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Straight & Narrow

By Alexander M. Laughlin

Unbundling as a Means of Financing Bankruptcy Fees and Working Without a "Wet" Signature

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Debtors are required to pay a filing fee in order to commence voluntary bankruptcy cases, and the U.S. Supreme Court has sustained the constitutionality of the filing fee as a predicate to the debtor receiving a discharge.[1] Cases are subject to dismissal if the filing fee is not paid.[2] The Bankruptcy Code[3] and Federal Rules of Bankruptcy Procedure[4] allow an individual debtor to commence a voluntary bankruptcy without paying the full filing fee and allow the debtor to, in essence, finance that fee.

In an effort to finance *debtor's counsel's fees*, attorneys have sought to restrict their roles as debtor's counsel by "unbundling" certain legal services as post-petition offenses. Attempts to use pre-petition engagement agreements in this fashion have not withstood challenges by the Office of the U.S. Trustee and the courts, especially when the required disclosures are not made, or when the petition or other documents have not actually been signed before filing. This article examines the problems surrounding the unbundling of legal representation as way to finance debtor's counsel's fees and the misuse of the electronic case filing protocols in failing to obtain original, signed ("wet") signatures prior to filing.

Individual debtors can unilaterally set forth the filing fee payment terms, but the last filing fee installment must be paid within 120 days of the filing date. Official Form B 3A provides, and Bankruptcy Rule 1006(b)(3) requires, that the debtor pay all of the filing fee installments prior to the debtor paying the debtor's attorney "or any other person who renders services to the debtor in connection with the case."[5] The "postponement of attorneys' fees" while the debtor is paying the filing fee in installments illustrates one of the boundaries that prohibits a debtor from entering into pre-petition agreements to finance professional fees.

Section 329 of the Bankruptcy Code and Bankruptcy Rule 2016(b) mandate disclosures for payments made "in a case under this title, or in connection with such a case," and requires that all fees paid for bankruptcy-related services be reasonable. The Rule 2016 disclosures must be made whether or not the attorney is applying for compensation, because "[i]t is only by review of the [Rule] 2016(b) statement that the trustee, the court, or any interested party can be apprised of the debtor's intentions to pay counsel before such payment occurs, and of any additional services that counsel intends to perform."[6] Payments made to attorneys in a case under title 11 "or in connection with such a case" that are not disclosed are inherently not reasonable and are subject to disgorgement.

Attorneys and clients are allowed to limit the scope of the attorney's representation of the client. The American Bar Association's Model Rules of Professional Conduct Rule 1.1(a) requires that attorneys provide "competent representation to a client [requiring] the knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Model Rule 1.2(c) allows attorneys to limit the scope of their representations as long as the limitation is reasonable and the client gives informed consent after full disclosure. The extent of this disclosure and the client's appreciation of the narrowed scope of the representation are of focused concern under the Model Rules.

Model Rule 1.4(b) requires that the lawyer "explain a matter to the extent [that is] reasonably necessary to permit the client to make informed decisions regarding the representation." However, can someone in financial distress understand the gravity and scope of the imposed restricted representation and make an "informed consent," especially when the informed consent is made in the context of obtaining a reduced fee? "Unless debtors truly understand what they bargain away [in the context of limited bankruptcy representation], the bargain is a sham."[7]

The Affordable Bankruptcy Program and a promissory note in *In re Grimmett*[8] established the terms of the debtor's chapter 7 engagement and were predicated on "the preparation and filing of a

1 *United States v. Kras*, 409 U.S. 434, 457 (1973) (Stewart, J. dissenting) (finding that debtor who cannot afford filing fee is "too poor to even go bankrupt").
2 *See* 11 U.S.C. §§ 707(a)(2), 1112(b)(4)(K), 1208(c)(2) and 1307(c)(2).
3 All references are to the U.S. Bankruptcy Code, 11 U.S.C. § 101, *et seq.*
5 All citations to Rules are references to the Federal Rules of Bankruptcy Procedure, unless otherwise noted.
5 *See* Fed. R. Bankr. P. 1006(b)(3).
6 *Goodbar v. Beskin*, 2013 WL 1249124 at *6 (D. W.D. Va. March 26, 2013) (citing 9 *Collier on Bankruptcy* ¶ 2016.18, p. 2016-22, and *In re Fricker*, 131 B.R. 932, 940-41 (Bankr. E.D. Pa. 1991)).
7 *In re Castorena*, 270 B.R. 504, 529 (Bankr. D. Idaho 2001).
8 2017 WL 2437231 (Bankr. D. Idaho June 5, 2017).

bare-bones petition." The filing of the schedules, statement of financial affairs and attendance at the § 341 meeting were contracted as post-petition services to be paid pursuant to the promissory note. *Grimmett* addressed what was determined to be an improper attempt to bifurcate the debtor's legal representation between pre-petition and post-petition services.

