

Distinguishing 'Excusable Neglect' In Filing Late Claims

Law360, New York (June 14, 2010) -- In a recent decision, the United States Bankruptcy Court for the Southern District of New York distinguished excusable neglect in filing a claim before the expiration of a clear bar date. In a written opinion issued on May 20, 2010, in the case of *In re Lehman Brothers Holdings Inc., et al.*, Case No. 08-13555 (JMP), Judge James M. Peck denied seven motions for leave to file late claims, finding none satisfied the Second Circuit's strict standard to find excusable neglect.

Bankruptcy Rule 3003(c) requires the bankruptcy court to set a bar date after which proofs of claim may not be filed. Bankruptcy Rule 9006(b)(1) gives the court the discretion to enlarge the time to file claims "where the failure to act was the result of excusable neglect."

In the landmark case *Pioneer Investment Services Company v. Brunswick Associates LP*, 507 U.S. 380 (1993), the U.S. Supreme Court interpreted "excusable neglect" to be a flexible standard which can include "inadvertence, mistake, or carelessness, as well as by intervening circumstances beyond the party's control." However, the Supreme Court also held that the determination "is at bottom an equitable one" and must take into account all relevant circumstances surrounding the party's omission. *Id.*

The Pioneer court set out four factors to guide in the analysis of excusable neglect: "[1] the 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." *Id.*

In applying Pioneer, the Second Circuit has adopted what has been characterized as a "hard line" test for determining whether a party's neglect is excusable. *In re Enron*, 419 F.3d 115, 121 (2d Cir. 2005).

The movants seeking leave to file a late claim in the Lehman Brothers Holdings case asserted various reasons for failing to file a timely proof of claim. The court found that each fell short of making a showing of excusable neglect.

The first group of claimants argued that their neglect was excusable because the failure to file a proof of claim by the deadline was based on the failures of their attorneys or advisers. In the case of at least one of the claimants, a claim was timely filed in a foreign proceeding but not in the Chapter 11 proceeding because its adviser failed to recognize the need to also file the claim in the U.S.

The court rejected these arguments out of hand, holding that "entities are bound by the actions and failures to act of their authorized representatives." The court also refused to deem the timely completion of the Guarantee or Derivatives Questionnaires — which all creditors whose claims are backed by a guarantee or arise from a derivatives transaction were required to complete — as tantamount to timely filed proofs of claim because they were filed

after the applicable bar date. In this regard, the court found that “[m]issing the bar date applicable to all claims is fatal.”

The second category of reasons for delay the court considered were asserted by creditors that claimed not to have become aware of their rights until after the bar date. The court found that these specific claims shared characteristics of inadvertence, lack of oversight, inadequate internal procedures, and operational errors which did not justify the filing of late claims.

In at least one instance, the court found that the late-filed claims resulted from the claimant’s internal policy that divided responsibility in the debtors’ Chapter 11 cases between two people. The court held that failure to communicate between these two people regarding the need to file a claim did not meet the high standard for a finding of excusable neglect.

In addition, the court found that two of the creditors’ failure to file a timely claim resulted from a lack of diligence which was within the control of the creditors. These creditors’ joint motion explained that the delay in filing the claim was the result of confusion relating to a proposed trade of certain notes between the two parties. On Sept. 4, 2009, one of the creditors confirmed a purchase of an 11-note portfolio issued by Lehman Brothers Treasury Co. BV and guaranteed by LHBI, but documentation for the purchase only confirmed a transfer of eight of the 11 notes.

Both parties failed to notice this omission, and the three outstanding trades failed to settle. Around Sept. 30, 2009, over one month before the applicable bar date, the parties realized the oversight, but the trades were not reconciled until Nov. 5, 2009, and a claim was not filed until Dec. 14, 2009. Under these circumstances, the court held that the cause of the delay was a series of errors, but these errors were all within the control of the creditors. Thus, it did not rise to the level of excusable neglect.

Finally, the court considered the identical motions of two other creditors, which argued that their claims, which were both based on LBIE obligations and guaranteed by LBHI, were filed late because they were unaware of their guarantee claims against LBHI until after the bar date. The court denied both motions because it found that the movants, with the exercise of reasonable diligence, could have discovered the existence of the guarantees.

At the end of its opinion, the court concluded that “[n]eglect in filing a claim before the expiration of a clear bar date is excusable when the creditor, after conducting a reasonable amount of diligence, is justifiably confused or uncertain as to whether a particular transaction giving rise to a claim is or is not subject to the bar date order.”

This decision, which was issued for publication, underscores the hardline test that courts in the Second Circuit apply to questions of excusable neglect, highlights the need for extra vigilance by creditors and their professionals, and demonstrates the harsh outcome (lack of a party’s ability to participate in plan distributions) for failing to exercise such vigilance.

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