

**Creditor's Failure to File a Proof of Claim is Inexcusable Where Potential Danger of
Prejudice to Debtor Exists**

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Introduction

The Federal Rules of Bankruptcy Procedure provide that when an act is required ... to be done at or within a specified period ... the court for cause shown may at any time in its discretion... on motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect.¹ Rule 9006 grants a pardon for late filings that were caused by neglect.² The Supreme Court has defined neglect as “‘giv[ing] little attention or respect’ to a matter or... ‘to leave undone or unattended to especially through carelessness’”³ Congress’ purpose in formulating this rule was to give courts discretion, where appropriate, to accept filings submitted past their deadlines due to inadvertence mistake, or carelessness, as well as by circumstances beyond the party’s control.⁴ The excusable neglect standard applies in cases brought under chapter 11 of title 11 of the United States Code (the

¹ Fed. R. Bankr. P. 9006(b)(1).

² Pioneer Inv. Services Co. v. Brunswick Associates Ltd. Partnership, 507 U.S. 380, 388 (1993).

³ *Id.*

⁴ *Id.*

“Bankruptcy Code”).⁵ The court in *Pioneer* determined that because Congress provided no guideposts for evaluating whether neglect is excusable, the analysis should be an equitable one that focused on the danger of prejudice to the debtor.⁶ Thus, the court created a four-factor balancing test to determine when prejudice to the debtor makes an attorney’s neglect inexcusable.

The *Pioneer* factors present a high burden to overcome. Indeed, there are very few cases in which a court allowed a creditor to file a late claim. This memorandum explores under what circumstances the court will allow a late file claim. Part I discusses the *Pioneer* case and analyzes the Supreme Court’s adoption and application of the four “*Pioneer* factors.” Part II examines a recent case in which a court applied the *Pioneer* factors, found excusable neglect, and allowed a creditor to file a late proof of claim. Part III addresses the Southern District of New York’s elaboration of each of the factors in *In re Lyondell*, in which the court gives a thorough analysis of each fact and its respective applicability.

I. The Pioneer Factors

In *Pioneer*, certain creditors filed their proofs of claim after the deadline (i.e., the bar date) for the filing of proofs of claim. In connection with the late claim filings, the creditors also filed a motion requesting permission for the late filings under Rule 9006(b)(1). In an attempt to qualify the late filing as excusable neglect, creditor’s counsel explained that he had recently left his former law firm and had been in a state of disruption and upheaval.⁷ The Bankruptcy Court for the Eastern District of Tennessee, following precedent from the Court of Appeals for the Eleventh Circuit, held that a party may claim excusable neglect only if its “failure to timely

⁵ See *id.* at 389; see also *US v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983).

⁶ *Pioneer*, 507 U.S. 380, 395.

⁷ *Id.*

perform a duty was due to circumstances which were beyond its reasonable control.”⁸ Because the court found that the creditors had received notice of the bar date and could have reasonably complied, it denied the creditors’ motion and refused the late filing.

On appeal, the United States District Court for the Eastern District of Tennessee found “respectable authority” for the narrow reading of excusable neglect by the Bankruptcy Court, but concluded that the Court of Appeals for the Sixth Circuit, which is where the Bankruptcy Court is located, would follow a more liberal approach. The District Court borrowed the relatively liberal test announced by the Court of Appeals for the Ninth Circuit that evaluates several factors in respondent’s conduct including: (1) whether granting the delay will prejudice the debtor; (2) the length of delay; (3) whether the delay was beyond the reasonable control of the person whose duty it was to perform; (4) whether the creditor acted in good faith; and (5) whether clients should be penalized for their counsel’s mistake or neglect.⁹ The District Court also stated that, on remand, the Bankruptcy Court should consider whether the failure to file the claims by the bar date resulted from negligence, indifference, or culpable conduct on the part of the moving creditor.¹⁰

On remand, the Bankruptcy Court again denied respondent’s motion and the District Court affirmed the ruling. However, the Court of Appeals for the Sixth Circuit reversed after concluding that excusable neglect is not limited to cases where the failure to timely act is due to circumstances beyond the movant’s control.¹¹

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* at 385.