In *Grimmett*, the lack of the debtor/client's informed consent as to the unbundling of legal services and financing of post-petition fees was exacerbated by the attorney's post-petition collection efforts. The dunning emails indicated that if payment was not made, the bankruptcy case would be dismissed, default interest under the promissory note (originated at 36 percent) would be imposed, the debtor would be subject to "collections," and counsel would withdraw as the debtor's attorney. Counsel also failed to give proper Bankruptcy Rule 2016 disclosures, and the court found that the engagement agreement required the debtor to make payments to the attorney before all of the filing fee installment payments had been made in violation of Bankruptcy Rule 1006(b)(3).[9]

The stressed-out debtor wrote to the judge and forwarded copies of the Affordable Bankruptcy Program as embodied in a "Chapter 7 Retainer Agreement and Promissory Note," along with the emails dunning her for payment under the retainer agreement. The U.S. Trustee then filed a motion to declare the agreements as unenforceable and requiring that all fees be subject to disgorgement.

In addition to addressing the unbundling of legal services in debtor representation for bankruptcy cases and the necessary informed consent by the lay client before entering into such limited representation, *Grimmett* also addressed conflicts of interest created by the chapter 7 retainer agreement and promissory note, counsel's Bankruptcy Rule 2016(b) disclosures, the violation of the court's installment fee payment order, and counsel's post-petition collection actions.

Against the attorney's arguments that the representation agreement rendered the claims for fees for legal services provided after the petition was filed as nondischargeable and not subject to the automatic stay, the *Grimmett* court, perhaps channeling former White House Press Secretary Sean Spicer at his first press conference, held that the pre-petition agreement "was discharged in bankruptcy, period."[10]

In finding that "the Agreement was inconsistent with counsel's obligation to represent a debtor/client as a matter of bankruptcy law,"[11] the *Grimmett* court, citing *In re Castorena* on the extent of the informed consent, found that "[i]f either [the] lawyer or client wishes to limit services in order to preserve a lower fee, that limitation must be carefully considered and narrowly crafted, and be a result of educated and informed consent."[12] The *Grimmett* court continued its reference to *Castorena* "for clarity" in finding that "when accepting an engagement to represent a debtor in relation to a bankruptcy proceeding, an attorney must be prepared to assist that debtor through the normal, ordinary and fundamental aspects of the process."[13] The court listed those "normal, ordinary and fundamental aspects" to include attendance at the first meeting of creditors "and responding to issues that arise in the basic *milieu* of the bankruptcy case."[14]

Attorneys representing individual debtors in bankruptcy proceedings seeking to contract away those "normal, ordinary and fundamental aspects" in the "basic *milieu*" of bankruptcy "will find it exceedingly difficult to show that he properly contracts away any of the fundamental and core responsibilities as such engagement necessarily imposes."[15] Attorneys restricting their debtor representations to exclude appearances at the first meeting of creditors will encounter substantial resistance, with most courts concluding that not appearing at a § 341 meeting is a fundamental failure to represent the debtor, causing one bankruptcy judge to state that "[a]ny debtor's counsel who does not understand the vital importance of attending a meeting of creditors with the debtor is in desperate need of further education."[16]

In cancelling the Affordable Bankruptcy Program and the chapter 7 retainer agreement and promissory note, and ordering all fees returned to the debtor, the court found that the agreement created an irreconcilable conflict of interest because it permitted counsel to withhold representation until the attorneys' fee payments had been made. The court also found that the attorney's original and amended Bankruptcy Rule 2016 statements contained inaccurate information, resulting in an admonishment from the court referenced in a footnote that began with, "But it gets worse!"[17] The court continued, "The compensation to be paid to an attorney can be deemed excessive [under § 329] for a host of reasons, including but not limited to ... failure to comply with the disclosure requirements, the existence of conflicts of interest, and the like."[18] After ruling that the obligations under the agreements executed pre-petition were subject to discharge "period," the *Grimmett* court went on to address the issues surrounding the signing and filing of the petition and other documents in the bankruptcy case.

Cases involving attempts to unbundle legal services and the failure to make proper Bankruptcy Rule 2016 disclosures seem to carry other problems. While the U.S. Trustee and court were addressing the issues and problems arising from the limited nature of the representation and engagement in *Grimmett*, it was discovered that the electronically filed documents in the case had not been signed before they were filed.

Bankruptcy Rule 5005(a)(2) permits documents to be filed, signed or verified by electronic means. As a result, most original, signed documents are no longer filed at the courthouse. Both debtor and counsel must sign the original document prior to it being filed electronically, and once signed, the original must be maintained and preserved by counsel. In an electronic case filing world, attorneys (as officers of the court) are now the custodians of those pleadings, and play a critical role in the archiving and maintenance of

9 Apparently, counsel intended to pay the remaining filing fee from the debtor's promissory note payments to the attorney.
10 *In re Grimmett*, 2017 WL 2437231 (Bankr. D. Idaho 2017), at *9.
11 *Id.* at *5.
12 *Id.* at *6 (citing *In re Castorena*, 270 B.R. at 531).
13 *Id.*
14 *Id.*
15 *In re Castorena*, 270 B.R. at 530 (Bankr. D. Idaho 2004).
16 Chief Judge Alan Jaroslovsky's 2004 letter to the attorneys appearing before him in the U.S. Bankruptcy Court for the Northern District of California as presented in "Ethics: Representation Issues: Don't Gamble With Your Reputation or Getting Paid," ABI Western Consumer Bankruptcy Conference, Jan. 21, 2013, *available at* abi.org/education-events/sessions.
17 *In re Grimmett*, 2017 WL 2437231, at *10 (Bankr. D. Idaho 2017), fn.17.
18 *Id.* at *9 (citations omitted).

