Can I Have a Do-Over?: Judicial Estoppel at the Crossroads of Bankruptcy and Personal Injury

This article examines two recent decisions from the Ninth Circuit Court of Appeals and their impact on the doctrine of judicial estoppel in the bankruptcy context. It follows up on an article from an earlier issue of In Brief (Feb. 2008). In that article, plaintiff’s counsel was anxiously waiting to find out if his largest case was about to take a nosedive due to the doctrine of judicial estoppel. Bankruptcy counsel tried to save the day by amending the bankruptcy schedules to disclose the personal injury claim that was not included initially. Defense counsel was trying to figure out his next move when faced with the schedule amendment and the claim that he had violated the automatic stay.

Fast forward to the present, bankruptcy counsel was feeling confident that her client was in the clear. The discharge order had been entered, and the case trustee had been alerted to the interest in the personal injury claim in the event of a recovery.

Just then, plaintiff’s counsel called in a panic. He had just received correspondence from defense counsel that provided a string of authority indicating that the schedule amendment was not enough to resolve the judicial estoppel issues. Plaintiff’s counsel was stunned; it was just a mistake by his client that led to the claim being left off the initial bankruptcy schedules. Once again, his case seemed to be hanging by a thread.

Defense counsel felt relieved after sending his letter to plaintiff’s counsel. His client could still prevail at summary judgment. He opened an email from the case trustee in the bankruptcy case, indicating that she had received his letter and was prepared to take action in the bankruptcy court to ensure that the claim was preserved for the benefit of creditors. She felt that the creditors had an interest to protect despite the debtor’s mistake in scheduling.

Simply stated, judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position, and then later seeking an advantage by taking a clearly inconsistent position. Hamilton v. State Farm Fire & Cas. Co., 270 F.3d 778, 782 (9th Cir. 2001), citing Rissetto v. Plumbers & Steamfitters Local 343, 94 F.3d 597, 600 (9th Cir. 1996). The doctrine is most frequently applied, in the bankruptcy context, when a debtor fails to schedule a claim against a third party, obtains a discharge, and then later pursues the claim.

In our example, the debtor apparently made a “mistake” in failing to list the claim in the bankruptcy schedules. There is also the rather innocent bystander in the case trustee, who is waiting in the wings to see if there is a potential recovery for the benefit of the creditors. Judicial estoppel is a powerful remedy for defense counsel to cut off liability for his or her client in this context and leave the debtor and her creditors with no means of recovery. In the case of an honest mistake in disclosure by the debtor, this can be
a harsh result, particularly for creditors that had no role to play in the disclosure but stand to lose out on what could be the last means of payment for their claims.

This set of circumstances was directly addressed by the Ninth Circuit in two recent decisions. The first, *Ah Quin v. County of Kauai DOT*, involved a bankruptcy debtor who filed an employment discrimination lawsuit approximately six months before filing a Chapter 7 case. 733 F.3d 267 (9th Cir. 2013). The bankruptcy schedules filed by the debtor included no reference to the employment discrimination claim, and the debtor answered in the negative to questions about such claims at the meeting of creditors. The debtor ultimately received a discharge, and the bankruptcy court closed the case.

The debtor’s lawyer in the employment discrimination case at some point became aware of the bankruptcy filing and alerted defendant’s counsel at a settlement conference. Defendant’s counsel urged dismissal of the employment discrimination case based on judicial estoppel. In response, the debtor’s counsel worked quickly to have the bankruptcy case reopened and the discharge order set aside. Included in that effort were declarations from the debtor and bankruptcy counsel indicating that the failure to disclose the employment discrimination claim was a result of a misunderstanding by the debtor of her responsibilities and that the claim was never disclosed to bankruptcy counsel. The bankruptcy case was reopened, and the debtor filed amended schedules to list the claim.