¹¹ *Id.*

On appeal, the Supreme Court agreed that a flexible interpretation of excusable neglect coincides with the policies underlying Chapter 11 and the bankruptcy rules.¹² According to the Court, the history of Rule 9006(b)(1) supports the conclusion that the extension of the time periods under the excusable neglect standard is not limited to circumstances beyond the party's control. To determine whether neglect should be considered "excusable," the Court identified the following four factors that considered all relevant circumstances surrounding the party's omission:

- (1) Danger of prejudice to the debtor;
- (2) The length of the delay and its potential impact on judicial proceedings;
- (3) The reason for the delay, including whether it was within the reasonable control of the movant; and
- (4) Whether the movant acted in good faith.¹³

The Court, however, rejected the Sixth Circuit's suggestion that it would be inappropriate to penalize respondents for the omissions of their attorney. According to the Court, the Court of Appeals should have considered whether the attorney, as the respondent's agent, did all he reasonably could to comply with the court-ordered bar, rather than whether the respondents did all they reasonably could in policing the conduct of their attorney.¹⁴

Despite finding that the Sixth Circuit erred in this part of its analysis, the Supreme Court concluded that the result was still correct. The Court concluded that there was no evidence of prejudice to the petitioner and there was no indication of bad faith, and that the unusual form of

¹² *Id.*

¹³ *Id.* at 395.

¹⁴ *Id.* at 396.

notice used in this case confirmed that the neglect of the respondent's counsel was, considering all the circumstances, excusable.¹⁵

II. Pioneer Factors Applied in *In re LMM Sports Management*

In June 2016, the United States Bankruptcy Appellate Panel for the Ninth Circuit commented on excusable neglect and its potentially prejudicial effects. In *In re LMM Sports Management*, appellant Warner Angle Hallam Jackson & Formancek, P.L.C. ("Warner Angle") filed proofs of claim against the debtor, LMM Sports Management ("LMM") for legal services it provided to LMM in connection with a prior state court case against Your Source Pacific Fund I, LLP ("Your Source").¹⁶ In the state court case, Your Source obtained a \$2.4 million judgment against LMM, causing LMM to file for protection under chapter 11 of the Bankruptcy Code. The bankruptcy court approved a settlement of \$1.5 million between Your Source and LMM (represented by new counsel) in full satisfaction of Your Source's judgment over Warner Angle's objection. Warner Angle filed its objection to the Debtor's settlement motion on February 17, 2015, two months after the bar date. One day later, Warner Angle belatedly filed the proofs of claim. The Debtor objected to the proofs of claim arguing they should be disallowed as untimely. Warner Angle then filed a cross-motion requesting that the proofs be treated as timely because the late filing was the result of excusable neglect. The bankruptcy court rejected Warner Angle's excusable neglect argument and denied its reconsideration motion. Warner Angle appealed.

The Bankruptcy Appellate Panel of the Ninth Circuit noted that requests to file a late proof of claim based on excusable neglect should be analyzed by considering the totality of the

¹⁵ *Id.* at 399.

¹⁶ *In re LMM Sports Mgmt.*, BAP No. AZ-15-1195, 2016 WL 3213829, at *1-3 (9th Cir. June 1, 2016).

circumstances and by focusing on the four specific factors established in *Pioneer*. (1) the danger of prejudice to the non-moving party; (2) the length of delay and its potential impact on judicial proceedings; (3) the reason for the delay, including whether it was within the reasonable control of the movant; and (4) whether the moving party’s conduct was in good faith.¹⁷