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those originals. A pleading filed without first obtaining an original executed signature breaks one of the key principles underlying electronic case filing: The attorneys are now the repositories of original pleadings filed in the bankruptcy case — not the court.

In *Grimmett*, the voluntary petition, installment filing fee application, declarations concerning the schedules, statement of financial affairs and the verification of the creditor matrix all bore electronic "Adobe Echosign" signatures, even though the debtor never actually signed these documents before they were filed with the court. The court found that "the use of the software-generated signatures ... fell short of compliance with the Local Rules."[19] The court contined, "[W]hen an attorney submits an electronically signed document to the Court, 'he is certifying to the court that he has the [document] in his physical possession bearing the original signature of the [party]. If the certification is false, the attorney is subject to sanctions pursuant to Rule 9011.'"[20] Stating this unacceptable practice and professional trespass more forcefully, the U.S. Bankruptcy Court for the Eastern District of Virginia has held, "In sum, an attorney's electronic submission of a document to the Court inaccurately 'purporting to have [a party's] signature is no different than [the attorney] physically forging [the party's] signature and handing the [document] over the counter to the clerk.'"[21]

When Rule 9011[22] is added to this troubling visual, the responsibilities of attorneys filing electronic documents to only do so after the original signatures have been obtained should not have to be emphasized further. However, further emphasis is warranted nonetheless, and the standard of "obsessive attentiveness" when filing documents is articulated in *U.S. v. Carelock*,[23] and, as reported in an *ABI Journal* article,[24] so that bankruptcy practitioners are not viewed as armed tequila-addled inebriates with law licenses.[25]

While the Bankruptcy Code and Rules allow individual debtors to pay their required filing fees in installments, debtor's attorneys are not permitted to act as lenders to their clients. A debtor/bankruptcy engagement structured in a manner that seeks to declare fundamental core bankruptcy services as post-petition, and to have those fees paid post-petition as an independent obligation not subject to discharge, is fraught with ethical pitfalls and serious sanctions. Attorneys have "an obligation to either handle the case from beginning to end and perform the services for whatever amounts the clients can afford, or refer the cases to another attorney."[26]

The ethical issues are exponentially expanded when conflicts of interest and inadequate or nonexistent disclosures concerning the fees are made. Those disclosures have a resemblance to firearms and alcohol, with the embedded capacity for mistakes and poor judgment when the original documents filed electronically with the court are not first signed as required under the Bankruptcy Rules. abi

19 *Id.* at *11.
20 *Id.* (citations omitted).
21 *In re Hurd*, 2010 WL 3190752 *3 (Bankr. D. Idaho 2010) (citing *In re Wenk*, 296 B.R. 719, 725 (Bankr. E.D. Va. 2002)).
22 Bankruptcy Rule 5005(a)(2) permits "filing by electronic means" and provides that a "document filed by electronic means in compliance with a local rule constitutes a written paper for the purpose of applying these rules, the Federal Rules of Civil Procedure made applicable by these rules, and § 107 of the Code."
23 459 F.3d 437, 443 (3d Cir. 2006) ("[The] ease of use [of computers] ... should not assuage the almost-obsessive attentiveness that is required when filing any document with a court.").
24 Hon. Mary P. Gorman and Khadijia V. Thomas, "Of Handguns, Tequila and Electronic Case Filing," XXX *ABI Journal* 7, 16, 74-75, September 2011, *available at* abi.org/abi-journal.
25 *U.S. v. Carelock*, 459 F.3d at 443 ("A computer lets you make more mistakes faster than any invention in human history — with the possible exceptions of handguns and tequila.").
26 *In re Basham*, 208 B.R. 926, 932-33 (B.A.P. 9th Cir. 1997).

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Rochelle's Daily Wire

ABI EXCLUSIVE

October 2, 2018

Sanctions Upheld Against 'Nationwide' Law Firm for Violating Section 526

> Law firm suspended 90 days for multiple violations of rules of professional conduct.

A district judge in Shreveport, La., upheld sanctions imposed by the bankruptcy court against a self-described "national consumer law firm." The significance of the opinion lies in coercing compliance with state rules of professional conduct and Section 526, regulating "debt relief agencies."

According to the September 24 opinion by District Judge Elizabeth Erny Foote, the parties agreed that the case was "horribly screwed up." Based on findings in other cases, the firm advertises nationally, has non-attorneys perform intake over the telephone, has the client sign a retainer agreement, collects the retainer, and assigns the case to an attorney presumably admitted to practice where the debtor will file bankruptcy.