The district court granted summary judgment for the defendant based on judicial estoppel. The Ninth Circuit Court of Appeals, for the first time, reviewed whether application of judicial estoppel is not warranted where the party’s initial position was the product of “inadvertence or mistake.” The Court found that inadvertence or mistake could provide a basis to withhold application of the doctrine and remanded the case to the district court. Key components of the Court’s findings were (1) the debtor reopened the case and amended her schedules to allow the bankruptcy court to process the claim; and (2) application of judicial estoppel based on a mistake would punish the debtor’s creditors, who had no part in the initial failure of disclosure, and benefit the “alleged bad actor,” the defendant.

Less than a year after the *Ah Quin* decision, the Ninth Circuit again took up the application of judicial estoppel in the bankruptcy context. In *Dzakula v. McHugh*, the Court encountered a very similar fact pattern. 746 F.3d 399 (9th Cir. 2014). The debtor had a pending employment discrimination claim at the time she filed Chapter 7 bankruptcy. The bankruptcy schedules did not list the discrimination claim. After the defendant in the discrimination case moved to dismiss based on judicial estoppel, the debtor amended her bankruptcy schedules to list the claim. After the schedule amendment, the bankruptcy court entered a discharge order and closed the case. Despite the amendment to the bankruptcy schedules, the district court dismissed the discrimination case on the defendant’s motion based upon judicial estoppel.

This time, the Ninth Circuit reached a different result. Distinguishing the cases, the court highlighted that Ms. Dzakula did not present any evidence to the district court to suggest that the initial, false disclosure was the product of inadvertence or mistake. Instead, she relied on the schedule amendment by itself and that the *Ah Quin* holding would require an evidentiary hearing on the question of inadvertence or mistake. The Court held this was insufficient to permit any fact finder to conclude that the omission of the discrimination claim was because of inadvertence or a mistake. Key to this holding was the lack of “any explanation whatsoever as to why the pending action was not included on her schedules in the first place.”

The *Ah Quin* and *Dzakula* decisions require attention to the details of the initial bankruptcy disclosure and a careful assessment of whether it was the product of mistake or inadvertence. Keep the following practice tips in mind when confronted with this scenario.

**For bankruptcy counsel:**

- Although *Dzakula* makes it clear that it is not sufficient to avoid application of judicial estoppel on its own, the bankruptcy schedules should be promptly amended to reflect the debtor’s claim(s) against third parties.
- Work with your client and personal injury counsel to determine the reasons for the initial disclosure in the bankruptcy schedules. If it is truly the product of inadvertence or mistake, then the client should execute a declaration supporting the explanation for the omission in the original schedules.
- Inform the bankruptcy trustee in writing of the claim and have him or her retain the bankruptcy estate’s interest in the claim and/or the proceeds of the claim. The Court in *Ah Quin* emphasized the possible harm to creditors as a reason for declining to apply judicial estoppel. Assisting the trustee would likely work to the debtor’s benefit and potentially avoid the elimination of any recovery on the client’s claim.
- Preserve the status quo in the bankruptcy case. Keeping the bankruptcy case open without entry of a discharge may prevent the application of judicial estoppel and give the bankruptcy court an opportunity to process the newly disclosed claim. If the discharge has been entered, counsel will...
need to evaluate if setting the discharge aside is necessary and/or prudent under the circumstances.

**For personal injury counsel:**

- Make a record to explain the omission of the claim from the bankruptcy schedules. The main distinction between *Ah Quin* and *Dzakula* was the record before the court. The plaintiff-debtor must make the proper showing to have the trial court consider whether the omission was due to inadvertence or mistake.

- Determine whether the current plaintiff is still the real party-in-interest for the claim. Once the bankruptcy trustee is notified of the claim, he or she may want to substitute in as the plaintiff in the litigation. Plaintiff’s counsel may be asked to represent the trustee, which may present ethical considerations as well. Defendant’s counsel wants to be sure that he or she is working with the person with the proper authority to bring and control the claim.

- Obtain any necessary relief from the Bankruptcy Court to allow the litigation to continue. Failure to do so could render any post-bankruptcy events void and could lead to sanctions for any damages.

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