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Developments in Post-Discharge Product-Liability Settlements

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Advances in medical technology have led to modern-day miracles when it comes to patient health and quality of life. With such scientific developments, however, serious post-surgery complications have also come to light resulting from defective or dangerous medical devices. As the U.S. Food and Drug Administration (FDA) scrambles to monitor and advise the public with respect to faulty or recalled implants or prosthetics, class-action lawsuits with sizeable monetary settlements have become more common. On the uptick is the intersection of these awards with bankruptcy litigation. It is not unusual for a chapter 7 trustee to receive a notification of a product-liability claim settlement long after a debtor's discharge, raising the issue as to whether a motion to reopen a closed case in order to administer such an asset is warranted, as it is an often costly and time-consuming consideration for the trustee.

Once the case has been reopened, the bankruptcy court is then charged with determining whether those settlement proceeds are property of the bankruptcy estate, which is especially challenging when the surgical procedure or product exposure itself occurred pre-petition, but the existence of an injury was not discovered until after the debtor's discharge was entered. Unlike those situations in which a personal injury arises out of a single traumatic event, it is far more difficult to ascertain the existence of a claim attributable to a faulty surgical implant that may have functioned properly for years before a defect was detected.[1] This article examines whether the settlement proceeds offered post-discharge by the device manufacturer in such circumstances constitute property of the bankruptcy estate under § 541 of the Bankruptcy Code.[2]

What Constitutes "Property of the Estate"?

The filing of a bankruptcy petition creates an estate consisting of all of the legal and equitable interests of the debtor in property as of the commencement of the case, wherever located and by whomever held.[3] Section 541 is interpreted broadly, as "[e]very conceivable interest of the debtor, future, nonpossessory, contingent, speculative, and derivative, is within the reach of § 541."[4] The term "property" is "construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed."[5]

Certain exceptions will remove a debtor's property from the broad scope of § 541(a), as are generally enumerated in § 541(b).[6] However, the U.S. Supreme Court's seminal decision in *Segal v. Rochelle* embraces within the definition of "property" a post-petition interest "sufficiently rooted in the prebankruptcy past and so little entangled with the bankrupt's ability to make an unencumbered fresh start that it should be regarded as 'property.'"[7] Congress adopted the *Segal* rationale when it enacted § 541,[8] concluding that the statutory provision reaches "all kinds of property, including tangible or intangible property, causes of action ... and all other forms of property."[9] Contingent interests that exist upon filing but do not materialize until after filing

1 *Sikirica v. Harber (In re Harber)*, 553 B.R. 522, 529 (Bankr. W.D. Pa. 2016).
2 11 U.S.C. § 541.
3 11 U.S.C. § 541(a)(1).
4 *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993).
5 *Segal v. Rochelle*, 382 U.S. 375, 379 (1966).
6 11 U.S.C. § 541(b).
7 *Segal*, 382 U.S. at 380. *Segal* construed the term "property" under the Bankruptcy Act (the predecessor to the current Bankruptcy Code), concluding that a post-petition tax refund resulting from pre-petition losses was indeed property of the bankruptcy estate.
8 The 1978 Bankruptcy Code follows *Segal*, but eliminates the requirement that property not be entangled in the debtor's ability to make a fresh start. *In re Richards*, 249 B.R. 859, 861 (Bankr. E.D. Mich. 2000) (citing S. Rep. No. 95-989, 95th Cong., 2d Sess. 82 (1978)).
9 *Barowsky v. Serelson (In re Barowsky)*, 946 F.2d 1516, 1518-1519 (10th Cir. 1991) (quoting S. Rep. No. 95-989, 95th Cong., 2d Sess. 82; H.R. Rep. No. 595, 95th Cong., 1st Sess. 367)).

might thus be considered property of the estate. Furthermore, property that the estate acquired after the commencement of the bankruptcy case might also be included.[10] A debtor's product-liability claim is generally considered to be a legal or equitable interest that is subject to § 541.[11]

While federal law will determine when a debtor's interest constitutes property of the bankruptcy estate, the Supreme Court determined in *Butner v. U.S.* that "property interests are created and defined by state law."[12] This distinction is particularly important in the analysis of product-liability claims and the debtor's legal interest in post-discharge settlement proceeds arising out of pre-petition conduct.