The shortcomings in the particular debtor's case included initially assigning a local counsel not licensed to practice in Louisiana, later assigning a local attorney located 350 miles from the chapter 7 debtor, never sending the debtor a retainer agreement signed by a lawyer admitted to practice in the state, employing a retainer agreement violating the Louisiana Rules of Professional Conduct, making oral representations that contradicted the written retainer agreement, repeatedly breaking promises to the debtor, and failing to supervise the local attorney properly.

With regard to the local counsel, the bankruptcy judge found that she "consistently" failed to contact the debtor, delayed filing the first petition, negligently allowed the first petition to be dismissed, falsely "indicated" that the debtor had signed the second petition, and allowed the second petition to be dismissed by failing to file required documents.

Judge Foote said the bankruptcy court found "professional negligence on the part of both [the nationwide firm] and [the local counsel], including multiple, continuous violations of the Louisiana Rules of Professional Conduct."

With regard to the nationwide firm, sanctions imposed by the bankruptcy court included disgorgement of fees paid by the debtor, suspension from practice in the district for 90 days, precluding the firm from accepting a retainer until the client had consulted with a lawyer in the district, requiring the retainer agreement to comply with Louisiana's Rules of Professional Conduct, requiring the client's wet signature on all documents filed in court that purport to bear the client's signature, requiring the client's wet signature on the engagement agreement, precluding the firm from accepting a retainer before the client signs the engagement agreement, and requiring local counsel to obtain a separate PACER login for cases where the attorney is representing a client though the nationwide firm.

The nationwide firm appealed, without success.

The firm argued that the 90-day suspension did not comply with Federal Rule 65(d) governing injunctions. Judge Foote ruled that courts have power to determine who may practice before them independent of Rule 65, based on Fifth Circuit authority. Furthermore, she said, a suspension is not an injunction.

Judge Foote found jurisdiction in the bankruptcy court to impose the sanctions, even though she said that nothing other than the 90-day suspension was a sanction or discipline. She also found no violation of the firm's due process rights.

Judge Foote rejected the notion that the bankruptcy court was required to make specific findings of bad faith based on clear and convincing evidence. With regard to state rules of professional conduct, she said the Fifth Circuit had held that a bad faith finding is not required to exercise authority under local rules.

Findings in the bankruptcy court's order required the nationwide firm's retainer agreement to include the provision of "all services integral to a chapter 7 filing." The firm argued that the order was not clearly defined and violated the specificity requirements under Rule 65.

Judge Foote said that "services integral to a chapter 7 filing" was not "ambiguous" when read in context with the bankruptcy court's opinion.

The firm objected to being characterized by the bankruptcy court as a "referral service" or a "marketer of legal services."

Judge Foote said that the statements were not intended as findings of fact, but if they were, "they are not clearly erroneous."

Case Details

Judge Name	Elizabeth Erny Foote
Case Citation	Law Solutions Chicago LLC v. U.S. Trustee, 18-216 (W.D. La. Sept. 24, 2018)
Case Name	Law Solutions Chicago LLC v. U.S. Trustee
Case Type	Consumer
Court	5th Circuit Louisiana Louisiana Western District
Bankruptcy Tags	Ethics Practice and Procedure Consumer Bankruptcy

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

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ABI EXCLUSIVE

February 15, 2017

Debtor's Consent Judgment Doesn't Result in Automatically Allowed Claim

> Clever strategy failed to limit a debtor's personal liability.

If a debtor consents to judgment in state court, does the judgment creditor have an unbeatable claim, or can the trustee object?

Chief Bankruptcy Judge Cynthia A. Norton of Kansas City, Mo., ruled that the judgment creditor cannot ride to victory automatically on the back of *Rooker-Feldman*, *res judicata* or collateral *estoppel*.

A husband and wife owned a business that went bust, leaving the landlord with a claim against the business. Although the couple had not guaranteed the lease, the landlord sued them personally in state court, contending they were liable for business debt on a veil piercing theory.

Before the case went to trial in state court, the couple filed bankruptcy, but they later waived their discharges. The waiver of discharge vacated the automatic stay, so the couple consented to the entry of a $150,000 judgment against them personally in state court. The landlord-judgment creditor then filed a $150,000 claim in the couple's "asset" bankruptcy, to which the chapter 7 trustee objected.

The landlord-judgment creditor contended that the $150,000 judgment was binding, but Judge Norton knocked down every theory in her Feb. 10 opinion.

The first theory to bite the dust was *Rooker-Feldman*. Named for two Supreme Court decisions, the *Rooker-Feldman* doctrine means that federal courts lack subject matter jurisdiction to review judgments by state courts. Judge Norton characterized the doctrine to mean that someone cannot appeal a state judgment in federal court.

Rooker-Feldman did not apply, Judge Norton said, because the trustee was not a party to the suit in state court.

Next on the chopping block was collateral *estoppel*, or issue preclusion.

In Missouri, issue preclusion is invoked only when the judgment is on the merits, but default judgments do not count. More to the point, Missouri case law says that a consent judgment is not on the merits, thus not allowing the invocation of collateral *estoppel*.

