Do Not Bite the Poisonous Apple: A Bankruptcy Petition's Effect on a Civil Lawsuit

by Bridget A. Clark

Even when the apple looks delicious and unspoiled, you may want to use caution before taking a bite. When accepting the responsibility to represent a new plaintiff, cautiously screen the client so you do not end up biting into a rotten apple. A potential plaintiff's bankruptcy history must be carefully screened at the initial consultation. A defense attorney may attempt to curtail your client's civil action if the plaintiff has filed for bankruptcy, but failed to disclose her tort claim in the bankruptcy case. Before an injured tort victim has filed suit on an injury claim, the insurance adjuster may go so far as to check the bankruptcy court website to verify whether the claimant has a pending bankruptcy petition, and if so, use the claimant's failure to disclose the tort claim as a basis to deny that claim.

A person filing for bankruptcy is required to disclose any pending lawsuit, any recently settled matter (whether an unfiled claim or a lawsuit), and any possibility of a claim. The scope of this necessary disclosure also encompasses any possible future claims. A common application of this law is that when a person is injured in an automobile collision and also files for bankruptcy, they must disclose this information to the bankruptcy court *even if* no claim has been made and no lawyer has been retained. "Federal statute places an affirmative duty on the plaintiff to disclose claims in bankruptcy."[1] "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.'"[2] "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."[3] Under federal law, "[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.[4]

It is of the utmost importance that your new or potential client with a pending or potential civil action disclose this information to the bankruptcy court. Why is this so important? First, the client has sought for bankruptcy protection, and in their petition, sworn under oath and identified their financial resources. The petitioner then meets with the bankruptcy trustee, and under oath, again discloses all financial resources. At this point, the bankruptcy petitioner has now sworn twice under oath to their financial status. When making a determination regarding the bankruptcy petition, the bankruptcy court must consider all possible sources of revenue to satisfy the petitioner's debts. If the petitioner does not disclose the information, and then later attempts to collect on a civil action, there will be a conflict that could trigger judicial estoppel.

The [*Bidani*] court explained that judicial estoppel is

> "a rule which estops a party from playing 'fast and loose' with the court. It means that a party is not permitted to maintain inconsistent positions in separate judicial proceedings. The doctrine of judicial estoppel rests upon public policy which upholds the sanctity of the oath and its purpose is to bar as evidence statements and declarations which would be contrary to sworn testimony the party has given in the same or previous judicial proceedings."[5]

"Judicial estoppel provides that a party who assumes a particular position in a legal proceeding is estopped from assuming a contrary position in a subsequent legal proceeding."[6] "It is designed to promote the truth and to protect the integrity of the court system by preventing litigants from deliberately shifting positions to suit the exigencies of the moment."[7] "Having affirmed under oath that certain facts exist, a party cannot be allowed to later affirm that the contrary is true."[8]

> Although judicial estoppel is flexible and not reducible to a formula, the following five elements are generally necessary: (1) the two positions must be taken by the same party; (2) the positions must be taken in judicial proceedings; (3) the positions must be given under oath; (4) the party must have successfully maintained the first position and received some benefit; and (5) the two positions must be totally inconsistent.[9]

In *Bidani*, plaintiff filed a breach of contract and constructive trust against an alleged former business partner and medical services company claiming ownership and profit interests in three companies.[10] The *Bidani*

plaintiff had previously testified in his dissolution of marriage action that he held no present or future interest in the same three companies for which he later brought the contract action.[11] The *Bidani* court upheld the trial court's decision to apply judicial estoppel and enter summary judgment in favor of defendants due to plaintiff taking inconsistent positions in his dissolution of marriage petition and the breach of contract action.[12]

In *Superior Crewboats v. Primary P & I Underwriters, et al.*, the court judicially estopped the personal injury lawsuit from moving ahead. In *Superior*, plaintiff was injured while exiting defendant's ship.[13] About one year after the injury, the *Superior* plaintiff and his wife filed a Chapter 13 bankruptcy petition.[14]

> As a condition of bankruptcy, the Hudspeaths [plaintiff and his wife] were required to report, under penalty of perjury, the existence of any pending litigation or potential lawsuits. This information is specifically required on the debtors' schedules and statement of affairs. The filings' general purpose is to permit the court, the trustee, and the creditors to evaluate the debtors' financial condition at the date of bankruptcy and ascertain what assets may be available for distribution to creditors. The debtors are also obliged to update their schedules as necessary to assure full disclosure."[15]

