Bankruptcy Law for the Personal Injury Attorney: What You Should Know

by Will Morrison, Esq.

This article is intended to be a brief primer on bankruptcy law for the personal injury attorney. As one who practices in both personal injury and bankruptcy law (how odd is that?), it never ceases to amaze me how often these two seemingly distinct areas of law intersect with each other. Some common issues actually arise with great frequency. A proper understanding of the basics of bankruptcy law can help the unwary personal injury attorney safely navigate what are typically perceived to be complex and uncomfortable bankruptcy waters. So here we go with an explanation of what you should know, whether you are on the receiving end of a bankruptcy or whether your own client has to file.

When the Defendant Files Bankruptcy

The fundamental purpose of a bankruptcy filing is to allow the honest but unfortunate debtor an opportunity for a fresh start. Upon the filing of a bankruptcy case, all collection efforts against the debtor must come to an immediate halt. The "Automatic Stay" provisions of the Bankruptcy Code go into effect immediately upon case commencement, staying nearly all collection activity. This is true whether the debtor has filed a Chapter 7 liquidation bankruptcy, a Chapter 13 repayment bankruptcy, or a Chapter 11 reorganization case.

The Automatic Stay is found at Section 362 of the Bankruptcy Code.[1] It operates as a powerful injunction against creditors and other parties attempting to collect on a debt. Included within the broad scope of the Automatic Stay is a prohibition against commencing or continuing civil actions to recover or enforce claims against a debtor or against the debtor's property, other than in the bankruptcy case.[2] Collection activities may continue, however, against any jointly-liable party that has not filed a bankruptcy petition. At the conclusion of a bankruptcy case the Automatic Stay becomes supplanted by the Discharge Order, a permanent injunction forever prohibiting collection on discharged debts.

The bankruptcy court does not look lightly upon violations of the Automatic Stay, and will appropriately punish any willful violations of the Stay. To reduce the incidence of such violations, the clerk of the bankruptcy court will, shortly after the commencement of a bankruptcy case, send written notice to creditors and interested parties. The notice includes this stern warning: "If you attempt to collect a debt or take other action in violation of the Bankruptcy Code, you may be penalized. Consult a lawyer to determine your rights in this case."[3] Not only does the Bankruptcy Code empower the bankruptcy court to impose sanctions against a party who willfully violates the Stay, but it mandates that sanctions be imposed, typically in the form of an award of damages to the aggrieved party, including an

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award of attorney fees and costs, as well as punitive damages where appropriate.[4]

In light of the need to abide by the Automatic Stay, upon receiving notice of a bankruptcy filing, what can a plaintiff's attorney do, other than just give up? First, the bankruptcy proceeding itself is a collective debt collection proceeding in which all of the debtor's creditors file proofs of claim in order to receive their share of the proceeds of the debtor's estate (if any). In the case of an estate with assets, creditors should timely file a proof of claim setting forth the basis for the claim. Second, there may be third-party insurers, guarantors, or co-liable persons against whom collection may proceed. If a debtor in a bankruptcy case was insured by a policy of liability insurance, relief from the Stay can be sought and obtained under certain conditions. Generally speaking, relief can be obtained for the specific purpose of pursuing a claim against the debtor's liability insurance policy or a third-party who is a guarantor or who is co-liable with the debtor, provided that no collection action is undertaken against the debtor personally. The case law allowing relief from the Stay under these conditions is well established.[5]

Obtaining relief from the Automatic Stay requires the filing of a motion in bankruptcy court, with notice and hearing given to the debtor and other interested parties. The filing fee for a motion for relief from Stay is currently $176. For those who have access to PACER, one example of a case in which relief from Stay was granted by the Bankruptcy Court to allow a plaintiff's attorney to pursue liability insurance proceeds is *In re Gordon*, #05-27658 JAB (District of Utah).[6] Generally speaking, the bankruptcy court will grant relief from the automatic stay to proceed with a prepetition litigation, including for the purpose of establishing liability against a debtor so long as the creditor does not engage in any collection activity once the judgment is rendered.

Once relief from Stay has been obtained – in the form of an order from the bankruptcy court – a plaintiff's attorney may then require the debtor defendant to respond to discovery requests, and to appear and give testimony in a case. Once again, however, care must be taken to avoid subjecting the debtor to any actual collection activity, such as attempts to collect amounts beyond the applicable policy limits of coverage. For example, in filing suit against a discharged debtor, the plaintiff's attorney may wish to include an allegation in the complaint specifically noting the debtor's bankruptcy filing and indicating that the action is intended to be against the debtor's liability insurance policy only, not against the debtor beyond the applicable policy limits. A similar notice may be inserted in other filings as necessary to apprise the court of the bankruptcy case and the lack of intent to proceed personally against the debtor.

