JUDICIAL ESTOPPEL – CIVIL LIABILITY CLAIMS & BANKRUPTCY

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Doctrine of Judicial Estoppel

The doctrine of judicial estoppel prevents a litigant from asserting a legal position in one proceeding from which the litigant receives a benefit, and then taking a contrary position in a separate legal proceeding simply because the litigant's interests may have changed. *New Hampshire v. Maine*, 532 U.S. 742, 794-51, 121 S.Ct. 1808, 149 L.Ed 2d 968 (2001). The doctrine is designed to protect the judicial system, not the litigant; thus, detrimental reliance or prejudice suffered by the opposing party is not a pre-requisite for the application of judicial estoppel. *See, e.g., In re Superior Crew Boats,* 374 F.3d, 330, 333 (5th Cir. 2004); *Burnes v. Pemco Aeroplex, Inc.,* 291 F.3d 1282, 1286 (11th Cir. 2002); *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.,* 81 F.3d 355, 360 (3rd Cir. 1996).

The court has discretion to apply judicial estoppel as necessary to preserve "the essential integrity of the judicial process." *New Hampshire*, 532 U.S. at 749. As the Kansas court of appeals has noted:

> "That integrity is compromised when a party invites a court to rule a certain way by advancing a particular argument and then allows another court to rule in an inconsistent way in cognate litigation. The doctrine is a flexible one, operating with sufficient suppleness to remedy impermissible manipulations in varied situations." *Estate of Belden*, 2011 W.L. 3759946 at *11; *In re Marriage of Hudson*, 39 Kan. App. 2nd 417, 425, 182 P.3d 25 (2008).

Application of Judicial Estoppel in Bankruptcy Cases

A typical application of the doctrine of judicial estoppel is evidenced by the Fifth Circuit Decision *In re Superior Crew Boats*, 374 F.3d at 334. This decision involved a personal injury claim against *Superior Crew Boats* that occurred a year before Hudspeath, the plaintiff, and his wife, filed a Chapter 13 Bankruptcy Petition. *Id.* at 334. They omitted including a potential personal injury claim on their schedules but while the bankruptcy case was pending, they filed a state court lawsuit against *Superior*. *Id.* The lawsuit, however, was not served until six (6) months later with no reflection of this lawsuit presented in the bankruptcy filings. Upon conversion to a Chapter 7 bankruptcy,

Hudspeath disclosed the existence of the personal injury lawsuit at the §341 Creditor's Meeting but inaccurately informed the creditors that their claims were time-barred. *Id.* Shortly after the Creditor's Meeting, the trustee filed a Petition of Disclaimer and Abandonment and, on October 1, 2001, the bankruptcy court declared a complete discharge. *Id.*

Later, *Superior Crew Boats* moved to dismiss the personal injury claim in the same federal court where the bankruptcy proceeding had taken place. 374 F.3d at 333-34. The Hudspeaths responded with a personal injury complaint, and, thereafter, the Defendant informed the trustee that the Hudspeaths were pursuing a pre-petition personal injury claim. *Id.* The trustee moved to re-open the bankruptcy proceeding and the Hudspeaths filed amended schedules disclosing the personal injury claim. The trustee moved to substitute for the Hudspeaths in the personal injury proceeding. *Id.* The district court rejected the Defendant's motion to dismiss which relied on judicial estoppel, finding that whether the Hudspeaths had taken inconsistent positions was a question of fact to be determined at trial.

On appeal, the Fifth Circuit recognized three (3) grounds for applying judicial estoppel:

1) If the party took a position that was inconsistent with a previous position;
2) If the court accepted the previous position; and
3) If the non-disclosure was not inadvertent.

The court held that the Hudspeaths had taken inconsistent positions in the bankruptcy proceedings and the personal injury litigation, that there was a continuous duty to disclose, and that their $2.5 million dollar personal injury claim was blatantly inconsistent. *Id.* The court also noted that the bankruptcy court had accepted the time-barred representation because the trustee formally abandoned the claim, and, finally, it held that the non-disclosure was not inadvertent because the Plaintiffs had knowledge of the claim and filed their state court action within a matter of months after initiating the bankruptcy proceedings. 374 F.3d at 335-36.