The *Superior* plaintiff and his wife converted the bankruptcy from a Chapter 13 to a Chapter 7, and then they disclosed the lawsuit at the §341 creditors' meeting, but the plaintiff inaccurately informed the creditors that the civil action was barred by the statute of limitations.[16] The bankruptcy court discharged the plaintiff and his wife's debts.[17] Three months later, defendant *Superior* informed the bankruptcy trustee that plaintiff was continuing to pursue the personal injury claim.[18] The bankruptcy trustee moved to re-open the bankruptcy.[19] *Superior* plaintiff and his wife filed amended schedules in the bankruptcy case disclosing the personal injury claim.[20]

In the civil action, the *Superior* defendant filed a motion to dismiss the claim and argued that the personal injury claim was barred by judicial estoppel and Federal Rule of Civil Procedure 17(a) requiring a lawsuit to be brought by the real party in interest.[21] In response to that motion, the bankruptcy trustee moved to substitute for plaintiff in the civil action.[22] The *Superior* court found that, "judicial estoppel bars the plaintiff from pursuing the personal injury claim as judicial estoppel "is designed to protect the judicial system, not the litigants, detrimental reliance by the party opponent is not required.[23] The *Superior* court found that, "the Hudspeaths' positions in the bankruptcy court and personal injury litigation were clearly inconsistent...the Bankruptcy Code and Rules impose upon bankruptcy debtors

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an express, affirmative duty to disclose all assets, *including contingent and unliquidated claims."*[24] The *Superior* court held that the case must be remanded with instructions to dismiss the Hudspeaths' claim.[25]

If a bankruptcy petitioner does not know about a possible claim when the bankruptcy petition is filed, they still have a duty to amend and disclose the bankruptcy petition. In practical terms, this means if a bankruptcy petitioner files for bankruptcy and then later is in a car crash and is injured, the bankruptcy petitioner must amend the petition and disclose this new possible claim. In *Berge*, plaintiff filed for bankruptcy under Chapter 13 in April 2006; she was allegedly injured in a car wreck one month later.[26] In May 2009 she converted her Chapter 13 bankruptcy into a Chapter 7 bankruptcy. In October 2009, plaintiff Berge received a "no assets" discharge of her debts in bankruptcy court, and her petition was closed as fully resolved.[27] "It is undisputed that plaintiff never disclosed her state court claim against the defendants to the bankruptcy court while her chapter 13 and 7 petitions were pending, although plaintiff had numerous opportunities to do so."[28] After the defendant in *Berge* filed a motion for summary judgment based on plaintiff's non-disclosure of the civil lawsuit in the bankruptcy petition, plaintiff returned to bankruptcy court to re-open her discharged case, and disclose the civil lawsuit.[29] The *Berge* court found that, "... allowing a belated amendment to plaintiff's list of assets to remedy the present situation plaintiff finds herself in does a disservice to the doctrine of judicial estoppel.[30] "Condoning a litigant's action in reopening a discharged bankruptcy case to amend his or her asset disclosure after being faced with a judicial estoppel motion in his or her pending lawsuit would only serve to promote less-than-truthful asset disclosures with a hope of not getting caught."[31] The *Berge* court affirmed the circuit court's decision to grant defendant's summary judgment.[32]

Once the plaintiff files for bankruptcy, she loses control over the personal injury action. When a bankruptcy petition is filed, the claim must be pursued by the bankruptcy trustee, not the injured party. After a bankruptcy is filed, all claims belong to the bankruptcy estate, and the bankruptcy trustee alone has standing to pursue them.[33] Accordingly, if a civil action is filed by a lawyer, and then the plaintiff files a bankruptcy petition, the bankruptcy trustee must then appoint that same lawyer before that lawyer may continue pursuing the claim. Even though the injured person hired you, the bankruptcy trustee must still appoint you in order for you to continue to work on the civil case.

