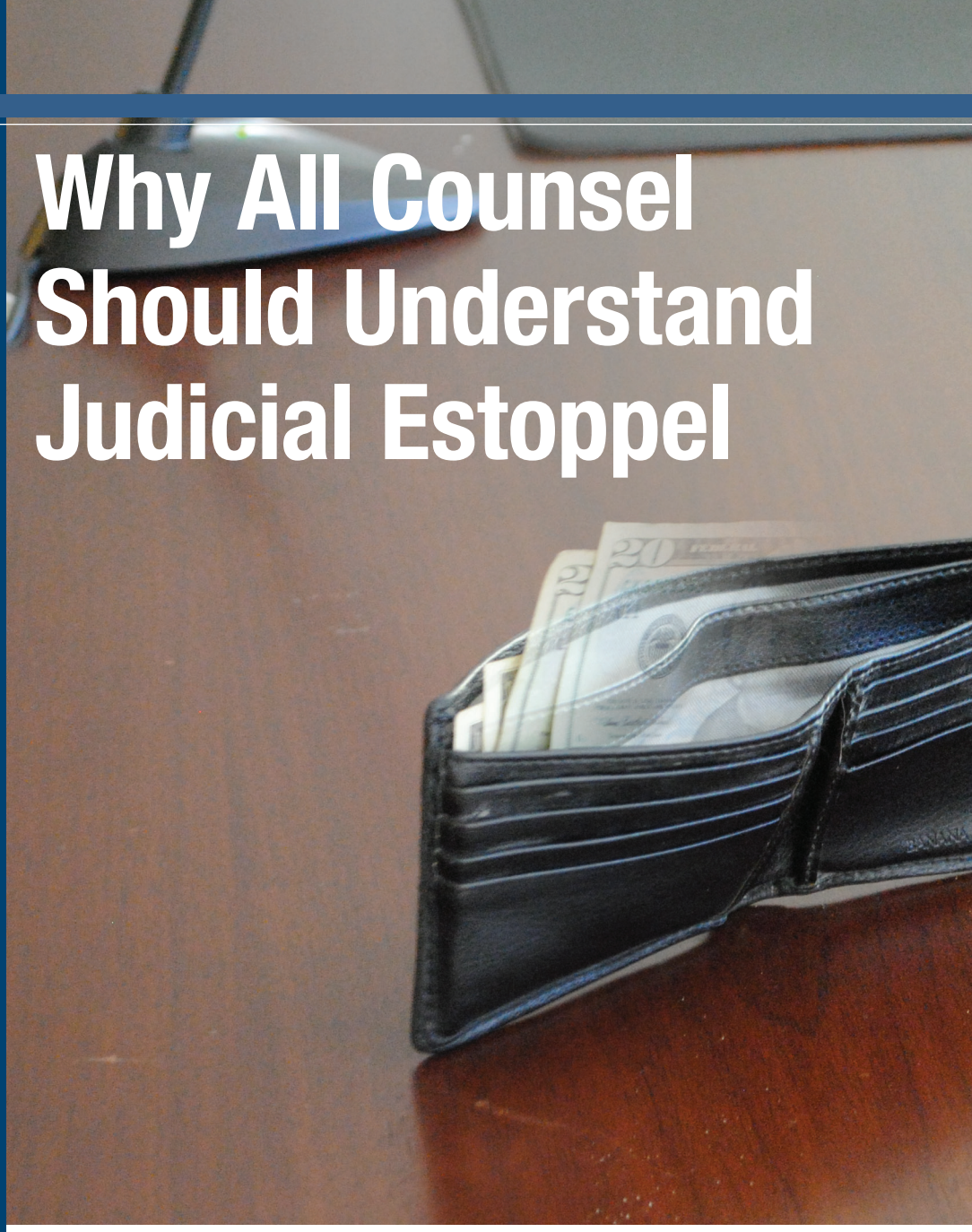
Beyond Practicing Bankruptcy Law

# Why All Counsel Should Understand Judicial Estoppel



By Christal A. Delgado

If a debtor/plaintiff fails to list a cause of action properly, the court may estop the plaintiff from asserting that cause of action and find that the claim remains as property of the bankruptcy estate.