> "The Hudspeaths had the requisite motivation to conceal the claim as they would certainly reap a windfall if they had been able to recover on the undisclosed claim without having to disclose it to the creditors. Such a result would prevent the debtors to 'conceal their claims; get rid of [their] creditors on the cheap and start over with a bundle of rights.' *Payless Wholesale Distrib., Inc., v. Alberto Culver (P.R.) Inc*., 989 F.2d 570, 571 (1st Cir. 1993). Accordingly, the Hudspeaths cannot be permitted, at this late date, to re-open the bankruptcy proceeding and amend their petition. Judicial estoppel was designed to prevent such abuses. *Id. at 336*."

The Fifth Circuit, therefore, barred the claim as a matter of law. *Id.*

The case of *Burnes v. Pemco Aeroplex, Inc., supra*, is another illustrative case. In *Burnes*, the Plaintiff filed a Chapter 7 bankruptcy proceedings more than six (6) months

before filing an EEOC complaint which had not been disclosed in the bankruptcy proceeding. 291 F.3d at 1283-84. The district court granted summary judgment to the employer/Defendant on the basis of judicial estoppel. *Id.* at 1284. Plaintiff appealed, arguing an inadvertent failure to list arguing that the failure to list the claim was inadvertent and that the employer lacked standing because it was not a creditor. *Id.* at 1286. The court rejected both arguments holding that privity and detrimental reliance did not preclude judicial estoppel and the court inferred a deliberate or intentional manipulation of the process from the fact at hand. 291 F.3d at 1287. Noting that full and honest disclosure was "crucial to the effective functioning of the federal bankruptcy system," the court found that creditors rely on a debtor's disclosure statement in determining whether to contest a no-asset discharge. *Id.* at 1286. The court further held that allowing a debtor to cure the prior omission by reopening the bankruptcy would condone the initial concealment and provide no incentive to ensure a truthful disclosure of assets. *Id.*; *see also DeLeon v. Comcar Industries, Inc.* 321 F.3d 1289, 1292 (11th Cir. 2003) (holding that judicial estoppel applies in Chapter 13 cases).

The Tenth Circuit has followed a similar rationale in *Eastman v. Union Pac. R.R. Co.,* 493 F.3d 1151 (10th Cir. 2007), where a plaintiff asserted a FELA claim against other defendants. *Id.* at 1153. With the personal injury claim pending, plaintiff then filed a Chapter 7 Bankruptcy Petition but did not disclose the FELA case as a potential asset, prompting the district court to grant summary judgment on the basis of judicial estoppel. *Id.* at 1154. The debtor, during a Creditor's Section 341 Meeting, flatly denied having a personal injury suit pending. *Id.* at 1153. A year later, the debtor's personal injury lawyer learned of the bankruptcy proceeding and the trustee moved to re-open the case and list the FELA action as an asset. *Id.* at 1154.

Despite these efforts, the district court estopped both the plaintiff and the trustee from pursuing a personal injury claim because of the inconsistent positions taken by the plaintiff and the concealment of the personal injury claim. 493 F.3d at 1154. On appeal, the 10th Circuit affirmed the district court's decision noting that in exchange for the ultimate benefit of a bankruptcy discharge, the bankruptcy code only required that a debtor be truthful and, without a satisfactory reason for this omission, the district court's discretion was upheld. *Id.*