Pointing fingers at the bankruptcy attorney is not a valid defense for not disclosing the claim in the bankruptcy petition. The bankruptcy petitioner cannot avoid judicial estoppel in the civil action by blaming the bankruptcy attorney for the inconsistent

positions taken in the bankruptcy case and the tort lawsuit. The plaintiff in *Cannon-Stokes*, "filed a Chapter 7 bankruptcy petition asserting that she had no assets; her petition expressly denied that she had any valuable legal claims ("contingent and unliquidated claims of every nature", the schedule calls them, leaving no room for quibbles)."[34] Relying on the plaintiff's assertion that there were no valuable legal claims, the bankruptcy court in *Cannon-Stokes,* discharged approximately $98,000 of plaintiff's unsecured debts."[35] After the *Cannon-Stokes* bankruptcy was over, plaintiff pursued an administrative claim seeking $300,000 from her employer, the U.S. Postal Service.[36] The Postal Service contended that judicial estoppel foreclosed the administrative claim.[37]

The *Cannon-Stokes* plaintiff attempted to blame her bankruptcy attorney for the false statement in the bankruptcy proceeding that she had no claim against the postal service.[38] The court rejected this argument, finding that a debtor in bankruptcy is bound by her own representations, even if she follows the advice of a bankruptcy lawyer.[39] The court found that if the plaintiff was "really making an honest attempt to pay her debts, then as soon as she realized that it *had* been omitted, she would have filed amended schedules and moved to reopen the bankruptcy, so that the creditors could benefit from any recovery... [she] never did that; she wants every penny of the judgment for herself."[40] The trial court's finding of judicial estoppel in *Cannon-Stokes* was affirmed.[41]

In *Berge*, the plaintiff argued that the bankruptcy attorney was to blame for not disclosing her civil lawsuit in the bankruptcy, because the attorney failed to include the lawsuit on her list of assets filed under oath in bankruptcy court.[42] The *Berge* court noted that plaintiff testified before the bankruptcy trustee that the disclosures were complete and correct.[43] "Plaintiff is bound by these statements, regardless of any advice or actions by her bankruptcy attorney and without regard to whether she relied on her attorney in good faith."[44]

As an injury attorney, you cannot rely on the bankruptcy attorney in cases where your client has filed for bankruptcy protection. You must monitor the bankruptcy case, and verify that the information is being timely disclosed. If not, be sure to talk to the bankruptcy attorney and, if necessary, educate the bankruptcy attorney on this area of law. A bankruptcy attorney is paid the legal fee before the petition is even filed in court. The client and the lawyer working on a contingency basis are the ones who are going to lose out if the bankruptcy is not properly handled. Contact the federal bankruptcy court and learn how you can access and monitor your client's bankruptcy case online.[45]

If an injured plaintiff does not disclose their injury claim in their bankruptcy case, this may result in a judgment notwithstanding

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the verdict for the defendant. In 1986, the plaintiff in *Dailey* filed for bankruptcy in the United States Bankruptcy Court for the Northern District of Illinois.[46] In *Dailey*, the plaintiff had entered into an oral partnership with two other partners in a business venture, but plaintiff never received his share of the profits.[47] The *Dailey* plaintiff filed a complaint against his two former business partners, though he failed to list the claim as an asset in the bankruptcy estate; denying he had any interest in any partnership.[48] There was a finding of no assets in the bankruptcy case, and the bankruptcy trustee was dismissed.[49] In 1988, the *Dailey* plaintiff received a jury verdict for $288,000; defendants then filed a motion for judgment notwithstanding the verdict.[50] The *Dailey* defendants' motion was granted after the court found plaintiff was judicially stopped from bringing the claim due to his lack of standing to bring his claim due to his failure to disclose the claim in his bankruptcy petition.[51]

The *Dailey* court found that once a bankruptcy petition is filed, all claims belong to the estate, and the bankruptcy trustee alone has standing to pursue them.[52] Therefore, only the bankruptcy trustee has standing to pursue a claim.[53] For these reasons, the court upheld the judgment of the trial court.[54]

This is the worst possible scenario for a plaintiff's lawyer. You put in all the time and effort necessary to insure a successful result at trial. Now, not only do you not recover for your client, you may have possibly opened yourself up to a malpractice claim. Do not be left with the bitter taste of a bad apple. Avoid expending your time and money on a contingency fee case in which you do not recover. Do your homework when you first meet with a potential client to avoid a judgment notwithstanding the verdict.