Chances are good that at some point in your legal career, you will defend a client against an opposing party plaintiff that filed bankruptcy after the cause of action against your client accrued. If the opposing party plaintiff failed to disclose the cause of action against your client properly, you should raise the doctrine of judicial estoppel to relieve your client of total liability or to reduce significantly the amount of potential damages.

## Which General Bankruptcy Principles Do You Need to Understand?

To understand the principle of judicial estoppel it is important to understand two of the main purposes of bankruptcy. The

■ Christal A. Delgado is an associate in the Houston office of Seyfarth Shaw LLP, and works primarily in the Commercial Litigation and Bankruptcy, Workouts & Business Reorganization Practice Groups.

United States bankruptcy laws are written to serve two broad purposes. The first is to provide a "fresh start" to individuals or companies without the burden of their old debts. The second is for the creditors of a debtor to be treated equally.

The only way these broad purposes are achieved is if a debtor acts transparently by disclosing all assets and liabilities. The duty for a debtor to disclose is a continuing duty and does not end once the petition, original bankruptcy schedules, or the statement of financial affairs (SOFA) are filed. Full and honest disclosure in a bankruptcy case is crucial to the effective functioning of the federal bankruptcy system. For example, creditors rely on a debtor's disclosure statements to determine whether to object to, to consent to, or to file a claim in a case involving a no asset discharge. Bankruptcy courts also rely on the accuracy of the disclosure statements in deciding whether to approve no asset discharges. Therefore, the importance of full and honest disclosure cannot be overstated. *Billips v. Pemco Aeroplex, Inc.*, 291 F.3d 1282, 1286 (11th Cir. 2002).

## A Court May Judicially Estop a Plaintiff for Failing to Disclose a Claim in a Bankruptcy Filing

The obligation for a debtor to list all assets in exchange for the "fresh start" includes that the debtor must list all pre-petition causes of action belonging to the debtor, as these constitute "assets" of the bankruptcy estate that benefit the creditors. As such, the bankruptcy schedules that all debtors must file require that a debtor list the potential cause of action in schedule B of the debtor's schedules.

### The Judicial Estoppel Doctrine

The judicial estoppel doctrine is intended to protect the integrity of courts, not to punish adversaries or to protect litigants. *In re Costal Plains*, 179 F.3d 197, 213 (5th Cir. 1999); *RTC Mortgage Trust v. McMahon*, 225 B.R. 604, 608 (E.D. Va. 1997). The purpose of the judicial estoppel doctrine is to prevent a debtor plaintiff from "playing fast and loose with the courts." *Matter of Cassidy*, 892 F.2d 637, 641 (7th Cir. 1990).

If a debtor fails to list the potential cause of action, a court may estop the debtor, now a plaintiff or "debtor plaintiff," from asserting that cause of action and find that the unscheduled claim remains the property of the bankruptcy estate. When a court does find that an undisclosed claim remains as property of the bankruptcy estate, the debtor lacks standing to bring the cause of action after emerging from bankruptcy, and the court must dismiss the claims.

### Schedule B—Disclosure of Debtor's Personal Property Assets

A debtor's bankruptcy filings are public record so you easily can discover whether a debtor plaintiff scheduled the cause of action by accessing the debtor's petition, schedules, and SOFA. If a debtor plaintiff properly claimed the potential or pending litigation, it should have listed the claim as an asset in Schedule B. Often debtors will list a litigation claim under question 21 of Schedule B.

## Fact Patterns Affect How Courts Apply the Judicial Estoppel Doctrine

Although sometimes it is easy to spot when a court should apply the judicial estoppel doctrine, several fact patterns can lead to confusing and often ambiguous results. Examples could be when a debtor plaintiff failed to disclose a claim, but a judge later dismissed the debtor's bankruptcy, or if a debtor plaintiff did disclose a claim, but valued the claim for substantially less than the amount that the debtor plaintiff later sought in the lawsuit.

