The State of Judicial Estoppel in Bankruptcy

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Judicial estoppel is intended to protect the judicial process by preventing parties from taking conflicting positions in litigation. It is an equitable doctrine, similar in some respects to other estoppel doctrines, such as equitable estoppel and the preclusion doctrines of collateral estoppel/issue preclusion and *res judicata*/claim preclusion.

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The U.S. Supreme Court, in *New Hampshire v. Maine,*[1] highlighted the factors giving rise to a claim of judicial estoppel: (1) in litigation, a party's later position must be "clearly inconsistent" with its earlier position; (2) the party must have succeeded in persuading a court to accept that party's earlier position, so that judicial acceptance of the inconsistent position in a later proceeding would create a perception that one court was misled; and (3) the party seeking to assert the inconsistent position would derive an unfair advantage on the opposing party.[2]

How Does Judicial Estoppel Arise in a Bankruptcy Case?

Judicial estoppel often arises when a debtor in bankruptcy fails to disclose a claim or cause of action in its bankruptcy schedules, and then later pursues the cause of action in separate litigation. With the filing of the schedules, the debtor asserts a position with respect to its assets and liabilities, which is relied on by creditors, the bankruptcy trustee and the bankruptcy court.

Several circuit court decisions echo the essential elements for judicial estoppel.[3] A "party is judicially estopped only if its position is clearly inconsistent with the previous one."[4] Failure to list an asset is the same as stating that the asset does not exist and may be deemed an admission.[5] Later asserting to a court that the cause of action exists is inconsistent with the prior statement.

About the Author

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It is essential that "the court must have accepted the previous position."[6] The court in *Superior Crewboats* stated that "adoption does not require a formal judgment; rather, it only requires 'that the first court has adopted the position urged by the party, either as a preliminary matter or as part of a final disposition.'"[7] Detrimental reliance is not an element in most cases. "[B]ecause judicial estoppel is designed to protect the judicial system, not the litigants, detrimental reliance by the party opponent is not required."[8]

Also necessary for the application of judicial estoppel is a finding that "the nondisclosure must not have been inadvertent."[9] If there is no motive for a nondisclosure, it is likely inadvertent.[10]

Trustee Talk

The typical motive is for the debtor to pay the creditors less than 100 percent in the bankruptcy case, and later receive the full recovery of the claim in litigation without any encumbrance by the creditors. However, if the reorganization plan that is approved calls for creditors to be paid in full, there is no motive for nondisclosure. A second means by which nondisclosure could be inadvertent is when the debtor is truly not aware of the cause of action: The cause of action may not have accrued.

In *Eastman v. Union Pacific Railroad Company,*[11] a railroad worker held a claim against multiple defendants with respect to an injury from an accident while an employee of the railroad company. After filing a chapter 7 case, in response to the trustee's examination at the meeting of creditors, the debtor and his attorney alluded to the accident but failed to disclose the claim in the bankruptcy schedules and failed to inform the trustee of the subsequent lawsuit. Upon discovery of the action, the trustee moved to reopen the bankruptcy case and also be substituted as the real party-in-interest in the personal-injury action. The trustee settled the claim with two of the defendants, which provided the bankruptcy estate with sufficient assets to pay all of the creditors' claims. The trustee then abandoned the estate's remaining interest in the lawsuit.

Facing a claim of judicial estoppel, the debtor asserted that his failure to disclose the personal-injury action was due to a "[m]istake, inadvertence, confusion, lack of understanding, lack of legal sophistication and the like."[12] He also blamed his bankruptcy attorney for failure to include the information in the bankruptcy papers. The court rejected the debtor's claim of inadvertent omission: "Where a debtor has both knowledge of the claims and a motive to conceal them, courts routinely, albeit at times *sub silentio,* infer deliberate manipulation."[13]

An appellate court found error in a bankruptcy court's refusal to consider evidence from the debtors concerning intent to deceive the court and the trustee by their failure to disclose a cause of action.[14] A successful claim of judicial estoppel should be supported by a finding that the party's prior position was not based on inadvertence or mistake. The court should evaluate all equitable considerations and all relevant factual circumstances of the situation.[15]

