

DEBTOR/CREDITOR

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Unscheduled Malpractice Claim

A debtor that seeks relief under the federal bankruptcy statute is required to disclose on schedules filed with the court all property owned by the debtor. This includes property that is intangible and/or unliquidated, such as disputed claims against others. A Maryland bankruptcy judge recently determined the effect of a debtor's failure to disclose in its schedules a malpractice claim against a former attorney of the debtor.

Prior to seeking bankruptcy relief, the debtor engaged a law firm to represent it in connection with a dispute regarding a construction contract. The dispute resulted in litigation which concluded adversely to the debtor. Engaging a different law firm, the debtor filed a Chapter 11 petition, but subsequently converted its case to a liquidation under Chapter 7. The debtor's schedules did not disclose any claims against its prior law firm. The Chapter 7 trustee administered the other assets and closed the case. Seven months later, the debtor sought to reopen its case, file amended schedules disclosing a malpractice claim against its former attorneys, and sue its former attorneys for alleged malpractice.

In determining whether the malpractice claim was barred, the court discussed the debtor's initial failure to disclose the claim on its schedules. The court noted that the malpractice claim was property of the bankruptcy estate. Even after the case was closed, the undisclosed malpractice claim remained property of the bankruptcy estate, depriving the debtor of the ability to prosecute or recover the claim. Only the Chapter 7 trustee could assert the malpractice claim against the debtor's former attorneys.

The bankruptcy court also opined that an intentional failure to disclose the malpractice claim on the debtor's schedules would bar the debtor from subsequently pursuing the claim against the former attorneys. However, a mere

inadvertent failure to disclose the malpractice claim would not bar pursuit of the claim subsequent to closure of the bankruptcy case.

In the end, the court permitted the reappointed Chapter 7 trustee to pursue the malpractice claim. *In re Sens*, 2021 Bankr. LEXIS 2704 (Bankr. D. Md. 2021).

No Priority for FLSA Claim

The Fair Labor Standards Act requires employers to pay employees on time. Late payment entitles the employee to damages from the employer in the amount of the late wages. Unpaid wages are entitled to priority distribution ahead of general creditors in a bankruptcy case. A Maryland bankruptcy court has ruled that damages owed by the employer for late payment do not receive priority status.

The court reasoned that the priority status for wages applied only to compensation for actual labor or services. The damages were a penalty imposed by Congress to encourage employers to pay wages timely. Although calculated based on the wages, the penalty was essentially different and not entitled to priority.

In re Creative Hairdressers, 637 B.R. 561 (Bankr. D. Md. 2021).



This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation. Congress has required bankruptcy attorneys to state: "I am a debt relief agency. I help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528. If you wish to receive "Notes on Debtor/Creditor Relations", go to www.jamesolsonattorney.com/newsletter.html and click on the link at the word "here".

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