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Consumer Corner

By Elizabeth E. Stephens

The Slip-and-Fall Slip-Up

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It happens, perhaps all too often: The debtor files for bankruptcy relief, passes uneventfully through the process and receives a discharge. Months or years later, debtor's counsel receives a frantic telephone call from the debtor or the debtor's nonbankruptcy counsel seeking assistance because the debtor, now a plaintiff in a civil action, is facing dismissal of the action, or summary judgment, on the basis of judicial estoppel. The defendant has asserted that the plaintiff's claim was undisclosed property of the debtor's bankruptcy estate. While this scenario could happen in the context of any type of claim, it seems to crop up most often in personal-injury cases. This article discusses the consequences of the failure to disclose an asset claim, and suggests curative measures.

All assets of the debtor, including personal-injury claims, become property of the estate on the date of filing the bankruptcy petition.[1] In addition, in a chapter 13 case, property of the estate includes any property acquired by the debtor after commencement of the case, but before the case is closed, dismissed or converted.[2] The debtor has the duty to disclose all assets and to schedule them.[3] The duty to disclose is a continuing duty.[4] The debtor must amend schedules and disclose claims when the debtor becomes aware of them. When a bankruptcy case is closed, only property that was scheduled and not administered is deemed abandoned.[5] Therefore, property that was not properly scheduled remains property of the estate.

The consequences of failing to disclose a claim depend on which chapter the debtor filed, when the claim accrued and whether the bankruptcy case was still open when the asset was discovered. Of course, the intentional omission of an asset of the estate is subject to a criminal penalty.[6] The fraudulent omission may also be grounds for denial or revocation of discharge in a chapter 7 case.[7] Much more common than intentional and fraudulent conduct, however, is the seemingly "inadvertent" failure to disclose.

Judicial Estoppel

A personal-injury plaintiff can be judicially estopped from pursuing an undisclosed claim in a state or federal court. Judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position and then later taking an inconsistent position.[8] It has been applied to cases of nondisclosure of assets in bankruptcy schedules.[9]

Courts have described discretionary factors to consider in applying judicial estoppel. First, a party's later position must be clearly inconsistent with its initial position. Second, the court may consider whether the party persuaded a court to accept the party's earlier position, so that there is a perception that the court was misled. A third consideration is whether the party seeking to assert the inconsistent position gained an unfair advantage. Judicial estoppel can apply to a party asserting two inconsistent positions in the same litigation or asserting inconsistent positions in different cases.[10] Key to the application of judicial estoppel in bankruptcy cases is whether the prior, inconsistent position was based on an "inadvertence or mistake."[11]

The law in the Fifth Circuit may be the best developed and the most stringent in regard to the application of judicial estoppel in the bankruptcy context. A debtor's failure to disclose a claim is inadvertent only when the debtor either (1) lacks knowledge of the undisclosed claim,

1 11 U.S.C. § 541(a); *U.S. v. Whiting Pools Inc.*, 462 U.S. 198, 205, n.9 (1983).
2 11 U.S.C. § 1306(a); *Dale v. Maney (In re Dale)*, 505 B.R. 8, 13 (9th Cir. 2014).
3 11 U.S.C. § 521(a)(1); Fed. R. Bankr. P. 1007(b)(1) and 1009(a).
4 Fed. R. Bankr. P. 1009(a); *Hamilton v. State Farm Fire & Casualty Co.*, 270 F.3d 778, 784 (9th Cir. 2001).
5 11 U.S.C. § 554(c).
6 18 U.S.C. § 152.
7 11 U.S.C. § 727(a) and (d).
8 *New Hampshire v. Maine*, 532 U.S. 742, 750 (2001).
9 *See generally Hamilton*, 270 F.3d. at 783, *et. seq.*
10 *Id.* at 783.
11 *New Hampshire*, 532 U.S. at 753.

or (2) has no motive to conceal a claim.[12] Under this view, a debtor nearly always has a motive to conceal a claim because after the debts are discharged, the claim becomes a windfall.[13] The Tenth and Eleventh Circuits are in accord with the Fifth Circuit as to the test for inadvertence.[14] When a debtor has knowledge of the claim and a motive to conceal, courts in those circuits routinely infer deliberate manipulation.[15]