Be sure to pick the best apples during case selection. At the initial interview, ask the client if he has filed—or intends to file—for bankruptcy. If he denies having filed for bankruptcy, go one step further and check the federal district court website to confirm whether the potential client has filed for bankruptcy. If there is a pending bankruptcy, speak with the potential client's bankruptcy attorney to confirm how far along the bankruptcy petition is, and whether the claim has been disclosed. If the claim has not been disclosed, find out if there is time to amend the bankruptcy petition to include the tort claim. You may also need to contact the bankruptcy trustee. If there is already a bankruptcy case pending, the bankruptcy trustee may choose to appoint you as the lawyer for the injury case; the trustee must appoint any lawyer as counsel for the injury claim before it can proceed. Ultimately, the potential client no longer can make the final decision to settle a claim, since the bankruptcy trustee will petition the federal judge for approval before the civil action can be resolved. In most cases, the bankruptcy court must approve a settlement before funds may de distributed.

If a potential plaintiff has not filed for bankruptcy, and you decide to pursue a tort claim, you may also choose to advise the client there are legal ramifications to their injury case if they decide to file for bankruptcy later. Your client should understand that if they decide to file for bankruptcy in the future, they must disclose the injury claim in their bankruptcy case.

What happens if you have a potential client who has a bankruptcy case that has already closed? This is a difficult problem to cure. Remember, though, your client may be judicially estopped from pursuing the civil action because of the bankruptcy *only if* the civil defense attorney takes affirmative steps to ask for that relief. Do not take that chance. You should never count on having a sloppy defense attorney in the hope of escaping this catastrophic result.

What remedies are available when both a tort claim and a bankruptcy petition have been filed? In *Lujano v. Town of Cicero*, petitioner filed a civil case three months before filing a Chapter 7 bankruptcy.[55] The *Lujano* defense counsel requested summary judgment based on the omission of disclosure of the civil action in the bankruptcy case.[56] *Lujano* filed a motion to re-open the bankruptcy case, convert it from a Chapter 7 to a Chapter 13, and submitted a plan to pay 100 percent payment of all allowed claims of unsecured creditors.[57] The proceeds from the civil action would be forwarded to the bankruptcy trustee for distribution to creditors.[58] The summary judgment was denied and the bankruptcy judge approved the plan.[59] This was a creative solution to a case that could have ultimately been barred.

No rotten apples, only fresh and juicy apples should be accepted. Screen your potential client regarding her bankruptcy history. If the potential client denies that a bankruptcy was filed, do your due diligence. Check the bankruptcy court website yourself. If there is a bankruptcy pending, communicate with the bankruptcy lawyer. Verify that the potential claim was disclosed. If not, ask the bankruptcy attorney if there is time to amend and disclose the claim. Make sure that you are appointed as the personal injury attorney. You must speak with the bankruptcy trustee to insure this occurs. Finally, continue to monitor the case online for developments in the bankruptcy case.

If you have successfully resolved a civil action and avoided any rotten apples, it is advisable to go one step further for your client. Upon settlement or jury verdict, let

the client know that this civil claim may have ramifications if the client chooses to file for bankruptcy in the future. Advise the client that if a bankruptcy attorney is retained, there must be a discussion regarding the ramifications of the settlement or jury verdict on a bankruptcy petition.

Endnotes

[1] *Berge v. Mader*, 957 N.E.2d 968, 970 (1st Dist. 2011) *citing* 11 U.S.C. § 541 *et seq.* (2006).

[2] *Dailey v. Smith*, 292 Ill.App.3d 22, 24 (1st Dist. 1997) *citing* 11 U.S.C § 541(a)(1) (1986); *Aspling v. Ferrall*, 232 Ill.App.3d 758, 762 (2nd Dist. 1992); *Koch Refining v. Farmers Union Central Exchange, Inc.* 831 F.2d 1339, 1343 (7th Cir. 1987).

[3] *Dailey*, 292 Ill.App.3d at 25; *citing Wright v. Abbot Capital Corp.*, 79 Ill.App.3d 986, 990 (1st Dist. 1979); *Hammes v. Brumley*, 659 N.E.2d 1021, 1025-26 (Ind. 1995).

[4] *Dailey*, 292 Ill.App.3d at 24; *citing Wright*, 79 Ill.App.3d at 990.