Potential Defenses to Judicial Estoppel

The most commonly asserted defense to judicial estoppel is a claim that the failure to disclose was inadvertent. Matter of *Cassidy*, 892 F.2d 637, 641 (7th Cir. 1990). Claims of inadvertence may be supported by affidavits from the debtors as to their intent, affidavits from attorneys representing the debtors, or inferences reasonably made from the evidence presented. Certainly, defendants can cite to the inherent motive of personal injury litigants to shield their potentially valuable claim from the bankruptcy court as a logical motive to intentionally deceive the bankruptcy court and trustee, the adverse inferences which defendants commonly offer from such facts have been rejected depending on the factual circumstances presented. *See Stallings v. Hussmann Corp.*, 447 F.3d 1041, 1049 (8th Cir. 2006) ("although it may generally be reasonable to

assume that a debtor who fails to disclose a substantial asset in bankruptcy proceedings gains an advantage, the specific facts of a case may weigh against such an inference").

For example, in *Loth v. Union Pac. R.R. Co.*, 354 SW 3d 635 (Mo. App. E.D. 2011), the court received an affidavit from the bankruptcy trustee after a reopened case noting the amendment of the schedules to list a FELA claim and that no creditor or other party in interest had objected to the amendment. *Id*. at 637. The trustee offered an opinion, from a review of the file, that there had been no intentional concealment of assets based on plaintiff's self-report of the omission, not claiming an exemption for the same, and the debtor's cooperation and reasonable explanation for the omission. The trustee further noted that by reopening and not claiming an exemption, only plaintiff's creditors would benefit from allowing the FELA claim to proceed since the creditors might obtain full payment of their debt. *Id.* at 638.

The trial court in *Loth* concluded that there was an omission that was the "product of a deliberate, considered decision" and it sustained the defendant's motion for summary judgment. *Id.* at 4. The Missouri court of appeals noted that the trial court disregarded summary judgment principals by choosing which evidence to believe and making improper creditability inferences. *Id.* at 640-41. Significantly, the court noted that a dismissal by judicial estoppel, "is not an equitable remedy to employ to injure creditors." *Id.* at 641. Finding a genuine dispute as to whether the plaintiff made a good faith mistake to exist, the appellate court reversed the summary judgment. *Id.* at 642.

Certainly, there is legal authority to the contrary conclusion finding that efforts to reopen the bankruptcy did not preclude imposition of judicial estoppel. *See Chandler v. Samford University*, 35 F.Supp. 2d 861, 863 (N.D. Ala. 1999).

Is Plaintiff the Real Party in Interest?

The nature of the bankruptcy process suggests strongly that the plaintiff may not be the real party in interest to pursue recovery in an on-going or subsequently-filed lawsuit. A debtor files for bankruptcy as a means of discharging debts and obligations and receiving a "fresh start." The bankruptcy case is initiated by the debtor filing a bankruptcy petition, which includes schedules of assets and liabilities and a statement of financial affairs. The debtor must execute these documents under penalty of perjury, and is required to include a good faith estimate of the value of all of his assets. *See* 11 U.S.C.§ 521(a)(1). Upon the bankruptcy filing, a trustee is appointed to administer the debtor's estate and liquidate the debtor's assets in order to pay creditors. The submission of the petition is required for the trustee to properly administer the debtor's estate, and ultimately, for the debtor to receive a discharge of his debts. The intentional or unintentional undervaluing of the debtor's assets, or the failure to disclose those assets in a bankruptcy petition, may limit or preclude the debtor from recovery in a subsequent legal proceeding based upon the doctrine of judicial estoppel.

However, courts have periodically expressed reservation in applying judicial estoppel against a trustee's request to proceed to recover on behalf of **creditors** after reopening a case upon learning of a debtor's omission or failure to disclose. The principal reason for these reservations is that any cause of action or contingent claim listed on a schedule in bankruptcy belongs to the bankruptcy estate, which compromises "all legal and equitable interests of the debtor and property as of the commencement of the case." 11 U.S.C. § 541(a)(1). *See also, In re Hedged-Investments Assocs., Inc.,* 84 F.3d 1281, 1285 (10th Cir. 1996) (holding that causes of action belonging to the debtor constitute the property of the estate); *U.S. ex rel. Gebert v. Transp. Admin. Servs.*, 260 F.3d 909, 913 (8th Cir. 2001) (potential claims constitute property of the bankruptcy estate); *In re Ozark Res. Equip. Co.,* 816 F.2d 1222, 1225 (8th Cir. 1987) (causes of action belonging to the debtor at commencement of the case are included within the definition of property of the estate); *Biesek v. Soo Line R.R. Co*., 440 F.3d 410, 413 (7th Cir. 2006) (pre-bankruptcy claims are part of the debtor's estates).

