Preventing a Windfall: Getting a Dismissal When Plaintiff Fails to Disclose the Claims in Bankruptcy

Toxic Tort and Environmental Law Update

April 2012 by Karen Maston, Stephanie Perkins

The bankruptcy code provides protection and relief to individuals facing insurmountable debt, but it carries certain obligations and limitations, notably requiring them to list all of their assets, including any claims or potential claims on the schedule of personal assets. As bankruptcy courts and creditors rely on the debtor's sworn representations to order a discharge of debt, a plaintiff who failed to disclose those claims in a prior or pending bankruptcy action has no standing to later pursue the non-disclosed claims and receive a windfall recovery free and clear of obligations to creditors. The failure to disclose claims also amounts to a fraud on the bankruptcy court and thus may be subject to dismissal under principles of judicial estoppel to prevent debtors from hiding assets in order to be discharged from debt. Defendants should discover early in the case any bankruptcy filings of the plaintiff, and file an appropriate motion on the basis of both theories together.

No Standing to Bring Non-Disclosed Claims

The defense that a plaintiff lacks standing to bring claims that were not disclosed in his bankruptcy property schedules is a straightforward jurisdictional issue of law that can be brought by any party at any time. Once a debtor files for bankruptcy protection, all of his assets become part of the bankruptcy estate. He receives ownership and control of those assets again only after disposition and discharge, or when the trustee releases or abandons assets. If the cause of action existed at the time of the filing of the bankruptcy petition, it is the property of the bankruptcy estate, regardless of whether it was disclosed on the schedules. *Pruitt v. Hancock Med. Ctr.*, 942 So.2d 797, 801 (Miss. 2006). The duty to disclose potential claims is wide and continuing, and covers all potential claims, even if the debtor does not know all of the facts or the legal basis for the cause of action. *Youngblood Group v. Lufkin Fed. Sav. & Loan Ass'n*, 932 F.Supp. 859, 867 (E.D. Tex. 1996). If the claim was not disclosed on the schedules, it cannot be released back to the debtor on discharge, but

remains the property of the bankruptcy estate with the trustee having exclusive standing to assert the claim. *Parker v. Wendy's Int'l, Inc.*, 365 F3d 1268, 1272 (11th Cir. 2004); *Kirk v. Pope*, 973 So.2d 981, 989 (Miss. 2007); *In re Educators Group Health Trust*, 25 F.3d 1281, 1288 (5th Cir. 1994), cert. denied 489 U.S. 1079 (1989); *Bauer v. Commerce Union Bank*, 859 F.2d 438, 441 (6th Cir. 1988); *Stein v. United Artists Corp.*, 691 F2d 885, 891 (9th Cir. 1982).

The trustee's exclusive standing to assert the claim is jurisdictional and cannot be waived or subject to agreement by parties. Indeed, in *Weiberg v. GTE Southwest, Inc.*, the Fifth Circuit Court of Appeals refused to validate a settlement agreement between the bankruptcy trustee and the debtor. 272 F.3d 302 (5th Cir. 2001). Similarly, the Seventh Circuit Court of Appeals was also not persuaded by a "stipulation" entered into between the debtor and the trustee to permit the debtor to pursue the claims subject to turning over the first $7,000 of any recovery for creditors' benefit – the court called the debtor an "interloper" with no standing and affirmed dismissal of the case. *Biesek v. Soo Line R.R. Co*., 440 F.3d 410 (7th Cir. 2006).

Judicial Estoppel to Prevent Gamesmanship

So, what is to prevent the plaintiff from simply reopening the bankruptcy case and joining the trustee as the appropriate plaintiff? Judicial estoppel. Designed to protect the integrity of the courts, the doctrine of judicial estoppel applies where a debtor intentionally contradicts himself in order to obtain an unfair advantage in a forum provided for suitors seeking justice. *Brandon v. Interfirst Corp.*, 858 F.2d 266, 268 (5th Cir. 1988). Courts consider three factors when applying this doctrine:

1. whether the position of the party is plainly inconsistent with its prior legal position;
2. whether a court accepted the previous position; and
3. whether the party did not act inadvertently.