The third leg on the stool, *res judicata* or claim preclusion, fared no better.

For *res judicata* to apply, the parties must be identical or in privity. In Missouri, courts hold that a bankruptcy trustee, owing a duty to the estate, is in privity with neither the debtor nor creditors. Consequently, claim preclusion did not result in automatic allowance of the judgment creditor's claim.

Judge Norton's conclusion makes sense as a matter of policy. Were it otherwise, a debtor in an "asset" case with nondischargeable debt would consent to judgment in state court to increase the distribution by the bankrupt estate and decrease his or her personal liability.

Judge Norton was careful to point out that the claim filed by the judgment creditor was worthy of *prima facie* validity. The judge warned the trustee that she bore the burden at the claim objection hearing of producing evidence to show that the claim should be disallowed in whole or in part. If the trustee got that far, the burden would shift back to the creditor to prove the veil piercing claim.

Case Details

Judge Name	Cynthia A. Norton
Case Citation	In re Ferguson, 14-30604 (Bankr. W.D. Mo. Feb. 10, 2017)
Case Name	In re Ferguson
Court	8th Circuit Missouri Missouri Western District
Bankruptcy Tags	Claims Bankruptcy Litigation Practice and Procedure Consumer Bankruptcy Business Reorganization

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By The Numbers

Total cases in system	1058
Business Cases	401
Consumer Cases	463
Circuit Splits Cases	43
Supreme Court Cases	61
Total Judges	590

Trustee Talk

By Lon A. Jenkins

Oh, Did I Forget to Mention...?

Considering Judicial Estoppel: Intentional Concealment or Inadvertent Omission?

Coordinating Editor Lon A. Jenkins
Office of the Chapter 13 Trustee (D. Utah); Salt Lake City

Lon Jenkins has been the standing chapter 13 trustee for the District of Utah since September 2015. He previously practiced for more than 30 years in primarily chapter 11 reorganizations and bankruptcy litigation, representing creditors, chapter 11 trustees, creditors' committees and indenture trustees.

In order for a debtor to obtain the significant benefits and protections available under the Bankruptcy Code, little is required of a debtor.[1] However, a singularly critical obligation requires a debtor to accurately and truthfully disclose all assets and liabilities to the court, creditors and trustee, including a full disclosure of "claims against third parties, whether or not you have filed a lawsuit or made a demand for payment."[2] But if a debtor fails to disclose such "claims against third parties," can the debtor subsequently be precluded from pursing claims against third parties in a civil lawsuit?

This question has given rise to differing approaches among the circuit courts in determining when judicial estoppel should prevent a debtor's prosecution of a civil claim. Recent circuit decisions, including the Eleventh Circuit's decision in *Slater v. United States Steel Corp.*,[3] suggest that courts might be less inclined to apply judicial estoppel, focusing on the debtor's actual intent in failing to disclose and the potential harm to innocent creditors by barring pursuit of a civil claim.

A debtor who fails to disclose a claim against a third party and subsequently attempts to pursue that claim in a lawsuit might be precluded from doing so by application of the doctrine of judicial estoppel. The U.S. Supreme Court has succinctly explained the doctrine of judicial estoppel: "Where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him."[4] The Supreme Court has emphasized that judicial estoppel is intended not to protect the litigants, but rather "to protect the integrity of the judicial process"[5] and prevent litigants from "playing fast and loose with the courts."[6]

In a bankruptcy case, invoking judicial estoppel to bar pursuit of a valuable civil claim can lead to harsh — and perhaps unintended — consequences. For example, the debtor's creditors, who are innocent of wrongdoing, might be deprived of recovery from a potentially valuable claim; an appointed trustee might be prevented from pursuing the action; an alleged wrongdoer (the defendant) might be undeservedly relieved of liability for an alleged bad act; and, indeed, a debtor who suffered serious harm might receive no recompense.

On the other hand, honest and full financial disclosure by a debtor is essential to the integrity of the judicial process, so debtors should not be rewarded for concealing assets from creditors.[7] Given these important competing concerns, courts increasingly focus on whether the debtor *actually intended* to mislead the court by failing to disclose a claim or lawsuit. In the process, recent decisions weigh the interests of creditors and reject the established test for assessing a debtor's "inadvertence," which may give rise to an unwarranted inference that the debtor intended to mislead the court based solely on a nondisclosure.

