Estop that Lawsuit: Judicial Estoppel and the Bankruptcy Debtor-Turned-Plaintiff

Did the plaintiff who sued your client recently declare bankruptcy? It's an important question. Judicial estoppel can derail a plaintiff who filed for bankruptcy but then brought a lawsuit he failed to reveal in the bankruptcy case.

By Christopher B. Lega

A client just received a summons and complaint and asks you to defend the suit. You review the complaint and create a checklist for defending the case. You consider whether you should file an answer, counterclaim, and motion, assert affirmative defenses, and initiate discovery. Recent cases (and the rise in bankruptcy filings) remind us that determining whether the plaintiff has recently filed bankruptcy must be on your checklist.

Bankruptcy? Yes, bankruptcy. If the plaintiff recently filed bankruptcy but did not disclose the lawsuit he or she filed against your client, you might well be able to raise a judicial estoppel defense. Judicial estoppel is an equitable doctrine meant to prevent a party from maintaining inconsistent positions in legal proceedings and a "'perversion of the judicial process.'"[1]

How does it work? Generally, bankruptcy law requires that a debtor who seeks its protection disclose all of his or her assets, including *known* causes of action, whether already filed and pending in a court, or only a potential cause of action. In other words, when the plaintiff filed bankruptcy, whom could he or she sue?

A debtor who fails to disclose a *known* cause of action in a bankruptcy case effectively represents that it does not exist.[2] When that debtor later asserts or continues to prosecute the unrevealed cause of action in another forum, he or she is saying just the opposite.

When this happens, a defendant can assert judicial estoppel as a defense based on the plaintiff's inconsistent legal positions: he told the bankruptcy court he did not have a right to sue anyone, but he now sues your client based on an action that existed at the time he filed bankruptcy. As one court held, "a debtor in bankruptcy who denies owning an asset, including a chose in action or other legal claim, cannot realize on that concealed asset after the bankruptcy ends."[3]

This article discusses the general concepts and requirements of this defense. It also reviews the relevant sections of the bankruptcy code, then discusses cases that apply these concepts.[4]

The Bankruptcy Code and "an existing cause of action"

Bankruptcy law demands complete disclosure from a debtor who seeks its protection.[5] For example, the Bankruptcy Code requires that a debtor file under oath and penalty of perjury a list of all assets and liabilities and a statement of financial affairs (the "schedules").[6] The Code also requires that the debtor attend a meeting of creditors, where he must testify under oath on the matters contained in his schedules.

Christopher B. Lega is an attorney with the Johnson Legal Group, LLC in Chicago and practices in the area of commercial litigation and bankruptcy.

In most Chapter 7 bankruptcy cases, a trustee is assigned to review the schedules and conduct the meeting of creditors.[7] Among other things, this examination reveals whether there are any assets of value to liquidate for the debtor's unsecured creditors. Under the Bankruptcy Code's broad scope,[8] assets mean not only real and personal property but also causes of action that were pending or that the debtor had a right to bring on the date of bankruptcy.[9]

The concept of "an existing cause of action" is very broad. As one court explained, "the debtor need not know all the facts or even the legal basis for the cause of action; rather, if the debtor has enough information...to suggest that it may have a possible cause of action, then that is a 'known' cause of action such that it must be disclosed."[10]

When a person files bankruptcy, at least in a Chapter 7 case, those actions belong to the bankruptcy estate, not the debtor. Only the Chapter 7 bankruptcy trustee has standing to prosecute them.[11] If a cause of action exists, the trustee decides whether there is enough value to the creditors to justify prosecuting it and, if there is, can choose to bring it. But the trustee cannot make that decision unless the debtor discloses it as an asset.[12]

How judicial estoppel works

The elements. The common law doctrine of judicial estoppel prevents a litigant from asserting a position in a legal proceeding inconsistent with one it successfully asserted in an earlier proceeding.[13] It punishes litigants who engage in such chameleon-like tactics and protects the integrity of the judicial process.[14]

Though the concept of judicial estoppel is uniform nationwide, the elements vary somewhat from jurisdiction to jurisdiction. Illinois cases state the elements as (1) two positions taken by the same party (2) in judicial proceedings (3) under oath, (4) with the party successfully maintaining the first position and receiving some benefit even though (5) the two positions are inconsistent.[15]

Applying judicial estoppel to the debtor-turned-plaintiff. How do the concepts work together? How does defense counsel satisfy the elements of this defense against a plaintiff who filed bankruptcy and did not reveal the cause of action?