As a final note, claims against a debtor for death or personal injury, caused by the debtor's operation of a motor vehicle as a result of intoxication from alcohol, drugs, or other substances, are indeed stayed by a bankruptcy filing, but are usually ultimately non-dischargeable. The Bankruptcy Code contains an important exception to the discharge of such claims.[7] The injured party need not file an adversary proceeding contesting the debtor's bankruptcy in order to preserve the claim, as the claim automatically survives discharge.[8] However, sometimes an accident victim may still need to file an adversary proceeding to determine that such a debt is non-dischargeable if there is any doubt as to whether the elements of

non-dischargeability are met.

When the Plaintiff Files Bankruptcy

Medical bills continue to be a leading cause of most bankruptcy filings. Not surprisingly, accident victims often incur significant medical bills, which they neither caused nor should have to pay for out of their own pocket, but since they are the recipient of much-needed medical care they are often stuck having to satisfy the bills on their own while awaiting the resolution of their injury claim. Sometimes the wait is too much, and bankruptcy becomes inevitable.

The good news is that most personal injury claims are exempt in bankruptcy, meaning they are protected from the reach of the bankruptcy trustee and from creditors. While bankruptcy is available as a matter of federal law, state exemption laws do come into play for the purpose of determining what assets in bankruptcy are exempt and therefore protected.

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Utah has fairly conservative exemption laws, but it does offer to accident victims a broad and well crafted personal injury exemption. This exemption is found at Utah Code Ann. § 78B-5-505(1)(a)(x). In practice, the exemption operates to fully protect the "proceeds of insurance, a judgment, or a settlement, or other rights accruing as a result of bodily injury of the individual or of the wrongful death or bodily injury of another individual of whom the individual was or is a dependent to the extent that those proceeds are compensatory." The key aspect of this provision is that the recovery must be compensatory in nature, as opposed to non-compensatory awards for punitive or exemplary damages.

There is very little case law in this jurisdiction interpreting Utah's personal injury exemption statute in the context of a bankruptcy proceeding. However, there is one important case to note: *In re Steiner*, Chapter 7 #03-21378 GEC (District of Utah). In *Steiner*, Judge Glen E. Clark determined that the following elements are compensatory in nature and are therefore exempt from the bankruptcy court and from creditor collection: claims for past and future general damages; claims for past medical expenses actually paid by the debtor; claims for future medical expenses; claims for past lost earnings and benefits; claims for impairment of future earning capacity; and, claims for mental anguish and emotional distress.[9]

Notably, however, *Steiner* holds that claims for past medical expenses, which have not actually been paid by a debtor and are based on debts listed in the bankruptcy case, are not compensatory claims with respect to the debtor, and thus are not exempt.[10] *Steiner* declares that such claims belong to the bankruptcy trustee to assert, to be administered for the benefit of creditors.[11] This decision was never appealed. Because it is a fairly obscure decision, few bankruptcy trustees seem to be aware of it. Yet some are, and they invoke it to partially object to a debtor's personal injury exemption claim. In the hands of an inexperienced bankruptcy attorney, some debtors are then caught off guard by learning that they may not be able to fully exempt their personal injury claims.[12]

Of course before a debtor's injury claim can be protected as exempt in bankruptcy, it must first be disclosed. This is done by appropriately listing the claim in the debtor's sworn bankruptcy schedules. The personal injury exemption should also be properly asserted. Failure to timely and properly disclose the claim can result in it becoming lost or barred. It is therefore critically important for the debtor to both list the claim and assert the applicable exemption. Several cases in the 10th Circuit have recently concluded that an otherwise exempt claim is no longer able to be pursued because the claim was not properly disclosed in a

debtor's bankruptcy case.[13]

