Time Limitations in Bankruptcy Proceedings

THE HYPOTHETICAL

The Far West Hospital Group, whom you insure, purchased a new surgical equipment sterilizer from Going Under Equipment Consultants. The sterilizer is manufactured by a reputable company and is state of the art. Unfortunately, it is not properly installed by Going Under. This results in a substantial insurance claim to your company when the sterilizer malfunctions and vents steam throughout the operating rooms of the hospital. A month after the loss, Going Under files for Chapter 11 bankruptcy. You, as the claim representative, are unaware of the bankruptcy filing and only learn of the bankruptcy after the loss is paid and you send notice of claim to Going Under, only to be gleefully told it has been recently fully discharged in bankruptcy.

What could you have done?

What can you do now?

THE PROBLEM

Learning of a potential tortfeasor's bankruptcy is discouraging news. You might well simply close your recovery file under the circumstances outlined in the preceding hypothetical. There are, however, circumstances where a claim may still be pursued against a bankrupt defendant. A number of steps must be taken – quickly – to help you preserve your claim.

The bankruptcy of a potential defendant, of course, suggests there might not be much (if any) money to recover from this potential defendant. A bankruptcy filing, however, has more immediate impacts upon the question of whether there is anything worth pursuing from the bankrupt tortfeasor at the end of the day. Most importantly, filing of a bankruptcy petition

operates as an automatic stay to the filing or continuance of any legal action against the debtor. (11 U.S.C. §362.) It also requires you to file a proof of claim to be eligible to recover a distribution from the estate of the debtor. Normally, a proof of claim must be filed within 90 days of the initial date scheduled for the meeting of creditors. (Fed.R.Bankr.P. 3002(c).) Failure to file a claim within the required period bars you from making any later claim or making any recovery under the circumstances.

This paper briefly outlines some of the steps which must be taken to timely present and preserve your claim against the bankrupt tortfeasor or "debtor."

DETERMINING IF THE TARGET TORTFEASOR IS IN BANKRUPTCY

In the "normal" case, a notice of claim to a potential tortfeasor who has or will be filing for bankruptcy puts the onus on it to include you within a list of "creditors" who are required to receive notice from the Bankruptcy Court of the case and the various deadlines. In most cases, the prompt sending of a notice of claim to a tortfeasor will result in your being advised that it is in bankruptcy so that you can then decide whether it is worth filing a proof of claim. But what if you do not receive a response from the tortfeasor to your notice of claim, or, as in the hypothetical, a bankruptcy petition has already been filed? How do you determine if the tortfeasor is in bankruptcy? If you have access to the PACER system which tracks filings in Federal Court, you can perform a global search to see if your debtor has filed or if an involuntary petition has been filed against it. This works best if the tortfeasor is a corporation and you have a specific identification of the corporate entity. If your debtor is an individual, the PACER search may reveal too many hits to be sure you are dealing with the same debtor. An alternate way when dealing with a corporate tortfeasor is to do a Google search which often reveals the status

of the company. Finally, a Dun & Bradstreet search may be utilized which should reveal the status of the corporate defendant.

Whatever the circumstances, however, it is imperative that you move quickly. The first step is to always mail a claim letter and follow that up with a telephone call if you do not receive a response. Bankrupt parties are usually eager to tell you that they have filed for bankruptcy to discourage further interest in them.

RECEIVING NOTICE OF BANKRUPTCY FROM THE COURT

If the tortfeasor is aware of your claim, he or it is required to list you as a creditor upon filing for bankruptcy. A standard form of the Notice of Bankruptcy is attached this paper as Exhibit "A". Be careful to note and calendar the date, time and place for the first meeting of creditors. The notice will also advise of the deadline for filing a proof of claim. Even if you are listed as a creditor on the schedule filed by the debtor, you must file a timely proof of claim.

FILING PROOF OF CLAIMS

The claims process can be different depending upon whether the case is Chapter 7, 9, 11, 12 or 13. Chapter 7 (liquidation) and Chapter 11 and 13 (reorganization) are what you will normally be dealing with. Chapter 9 deals with adjustment of debts of municipalities. Chapter 12 provides for adjustment of debts of a family farmer with regular annual income.

In Chapter 7, 12 and 13 cases, a creditor is required to file a proof of claim to be eligible to recover a distribution from the debtor's estate. Fed.R.Bankr.P. §3002(a). A Chapter 7 proof of claim form, along with an explanation for its completion, is attached as Exhibit "B." The deadline for filing a claim is 90 days after the initial date scheduled for the meeting of creditors. Id. §3002(c). The Court does not have equitable power to allow late filed claims. See In re

Coastal Alaska Lines, (9th Cir. 1990) 920 F.2[d] 1428. Even if the date of the meeting of creditors is changed, claims will still be due on the ninetieth day after the date the meeting was initially scheduled. The deadline to file a claim is listed under the Deadlines section of the notice of bankruptcy. Some courts will send you a notice that due to insufficient funds it is not necessary to file a claim until notified to do so by the court. We believe that it is still good practice to file a proof of claim. It does not take long to prepare the claim and you are protected if funds are later located.