When the debtor files his schedules he asserts a position in a judicial proceeding – the bankruptcy case – a position asserted under oath and penalty of perjury. The bankruptcy court accepts the debtor's statements in his schedules (that there is no cause of action) and the debtor successfully maintains that position when he receives his discharge from the bankruptcy court.[16] The defendant then asserts an inconsistent position in another proceeding when the debtor-plaintiff sues your client claiming the cause of action – hidden in the earlier bankruptcy case –now exists.

Representative cases

The following cases discuss the application of judicial estoppel to debtors-turned-plaintiffs.

Dailey v Bittner. In *Dailey v Bittner*,[17] the plaintiff sued his former business partners in state court alleging they breached a partnership agreement. Prior to filing suit, however, the plaintiff filed a personal bankruptcy case but omitted from his schedules the potential claim against his former partners – which he knew existed as of the date of his bankruptcy.

After a jury verdict for the plaintiff in the state court action, the defendants moved for judgment notwithstanding the verdict. They argued that judicial estoppel prevented the plaintiff from asserting the lawsuit and argued he lacked standing. The Illinois Appellate Court agreed, finding the plaintiff's position in the lawsuit against his partners inconsistent with his position in the bankruptcy case, where he represented no cause of action existed:

> Judicial estoppel prevents a party from asserting inconsistent positions before courts in separate proceedings in the hope of receiving favorable judgments in each proceeding. "At its heart, this doctrine prevents chameleonic litigants from 'shifting positions to suit the exigencies of the moment.'" Judicial estoppel is designed to protect the integrity of the courts; it does not focus on the fairness of the relationship between the litigants. Plaintiff's position in the present case – that he entered an oral "partnership" with defendants and is now entitled to his share of profits – is diametrically opposed to the position he maintained in the course of the bankruptcy proceedings.[18]

The court also addressed the issue of standing that defendants argued as a related defense based on the same facts and where the plaintiff was in Chapter 7:

> Plaintiff clearly did not have standing to bring the instant claim against defendants,

> in light of the prior bankruptcy proceedings. The filing of a bankruptcy petition is an assertion of the jurisdiction of the bankruptcy court over all the assets and property of the alleged bankrupt. Section 541 of the Bankruptcy Code broadly defines what property belongs to the bankruptcy estate as "all legal or equitable interests of the debtor in property as of the commencement of the case. The reach of this section is extensive; section 541 has been found to encompass "every conceivable interest of the debtor, future, non-possessory, contingent, speculative, and derivative. The preceding principles apply regardless of whether the bankruptcy petitioner has scheduled the property or assets. Once a debtor files for bankruptcy, any unliquidated lawsuits become part of the bankruptcy estate, and, even if such claims are scheduled, a debtor is divested of standing to pursue them upon filing his petition.[19]

Either way, the result in the same: the dishonest debtor cannot later profit from an undisclosed asset.

Eastman v Union Pacific Railroad Co. Unlike the plaintiff in *Dailey*, in *Eastman v Union Pacific Railroad Co*[20] the plaintiff filed a personal injury lawsuit against his employer and *while* that lawsuit was pending, filed a Chapter 7 bankruptcy case. Like the plaintiff in *Dailey*, he failed to list the lawsuit in his schedules but also failed to reveal it during his meeting of creditors. With no assets, the bankruptcy court closed the case and the plaintiff received a discharge of his debts.

When the defendant learned of the omission in the bankruptcy case, it moved for summary judgment based on judicial estoppel. The district court granted the motion and the tenth circuit affirmed, noting the plaintiff's lack of candidness in the bankruptcy court despite repeated opportunities:

> The bankruptcy petition, which Gardner signed under penalty of perjury, failed to disclose his pending lawsuit as a potential asset of the estate. By signing the petition, Gardner verified he had read the petition, schedules, and statement of financial affairs, and the information contained therein was true and correct. On schedule B relating to personal property, Gardner checked "none" as to item 20. Item 20 required Gardner to disclose "[o]ther contingent and unliquidated claims of every nature[.]" Item 4 on his statement of financial affairs required Gardner to "[l]ist all suits and administrative proceedings to which the debtor is or was a party" within the preceding year. Gardner listed two collection suits. Conspicuously absent from the list was Gardner's pending personal injury lawsuit against Defendants.
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> At the section 341 meeting of creditors in June 2004, Gardner unequivocally responded "no" when the trustee asked him if he had a personal injury suit pending. When given a second chance to set the record straight, Gardner failed to do so.[21]