In *New Hampshire v. Maine*,[8] the Supreme Court announced a three-part test for application of judicial estoppel. Judicial estoppel should be applied if three factors are present: (1) the party's later position must clearly be inconsistent with its earlier position; (2) the court was persuaded to accept the party's earlier position such that judicial acceptance of the inconsistent position in the later proceeding leads to the perception that one of the courts was misled; and (3) the party seeking to assert the inconsistent position would enjoy an unfair advantage over the opposing party if not estopped.[9] However, the Court cautioned that these factors are neither "exhaustive" nor constitute "inflexible prerequisites." Particularly relevant to the courts' present analyses, the Court instructed that "[w]e do not question that it [might] be appropriate to resist application of judicial estoppel '*when a party's prior position was based on inadvertence or mistake*.'"[10]

Most recently, the Eleventh Circuit considered the application of judicial estoppel in *Slater v. United States Steel Corp.*[11] In this case, the court concluded that the debtor's failure to disclose

1 *See Eastman v. Union Pac. R.R. Co.*, 493 F.3d 1151, 1159 (10th Cir. 2007) ("[I]n exchange for these benefits, the [B]ankruptcy [C]ode required only that [the debtor] fully and accurately disclose his financial status.").
2 Official Form 106A/B, line 33.
3 871 F.3d 1174 (11th Cir. 2017).
4 532 U.S. 742, 749 (2001) (quoting *Davis v. Wakelee*, 156 U.S. 680, 689 (1895)).
5 *Id.* at 749 (citations omitted).
6 *Ryan Operations GP v. Santiam-Midwest Lumber Co.*, 81 F.3d. 355, 358 (3d Cir. 1996) (citation omitted).
7 *See In re Coastal Plains Inc.*, 179 F.3d 197, 208 (5th Cir. 1999).
8 532 U.S. 742 (2001).
9 *Id.* at 750.
10 *Id.* at 753 (quoting *John S. Clark Co. v. Faggert & Frieden PC*, 65 F.3d 26, 29 (4th Cir. 1995) (emphasis added)).
11 871 F.3d 1174 (11th Cir. 2017).

employment-discrimination claims in her bankruptcy case was "inadvertent"; therefore, pursuit of those claims by the debtor would not be barred. Pre-petition, Sandra Slater had commenced an employment-discrimination lawsuit against her former employer but did not disclose the lawsuit in her chapter 7 schedules. Subsequently, faced with a motion to dismiss based on judicial estoppel in the civil case, Slater contended that her nondisclosure in her bankruptcy case was inadvertent because she mistakenly understood that only lawsuits filed *against her* needed to be disclosed. She immediately amended her schedules.

Nonetheless, the trial court barred prosecution of the claims based on judicial estoppel, relying on well-established precedent that a debtor's nondisclosure is inadvertent *only if* the debtor (1) lacks knowledge of the claim or (2) has no motive to conceal the claim.[12] Otherwise, the debtor's intent to conceal is inferred.

Applying the two-prong test, the district court found that the debtor both knew about her civil claims and had a motive to conceal them in her bankruptcy case, because she could receive a no-asset discharge and a potential monetary windfall. Accordingly, it was determined that Slater intended to "make a mockery of the judicial system,"[13] so her claims were barred.

On appeal, the Eleventh Circuit reversed. The court rejected the two-prong test for a debtor's "inadvertence," criticizing the "flawed reasoning" of previous Eleventh Circuit precedent, which had

> endorsed an inference that a plaintiff who failed to disclose a lawsuit in a Chapter 7 bankruptcy intended to manipulate the judicial system because the omission was not inadvertent. In effect, we treated the fact that the plaintiff could potentially benefit from the non-disclosure as sufficient to establish that the plaintiff, in fact, intended to deceive the court.[14]

Under the established test for inadvertence, "[n]o plaintiff who omitted civil claims from bankruptcy disclosures will be able to show that he acted inadvertently because ... [the] plaintiff will always have knowledge of his pending civil claim and a potential to conceal it due to the very nature of bankruptcy."[15] Instead, *Slater* formulated six nonexhaustive factors to assess a debtor's intent: (1) the debtor's level of sophistication; (2) whether and under what circumstances the debtor amended the disclosures; (3) whether bankruptcy counsel was told about the civil claim before filing the disclosures; (4) whether the trustee or creditors were aware of the civil claim before the disclosures were amended; (5) whether the debtor identified other lawsuits to which the debtor was party; and (6) any findings or actions by the bankruptcy court after the nondisclosure was discovered.[16] Weighing these factors, the court concluded that Slater's nondisclosure was likely inadvertent and excused her omission.

The court expressed concern that merely inferring a debtor's intent to prevent pursuit of a claim "risk[s] harm to innocent creditors"[17] and might provide the civil defendant with "an unjustified windfall":[18] "[E]quity cannot condone a defendant's avoidance of liability through a doctrine premised upon intentional misconduct without establishing such misconduct."[19]

In *Ah Quin v. County of Kauai Dept. of Transp.*,[20] the Ninth Circuit adopted similar reasoning in declining to apply judicial estoppel in order to prevent prosecution of a debtor's undisclosed employment-discrimination lawsuit. In this case, the debtor had reopened her bankruptcy case, amended her schedules to disclose the omitted claim and sought to vacate her discharge. The Ninth Circuit chastised the district court for applying the wrong legal standard in concluding that judicial estoppel was compelled: "The district court's belief that it was *bound* to preclude [the] Plaintiff from bringing her discrimination claim is mistaken and fundamentally at odds with equitable principles. Judicial estoppel is a discretionary doctrine, applied on a case-by-case basis."[21]