In Chapter 9 or 11 cases, any debts scheduled by the debtor that are not listed as contested, unliquidated or contingent are deemed allowed in the amount the debtor lists in its schedules. Fed.R.Bankr.P. §3003. However, as with Chapter 7, 12 and 13 cases, we recommend that a claim be filed in the event the case converts to another chapter so the creditor will not have to worry about filing a claim at that time because one will already be on file. Claims must be filed within the time set by the court. In many jurisdictions, the deadline is set by the court and listed on the notice of bankruptcy. Others set it upon a motion by a party to do so. The deadline for Chapter 9 and 11 claims can be adjusted by a motion of a party in interest. Id. §3003(c)(3). Further, the court may allow late filed claims upon a showing of excusable neglect. See Pioneer Investment Services Co. v. Brunswick Associates Ltd. P 'ship, (1993) 507 U.S. 380.

In Chapter 7 filings, which are the most common for individuals, a proof of claim must be filed within 90 days after the initial date scheduled for the meeting of creditors. This requirement is close to absolute. As a subrogating insurer, if you have not filed a proof of claim within this time period your claim will be barred. You should look to see if your insured has filed a proof of claim and whether this might include your interests. In such circumstances, the court may permit you to proceed under the insured's proof of claim.

WHAT IF YOU DON'T RECEIVE NOTICE OF BANKRUPTCY?

For your claim to be discharged in bankruptcy, you must be listed as a creditor. Therefore, if Going Under has reason to believe it is responsible for the loss and either you or the insured will be pursuing a claim against it, your claim will only be discharged if you or your insured is listed as a creditor. (Unlike an individual, a corporation filing under Chapter 7 is never actually " discharged " from its debts or liabilities. All of its assets are distributed as part of the liquidation and there is nothing left to go after once the case is closed. Going Under has filed for Chapter 11 reorganization. It would therefore be discharged of further pre-petition liabilities upon approval of its reorganization plan.)

What if you find out after the claim bar date that your insured or your Home Office or underwriting department on the East Coast received notice and did not advise you of the bankruptcy?

As a creditor, you may seek to file an extension in which to file a claim with the court if you did not receive notice of the filing of the bankruptcy case. If a debtor lists you as a creditor in its schedules, however, there is a high burden of proof to show that notice of filing was not received. See e.g., In re Ryan, (Bankr. E.D.PA 1985) 54 B.R. 105. Be aware in this regard that the notice need not be sent to your regular or normal business address, but may be served upon an agent or post office box which you use for billing purposes. In some cases, notice by publication in newspapers such as the *Wall Street Journal* has been considered sufficient to defeat an application to permit a late filing of proof of claim. For the creditor who was not listed in the schedule and did not receive some other notice of the bankruptcy, however, it is easier to obtain an extension to file a claim. See In re Cmehil, (Bankr. N.D. Ohio 1984) 43 B.R. 404.

RELIEF FROM THE STAY

If the debtor has insurance which would respond to your claim, you should consider filing a motion for relief from the automatic stay. (11 U.S.C. §362(d).) There is no deadline for moving for relief from the stay. Usually, the court will require you to limit your right of recovery to available insurance. In most cases, you may initiate legal proceedings in the court of your choice and proceed to judgment and collection in such court. The Bankruptcy Court can condition lifting the stay upon returning to the Bankruptcy Court to approve any settlement if insurance coverage could be insufficient to cover all potential claims against the debtor.

If the debtor was not insured, you can still proceed before the Bankruptcy Court to prove your claim. Normally an attorney is required for this purpose. If the amount of your claim is known you should complete a proof of claim. If the debtor or trustee files an objection to the claim, however, you will be required to retain counsel to prove your claim.

REMEMBER: You should still file a proof of claim even if the Court lifts the automatic stay to the extent of insurance coverage, particularly if coverage may be in question.

PRE-PETITION AND POST-PETITION DAMAGE CLAIMS

A bankruptcy case normally deals only with claims arising before the filing of the bankruptcy petition. As such, a claim arising after a petition has been filed is treated as an administrative claim and not discharged through the bankruptcy. Therefore, in the Hypothetical, Going Under would be entitled to a discharge of your claim. Changing this hypothetical slightly, what if Going Under filed its Chapter 11 petition five days before the loss occurred. As such, your claim against Going Under would not be discharged by the bankruptcy. If Going Under wishes to avoid the claim (i.e., have it discharged) it might argue that the damages began before

the bankruptcy petition was filed due to a latent defect in the installation, and were only discovered post-bankruptcy after the major leakage occurred. (And you thought "manifestation" issues were limited to insurance coverage!) In this circumstance, you would have to establish what damages occurred after the petition was filed and seek to recover the same as an administrative claim. Under the hypothetical, the cost of making good the defective workmanship involved in the installation would be considered pre-petition and thus discharged (and probably not covered under your policy anyway), whereas the more substantial consequential damages from the steam leakage which occurred after filing would not be dischargeable.

CONCLUSION

Filing of bankruptcy by a potential defendant is never good news for a handler of subrogation claims. There may be very little gold in that pot at the end of the rainbow under the best of circumstances. The filing of a proof of claim, however, is relative easy and should be done whenever you receive notice of the filing of a bankruptcy by any potential tortfeasor. If the tortfeasor is insured, the automatic stay can usually be lifted and you can proceed against the tortfeasor to the extent of his or its insurance. If you have not filed a required proof of claim, however, collecting on the claim through the Bankruptcy Court may be impossible.

Therefore, act quickly, both notifying a tortfeasor of your claim and verifying whether it is in bankruptcy. In all circumstances, file your proof of claim within the required 90 day period. Then, you are at least in the game if the debtor has funds or insurance.