In re Coastal Plains Inc. The fifth circuit's decision in *In re Coastal Plains Inc*[22] shows the breadth of this doctrine. Unlike *Dailey* and *Eastman*, judicial estoppel barred a lawsuit brought by a corporate plaintiff that "substituted in" as the plaintiff for the original debtor. The case also broadened the doctrine because the failure to list the claim as an asset originally occurred in a Chapter 11 reorganization case that later converted to Chapter 7 liquidation.[23]

Moreover, *Coastal Plains* also holds that the defendant's knowledge of the potential yet undisclosed claim *is irrelevant*. Thus, the plaintiff cannot argue that the defendant suffered no harm because it had not detrimentally relied on the omission in the bankruptcy schedules. The court held "detrimental reliance by the party seeking *judicial estoppel* is not required. Again, the purpose of *judicial estoppel* is not to protect the litigants, it is to protect the integrity of the judicial system."[24]

Options for the debtor-turned-plaintiff

Amending the bankruptcy schedules to list the cause of action. When confronted with this defense, some plaintiffs attempt to amend their schedules and add the lawsuit as an asset. Bankruptcy law allows a debtor to amend his or her schedules while the case is pending and even reopen the bankruptcy case after it has closed under limited circumstances.[25] But plaintiffs relying on this maneuver have had mixed results.[26]

In *Casey v Peco Foods, Inc*, the plaintiff filed a discrimination charge against her employer with the Equal Employment Opportunity Commission. With that charge pending, the soon-to-be-plaintiff filed bankruptcy but failed to list the pending employment charge or the lawsuit that would likely follow. The bankruptcy trustee relied upon her schedules and, finding no assets, the bankruptcy court entered an order discharging the plaintiff's debts.

The plaintiff then filed her discrimination suit in district court. The employer moved for summary judgment asserting judicial estoppel because the plain-

tiff omitted the lawsuit as an asset in her bankruptcy case. The district court granted the motion.

In an effort to save her claim, the plaintiff moved to reopen her bankruptcy case and list the lawsuit. The court rejected this request and held that reopening a bankruptcy case to allow a debtor to amend schedules after she is caught would "frustrate the disclosure requirement of the Bankruptcy Code."[27] And as another court stated, allowing a debtor to "back up" and "benefit from the reopening of his bankruptcy only after his omission had been exposed would 'suggest that a debtor should consider disclosing potential assets only if he is caught concealing them.'"[28]

Blaming the bankruptcy attorney. Unfortunately for them, plaintiffs who fail to list a claim cannot blame their bankruptcy counsel.[29] In *Cannon-Stokes v Potter*, the plaintiff filed an administrative complaint against her employer, the postal service, alleging discrimination and retaliation. While pursuing her internal administrative remedies, she filed a Chapter 7 bankruptcy case but failed to list the claim on her schedules. After the bankruptcy case she received a discharge, then sued the postal service.

The postal service moved for summary judgment and asserted judicial estoppel based upon the omission in her bankruptcy case. In response, the plaintiff claimed her bankruptcy counsel told her not to list the claim on her schedules.

The court held that even if true, bankruptcy counsel's bad advice could not save her, stating that "a lawyer is the client's agent, and the client is bound by the consequences of advice that the client chooses to follow."[30] Similarly, pro se debtors cannot plead ignorance of their statutory duty to disclose a claim in bankruptcy and later assert it in another forum.[31]

Other issues

Judicial estoppel and Chapter 13 debtors. There are fewer reported cases where the plaintiff was a Chapter 13 debtor. This might be because a Chapter 13 debtor, unlike a Chapter 7 debtor, holds property – including lawsuits – while in bankruptcy. The debtor thus has standing to pursue a lawsuit in his or her own name, but for the benefit of the creditors.[32]

Nonetheless, a few interesting issues arise with Chapter 13 debtors. For instance, *Williams v Hainje*,[33] holds that judicial estoppel applies to a debtor-plaintiff formerly in Chapter 13, including a debtor-plaintiff who never received a Chapter 13 discharge.

In *Hainje*, the plaintiff sued a police officer and sought damages from injuries sustained from a police dog. With the lawsuit pending, the plaintiff filed a Chapter 13 but omitted the lawsuit from her schedules.