Third parties cannot pursue or prosecute actions that are the property of the bankruptcy estate and such actions are typically dismissed. *Asmus v. Capital Region Family Practice*, 115 S.W. 3d 427, 431 (Mo. App. W.D. 2003) (bankruptcy trustee was the real party in interest with the exclusive right to pursue medical malpractice action); *First New York Bank For Business v. DeMarco*, 130 B.R. 650, 655 (S.D.N.Y. 1991).

When a claim is omitted from the estate which accrued prior to the filing of the bankruptcy petition, it remains an asset of the estate. *In re Jackson*, 593 F.3d 171, 176 (2nd Cir. 2010). This is true even if the debtor fails to schedule the claim in the bankruptcy petition. *Rosenshein v. Kleban,* 918 F.Supp. 98, 102, 103 (S.D.N.Y. 1996).

Practical Effects

The assertion of the judicial estoppel defense has a number of beneficial, practical effects when defending personal injury claims. As noted above, a primary benefit to the defense is the opportunity to potentially prevail on a dispositive motion thereby eliminating a claim all together. To obtain this result, pretrial discovery must be effectively utilized to not only demonstrate the failure to disclose plaintiff's claim in the bankruptcy proceeding, but to also pre-emptively address the potential defense that the omission was merely inadvertent.

Among the factors that may assist in shedding light on the debtor/plaintiff's intentions include written evidence of pre- and post-suit settlement negotiations, plaintiff's response to discovery requests designed to establish the perceived value of plaintiff's claim and the proximity between the date of discharge in bankruptcy and the filing of any potential third-party claim

In the event the trial court denies the dispositive motion, there are still additional benefits to be reaped by pursuing the judicial estoppel defense. More than likely, the trial court will be forced to conclude that the plaintiff is no longer the real party in interest or at a minimum, that the bankruptcy trustee holds the right to recover the proceeds of

the litigation. As a representative of the creditors, and not the debtor, the trustee likely has much more than incentive to resolve a potentially valuable claim quickly and at a discount when compared to the plaintiff and the plaintiff's attorney. Once the debtor/plaintiff realizes that the proceeds of the litigation will not directly inure to his or her benefit, the plaintiff will likely lose interest in cooperating with the prosecution of the personal injury case.

In the event that the civil litigation cannot be resolved quickly following such a development, the defense can usually utilize the trial court's declaration that a "question of fact" exists on the debtor's intentions to create a new, separate issue to be litigated: whether plaintiff intentionally deceived the bankruptcy court. Tactically, there may be much benefit to be gained by focusing the jury's attention on suspicious facts surrounding the bankruptcy claims as another means to impair and attack the plaintiff's credibility in the civil litigation.

Conclusion

In light of the various benefits and opportunities generated by the doctrine of judicial estoppel, attention should be directed both during the investigation of claims pre-suit, and during post-suit discovery to the possibilities of asserting this defense. Since judicial estoppel is an affirmative defense, many courts will require that the answer be amended to add this particular defense prior to asserting any dispositive motions. Examination of available on-line filing systems for the federal court should yield promising avenues to discover whether claimants have filed bankruptcy and whether those bankruptcy disclosures refer to the existence of the claim at hand.

The doctrine of judicial estoppel is receiving increasing attention in civil litigation and deservedly so. Not only does the doctrine offer an opportunity to potentially bar a plaintiff's claims in their entirety, the strategic use of the defense can greatly affect the potential value of a claim during settlement negotiations.