[5] *Bidani v. Lewis*, 285 Ill.App.3d 545, 549 (1st Dist. 1996).

[6] *Bidani*, 285 Ill.App.3d at 550; *citing Parisi v. Jenkins*, 236 Ill. App.3d 42, 53 (1st Dist. 1992); *Dept. of Transportation v. Grawe*, 113 Ill. App.3d 336, 341 (4th Dist. 1983).

[7] *Bidani*, 285 Ill.App.3d at 550; *citing Ceres,* 259 Ill.App.3d at 857; *Cashmore v. Builders Square, Inc.*, 211 Ill.App.3d 13, 18 (2nd Dist. 1991).

[8] *Bidani,* 285 Ill.App.3d at 550; *citing Ceres*, 259 Ill.App.3d at 854; *Finley v. Kesling*, 105 Ill.App.3d 1, 9 (1st Dist. 1982).

[9] *Bidani*, 285 Ill.App.3d at 550; *citing Ceres*, 259 Ill.App.3d at 851; *Trombello v. United Airlines (In re Air Crash Disaster at Sioux City)*, 259 Ill.App.3d 231, 238-39 (1st Dist. 1994); *Parisi*, 236 Ill.App.3d at 53-54; *Grawe*, 113 Ill.App.3d at 341-42.

[10] *Bidani*, 285 Ill.App.3d at 547.

[11] *Id.*, at 548.

[12] *Id.*, at 554.

[13] *Superior Crewboats v. Primary P & I Underwriters, et al.*, 374 F.3d 330, 333 (5th Cir. 2004).

[14] *Superior Crewboats,* 374 F.3d at 333.

[15] *Id.*, at 333.

[16] *Id.*

[17] *Id.*

[18] *Id*.

[19] *Id*.

[20] *Id*.

[21] *Id*.

[22] *Id*. at 333-34.

[23] *Id.*, at 334; *citing Matter of Cassidy*, 892 F.2d 637, 641 (7th Cir. 1990).

[24] *Id.*, at 335; *citing In re Coastal Plains, Inc.* 179 F.3d 197, 207-08 (5th Cir. 1999).

[25] *Superior Crewboats,* 374 F.3d at 336.

[26] *Berge*, 957 N.E.2d at 970.

[27] *Id.*

[28] *Id.*

[29] *Id*.

[30] *Id.*, at 973.

[31] *Berge*, 957 N.E.2d at 973 (1st Dist. 2011) *citing White v. Wyndham Vacation Ownership, Inc.*, 617 F.3d 472, 481 (6th Cir. 2010); *Barger v. City of Cartersville*, 348 F.3d 1289, 1297 (11th Cir. 2003).

[32] *Berge*, 957 N.E.2d at 974.

[33] *Dailey*, 292 Ill.App.3d at 26; *citing generally* 8A C.J.S. Bankruptcy § 27 (1988).

[34] *Cannon-Stokes v. Potter*, 453 F.3d 446, 447 (7th Cir. 2006).

[35] *Id*.

[36] *Id*.

[37] *Id*.

[38] *Id.* at 448-49.

[39] *Id*. at 449.

[40] *Id.*, at 448.

[41] *Id.*, at 449.

[42] *Berge*, 957 N.E.2d at 973.

[43] *Id*.

[44] *Berge*, 957 N.E.2d at 973; *citing Cannon-Stokes*, 453 F.3d at 449.

[45] A good place to start is http://www.ilnb.uscourts.gov/.

[46] *Dailey*, 292 Ill.App.3d at 24.

[47] *Id*. at 23-24.

[48] *Id*.

[49] *Id.* at 24.

[50] *Id.*

[51] *Id.*, at 24-25.

[52] *Dailey*, 292 Ill.App.3d at 26; *citing generally* 8A C.J.S. Bankruptcy § 27 (1988).

[53] *Dailey*, 292 Ill.App.3d at 26; *citing generally* 8A C.J.S. Bankruptcy § 117 (1988).

[54] *Dailey,* 292 Ill.App.3d at 29.

[55] Steven P. Garmisa, *Bankruptcy Ruling Helps Tort Plaintiff, Chicago Daily Law Bulletin*, Vol. 158, No. 242, (Dec. 11, 2012).

[56] *Id.*

[57] *Id.*

[58] *Id.*

[59] *Id*.

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