The bankruptcy court confirmed the plaintiff's Chapter 13 plan that reduced the plaintiff's debt. With the Chapter 13 case pending, the police officer moved for summary judgment based on the omission. The plaintiff then amended his schedules and added the lawsuit. He argued that because the Chapter 13 case was open when he disclosed the lawsuit, judicial estoppel does not apply. He then failed to complete his Chapter 13 plan, which the bankruptcy court dismissed.

The district court granted the officer's motion for summary judgment, and the seventh circuit affirmed. The court held that even though the plaintiff did not complete his Chapter 13 plan and receive a discharge, he still received significant benefits while in bankruptcy by, among other things, preventing creditors from taking any action against him for 20 months.[34] The court then cited cases from other circuits also holding that the size of the plaintiff's benefit from bankruptcy is not relevant and that a debtor who receives "even preliminary benefits" from the bankruptcy court is subject to this defense.[35]

What if the omission is inadvertent? The plaintiff who shows that the omission in his bankruptcy was inadvertent might be able to save the case from dismissal. Courts consider an omission inadvertent if at the time of bankruptcy the debtor lacked knowledge of the undisclosed claim or had no reason to conceal it.[36] In some cases it requires an inquiry into the plaintiff's knowledge of a potential claim, while in other cases it is obvious.

For example, the plaintiff might show that he or she has retained counsel or otherwise begun some type of process that indicates knowledge of a potential right to sue. Second, the plaintiff can argue that the asset is exempt under bankruptcy law anyway (meaning he or she can keep it) and thus there was no reason to conceal it.[37] Other courts hold that a debtor must disclose exempt assets

even though they are exempt.[38]

The bankruptcy trustee – stepping into the plaintiff's shoes. The defendant who might have an estoppel defense should wait before celebrating. Although many cases do not discuss it, the bankruptcy trustee – the real party with standing to bring the plaintiff's lawsuit in a Chapter 7 – may seek to step into the plaintiff's shoes and begin or continue to prosecute the matter for the bankruptcy estate.[39]

While the decision to do so depends on many factors, including whether pursuit of the action will benefit the bankruptcy estate, the trustee may end up as the plaintiff in your case. But even then, you might be able to assert judicial estoppel on a limited basis.

For instance, in *Wiggins v Citizens Gas & Coke Utility*,[40] the trustee sought to "cure" the debtor's judicial estoppel problem by reopening the bankruptcy case, listing the lawsuit and appearing as plaintiff.

The court rejected the trustee's argument that he should not be judicially estopped because it was the debtor who failed to declare the claims in the bankruptcy proceeding. The court held that trustee stands in the debtor's place and is subject to this defense, but also recognized the creditors' interest and allowed the trustee to proceed with the case and recover just enough to pay creditor's claims and related trustee fees.

Regardless, many defendants prefer to litigate or negotiate with a bankruptcy trustee than the actual plaintiff. The trustee does not have an emotional attachment to the case and generally seeks a more modest recovery that will pay statutory fees, attorney's fees, and some amount to creditors.

Conclusion

While judicial estoppel will not apply in all cases, defense counsel should keep it on their litigation checklist. Plaintiff's counsel should see it as a potential issue and investigate early on before investing significant time in preparing a case.

Indeed, the facts giving rise to its use show no signs of abating. One court recently remarked that "[t]he ever present motive to conceal legal claims and reap the financial rewards undoubtedly is why so many of the cases applying judicial estoppel involve debtors-turned-plaintiffs who have failed to disclose such claims in bankruptcy."[41] ■

A debtor who fails to disclose a cause of action in a bankruptcy case effectively represents that it does not exist. When that debtor later sues, he or she is saying just the opposite.

The defendant with an estoppel defense should wait before celebrating. The bankruptcy trustee may seek to step into the plaintiff's shoes.

