Benchnotes

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Judicial Estoppel Bars Prosecution of Unscheduled Causes of Actions

Sometimes Timing of Disclosure Does Not Matter

Two courts recently reached opposite conclusions as to whether judicial estoppel should apply to preclude a plaintiff debtor from persecuting an employment-discrimination claim that was not timely disclosed by the debtor his bankruptcy case. In *Pruitt v. Quality Labor Services LLC and Highland Baking Co. Inc.*,[1] the U.S. District Court for the Northern District of Illinois considered a motion for summary judgment by defendants in an Equal Employment Opportunity Commission (EEOC) complaint brought by a debtor prior to his chapter 7 bankruptcy.

The debtor, Derell Pruitt, had seven EEOC complaints on file at the time of his chapter 7 filing, none of which were disclosed on his bankruptcy schedules. Following his bankruptcy, one particular EEOC complaint resulted in the present suit. Upon discovery of Pruitt's bankruptcy, the defendants in the suit moved for summary judgment on the grounds of judicial estoppel.

In the Seventh Circuit, judicial estoppel applies to prevent "litigants from manipulating the court system by adopting inconsistent positions in different cases or phases of the same case."[2] In order to win on the grounds of judicial estoppel, the movant must prove, by a preponderance of the evidence, that that the plaintiff/debtor intentionally concealed the undisclosed claim.[3]

In *Pruitt*, the court took evidence in the form of testimony by Pruitt himself, his bankruptcy counsel and the chapter 7 trustee. Pruitt and his counsel testified that the existence of the EEOC complaints was never discussed, and Pruitt further testified that he had no appreciation that the EEOC claims were assets of the estate that needed to be disclosed. The defendants argued, among other things, that Pruitt's failure to disclose the existence of the claims only after the defendants had moved for summary judgment evidences his intent to conceal.

The court was not persuaded that the timing was indicative of Pruitt's intent, finding that "[t]his argument does not hold water. Of course, Pruitt was motivated to reopen his bankruptcy proceeding at least in part because it would raise his chances of litigating the merits of his claim in this case."[4] Ultimately, the court determined that the testimony offered was credible and that the movants failed to meet their burden in establishing that Pruitt intentionally concealed his EEOC complaints.

1 --- B.R. ---, 2018 WL 5808461 (N.D. Ill. 2018).
2 *Id.* at *1 (citing *Spaine v. Cmty. Contacts Inc.*, 756 F.3d 542, 548 (7th Cir. 2014)).
3 *Id.*
4 *Id.* at 5.

Sometimes Timing of Disclosure Matters

By contrast, a decision by the Sixth Circuit reached the opposite conclusion on very similar facts. In *Newman v. University of Dayton*,[5] the Sixth Circuit recently affirmed the dismissal of employment-discrimination claims by debtor/plaintiff Peter Newman against the University of Dayton after Newman failed to disclose his claims during the pendency of his chapter 13 case.

The Sixth Circuit's test for judicial estoppel differs slightly from that of the Seventh Circuit. The Sixth Circuit does not expressly require a finding of intentional concealment, but instead requires that the omission "did not result from mistake or inadvertence."[6] The Sixth Circuit adopted a test to determine a mistake or inadvertence by asking "whether (1) Newman lacked knowledge of the basis of the undisclosed claims; (2) he had a motive for concealment; and (3) the evidence indicates an absence of bad faith."[7]

The Sixth Circuit noted that not only did Newman fail to disclose his employment claim against the university, he had also failed to disclose his ongoing employment relationship (and income from) the university during his chapter 13 case. Newman argued that the omission was unintentional and not in bad faith because Newman had been providing his chapter 13 trustee with copies of his annual tax returns (disclosing income from the university) during the ongoing chapter 13 case. Ultimately, and in contrast to the *Pruitt* court's view on the same issue, the Sixth Circuit found it highly persuasive that Newman only disclosed his claim in bankruptcy after he became aware of the defendant's motion for summary judgment.[8] "To allow a party to avoid judicial estoppel by rectifying omissions after a motion to dismiss has been filed would encourage gamesmanship and defeat the purpose of the doctrine."[9]

Miscellaneous

• *In re Aurora Memory Care LLC*, 589 B.R. 631 (Bankr. N.D. Ill. 2018) (bankruptcy court held that debtor's failure to file monthly operating reports — the "lifeblood" of chapter 11 cases — coupled with debtor's failure to present feasible chapter 11 plan proposal warranted conversion under 11 U.S.C. § 1112(b); court considered whether debtor could refinance its existing bank debt through new loan; court pointed out that loan term sheet was not firm loan commitment, and that term sheet itself had expired; court also found that even if loan proposal