What happens to medical liens in bankruptcy is another important issue confronting personal injury attorneys. Do such liens survive bankruptcy, or are they dischargeable? The general rule is that a discharge in bankruptcy eliminates a debtor's personal liability on discharged debts, but it does not eliminate liens. Thus, liens generally survive discharge and remain attached to their collateral. Here is a quick example: a debtor who is vexed with a burdensome auto loan can discharge the loan obligation in bankruptcy, but cannot keep the vehicle without reaffirming the debt, since the vehicle is subject to a secured lien. The secured lienholder retains its lien rights in the vehicle, despite the bankruptcy discharge, and can recover its collateral from the debtor by obtaining relief from Stay or by waiting for the case to be closed. In the context of a personal injury claim, a medical lienholder has similar rights. The medical lienholder has a security interest in the debtor's personal injury claim (which comprises its collateral). Consequently, medical liens such as hospital liens and chiropractor liens that are listed as debts in a bankruptcy case should survive discharge and remain attached to the proceeds of the debtor's injury claim.[14] In the event of a settlement or recovery, the medical lienholder would still need to be paid from the proceeds of the recovery, absent some defect in the lien.

Subrogation claims present a somewhat similar issue, but can be even more tricky. Depending on the language of the insurance policy giving rise to the subrogation claim, a subrogation interest may actually be a property right, not a secured claim against collateral or a general unsecured claim. As such, a subrogation claim is not a claim against the debtor and, therefore, is not dischargeable in bankruptcy.[15] If the language of the insurance policy is worded in such a fashion as to create a property interest in the personal injury claim, then the subrogation interest does

not give rise to either a secured claim or an unsecured claim, but rather a property right. In such instance, the subrogation claimant actually co-owns the personal injury claim in conjunction with the accident victim. Should the accident victim then file for bankruptcy and obtain a discharge, the interest of the subrogation claimant would be unaffected and the subrogation claimant would continue to "own" part of the personal injury action, to the extent of its interest. Therefore, the ability of an accident victim to eliminate a subrogation claim in bankruptcy can be surprisingly limited.

Conclusion:

Bankruptcy law can be extremely complex, and it is prudent to confer with an experienced bankruptcy attorney when either a plaintiff or a defendant in a personal injury action seeks bankruptcy relief. Fortunately, understanding the basic issues that commonly arise can help to limit or avoid some of the major pitfalls and traps, and can ultimately lead to a more favorable outcome for both the client and the attorney. Now keep up the good fight, and may the Force be with you.

1. The proper legal citation is 11 U.S.C. § 362.
2. *Id.* at § 362(a).
3. United States Bankruptcy Court, District of Utah, Form RA B9A ("Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines").
4. 11 U.S.C. § 362(k).
5. *See, e.g., Walker v. Wilde*, 927 F.2d 1138 (10th Cir. 1991); *Owasaki v. Jet Florida Systems*, 883 F.2d 970 (11th Cir. 1989) (creditor may bring or continue an action directly against a debtor to establish the debtor's liability when establishment of liability is a prerequisite to recovery from a third-party).
6. The "notice of hearing" form filed in this particular case has since been updated and can be found online at the Bankruptcy Court's website, located at http://www.utb.uscourts.gov/.
7. *See* 11 U.S.C. § 523(a)(9).
8. *Id.* at § 523(c). This contrasts with claims asserting willful and malicious injury by a debtor, which require adversary proceedings to be filed.
9. *In re Steiner*, #03-21278 GEC (District of Utah) ("Order Regarding Trustee's Objection to Debtors' Claim of Exemptions", dated Nov. 6, 2003, Docket # 27).
10. *Id.*
11. *Id.*
12. One glaring weakness with the *Steiner* decision is that it does not address the situation that often arises when a debtor's personal injury claim far exceeds the available insurance policy limits, such that it becomes difficult if not impossible to determine what portion of the recovery is attributable to pain and suffering, what portion is attributable to past medical expenses, to future medical expenses, and so on. In such cases, *Steiner* offers no guidance in the case of an accident victim whose recovery become compromised by it.
13. *See, e.g., Queen v. TA Operating, LLC*, 734 F. 3d 1081 (10th Cir. 2013) (applying judicial estoppel to bar a personal injury claim that was not timely and properly disclosed in a bankruptcy case); *In re Ford*, 492 F. 3d 1148 (10th Cir. 2007) (affirming the bankruptcy court's decision to deny a personal injury exemption claim that had not been timely and properly disclosed by a debtor). Plaintiff attorneys should instruct their clients to inform them of any bankruptcy filing during the pendency of their personal injury case, and should verify that the injury claim has been properly disclosed and exempted in the bankruptcy case.
14. Note that this is the opinion of the author, as there is no known case law on this point in this jurisdiction.
15. *See, e.g., In re Bergman*, 467 F.3d 536 (6th Cir. 2006); *In re Cupp*, 383 B.R. 84 (ED Tenn. 2008).