1. *Smith v American General Life Ins Co*, 544 F Supp 2d 732, 734 (CD Ill 2008), quoting *Matter of Cassidy*, 892 F2d 637, 641 (7th Cir1990).
2. *Acuna v Connecticut General Life Ins Co*, 560 F Supp 2d 548, 553-54 (ED Tex 2008).
3. *Cannon-Stokes v Potter*, 453 F3d 446, 448 (7th Cir 2006).
4. Most cases discussed arise in the context of a debtor-plaintiff who was in chapter 7, but may also apply to debtors emerging from chapter 13 and 11.
5. *Ajaka v Brooksamerica Mortgage Corp*, 453 F3d 1339, 1344 (11th Cir 2006) (the debtor's duty to disclose does not end once he files the initial documents).
6. 11 USC §521.
7. 11 USC §343; 11 USC §341.
8. 11 USC §541.
9. *Dailey v Smith*, 292 Ill App 3d 22, 25, 684 NE2d 991, 993 (1st D 1997); *Hernandez v Forest Preserve Dist of Cook County, Illinois*, 2010 WL 1292499 (ND Ill) (unlike a chapter 7 debtor, a chapter 13 debtor keeps his property and can assert a cause of action in his own name on behalf of his creditors).
10. *In re Envirodyne Indus, Inc*, 183 BR 812, 821 FN17 (Bankr ND Ill 1995).
11. *Acuna*, 560 F Supp 2d at 553-54.
12. *In re Miller*, 347 BR 48, 53 (Bankr SD Tex 2006) ("it is clear that an asset that is not listed in a debtor's schedules or otherwise disclosed and administered remains property of the estate").
13. *Dailey* at 27, 684 NE2d at 995.
14. Id.
15. Id.
16. *Acuna*, 560 F Supp 2d at 553-54 (courts consider an omission on the Schedules a representation that no claim or asset exists); *In re Enyedi*, 371 BR 327, 336 (Bankr ND Ill 2007).
17. *Dailey*, 292 Ill App 3d 22, 684 NE2d 991 (1st D 1997).
18. Id at 27-28, 684 NE2d at 995 (internal citations omitted). Unlike chapter 7, when the debtor-plaintiff was formerly in chapter 13 or 11, the chose in action does in fact vest with the debtor, not a trustee, thus, the standing issue does not arise. *Cable*, 200 F3d at 473; *Hernandez*, 2010 WL 1292499.
19. Dailey at 25, 684 NE2d at 993 (internal citations omitted).
20. *Eastman*, 493 F3d at 1159.
21. Id at 1153.
22. *Coastal*, 179 F3d 197, 208 (5th Cir 1999).
23. Id.
24. Id at 210 (emphasis in original).
25. 11 USC §350
26. *Casey v Peco Foods, Inc*, 297 BR 73 (SD Miss 2003).
27. Id at 78. See also *Acuna*, 560 F Supp 2d 548 (ED Tex 2008); but see *In re Hamlett*, 304 BR 737 (Bankr MD NC 2003) (allowing a case to be reopened and trustee appointed to review cause of action); *Dumore v United States*, 358 F3d 1107, 1113 FN3 (9th Cir 2004) (remarking that while reopening a bankruptcy case was cumbersome it might be a permissible alternative to judicial estoppel).
28. *Eastman*, 493 F3d at 1160, quoting *Burnes v Pemco Aeroplex, Inc*, 291 F3d 1282, 1288 (11th Cir 2002).
29. *Cannon-Stokes*, 453 F3d 446.
30. Id at 449.
31. *Casey*, 297 BR at 77.
32. *Cable*, 200 F3d at 472; *Hernandez*, 2010 WL 1292499 *3.
33. *Williams*, 375 Fed Appx 625 (7th Cir 2010).
34. Id at 627.
35. Id.
36. *Estel v Bigelow Mgmt, Inc*, 323 BR 918 (ED Tex 2005); see also *Elliot v ITT Corp*, 150 BR 36, 40 (Bankr ND Ill 1992); *Casey*, 297 BR at 77 (inadvertence may preclude judicial estoppel); *Eubanks v CBSK Financial Group, Inc*, 385 F3d 894 (6th Cir 2004) (judicial estoppel not applied where omission held inadvertent).
37. But see *Calafiore v Werner Enterprises, Inc*, 418 F Supp 2d 795 (D Md 2006) (holding that a debtor-plaintiff may not be subject to judicial estoppel to the extent any realized damages would be exempt, thus the defense can be bifurcated between exempt and non-exempt).
38. *Acuna*, 560 F Supp 2d at 556.
39. *Canterbury v Federal-Mogul Ignition Co*, 483 F Supp 2d 820 (SD Iowa 2007).
40. *Wiggins*, 2008 WL 4530679 (SD Ill)
41. *Eastman*, 493 F3d at 1159.