The Ninth Circuit disregarded the two-prong test for inadvertence, stating, "The relevant inquiry is, more broadly, the plaintiff's subjective intent when filling out and signing bankruptcy schedules."[22] Moreover, inquiry into a debtor's subjective intent may avoid the unintended consequences of inferring intent:

> [W]hen the plaintiff/debtor has reopened the bankruptcy proceedings and has corrected the initial filing error, the narrow interpretations of "mistake" and "inadvertence" do not apply ... the application of judicial estoppel in this case would do nothing to protect the integrity of the courts, would inure to the benefit only of an alleged bad actor, and would eliminate any prospect that [the] Plaintiff's unsecured creditors might have of recovering.[23]

In two post-*New Hampshire* decisions, *Eubanks v. CBSK Financial Group Inc.*[24] and *Spaine v. Community Contacts Inc.*,[25] the Sixth and Seventh Circuits both reversed lower court decisions applying judicial estoppel to bar debtors' civil lawsuits. Important to the *Eubanks* decision was that the debtors had eventually amended their schedules, informed the trustee of the claims at the § 341 meeting, and sought to contact the trustee about the status of the claims. The Sixth Circuit warned that judicial estoppel should be applied narrowly to "avoid impinging on the truth-seeking function of the court, because the doctrine precludes a contradictory position without examining the truth of either statement."[26]

The Seventh Circuit in *Spaine* questioned inferring a debtor's intention to conceal based on a mere nondisclosure where the debtor alleged that she had verbally disclosed her claim to the bankruptcy judge and trustee. A debtor's

12 *See Burnes v. Pemco Aeroplex Inc.*, 291 F.3d. 1282, 1287 (11th Cir. 2002); *Barger v. City of Cartersville, Ga.*, 348 F.3d 1289, 1295 (11th Cir. 2003).
13 *Slater*, 871 F.3d at 1181. Slater noted that the Eleventh Circuit employs a two-part test: (1) whether the party took an inconsistent position; and (2) whether the inconsistent position was calculated to make a mockery of the judicial system.
14 *Id.* at 16-17. The Eleventh Circuit extended the test for assessing a debtor's inadvertence to chapter 13 cases. 871 F.3d at 1182 (citation omitted).
15 *Id.* at 1189.
16 *Id.* at 1185.
17 *Slater*, 871 F.3d at 1187.
18 *Id.*
19 *Id.* at 1188.
20 733 F.3d 267 (9th Cir. 2013).
21 *Id.* at 272.
22 *Id.* at 276-77.
23 733 F.3d at 276.
24 385 F.3d 894 (6th Cir. 2004).
25 756 F.3d 542 (7th Cir. 2014).
26 *Id.* at 897.

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knowledge of a claim, coupled with the "universal motive"[27] of a bankruptcy debtor to conceal assets, without more, the court urged, should not compel an inference that the debtor intended to conceal the claim.

In addition to assessing a debtor's actual intention in failing to disclose a claim, courts have weighed the plight of innocent creditors in applying judicial estoppel. Historically, the Tenth and Fifth Circuits appear to have been most inclined to judicially estop debtors' lawsuits. However, more recent decisions in those circuits suggest a reluctance to invoke judicial estoppel if creditors will be harmed. Two Tenth Circuit decisions, *Anderson v. Seven Falls Co*.[28] and *Eastman v. Union Pacific Railroad Co*.[29] (including one very recent decision), are demonstrative.

In *Anderson*, the Tenth Circuit embraced an inference that the debtor had intended to conceal her claim. Notwithstanding that the debtor had taken pre-petition actions to preserve her personal-injury claim, she failed to disclose it in her schedules or at the § 341 meeting. Post-petition, the debtor commenced a lawsuit but made no supplemental disclosure. Upon learning of the lawsuit, the trustee successfully moved to be substituted as the plaintiff. Although the debtor would be estopped from pursing the claim, the district court limited its application to protect creditors: "'[T]o the extent [the plaintiff's] personal-injury claims were necessary to satisfy the trustee's debts,' judicial estoppel does not apply to a compliant bankruptcy trustee."[30]

In *Eastman v. Union Pacific Railroad Co*., relied upon by *Anderson*, the Tenth Circuit also barred a debtor's pursuit of an undisclosed personal-injury lawsuit. As in *Anderson*, the creditors in *Eastman* were made whole through the chapter 7 trustee's settlement with co-defendants in the debtor's civil lawsuit, so barring the debtor from pursuing the lawsuit would not harm innocent creditors. Significantly, the court stated that application of judicial estoppel would be inappropriate against the trustee, "as the real party-in-interest had not engaged in contradictory litigation tactics."[31] Since the debtor in *Eastman* had expressly denied that the lawsuit existed, once the trustee abandoned the litigation following a payment in full to the creditors, the court easily precluded the debtor from pursuing the lawsuit.