In contrast, the Ninth Circuit has determined that the mere failure to disclose an asset was too strict a standard. Reopening a case and scheduling an asset may mitigate against a finding of judicial estoppel.[16] The Eighth Circuit is in accord,[17] while the Fourth Circuit deems the determinative factor in the application of judicial estoppel as whether the court was intentionally misled to gain an unfair advantage.[18]

Similar actions by a debtor might be treated differently depending on which circuit law is applied. Two things are apparent, however: (1) defendants will raise the issue of judicial estoppel and possibly prevent the debtor from pursuing a claim; and (2) the defendants will cite case law from the Fifth, Tenth and Eleventh Circuits (the plaintiffs will cite case law from the Eighth and Ninth Circuits). Judicial estoppel may be invoked to prevent a plaintiff from pursuing a claim in its entirety, or it may be used to cap damages.[19]

Many debtors attempt to defend against judicial estoppel claims by asserting that their attorneys failed to give them proper legal advice, or mistakenly failed to schedule an asset disclosed to them. But it is well established that the client is responsible for attorney lapses in a case. The client voluntarily chose his counsel and cannot avoid the consequences of the conduct of counsel.[20] That does not mean, however, that there are no consequences to the attorney.

As the Seventh Circuit noted: "[A] client is bound by the acts of her attorney and the remedy for bad legal advice rests in malpractice litigation."[21] Bad legal advice may not be a defense to the failure to disclose, but it could result in malpractice claims and state bar complaints against bankruptcy counsel.[22] Further, if an attorney knows there is no "colorable basis" to exclude a claim from the bankruptcy schedules, the attorney could be subject to Rule 9011 sanctions.

Fixing the Problem

As a threshold matter, it cannot be over-emphasized that just because a debtor has a good *argument* that an asset is not property of the estate does not mean that the asset should be omitted from the schedules. A debtor is not free to unilaterally decide whether to omit an asset. Even worthless assets must be disclosed.[23]

Bankruptcy counsel should list property on the Schedule B and then explain why it is excluded or exempted from property of the estate, thereby placing the onus on third parties to pursue recovery of the asset. Further, scheduling avoids the issue that property not scheduled under § 521(a)(1) is not abandoned under § 554(d) and remains property of the estate after the closing of the case.[24]

When there has been an inadvertent nondisclosure in an open chapter 7 case, the trustee should be contacted immediately and the schedules should be amended to reflect the personal-injury case and the claim of exemptions. The trustee may continue to litigate the case on behalf of the estate, or abandon it. Courts have found that swift corrective action may cure even a previous concealment of the asset.[25] Similarly, courts view a debtor's cooperation with the trustee as a favorable factor.[26]

In an open chapter 13 case, there are some added wrinkles. First, the chapter 13 debtor is considered analogous to a chapter 11 debtor in possession and has standing to bring an action on behalf of the estate in the debtor's own name.[27] Second, although § 1306(a) broadens the definition of "property of the estate" to include post-petition property, there is no concomitant requirement that the post-petition property be listed in the schedules.[28]

Finally, under § 1327, upon confirmation of a plan, all property of the estate vests in the debtor, except as otherwise provided in the plan.[29] The interplay between §§ 1306(a)(1) and 1327(b) has given rise to much discussion and at least four schools of thought on vesting rules. It appears that at least in the Ninth Circuit, an argument can be made that a post-confirmation claim never becomes property of the estate, thus it is unnecessary to schedule it.[30] Let's face it: If the debtor is reduced to arguing vesting rules, the debtor is not in a strong position.

If the bankruptcy case is closed, then the debtor must bring a motion to reopen the case under § 350(b).[31] The debtor must now convince two courts that the failure to disclose was inadvertent/in good faith. The decision to reopen a case is within the bankruptcy court's sound discretion.[32] Generally, bankruptcy courts will liberally grant motions to reopen a case to schedule assets. At least one court ordered a case to be reopened to prevent the unfair imposition of judicial estoppel.[33]

It should be noted that reopening the case might not automatically allow the debtor to claim property as exempt.[34] When the debtor is allowed to amend exemptions, the debt-