**The purpose** of the judicial estoppel doctrine is to prevent a debtor plaintiff from "playing fast and loose with the courts."

### A Debtor Plaintiff Failed to Disclose a Claim but the Bankruptcy Was Dismissed

Again, a basic tenet of bankruptcy law is that all assets of a debtor are assets of the bankruptcy estate that the debtor must list in a schedule for the benefit of the creditors. If a debtor files for bankruptcy relief, any pre-petition asset, including claims that arose before the debtor filed for bankruptcy, are property of the estate. Therefore, courts have held that both scheduled and unscheduled claims remain the property of bankruptcy estates, and a debtor lacks standing to bring undisclosed claims after emerging from bankruptcy. *Kunica v. St. Jean Fin., Inc.*, 233 B.R. 46, 52 (S.D.N.Y. 1999).

Although most courts agree that a debtor plaintiff cannot later assert an unscheduled claim, courts differ in holding whether a debtor plaintiff can assert an unscheduled claim later if a judge dismisses the bankruptcy case. Ultimately, in deciding whether a debtor plaintiff has standing, courts balance the plain meaning of 11 U.S.C. §349 with equitable considerations, including the debtor plaintiff's conduct during the bankruptcy.

**A Debtor Received a Benefit and the Bankruptcy Was Involuntarily Dismissed**

In *Crawford v. Franklin Credit Management Corporation*, the plaintiff filed bankruptcy in 2006, but failed to list any of the claims against the defendants, which she subsequently sued. The defendants argued that the plaintiff lacked standing and judicial estoppel should apply to prevent her from pursing claims against them. The plaintiff urged the court to find that she did have standing because the plain language in 11 U.S.C. §349 states that once a judge dismisses a bankruptcy proceeding, the dismissal restores the previously bankruptcy-seeking party to the position that the party held before filing for bankruptcy. The defendants opposed this argument and urged the court to consider the debtor plaintiff's conduct, including that the judge had dismissed the debtor plaintiff's bankruptcy because the debtor plaintiff created unreasonable delay, she failed to appear at the confirmation hearing, and she failed to remain current in the proposed plan payments to the trustee. The court in *Crawford* ultimately held that the plaintiff lacked standing because the plaintiff obtained a considerable benefit by filing for bankruptcy relief as she filed two days before a foreclosure sale began and did not attend hearings, which suggested that she had not intended to amend her bankruptcy schedules later. *Crawford v. Franklin Credit Management Corporation*, No. 09 C 3576, 2011 WL 1118584, at *13–14 (S.D.N.Y. Feb. 16, 2010).

**Courts differ** in holding whether a debtor plaintiff can assert an unscheduled claim later if a judge dismisses the bankruptcy case.

**Practice Pointer 1—*Equitable Considerations to Determine Whether the Judicial Estoppel Doctrine Should Apply When a Debtor Plaintiff Failed to Disclose a Claim and the Bankruptcy Was Dismissed***

- Did the debtor plaintiff receive benefit from filing for bankruptcy?
- Was the bankruptcy voluntarily or involuntarily dismissed?
- Did the debtor plaintiff create unreasonable delay?
- Did the debtor plaintiff fail to appear at hearings?
- Did the debtor plaintiff keep current with payments to the trustee?

**A Debtor Plaintiff Did Not Benefit and the Bankruptcy Was Dismissed Voluntarily**

In contrast to *Crawford*, 2011 WL 1118584, at *13–14 (S.D.N.Y. Feb. 16 2010), in *Greenfield v. Kluever and Platt, LLC*, the court permitted the debtor plaintiff to bring forth an unscheduled pre-petition claim against the defendants because the debtor plaintiff voluntarily dismissed a chapter 13 bankruptcy proceeding before pursuing the unscheduled claims. In recognizing that a court had the power to dismiss the claims, the court balanced equitable considerations including that the debtor plaintiff did not play "fast and loose" with the court but rather exercised her statutory right to dismiss the bankruptcy case voluntarily. Additionally, the *Greenfield* court found that unlike the debtor plaintiff in *Crawford*, the *Greenfield* debtor plaintiff did not benefit from withholding information from the bankruptcy court.