In the chapter 11 context, the bankruptcy court in *In re LJM2 Co-Investment LP* found that the defendant overstated the reach of the doctrine of judicial estoppel.[16] The debtor filed a fraudulent-transfer claim against multiple defendants, following approval of its chapter 11 disclosure statement and confirmation of the chapter 11 plan. The disclosure statement revealed potential litigation

1 532 U.S. 742, 121 S.Ct. 2808 (2001).
2 *Id.* at 750.
3 *Kane v. National Union Fire Ins. Co.,* 535 F.3d 380 (5th Cir. 2008); *Eastman v. Union Pacific Railroad Company,* 493 F.3d 1151 (10th Cir. 2007); *Burnes v. Pemco Aeroplex Inc.,* 291 F.3d 1282 (11th Cir. 2002).
4 *In re Superior Crewboats,* 374 F.3d at 335. *See also In re Walker,* 323 B.R. at 195.
5 *Id.*
6 *Id.*
7 *In re Superior Crewboats,* 374 F.3d at 335, quoting *In re Coastal Plains,* 179 F.3d at 206.
8 *Id.* at 334.
9 *In re Superior Crewboats,* 374 F.3d at 335. See also In re Walker, 323 B.R. at 195.
10 *Wolfork v. Tackett,* 526 S.E. 2d 436 (Ga. App. 1999).
11 493 F.3d 1151 (10th Cir. 2007).
12 *Id.* at 1157.
13 *Id.* at 1157, citing *Burnes v. Pemco Aeroplex Inc.,* 291 F.3d at 1287.
14 *In re Riazuddin,* 363 B.R. 177, 188 (Bankr. 10th Cir. 2007).
15 *See also Jethroe v. Omnova Solutions Inc.,* 412 F.3d 598 (2005) (court inferred that nondisclosure by debtor was intentional as debtor was actively involved in litigation of discrimination case before and during bankruptcy case, without disclosing its existence to bankruptcy court).
16 *In re LJM2 Co-Investment LP,* 327 B.R. 786 (Bankr. N.D. Tex. 2005).

and the investigation of potential claims against entities based on their relationship with the debtor prior to the bankruptcy filing. The plan expressly reserved all claims, rights and causes of action against one of the defendants, and included payments or transfers made to or for the benefit of third persons. The plan transferred those causes of action to a litigation trust for later adjudication, and provided that the confirmation of the plan would have no preclusive effect. The bankruptcy court, in its written decision, concluded that the claim against the defendant had been disclosed, even though this particular related defendant was not expressly named.

The court points out that at the time of the disclosure statement hearing, the debtor requested that the court make a finding concerning the adequacy of the information in the disclosure statement. Therefore, the debtor did not induce the court to accept a position inconsistent with the prosecution of the claims. Judicial estoppel did not bar later litigation of the fraudulent-transfer claims.

Can the Debtor Cure a Deficiency?

One important query is whether the debtor can cure a deficiency in the schedules to allow the cause of action to proceed. If the debtor has not yet been judicially estopped, it appears that the debtor can cure the omission by amending the schedules. Once an estoppel defense has been raised, courts have found that "allowing [the debtor] to back-up, reopen the bankruptcy case and amend his bankruptcy filings, only after his omission has been challenged by an adversary, suggests that a debtor should consider disclosing personal assets only if he is caught concealing them."[17]

The failure of debtor's counsel to advise the debtor about the disclosure obligation does not save the debtor from estoppel. "The Debtor's reliance on her attorney...relieves her neither of her affirmative duty to disclose nor of the diligence required to ensure the Court that her sworn statements remain true."[18] The debtor has a continuing duty to ensure the accuracy of the schedules. A client is bound by the acts of counsel, and the remedy for improper legal advice is a malpractice claim. It is the debtor who signs the bankruptcy schedules under oath and receives the benefit of a discharge. Courts are reluctant to "diminish the necessary incentive to provide the bankruptcy court with a truthful disclosure of the debtor's assets."[19]

Shall the Trustee Also Be Barred?

Earlier decisions in bankruptcy cases developed the theory that judicial estoppel would bar both the debtor and the trustee from pursuing a cause of action.[20] Courts had determined that accurate and complete disclosure in the schedules was more important that a potential recovery and distribution for the benefit of creditors. "It goes without saying that the Bankruptcy Code and Rules impose upon bankruptcy debtors an express, affirmative duty to disclose all assets, including contingent and unliquidated claims."[21] As the doctrine has continued to develop and as currently applied in most circuits, the trustee will not be barred by judicial estoppel for the failure of the debtor to disclose the potential claim.