Chapter 7 trustees have the exclusive authority to administer and dispose of property of the bankruptcy estate,[13] including the obligation to "collect and reduce to money the property of the estate for which such trustee serves."[14] The trustee has both the right and the obligation to pursue the debtor's pre-petition causes of action. Product-liability claims are tricky for the trustee because the debtor's exposure to a defective medical device or dangerous substance may not immediately, if ever, result in appreciable injury. For many, physical harm is only a possibility that may not manifest itself in recognizable symptoms for months, or even years, post-petition. When confronted with the post-discharge settlement of a debtor's product-liability claim, when should the trustee take the steps that are necessary to secure that property for the benefit of the estate? There is no apparent uniform approach, as recent decisions have examined the issue with differing results.

The "Sufficiently Rooted" Approach

Relying on the Supreme Court's decision in *Segal v. Rochelle*, this method of determining whether after-acquired settlement proceeds can constitute property of the bankruptcy estate looks to whether the property interest is "sufficiently rooted in the [debtor's] prebankruptcy past." The most critical elements of a debtor's product-liability claim must manifest themselves pre-petition in order for the trustee to recover the settlement for the benefit of the estate. While accrual of a claim is relevant to determining the extent of its pre-petition roots, it is not the only factor — and not necessarily a dispositive one. The fact that an element of a debtor's cause of action accrued after the petition was filed is not controlling as to whether the claim is property of the estate; the significance of post-petition elements should be fully considered.

Numerous courts have found merit in this approach, particularly where exposure to a dangerous device or substance occurred over an extended period of time. For example, in *In re Richards*,[15] evidence of the debtor's job-related exposure to asbestos for 14 years pre-petition "tipped the balance" in favor of finding his injury claim against a former employer to be property of the estate under § 541, despite the fact that his medical diagnosis occurred post-petition. The court concluded that under the *Segal* holding, all of the wrongful conduct giving rise to the debtor's claim occurred pre-petition, including exposure to asbestos and the onset/development of the debtor's disease. Thus, the debtor's claim was "sufficiently rooted in the prebankruptcy past," even though the diagnosis and his legal ability to sue arose post-petition. *In re Sommer*[16] is another asbestos case in which the bankruptcy court found that the debtor's death was undeniably related to his prolonged pre-petition exposure, thus the foundation of his wrongful-death claim due to asbestos-related lung cancer was "sufficiently rooted" in his prebankruptcy past.

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Most recently, in *Mendelsohn v. Ross*,[17] the district court applied the "sufficiently rooted" approach in a mesh-implant case in which the debtor underwent implant surgery and subsequently had the device removed more than five years prior to the petition date. The debtor later filed her chapter 7 case, receiving a discharge in 2005. In July 2011, the FDA issued a public advisory opinion warning of "serious complications" with the implant.

Despite the fact that the debtor never experienced pain or complications related to the surgery, she retained counsel and secured a sizeable settlement in exchange for a release of any future injury claims. The bankruptcy court denied the trustee's motion to reopen her bankruptcy case in order to administer the settlement proceeds, and on appeal to the district court, the decision was upheld. The court found that under the *Segal* framework, the "prebankruptcy past did not create an interest that manifested itself in the settlement agreement."[18]

The decision also points out the somewhat novel situation wherein the settlement proceeds were not generated as a result of a viable injury, but rather were offered to the debtor in exchange for a pre-injury release. Although the implant and its removal occurred pre-petition, the FDA warning and debtor's knowledge of the possible defects in the device occurred after her bankruptcy case was concluded, with the court stating:

> [T]he most critical element that created her interest — the discovery that there was a defect with the medical device — did not occur until well after the petition date. Thus, her interest was not "substantially rooted" in her prebankruptcy past for purposes of § 541.[19]

The Claim Accrual or Discovery Rule Approach

The "claim accrual" or "discovery rule" approach incorporates certain state law property definitions, such that a

10 *See* 11 U.S.C. § 541(a)(7).
11 *Matter of Geise*, 992 F.2d 651, 655 (7th Cir. 1993).
12 *Butner v. U.S.*, 440 U.S. 48, 55 (1979).
13 *See generally* 11 U.S.C. §§ 541(a)(1) and 704.
14 11 U.S.C. § 704(a)(1).
15 *In re Richards*, 249 B.R. 859 (Bankr. E.D. Mich. 2000).
16 *In re Sommer*, 2008 WL 704401 (Bankr. N.D. Ohio March 14, 2008).
17 *Mendelsohn v. Ross*, 251 F. Supp. 3d 518 (E.D.N.Y. 2017).
18 *Id.* at 525.
19 *Id.* at 526 (internal quotations omitted).

cause of action cannot arise until all elements of the claim are discovered or should have been discovered. This method gives particular credence to the Supreme Court's finding in *Butner*, which recognized that absent congressional pre-emption, property interests are created by state law.