From these cases we know that if a debtor sues your client, the debtor has failed to schedule a claim against your client, and a judge subsequently dismisses the bankruptcy, you need to gather specific facts related to the bankruptcy and the reasons for the bankruptcy dismissal and to evaluate the various equitable considerations that a court likely will apply. Having information regarding the initial bankruptcy filings and the 341 creditors' meeting audio recordings or transcripts, as well as hearing transcripts or minute entries discussing the reason for the dismissal can help.

**A Debtor Plaintiff Disclosed but Undervalued a Claim**

If a debtor plaintiff schedules a claim against "ABC Company, Inc." for "$5,000," but the debtor plaintiff later sues ABC Company, Inc., for $50,000, is the debtor plaintiff limited to earning no more than $5,000? The answer to this question, unfortunately, is "it depends." Courts will evaluate a variety of equitable considerations in determining whether a debtor plaintiff has standing to pursue a claim if the debtor plaintiff properly scheduled a claim but valued the claim in the schedule at a substantially lower value than the debtor sought later. Ultimately, a court will mainly consider whether a debtor plaintiff intentionally misled the court by failing to amend the bankruptcy schedule so that it reflected a greater value.

**Practice Pointer 2—*Equitable Considerations to Determine Whether the Judicial Estoppel Doctrine Should Apply When a Debtor Plaintiff Disclosed But Undervalued a Claim***

- Did the debtor plaintiff intentionally mislead the bankruptcy court?
- What state or federal statutes apply and show that the debtor plaintiff intended to conceal the higher value of the claim?
- Consider filing a motion to limit damages or a motion in limine to exclude evidence of damages over the amount claimed in schedules.

In *Payne v. Wyeth Pharmaceuticals, Inc.*, the defendants filed a motion to limit damages to $1,000,000 since the debtor plaintiff sought damages exceeding $1,000,000, and the debtor plaintiff previously declared the value of his claim as $1,000,000. The court ultimately applied the judicial estoppel doctrine and held that the plaintiff could not recover any more than $1,000,000 because the plaintiff had motive to conceal the higher value of his claim. To determine whether the plaintiff had motive, the court considered the Virginia bankruptcy exception code and found that under §34-28.1 of the Virginia Code proceeds from personal injury actions are exempt from creditor process unless the lien holder is secured. Because the plaintiff in *Payne* identified multiple secured creditors holding approximately $762,000 in secured debt against the plaintiff, the court found that the plaintiff intentionally misrepresented his claim to the bankruptcy court. *Payne v. Wyeth Pharmaceuticals, Inc.*, 606 F. Supp. 2d 613, 616 (E.D. Va. 2008).

## Common Defenses to Judicial Estoppel

Once you have raised the doctrine of judi-

**Practice Pointer 3—*Overall Judicial Estoppel Doctrine Application Considerations***

- Complete a Pacer bankruptcy search to discover if a plaintiff previously filed for bankruptcy or always ask in initial discovery requests whether a plaintiff has filed for bankruptcy.
- Consider when you will raise the judicial estoppel doctrine.
- Research your local requirements, including your circuit, district, or judge to understand how to prove that judicial estoppel applies.
- Review bankruptcy schedules.
- Review the statement of financial affairs.
- Review available transcripts or audio recordings, including hearings and 341 creditors' meetings.
- Make sure to include a plaintiff's lack of standing as an affirmative defense.

cial estoppels properly, you need to understand the defenses that a debtor plaintiff likely will raise in response. This section discusses not only the common defenses to judicial estoppel but also suggests helpful responses.

### No Privity in the Bankruptcy Proceeding

A debtor plaintiff may argue that a defendant was not a creditor or a party to the bankruptcy proceeding; therefore, the defendant cannot rely on the doctrine of judicial estoppel because the defendant lacks privity. You can defeat this argument, easily, however, if you point out the purpose of the doctrine of judicial estoppel. The doctrine of judicial estoppel protects the integrity of the judicial system, not the litigants; therefore, numerous courts have concluded that while the party arguing for judicial estoppel often is in privity, judicial estoppel does not require that privity. *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 360 (3d Cir. 1996); *Patriot Cinemas, Inc. v. General Cinema Corp.*, 834 F.2d 208, 214 (1st Cir. 1987); *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 598 (6th Cir. 1982).