Section 554(c) of the Bankruptcy Code provides that property that is scheduled, but not otherwise administered when a case is closed is abandoned to the debtor and, for purposes of §350, is administered. If the potential claim is not scheduled, it is neither administered nor abandoned at the closing of the case. It remains property of the bankruptcy estate, available for pursuit by the trustee.[22]

In *Kane v. Nat'l Union Fire Ins. Co.,*[23] the Kanes filed a prepetition personal-injury lawsuit against the defendants in a Louisiana state court. While that case was pending, the Kanes filed a chapter 7 bankruptcy case. They failed to disclose the personal-injury claim in the appropriate bankruptcy schedules, and the chapter 7 trustee remained unaware of the claim until after the Kanes had received a discharge. The defendants in the personal-injury suit moved for summary judgment on the grounds that the Kanes should be judicially stopped from pursuing their claim for failing to disclose it in their bankruptcy schedules. The Kanes then successfully moved to reopen their bankruptcy case. The defendants removed the case to federal court, where they argued that judicial estoppel should also bar the bankruptcy trustee who had asked to be substituted as the real party-in-interest. The district court granted the defendant's motion for summary judgment and dismissed the trustee's motion to substitute.

The Fifth Circuit reversed and remanded after finding that the district court had incorrectly applied its decision in *In re Superior Crewboats Inc.*[24] The court drew the distinction between claims that had been formally abandoned by the trustee under §554 and claims that were never abandoned and therefore remained property of the bankruptcy estate, subject to administration by the bankruptcy trustee. The Kanes' claim had never been abandoned, it remained property of the estate, and the trustee was the real party-in-interest. In this case, it was the estate and the estate's creditors that stood to benefit from the claim against the defendants. The court contrasted this situation with that in *Superior Crewboats,* where the trustee had abandoned the claim such that the debtors would receive a windfall at the expense of their creditors. Equity favored the trustee's position in *Kane*.

The better rule, consistent with procedural rules allowing liberal amendments to schedules, is to allow the debtor to amend schedules to disclose the cause of action. Recall also that in a chapter 13 case, §1306 brings a postpetition cause of action into the bankruptcy estate, and debtors are expected to update schedules as necessary. The best interests of creditors should be a primary concern, and the trustee should be substituted as the real party-in-interest to protect the assets of the estate. Many courts now recognize that the undisclosed cause of action, like every other omitted asset, continues its existence as property of the estate protected by the automatic stay even after the bankruptcy case is closed.[25] Property can only be abandoned and returned to the debtor if the trustee knows of its existence and knowingly relinquishes the property. A debtor in bankruptcy should not receive the benefit of a discharge, free and clear of obligations, unless the debtor has shown an entitlement to that fresh start by disclosing all assets and making those assets available for distribution toward the claims of creditors. ■

[17] *In re Superior Crewboats,* 374 F.3d at 336, quoting *Burnes v. Pemco Aeroplex Inc.,* 291 F.3d at 1288 (11th Cir. 2002).

[18] *Walker,* 323 B.R. at 196 (Bankr. S.D. Tex. 2005), citing *In re Sholdra,* 249 F.3d. 380, 383 (5th Cir. 2001).

[19] *Eastman v. Union Pacific Railroad Co.,* 493 F.3d 1151 (10th Cir. 2007), citing *Burnes v. Pemco Aeroplex Inc.,* 291 F.3d 1282 (11th Cir. 2002).

[20] *In re Superior Crewboats Inc.,* 374 F.3d 330 (5th Cir. 2004).

[21] *In re Coastal Plains Inc.,* 179 F.3d 197, 207-8 (5th Cir. 1999).

[22] *In re Riazuddin,* 363 B.R. 177 (Bankr. 10th Cir. 2007).

[23] 535 F.3d 380 (5th Cir. 2008).

[24] 374 F.3d 330 (5th Cir. 2004).

[25] *In re Barger,* 279 B.R. 900 (Bankr. N.D. Ga. 2002). *See* Klein, "Ponoroff and Borrey, Principles of Preclusion and Estoppel in Bankruptcy Cases," 79 *Am. Bankr. L.J.* 839 (2005).

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