The lower bankruptcy court found that Warner Angle had satisfied two of the four *Pioneer* factors; Warner Angle (1) acted in good faith, and (2) established that the length of delay was relatively minor and did not influence the debtor’s bankruptcy cases.¹⁸ Warner Angle conceded that there was not a good reason for the delay and that avoiding the delay would have been within Warner Angle’s reasonable control.¹⁹ On appeal, Warner Angle focused on the “danger of prejudice” element. The lower court found that if Warner Angle had timely filed its proofs of claim, LMM would have had the option to consider a different path than the one they chose, which involved finalizing and submitting their settlement agreement for approval with Your Source.²⁰ Accordingly, the Bankruptcy Appellate Panel concluded that LMM would be prejudiced by allowing Warner Angle to file a late claim.

III. The *Pioneer* Factors Elaborated Upon in *In re Lyondell Chemical Co.*

The Bankruptcy Court for the Southern District of New York found that excusable neglect should be elastic in its application and should be fact specific rather than held to a rigid standard.²¹ In *In re Lyondell*, a trustee did not request an extension of time to move to substitute a new executor to the deceased defendant’s estate within the 90-day period specified by the

¹⁷ See *Pioneer*, 507 U.S. 380, 395.

¹⁸ *In re LMM Sports Mgmt*, 2016 WL 3213829, at *2.

¹⁹ *Id.*

²⁰ See *id.* at *4.

²¹ *In re Lyondell Chemical Co.*, 543 B.R. 400, 407 (Bankr. S.D.N.Y. 2016); see also 4B Wright & Miller, *Federal Practice and Procedure: Civil 3d* § 1165 at 533–34 (3d ed.2002).

court.²² The court applied the *Pioneer* factors, and elaborated on the proper weight each factor should be given.

The court opined that the first Pioneer factor, danger of prejudice to the non-moving party, is more complex than a “simple dollar-for-dollar depletion of assets otherwise available for timely filed claims.”²³ Courts apply more than this simple analysis by delving into any adverse impacts a claim might have on the judicial administration of the case.²⁴

With regard to the second factor, the length of delay and its potential impact on judicial proceedings, the Bankruptcy Court considered the Second Circuit’s opinion in *In re Enron Corp.*,²⁵ that the length of delay in time is only given meaning by its effect on the administration of the case and that there has been no court which established a bright-line rule to determine when the lateness of a claim would be considered substantial.²⁶

The Bankruptcy Court emphasized the third factor -- reason for delay -- noting that it is the “predominant factor” and should be given the most weight.²⁷ The fourth factor, good faith, is rarely at issue.²⁸ Though there is no formal presumption of good faith, courts have stated that a record lacking bad faith provides appropriate grounds for a finding of good faith.

The *Lyondell* court focused primarily on the third factor. According to the court, the evidence demonstrated that the trustee, for reasons beyond his control, could not substitute the executor of the defendant on the proof of claim. Consequently, the court found the trustee’s neglect excusable. The court stated that where an unusual form of notice provides an “adequate

²² *Id.*

²³ *Id.* at 410; *see also In re R.H. Macy*, 166 B.R.799, 802 (Bankr. S.D.N.Y.1994).

²⁴ *Id.*

²⁵ 419 F. 3d 115 (2d Cir. 2005).

²⁶ *Id.* at 410; *see also In re Enron Corp.*, 419 F. 3d 115.

²⁷ *Id.* at 409.

²⁸ *Id.* at 410.

reason” for the delay and where there is no indication of any “intentional effort to withhold information from the claimant,” the negligence should be found excusable.²⁹

Conclusion

When determining whether to allow a late filing, a court will consider all four of the *Pioneer* factors in determining if excusable neglect exists. Courts, however, will likely focus principally on reason for the delay. As illustrated in the cases discussed herein, determining whether late filings of proofs of claim will be considered excusable is extremely fact-specific and depends heavily upon circumstances and whether those circumstances were within the movant's reasonable control.

²⁹ *Id.* at 413.