### No Prejudice

A debtor plaintiff also may argue that a debtor was not personally prejudiced by the omission of the claim. Once again, the doctrine of judicial estoppel is not designed to protect litigants but rather the integrity of the judicial system. Therefore, judicial estoppel does not require detrimental reliance. *Ryan*, 81 F.3d at 360 (explaining that judicial estoppel does not require detrimental reliance); *Matter of Cassidy*, 892 F.2d 637, 641 n.2 (7th Cir. 1990) (same).

### No Intent to Mislead the Bankruptcy Court

The most common defense against the doctrine of judicial estoppel is that a debtor plaintiff did not have the requisite intent to mislead the bankruptcy court so judicial estoppel should not apply. Judicial estoppel only applies in situations involving *intentional* contradictions not *simple errors* or *inadvertent errors*: "The doctrine of judicial estoppel does not apply when the prior position was taken because of a good faith mistake rather than as part of a scheme to mislead the court." *Matter of Cassidy*, 892 F.2d at 642. With that said, several circuits have concluded that a court can infer deliberate or intentional manipulation from the record. For example, the Fifth Circuit has held that a court can characterize a debtor plaintiff's failure to disclose as "inadvertent" only if the debtor plaintiff "lacks knowledge of the undisclosed claims or has no motive for their concealment." *In re Costal Plains, Inc.*, 179 F.3d 197, 210 (5th Cir. 1999).

### Right to a Cure

A debtor plaintiff may ultimately argue that the debtor plaintiff should have the right to reopen a bankruptcy case to amend the bankruptcy schedules to reflect a claim or the "true" value of a claim. Courts have often disagreed with this argument and held that allowing this would suggest to other debtors that they only need to disclose properly if someone catches them concealing the causes of action. This remedy would only "diminish the necessary incentive to provide the bankruptcy court with a truthful disclosure of the debtor's assets." *Billups v. Pemco Aeroplex, Inc.*, 1282 F.3d 1282, 1288 (11th Cir. 2002). *See also Traylor v. Gene Evans Ford, LLC*, 185 F. Supp. 2d 1338, 1340 (N.D. Ga. 2002) (denying a debtor's request to back up and disclose a previously undisclosed claim to the bankruptcy court); *Scoggins v. Arrow Trucking Co.*, 92 F. Supp. 2d 1372, 1376 (S.D. Ga. 2000) (same); *Chandler v. Samford University*, 35 F. Supp. 2d 861, 863–865 (N.D. Ala. 1999) (applying the doctrine of judicial estoppel to bar a plaintiff from asserting a previously undisclosed tort claim even though she eventually informed her attorney and the bankruptcy court of the claim).

**Ultimately,** a court will mainly consider whether a debtor plaintiff intentionally misled the court by failing to amend the bankruptcy schedule so that it reflected a greater value.

### Motion Practice and Timing

When dealing with a plaintiff, you habitually need to run either a Pacer bankruptcy search or ask in initial discovery requests whether the plaintiff filed bankruptcy. If you find that a plaintiff did file for bankruptcy and did not schedule a claim properly, you should consider filing a motion to dismiss the proceeding for lack of standing. Or, conversely, if the debtor plaintiff did schedule the claim, consider filing a motion to limit damages or a motion in limine to exclude any evidence concerning damages above the scheduled amount. Remember to consider when you want to raise the judicial estoppel doctrine: you will want to wait for a debtor to receive a discharge first.

As this article reveals, judicial estoppel cases do differ, and you probably will run into a situation that varies from the ones mentioned here. Hiring a bankruptcy lawyer to flesh out potential case issues or to review the bankruptcy case to uncover helpful information may serve your client's interest best. A bankruptcy docket is always rich with evidence for a subsequent litigation. Do not overlook it as a resource, even if a debtor plaintiff properly disclosed a claim in a schedule. FD