12 *Superior Crewboats Inc. v. Primary PPI Underwriters*, 374 F.3d 330, 335.
13 *Id.* at 336.
14 *Gillman v. Ford (In re Ford)*, 492 F.3d 1148, 56 (10th Cir. 2007); *accord*, *Barger v. City of Cartersville, Ga.*, 348 F.3d 1289, 1296 (11th Cir. 2003).
15 *Barger*, 348 F.3d at 1296.
16 *Ah Quin v. Cnty. of Kauai, Dept. of Trans.*, 733 F.3d 267, 279 (9th Cir. 2013).
17 *Stallings v. Hussman Corp.*, 447 F.3d 1041, 1049 (8th Cir. 2006) (rule that establishes requisite intent for judicial estoppel from mere nondisclosures unduly expands its reach).
18 *John S. Clark Co. v. Faggert & Frieden PC*, 65 F.3d 26, 29 (4th Cir. 1995).
19 *Thomas v. Indiana Oxygen Co. Inc.*, 32 F. Supp. 3d 983, 988-93 (S.D. Ind. 2014) (court declined to cap damages).
20 *Link v. Wabash R.R. Co.*, 370 U.S. 626, 633-34 (1962).
21 *Cannon-Stokes v. Potter*, 453 F.3d 446, 449 (7th Cir. 2006).
22 *In re Narcisse*, 2013 WL 1316706 at *8 (Bankr. E.D.N.Y. 2013) (attorney accused of failing to provide good legal advice regarding accident surrendered his license).
23 *See In re Opra*, 365 B.R. 728, 740 (Bankr. S.D. 2007) (attorney had mistaken belief that claim did not exist until it was formally asserted), and *In re Amaya*, 2014 WL 7004848 at *4 (Bankr. E.D.N.Y. 2014) (debtor wrongly relied on advice of personal-injury attorney that he had no case).
24 *In re Hamlett*, 304 B.R. 737, 741 (Bankr. M.D.N.C. 2003) (undisclosed personal-injury claims remained property of estate after case was closed).
25 *Thomas*, 32 Supp. at 990-91, and Amaya, 2014 WL 7004848 at *5 (objecting parties not prejudiced because no significant discovery before debtor sought to reopen case).
26 *Meyers*, 431 B.R. at 824-25.
27 Fed. R. Bankr. P. 6009; *Wilson v. Dollar Gen. Corp.*, 717 F.3d 337, 343-44, (4th Cir. 2013), and *Smith v. Rockett*, 522 F.3d 1080, 1081-82 (10th Cir. 2008) (all four circuit courts that have considered the issue have concluded that chapter 13 debtors have standing to bring claims in their own name).
28 *Colliers on Bankruptcy*, § 1306.1 (16th ed.) (requiring amendment would be unworkable because every paycheck would have to be scheduled).
29 11 U.S.C. § 1327(b) and (c).
30 *See generally In re James*, 420 B.R. 506 (9th Cir. 2009), and *In re Farmer*, 324 B.R. 918, 922-23 (Bankr. M.D. Ga. 2005) (personal-injury claim was not property of estate because it arose almost five years after filing and was not necessary to fulfill plan; debtors did not take inconsistent positions).
31 11 U.S.C. § 1327(b) and (c).
32 *Elias v. U.S. Trustee (In re Elias)*, 188 F.3d 1160 (9th Cir. 1999).
33 *In re Rita James*, 487 B.R. 587 (Bankr. N.D. Ga. 2013) (debtor failed to schedule counterclaim, which she later pursued).
34 *See In re Wilmoth*, 412 B.R. 791, 796-97 (Bankr. E.D. Va. 2009) (debtor's ability to amend schedules as a matter of right under Rule 1009 expired when case closed; Rule 9006(b)(1) governs motions to permit act after expiration of specified time period).

or should be sure to claim all that are applicable. Under the federal exemption scheme, the debtor should claim the personal-injury exemption, the future wages exemption and the wildcard.[35]

There is really no substitute for experience in preventing an inadvertent failure to disclose. The intake questionnaire should include a couple of questions like, "Does anyone owe you or your family money?" or "Have you been injured in a slip-and-fall?" But essentially, a bankruptcy attorney needs to speak to a potential client in person, listen carefully to what is said and communicate clearly the duties of a debtor. abi

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35 11 U.S.C. §§ 522(d)(5) and 11 (D)-(E).