby v. Monroe Cnty., 394 F.3d 1328, 1331 n. 2 (11th Cir. 2004). This distribution of settlement proceeds and whether your client is entitled to any will depend on the type of proceeding. In a Chapter 7, all settlement proceeds are used to satisfy creditors, subject only to the debtor's statutory exemptions. In a Chapter 13, distribution will depend on the percentage of the unsecured debt paid under the bankruptcy plan.

You Must Be Appointed as Counsel by the Bankruptcy Court.

Section 327 of the Bankruptcy Code requires court approval of the hiring of any professional, including any attorney hired by debtor to pursue a claim for damages. 11 U.S.C § 327. This is the case for both Chapters 7 and 13 and applies to any attorney hired by the debtor, regardless of the fee arrangement. It also applies to attorneys hired before the bankruptcy was filed. In re Fisher, No. 16-1911, 2019 WL 1875366 (Bankr. S.D. Ala. Mar. 27, 2019).

So, even if you were retained months before the bankruptcy was filed, you must be approved by the bankruptcy court in order to continue to represent the debtor and take a fee from the proceeds of the case. The Code also requires court approval of your contingency fee agreement.

The consequences of failing to be appointed can be severe and include possible forfeiture of any fee received in the absence of appointment. See In re Fisher, No. 16-1911, 2019 WL 1875366 (Bankr. S.D. Ala. Mar. 27, 2019).

The Appointment Process. The appointment process requires filing an Application for Employment which describes the matter, the fee arrangement and includes a sworn statement from the attorney regarding a lack of an interest conflict. Also, some courts require that the retainer agreement be attached to the application. The application may either be filed by the client's bankruptcy attorney or directly by the attorney seeking appointment. In any event, a hearing will typically be set on the application.

When to Seek Appointment. Approval is required before the professional services are rendered, and some jurisdictions strictly adhere to this rule. Other courts adopt a more lenient approach, allowing *post hoc* approval if: (1) applicant demonstrates that he was qualified at the outset; and (2) the delay in seeking approval was excusable. *In re Osprey Utah, LLC*, Case No. 16-2270 (Bankr. S.D. Ala. Mar. 27, 2018) (doc. 295) (cited in In re Fisher, No. 16-1911, 2019 WL 1875366, at *2 (Bankr. S.D. Ala. Mar. 27, 2019). "Sooner the better" and "better late than never" are the rules here; so if you discover your client's bankruptcy well into your representation, file your application as soon as you can and be prepared to explain why it was not filed earlier.

Any Settlement Must Be Approved.

Because any claim is property of the bankruptcy estate, any settlement must be approved by the bankruptcy court. 11 U.S.C. § 363(b). Accordingly, any settlement agreement should be made contingent upon approval by the bankruptcy court and no distribution may take place until after approval. The motion to approve the settlement and the fee should disclose all terms that impact the amount to be paid to the debtor, including expenses and any applicable subrogation terms.

Confidential Settlements. Because the specifics of the settlement and proposed distribution must be disclosed to the court and other interested parties, a confidentiality clause presents a challenge. Simply carving out the bankruptcy process from the clause would be the easiest fix, but Defendants may balk. After all, a filed motion for approval, including all the settlement terms, will be part of the public record and viewable by anyone with PACER access. If a carve-out is not an option, you should find out ahead of time the court's approach to approval of confidential settlements. Some courts may allow you to include basic non-confidential information in the filed motion and send details of the agreement by email to chambers and the trustee. Other courts may require a more formalized motion to seal process.

You May File Pleadings Directly if Confronted with an Unresponsive Bankruptcy Attorney.

In a perfect world, your client's bankruptcy attorney will promptly return your calls and help get the necessary pleadings filed to make sure your client's claim is properly listed, you're appointed as counsel and your settlement gets approved. But it's sometimes difficult to get prompt responses from busy or uninterested bankruptcy attorneys. That's a problem when your client's claim (and your fee) depend on timely compliance with the bankruptcy requirements. Fortunately, ther's a back-up plan. Bankruptcy courts allow you to file pleadings directly, as long as you're admitted in the federal court district court. While you might be unsure whether you're filing the correct form, it's better to file an imperfect pleading yourself than to have your claim estopped or your fee disapproved because nothing was filed. Remember, the Slater II totality-of-circumstances test focuses on actual notice, not a particular format. Any expression of an intent to notify the court, the trustee and the creditors of the claim will help avoid estoppel, even if the notice is technically deficient under the bankruptcy rules.

Your Duty to Know Whether Your Client is In Bankruptcy

What steps are we expected to take to determine whether our client is in bankruptcy? Is it enough to simply ask the client and then rely on his answer? Is it enough to insert in a retainer the client's duty to disclose any bankruptcy filing? Will the client's failure to notify his attorney of the bankruptcy excuse a failure to comply with the bankruptcy rules? While the answers may depend on the jurisdiction and the judge, Judge Callaway in the Southern District has made his views on the matter crystal clear. In the Fisher decision, he served notice that lawyers are expected to independently verify (through PACER) whether their clients are in a bankruptcy and may not simply rely on their client's representations. In short, ignorance of the client's bankruptcy will not be an excuse for failing to comply the bankruptcy requirements and avoiding the harsh consequences. His instructions are worth reading:

> This court regards the law firm's reliance on (the client's) representation (that she was not in bankruptcy) without any further checking as wholly inadequate. A debtor who fails to list a claim in his or her schedules may also lose that claim based on judicial estoppel. [citation]. The question of whether a plaintiff is in bankruptcy is thus very significant. Every trial attorney has or should have a PACER account with which to check federal court pleadings, including bankruptcy court pleadings. It takes only a few moments to check a client's name on PACER before distributing settlement proceeds to determine whether that client is in bankruptcy. To rely on a client's representation that he or she is not in bankruptcy is not enough. . .. In this court's view, if a lawyer fails to check PACER to confirm that a client

is not in bankruptcy immediately before distributing settlement proceeds, the lawyer runs the risk of being held liable for the settlement funds that would have otherwise gone into the bankruptcy estate. Of course, a prudent lawyer should also check PACER upon initial retention as well so that his or her employment can be approved by the bankruptcy court on a timely basis.

In re Fisher, 2019 WL 1875366, at *2 (Bankr. S.D. Ala. Mar. 27, 2019).

Practice Tip: Understanding and Anticipating the Decision to File Bankruptcy Allows You To Minimize its Impact on Your Practice

Beyond checking PACER and complying with the rules once you discover a client's bankruptcy, knowing more about your clients' financial picture at the outset empowers you to identify at-risk clients and take steps to minimize the impacts of a bankruptcy filing on your case.

Consider the factors driving clients to bankruptcy and why so many do so without consulting their injury attorneys. For starters, many consumers have little or no cushion to survive financial difficulties. This was true before COVID 19 and is even more the case now. Also, the collection calls and threats that come once a client falls behind in paying the bills create a sense of urgency (often false) to take some action. At the same time, consumers are bombarded by advertising messages from bankruptcy firm touting the benefits of bankruptcy and leaving the impression that bankruptcy is the best, if not only, option. The result is often an abrupt decision to file bankruptcy without taking the time to explore other options. Also, once the bankruptcy is filed, the client may not to fully understand the implications on the other aspects of his life, including his injury case. When you throw in the natural reluctance to discuss financial difficulties, it's no surprise that many clients fail to inform their injury attorney before or after filing a bankruptcy.

But there is large degree of predictability here. A host of reliable indicators, easily identifiable at intake, will tell you whether your client will likely consider bankruptcy at some point during the litigation. Here are a few (in no particular order):

1. A loss of wages (client or spouse);
2. A recent or imminent divorce;
3. Unservicable credit card debt;
4. Unservicable medical debt;
5. Unservicable student loan debt;
6. Unservicable tax debt;
7. Calls from collectors;
8. A pending disability claim (client or spouse);
9. In-home care of disabled or elderly relative;
10. Threatened or filed collection suit:
11. Garnishment;
12. Auto loan arrearage/threatened repossession; and
13. Mortgage or rent arrearage/threat of foreclosure or eviction.

Identifying at-risk clients allows you to guide them to those you trust will give sound advice in managing the debt, possibly without a bankruptcy. In fact, there are many non-bankruptcy tools available to address a debt crisis, and the right approach is devising a strategy tailored for the client's individual circumstances, not a "one-size-fits-all" approach of simply filing a bankruptcy. Non-bankruptcy tools include negotiating directly with individual creditors, issuing protection letters or simply waiting the situation out until you secure a settlement which would resolve or ease the debt problems. Also, federal law empowers consumers to stop collections calls by simply sending a cease and decease letter. And if bankruptcy is indeed the best option, by identifying your at-risk clients on the front end, you can steer them to a bankruptcy attorney you trust will represent them well and cooperate with you in filing the bankruptcy pleadings relating to your case.

1. The Alabama Supreme has not addressed judicial estoppel since Slater II.

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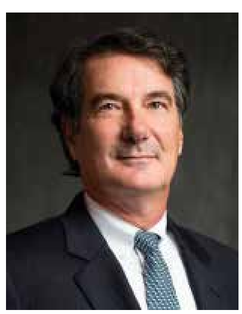
practices in Mobile with Underwood & Riemer, P.C. Ken's practice is focused on representing consumers in finance-related litigation in federal and state court, including class actions. For over 20 years he's sued banks, mortgage companies, credit bureaus, debt collectors and credit card companies. He and his partners handle consumer cases statewide addressing mortgage servicing issues, identity theft, credit reporting, auto defects, and debt collection abuses, among others. His firm also represents consumers in bankruptcy.



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is a partner with the firm Cunningham Bounds, LLC in Mobile. Known for his Bet-the-Company cases, his practice focuses on business litigation and complex litigation, including class actions and mass torts. He also has extensive experience in oil & gas litigation, construction litigation and environmental litigation. In addition to his cases, Steve actively works to better the legal profession. He has served as President of the Paul Brock chapter of the American Inns of Court, and serves on the Executive Committee of the South Alabama Trial Lawyers Association. Steve formerly served on the Board of Governors of the American Association of Justice. He is a Fellow of the American Bar Foundation, the Alabama Bar Foundation and a Fellow of the Litigation Counsel of America. He currently serves as immediate past president of the Alabama Civil Justice Foundation. Born in Mobile, Alabama, Steve earned his B.B.A. from the University of Georgia in 1981, and his J.D. from the University of Alabama in 1984. He is married to Charlotte Adams Nicholas, and they have two children, Adam and Caroline.

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