Note to Debtors: Disclose All Causes of Action or Face the Consequences

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The Bankruptcy Code provides that all assets must be disclosed in a bankruptcy case, including all causes of action against third parties, regardless of whether a lawsuit has been filed. Despite this important requirement, some debtors fail to disclose all of their assets in their bankruptcy schedules, including potential or pending causes of action in other courts. A debtor may reason that such an omission is justified because no money has yet been awarded, or the cause of action is not likely to be successful, or the bankruptcy trustee will not discover the existence of the cause of action during the bankruptcy case. Regardless of the debtor's reasoning, in the end, the cause of action will almost always be discovered, the debtor will lose his or her interest in the cause of action, and the cause of action will be deemed an asset of the bankruptcy estate.

When a pending cause of action is disclosed by a debtor in a bankruptcy case, and listed in the debtor's bankruptcy schedules, the bankruptcy trustee appointed may choose to abandon the cause of action. If the bankruptcy trustee abandons the cause of action, the cause of action belongs to the debtor and is not an asset of the bankruptcy estate. Thus, the debtor would be entitled to retain any money collected should a judgment be entered in the debtor's favor, arising out of the cause of action.

According to the applicable case law, the bankruptcy trustee may abandon a cause of action in one of two ways: technical abandonment or express abandonment. With respect to technical abandonment, the debtor discloses the cause of action in his or her bankruptcy schedules, but the cause of action is not administered by the bankruptcy trustee by the time the bankruptcy case closes, in accordance with 11 U.S.C. § 554(c). *See*, In re Davis, 2002 WL 33939739, 4-5 (Bankr. D. Idaho 2002). Therefore, if a cause of action is not administered by the bankruptcy trustee by the time the bankruptcy case closes, but the cause of action was disclosed in the debtor's schedules, the cause of action is deemed technically abandoned by the trustee. Regarding express abandonment, such abandonment is generally sought by motion, or through a general notice issued by the trustee; in either case, notice and a hearing, or an opportunity for a hearing, is required, in accordance with 11 U.S.C. §§ 554(a) and (b). Id. at 4-5.

However, generally speaking, according to the relevant case law, a bankruptcy trustee may not abandon a cause of action that was never disclosed in the debtor's bankruptcy schedules. For instance, the Court in In re Miller, 347 B.R. 48, 53-4 (Bankr. S.D. Tex. 2006) explained "it would be truly unjust, and a source of endless mischief, if a debtor could deny to the trustee the right to pursue assets merely by failing to list the assets in Bankruptcy Schedules." Similarly, the Court in In re Bryson, 53 B.R. 3, 4 (Bankr. M.D. Fla. 1985) reasoned that an asset not disclosed in the bankruptcy schedules is not deemed abandoned by the trustee because the omission prevents the trustee from having any knowledge of its existence.

In addition, even if a debtor discloses a cause of action in the bankruptcy schedules and the bankruptcy trustee abandons the cause of action, that trustee may seek to revoke his or her abandonment if the trustee was misled by the debtor's disclosures. For example, the trustee may be able to revoke the abandonment if the trustee can demonstrate that he or she was misled as to

the value of the cause of action, as disclosed by the debtor in the bankruptcy schedules. *See*, In re Adair, 253 B.R. 85 (9th Cir. BAP 2000).

In summary, it is important for debtors and their attorneys to realize that all causes of action need to be disclosed in bankruptcy schedules, even if those causes of action are not likely to be successful. Furthermore, any cause of action disclosed should not be revealed in a manner that would be misleading to a bankruptcy trustee.

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