The first two factors are fairly noncontentious in this bankruptcy disclosure context. The third factor, whether the party did not act inadvertently, is not as subjective as it sounds and is almost as straightforward in this bankruptcy context as the other two elements. Non-disclosure is only

inadvertent when the debtor lacks knowledge of the claim or has no motive for concealment, and the motivation element can be inferred from the fact that a complete discharge in bankruptcy would not be available if the bankruptcy court or creditors knew of a potential lawsuit claiming millions of dollars in damages. *Burns v. Pemco Aeroplex*, 291 F.3d 1282 (11th Cir. 2002). Bad faith is not an element – even where the failure to disclose was genuinely unintentional, judicial estoppel may apply if the debtor had knowledge of the facts of her undisclosed claim at the time of the bankruptcy petition. *Mack v. Lester Coggins Trucking, Inc*., 2008 WL 190740 (S.D. Miss. 2008). Whether the debtor had knowledge of the claim will be fact dependent in each case, but may be established by such facts as when the plaintiff sought medical treatment or legal advice, or filed an EEOC complaint, or attempted to resolve his disputes. Again, the disclosure duty is extremely broad because of the purposes, functions and benefits of bankruptcy discharge.

Facts, Facts, Facts

There are very few defenses open to the plaintiff who is caught trying to pursue an undisclosed claim. The most common defense attempted by plaintiffs is the one alluded to by the Fifth Circuit in *Weiberg* – seeking a stay to reopen the bankruptcy estate, amend the disclosures, and substitute the trustee as real party in interest. Some courts have seemed amenable to this procedure, but there are strong policy arguments against it. The Fifth Circuit itself later addressed this policy consideration and rejected this defense strongly in *Superior Crewboats* when it stated that to allow the plaintiff to go forward allows these debtors to "have their cake and eat it too, as they retain the enormous benefit of a bankruptcy discharge while standing in line to receive funds from the injury lawsuit after creditors are paid. Judicial estoppel is designed to prevent such guile." As the 11th Circuit Court of Appeals stated, "allowing a 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 potential assets only if he is caught concealing them." *Burns v. Pemco Aeroplex*, 291 F.3d 1282 (11th Cir. 2002).

However, despite the strength of precedent in favor of judicial estoppel and the policy considerations in support, it is an equitable remedy subject to review only under the abuse of discretion standard and is therefore not guaranteed. It may not apply against the bankruptcy trustee, and thus the

questions of whether and when the debtor seeks to reopen the bankruptcy action and join the trustee are key. As with so many things, timing is paramount.

Even when the court is inclined to allow the trustee to substitute or pursue undisclosed claims, judicial estoppel may still be invoked against the debtor to limit the defendant's liability. The Mississippi Supreme Court in one case found that where the bankruptcy trustee subsequently ratified the action, the case would not be dismissed. *Kirk v. Pope*, 973 So.2d 981 (Miss. 2007). However, it affirmed the trial court's finding that the debtor only notified the trustee because the defendant forced his hand, and he intended to conceal his claim to reap a windfall. Therefore, the court limited the potential recovery to the amount necessary to satisfy creditors and prevented the debtor from recovering any proceeds of the judgment.

Conclusion

When individuals seek bankruptcy protection from their creditors, they cannot withhold information about potential causes of action to later pursue for their own benefit once their debts have been discharged. If a plaintiff has filed for bankruptcy protection but failed to disclose potential claims – those claims are no longer his to assert. Once caught, he should not be entitled to avoid responsibility by amending and bringing in the trustee as the proper party. The court should not validate a plaintiff playing fast and loose with the bankruptcy system for the potential windfall of a tort recovery without the necessity of paying rightful creditors. A defendant who discovers that a plaintiff is attempting to assert claims he did not properly disclose in a prior or pending bankruptcy should move for dismissal based on the legal ground that only the trustee has standing to assert those claims, and the equitable ground that judicial estoppel prevents such guile.

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