5 --- Fed. App'x ---, 2018 WL 5292209 (6th Cir. 2018).
6 *Id.* at *4.
7 *Id.*
8 *Id.* at 5.
9 *Id.* (quoting *White v. Wyndham Vacation Ownership Inc.*, 617 F.3d 472, 480 (6th Cir. 2010)).

was committed, debtor's business model generated insufficient revenue to service debt on new loan, rendering plan infeasible; thus, court concluded that successful chapter 11 plan was not likely; while secured lender moved for dismissal, court exercised its discretion to convert case to chapter 7, noting that chapter 7 trustee could determine whether debtor's health care facility could be marketed and sold for price sufficient to distribute proceeds to unsecured creditors; if trustee determined that such process would be futile, trustee could issue no-asset report and close case);

• *In re Metz*, 589 B.R. 750 (Bankr. D. Kan. 2018) (court allowed "undue hardship" discharge for interest portion of student loan, which had ballooned to point where debtor could not afford to make dent in her loan principal; debtor had paid more than $14,000 toward her student loans (including through completed chapter 13 plans); loans were originally $16,000, but had grown to $67,000 through capitalized interest; court explained that income-based payment plans offered by ECMC were insufficient to afford debtor realistic opportunity to repay her loans; she could either pay $560 per month (which she could not afford) and repay the loan by time she turned 84, or pay minimum of $203 per month, but end up accruing $300 more in interest as she continues to make payments; under *Brunner* test, court found that debtor could not maintain minimum standard of living if required to make payments on interest portion of loans; debtor also demonstrated that her financial condition was likely to persist and that she made good-faith effort to make payments on her debt; Court discharged all of her unpaid interest, and excepted from discharge only original $16,000 principal, instructing debtor to make arrangements to repay original principal over a five- to 10-year period);

• *In re Belew*, 588 B.R. 875 (B.A.P. 8th Cir. 2018) (noting that "not all *dicta* are created equal," BAP considered *dicta* from *Law v. Siegel*, 571 U.S. 415, 428, 134 S. Ct. 1188 (2014), wherein Justice Antonin Scalia noted that there is no basis under federal law to deny debtor's exemption for misconduct; before that decision and its *dicta*, many circuits recognized as basis to deny exemptions the debtor's fraud, concealment or similar misconduct (*see, e.g., Kaelin v. Bassett (In re Kaelin)*, 308 F.3d 885, 889 (8th Cir. 2002); *Lucius v. McLemore (In re Lucius)*, 741 F.2d 125, 127 (6th Cir. 1984); *Martinson v. Michael (In re Michael)*, 163 F.3d 526, 529 (9th Cir. 1998)); however, since *Law*, both Sixth and Ninth Circuits have interpreted Scalia's *dicta* as direct abrogation of these exceptions (*see Ellmann v. Baker (In re Baker)*, 791 F.3d 677, 683 (6th Cir. 2015); *Lua v. Miller (In re Lua)*, 692 Fed. App'x 851, 852 (9th Cir. 2017)); accordingly, in this decision, Eighth Circuit BAP followed Sixth and Ninth Circuits, concluding that bankruptcy courts lack authority to deny debtor's exemptions on grounds of bad faith, misconduct or any other grounds not specified in Bankruptcy Code) (*but see Law*, 571 U.S. at 428 ("It is of course true that when a debtor claims a state-created exemption, the exemption's scope is determined by state law, *which may provide that certain types of debtor misconduct warrant denial of the exemption*.") (emphasis added));

• *In re AFY*, --- F.3d ---, 2018 U.S. App. LEXIS 25472, 2018 WL 4224060 (8th Cir. Sept. 6, 2018) (in family dispute over ownership of debtor, court of appeals affirmed bankruptcy court's dismissal of plaintiffs' claims against their family members over stock purchase agreement; court concluded that claims asserted by plaintiff really belonged to company, and, as such, "shareholder standing" doctrine barred claims (*see Franchise Tax Bd. of Cal. v. Alcan Aluminium Ltd.*, 493 U.S. 331, 336, 110 S. Ct. 661, 107 L. Ed. 2d 696 (1990)) because doctrine requires shareholders to assert their own direct claims, not claims that belong to company);