A number of courts have found the "claim-accrual" approach to be the fairer rule in circumstances where injuries are potential but not certain. A claim will exist only if a debtor knew of or could have discovered his/her injury prior to the petition date through the exercise of reasonable diligence. For example, in *In re Wagner*,[20] the debtor had two hip replacements well before filing her chapter 7 case, alleged no pre-petition pain or injury, and only learned of the defects with the devices several months after her case had been closed. She later underwent hip-revision surgery post-discharge, entitling her to a settlement award from the device manufacturer.

The court rejected the "substantially rooted" approach and denied the trustee's motion for summary judgment, reasoning that under Wisconsin's "discovery rule," "[a] bankruptcy debtor cannot be expected to predict and disclose possible future injury by each and every product he or she has previously used. To be rooted in the debtor's prebankruptcy past, there is no way of knowing how far back the root would go."[21]

In *In re Purcell*,[22] the bankruptcy court (citing *Butner*) determined that the debtor's product-liability claim related to a defective implant was not property of the estate for the reason that the injury itself had not been discovered pre-petition, irrespective of the date that the device was implanted. Under Kansas law, a debtor's claim could not accrue "until the act giving rise to the cause of action first causes substantial injury, or, if the fact of injury is not reasonably ascertainable until sometime after the initial act, then the period of limitation shall not commence until the fact of injury becomes reasonably ascertainable to the injured party."[23] The court's decision turned on the fact that the debtor had no cause of action against the manufacturer under state law until after the close of her case, thus the settlement was not property of her estate.

Both Approaches Are Embraced

The bankruptcy court in *In re Harber*[24] recently analyzed a debtor's product-liability claim using both of these described methods. In *Harber*, 11 months after filing her case, the debtor received test results indicating the presence of metal in her bloodstream related to a defective hip device implanted pre-petition and underwent hip-revision surgery post-petition. The court recognized the difficulties attendant in determining property interests in defective-medical-product cases and analyzed the claim under both the claim-accrual and "sufficiently rooted" approaches.

Pennsylvania law provides that a cause of action involving a latent injury will accrue when the plaintiff "discovers or reasonably should discover" an injury caused by another's conduct. The court found that the claim here accrued on the date that the debtor received her test results because until such time, in the absence of ascertainable physical damages, she could not have maintained a cause of action under state law. As no identifiable injury existed on the petition date, under the claim-accrual method the trustee had no claim on the petition date, and thus the cause of action was not property of the estate.

Under the "sufficiently rooted" approach, the debtor's claim against the manufacturer had roots in her prebankruptcy past because her artificial hip was implanted seven years pre-petition and she received notice of a potential defect prior to filing her bankruptcy case. However, the court pointed out that a cause of action must not just be "rooted" but "sufficiently rooted" in the prebankruptcy past, requiring a "fact-intensive analysis to assess whether a substantial portion of the claim elements existed pre-petition."[25] In this particular case, the most critical elements had not yet taken root, as there had been no (1) injuries, (2) symptoms, (3) evidence of purposeful delay by the debtor in obtaining a medical evaluation, (4) evidence that the injury developed slowly over time as a gradual deterioration versus a single acute event triggering the injury and (5) knowledge of the debtor's condition until after her discharge. For these reasons, the court found the absence of a property interest under § 541.

Conclusion

Recent decisions tackling the treatment of pre-petition conduct resulting in post-discharge settlement awards suggest a variety of viable approaches. Prior to reopening a case or attempting to compromise a claim on behalf of an estate, the trustee would be best advised to perform an analysis to determine where certain events fall in the bankruptcy timeline. In the event that the critical elements of a product-liability claim occurred pre-petition, even though a debtor may not have known of his/her condition until after receiving a discharge, the "substantially rooted" approach will allow the trustee to retain those proceeds. And under the claim-accrual approach, if a debtor knew or reasonably should have discovered a compensable injury prior to the commencement of his case, a property interest under § 541 will also exist. abi

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20 *In re Wagner*, 530 B.R. 695 (Bankr. E.D. Wis. 2015).
21 *Id.* at 705.
22 *In re Purcell*, 573 B.R. 859 (Bankr. D. Kan. 2017).
23 *Id.* at 863-64 (quoting K.S.A. § 60-513(b)).
24 *Sikirica v. Harber (In re Harber)*, 553 B.R. 522 (Bankr. W.D. Pa. 2016).
25 *Id.* at 533.