The Fifth Circuit in *In re Superior Crewboats Inc*.[32] applied judicial estoppel to bar the debtors' undisclosed personal-injury lawsuit, but did not address the trustee's standing or the impact on creditors. There, the debtors had actively misled the trustee about the viability of the lawsuit, causing the trustee to abandon the claim. Therefore, the court held that the trustee's motion to be substituted in the lawsuit had been rendered moot, and the debtors were barred from prosecuting the lawsuit. Four years later, however, the Fifth Circuit in *Kane v. National Union Fire Ins. Co*.[33] declined to apply judicial estoppel to a debtor's undisclosed personal-injury claim, distinguishing *Superior Crewboats* because the *Kane* trustee had not abandoned the claim and was the real party-in-interest. Mindful of the interests of creditors, the *Kane* court observed, "[T]he only way the Kanes' creditors would be harmed is if judicial estoppel were applied to bar the Trustee from pursuing the claim against Defendants on behalf of the estate."[34]

In *Reed v. City of Arlington*,[35] the Fifth Circuit upheld a district court ruling that judicially estopped a debtor from collecting a $1 million undisclosed FMLA judgment but permitted the trustee to collect the judgment in an amount sufficient to pay creditors in full. The court noted that the trustee had become the real party-in-interest upon the debtors' bankruptcy filing and the trustee had not abandoned the lawsuit, therefore the debtor's "post-petition misconduct does not adhere to the Trustee."[36] The court reasoned that judicial estoppel "must be applied in such a way as to deter dishonest debtors, whose failure to fully and honestly disclose all their assets undermines the integrity of the bankruptcy system, while protecting the rights of creditors to an equitable distribution of the assets of the debtor's estate."[37]

Conclusion

Courts have demonstrated an increasing inclination to preserve a debtor's undisclosed causes of action for the benefit of creditors, either by assessing a debtor's actual intent to conclude that a debtor's failure to disclose was inadvertent, or by reasoning that while a nondisclosing debtor should be punished, a debtor's misconduct should not be imputed to an innocent trustee who is charged with maximizing an estate for the benefit of creditors. Because the trustee's real party-in-interest status might well be an important consideration, trustees should conduct a thorough inquiry before abandoning a cause of action or lawsuit. abi

27 *Id.* at 548 (citing *Ah Quin*, 733 F.3d at 276-77).
28 696 Fed. App'x 341 (10th Cir. 2017).
29 493 F.3d 1151 (10th Cir. 2007).
30 696 Fed. App'x at 344.
31 493 F.3d at 1155 n.3.
32 374 F.3d 330 (5th Cir. 2004).
33 535 F.3d 380 (5th Cir. 2008).
34 *Id.* at 387.
35 650 F.3d 571 (5th Cir. 2011).
36 *Id.* at 574.
37 *Id.*

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ABI EXCLUSIVE

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Dismissing a Bankruptcy Won't Fend Off Invocation of Judicial Estoppel

> Eleventh Circuit holds that dismissing bankruptcy comes too late if claims weren't disclosed.

Dismissing a bankruptcy where the debtor did not disclose a claim will not prevent a court in the Eleventh Circuit from invoking judicial estoppel.

The facts presented an unassailable case for invoking judicial estoppel.

The debtor amended his schedules six times, but he did not disclose two lawsuits until the seventh amendment had been filed after the defendants in those suits had submitted motions to dismiss based on judicial estoppel.

Evidence pointed toward the debtor's intent to dupe the court. The debtor had scheduled two other lawsuits, but not the two where he was seeing larger damages, together amounting to $14 million.

The debtor opposed the motion to dismiss in district court, contending that the defendants' motions were moot because he had voluntarily dismissed his bankruptcy following the seventh amendment to his schedules. First ruling that the dismissal motions were not moot, the district court went on to dismiss the suits based on judicial estoppel.

In a *per curiam* opinion on June 29, the circuit court agreed and upheld dismissal.

The Eleventh Circuit said that dismissal was proper under the appeals court's *en banc* opinion last year in *Slater v. U.S. Steel Corp.*, 871 F.3d 1174 (11th Cir. 2017) (*en banc*). Overruling its own precedent, the *en banc* court held in *Slater* that a court may not "automatically infer a plaintiff's intent to mislead based solely on the plaintiff's failure to disclose a civil claim in a bankruptcy proceeding." To read ABI's discussion of *Slater*, click here.

The circuit held that voluntary dismissal of the bankruptcy did not render the dismissal motion moot in district court, because the "judicial estoppel issue presented to us in this appeal is not about what should happen in the bankruptcy proceedings, a case that was not appealed to us." The debtor did not dismiss either of his two lawsuits, so the "propriety of that dismissal is not moot," the circuit said.

The appeals court also rejected the notion that dismissal of the bankruptcy made invocation of judicial estoppel an abuse of discretion, because "[j]udicial estoppel serves to 'prevent the perversion of the judicial process and protect its integrity,'" citing *Slater*.

The circuit court said that judicial estoppel "cannot serve that purpose . . . if a duplicitous debtor is assured that he can always avoid the doctrine's bite by dismissing his bankruptcy petition after his duplicity is found out."

Opinion Link

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Case Details

Case Citation Weakley v. Eagle Logistics Celadon Trucking, 17-14022 (11th Cir. June 29, 2018)

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