• *Matter of Provider Meds, LLC*, --- F.3d. ----, 2018 WL 5317445 (5th Cir. 2018) (on issue of first impression for Fifth Circuit, court of appeals affirmed lower court determinations that purchaser of assets from chapter 7 trustee through § 363 sale did not acquire the rights under license agreement because court determined that license agreement was executory contract that was deemed rejected 60 days after debtor's case was converted to chapter 7 pursuant to § 365(d)(1), despite fact that debtor had not scheduled the agreement as an executory contract; purchaser had urged court of appeals to imply an exception to § 365(d)(1) for unscheduled contracts, but court followed Ninth Circuit's reasoning in *Cheadle v. Appelatchee Riders Assn'n (In re Lovitt)*, 757 F.2d 1035 (9th Cir. 1985), that "trustee has an affirmative duty to investigate for unscheduled executory contracts" and that statutory presumption of rejection is a conclusive presumption, regardless of whether or not an executory contract is scheduled (*Id.* at 8 (quoting *In re Lovitt* at 1040-42)));

• *In re Sandia Tobacco Manufacturers Inc.*, --- B.R. ---, 2018 WL 4964295 (Bankr. D.N.M. 2018) (bankruptcy court held that assessments arising under Fair and Equitable Tobacco Reform Act of 2004 were in nature of excise taxes and therefore are entitled to priority under 11 U.S.C. § 507(a)(8)(E));

• *In re Jackson Masonry LLC*, 906 F.3d 494 (6th Cir. 2018) (Sixth Circuit Court of Appeals held that order denying stay relief is final order subject to immediate appeal; court rejected appeal of purchaser to pre-petition agreement with debtor who first sought relief from stay to prosecute its breach-of-contract claims outside of bankruptcy court but was denied relief; purchaser later prosecuted its claim in adversary proceeding before bankruptcy court and lost, at which time purchaser appealed both denial of its motion for stay relief and bankruptcy court's determination of its claim on merits; Sixth Circuit rejected appeal as to stay relief as untimely, holding that order denying motion for stay relief is final and appealable within 14 days after its entry because stay-relief motion initiates proceeding within context of bankruptcy case and that proceeding is concluded by entry of order either granting or denying relief requested; Sixth Circuit further upheld bankruptcy court's decision in adversary proceeding as not having been in clear error);

• *In re Swintek*, 906 F.3d 1100 (9th Cir. 2018) (Ninth Circuit Court of Appeals held that period in which lien might expire and must be renewed is tolled by filing of a chapter 7; in *Swintek*, pre-petition judgment creditor had obtained order for appearance and examination from California court, which

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automatically created lien on debtor's assets under California law; such liens expire in one year unless renewed; judgment debtor filed for bankruptcy prior to expiration of lien, and judgment creditor subsequently sought determination from bankruptcy court that its lien had priority over chapter 7 trustee; trustee argued that lien had expired and had not been renewed after bankruptcy was filed and therefore was no longer valid lien; plaintiff/creditor responded that lien expiration was tolled by 11 U.S.C. § 108(a), which tolls commencing or continuing civil action against debtor that had not expired as of debtor's petition date; court of appeals, in relying primarily on its prior holding in *Spiritos v. Moreno (In re Spiritos)*, 221 F.3d (9th Cir. 2000), in which court had previously held that 11 U.S.C. § 108(a) tolls period for renewing judgment, held that extension of lien is also continuation of civil action that is contemplated by § 108 and is therefore also tolled);

• *In re Oliva*, --- B.R. ---, 2018 WL 5279493 (Bankr. N.D. Ill. 2018) (bankruptcy court held that chapter 7 trustee has standing to request and obtain extension of time to file objections to discharge of debts under 11 U.S.C. § 523 despite chapter 7 trustee not having standing to actually file such an objection; bankruptcy court further held that service of motion to extend time for objecting to discharge of claim is proper if served upon counsel for debtor, and because motion is not contested proceeding, that trustee is not required to obtain personal service on debtor himself); and

• *In re Old Carco LLC*, --- B.R. ---, 2018 WL 5761772 (Bankr. S.D.N.Y. 2018) (bankruptcy court held that "free and clear" purchase of assets of debtor Chrysler Corp. (Old Chrysler) barred plaintiff from suing and recovering from purchaser (New Chrysler) any damages applicable under state court law that would act to punish and deter rather than compensate for damages actually incurred; however, despite its purchase of assets "free and clear," New Chrysler might still be liable for its post-sale failures to warn or recall defective vehicle manufactured by Old Chrysler prior to sale). abi