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JUDGES' ROUND AND ROUND

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En Banc, Eleventh Circuit Narrows Applicability of Judicial Estoppel in Bankruptcy - *Slater v. U.S. Steel Corp.*, 12-15548 (11th Cir. Sept. 18, 2017)

At the urging of one of the judges on the original panel, the Eleventh Circuit sat *en banc* and reversed two of its prior decisions by holding that a court must consider all the facts and circumstances before invoking the doctrine of judicial estoppel. To prevent a defendant from reaping an "unjustified windfall," the intentional failure to list a claim belonging to a bankrupt no longer results in the automatic application of judicial estoppel.

Even after the Sept. 18 opinion by Circuit Judge Jill Pryor, the Eleventh Circuit still has not gone as far as the Fifth Circuit when the New Orleans-based court sat *en banc* and functionally held in *Reed v. City of Arlington*, 650 F.3d 571 (5th Cir. 2011), that a defendant in a lawsuit cannot assert judicial estoppel to inflict harm on a bankruptcy trustee and innocent creditors based on a debtor's shortcomings.

The Facts

A woman initiated an employment discrimination suit two years before filing a chapter 7 petition. The employer learned about the bankruptcy and filed a motion to dismiss based on judicial estoppel, because the debtor had not scheduled the lawsuit among her assets. The debtor modified her schedules to list the claim, and the chapter 7 trustee retained the debtor's litigation counsel as special counsel to pursue the suit on behalf of the estate.

The debtor then converted her case to chapter 13 and confirmed a plan, but the chapter 13 case was dismissed when the debtor failed to make plan payments.

Invoking judicial estoppel, the district court dismissed the discrimination suit. Recognizing that it was bound by Eleventh Circuit precedent, the appeals court's three-judge panel upheld dismissal in February 2016 in an unsigned, 32-page *per curiam* opinion.

One of the three judges on the panel, Circuit Judge Gerald B. Tjoflat, wrote a special concurrence that reads like a dissent. He urged the appeals court to rehear the case *en*

banc and overrule two Eleventh Circuit precedents that he believed were "wrongly decided." Anyone confronted with an issue involving judicial estoppel should study Judge Tjoflat's 78-page concurrence from last year, because it reads like a treatise discussing everything there is to know on the subject.

The appeals court granted rehearing *en banc*, heard argument in February and reversed its own precedents in Judge Pryor's 33-page opinion.

'Mockery' No Longer Automatic

Judge Pryor began by reaffirming the circuit's general rule that judicial estoppel applies when a litigant takes inconsistent positions and intends "to make a mockery of the judicial system." Her opinion focused on the mockery element because the debtor unquestionably took inconsistent positions by originally omitting the suit from her schedules.

Under the circuit's *Barger* and *Burnes* decisions from 2003 and 2002, respectively, Judge Pryor said that the mockery element was conclusively established by a debtor's nondisclosure, "even if the plaintiff corrected his bankruptcy disclosures after the omission was called to his attention and the bankruptcy court allowed the correction without penalty."

Judge Pryor devoted her opinion to explaining why the court was reversing *Barger* and *Burnes* and holding that the court instead "should consider all the facts and circumstances," including the "plaintiff's level of sophistication, his explanation for the omission, whether he subsequently corrected the disclosure, and any action taken by the bankruptcy court concerning the nondisclosure." She said that "voluntariness alone does not necessarily establish a calculated attempt to undermine the judicial process."

In refusing to impose judicial estoppel reflexively, Judge Pryor seemed largely motivated to avoid giving "an unjustified windfall" to "an otherwise liable civil defendant," in the process harming "innocent creditors." She recognized that *pro se* debtors may not understand how the requirement for disclosing contingent and unliquidated claims also means claims that the debtor holds, not just claims against the debtor.

Judge Pryor explained why courts should not automatically apply judicial estoppel even in chapter 13 cases. Because the debtor must satisfy the best interests test to confirm a plan, creditors in chapter 13 would be harmed just like in chapter 7 if a claim by the debtor is treated as worthless.

Is a *Cert* Petition Next?

Judge Pryor said there is a split of circuits even after abandoning *Burnes* and *Barger*. Like her court now holds, the Sixth, Seventh and Ninth Circuits previously ruled that the "mockery" element requires showing more than an intention not to disclose.

The Fifth and Tenth Circuits, she said, take the opposite view by endorsing "the inference that a plaintiff who omitted a claim necessarily intended to manipulate the judicial system."

Judge Pryor may have overstated the circuit split.

The *en banc* opinion in *Reed*, written for the Fifth Circuit by Circuit Judge Carolyn King, laid down a "general rule that, absent unusual circumstances, an innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose." She also said that judicial estoppel must be applied "flexibly" to achieve "substantial justice," a principle that Judge Tjoflat advocated in his concurrence in the Eleventh Circuit's original decision last year.

In substance, the applicability of judicial estoppel is now virtually irrelevant in the Fifth Circuit when a trustee is prosecuting a previously undisclosed claim for the benefit of creditors. The Fifth Circuit also endorsed the idea of precluding a culpable debtor from benefitting from successful prosecution by directing any recovery exclusively toward creditors.

Therefore, the Fifth Circuit's pre-*Reed* automatic invocation of judicial estoppel may no longer be good law in that circuit. Even if it is, the principle has little relevance after *Reed*, which permits recoveries on undisclosed claims to benefit innocent creditors.

Consequently, the Tenth Circuit may be the only circuit functionally at odds with four other circuits. As such, there may not be a fully developed, entrenched split warranting a grant of *certiorari*. For lack of a final order, a *certiorari* petition also would be premature at this juncture because the circuit remanded for more than ministerial duties.

The *Amicus* in the Eleventh

Supporting the debtor, J. Erik Heath of San Francisco submitted an *amicus* brief in the Eleventh Circuit on behalf of the National Association of Consumer Bankruptcy Attorneys. In addition to explaining how Eleventh Circuit precedent had gone beyond the purpose of judicial estoppel, he recommended adopting the approach in *Reed* by granting a trustee standing to pursue a claim not available to a debtor in view of judicial estoppel.

Unfortunately, Judge Pryor did not cite *Reed* or consider how that case might inform the relief available on remand. Although the Eleventh Circuit "may not have explicitly

gone the route of *Reed*," Heath told ABI in an email that he believes it's "part of the result." He also praised the appeals court for overruling *Barger* and thereby allowing "trustees to escape judicial estoppel."

Remand to the Panel

When a circuit court reverses, it ordinarily remands to the trial court. But not here.

Judge Pryor remanded the case to the original three-judge panel "to consider whether the district court abused its discretion in applying judicial estoppel *and to resolve any other remaining issues.*" [Emphasis added.]

The mandate to consider other issues should allow the three judges to opine on a result like *Reed*, where creditors can benefit but the debtor cannot.

Supreme Court Grants *Certiorari* in a Third Bankruptcy Case This Term - *Lamar, Archer & Cofrin LLP v. Appling*, 16-1215 (Sup. Ct.)

On Jan. 12 the Supreme Court granted *certiorari* and will review *Lamar, Archer & Cofrin LLP v. Appling*, 16-1215 (Sup. Ct.), to resolve a split of circuits and decide whether a false oral statement about one asset is a statement of "financial condition" that must be in writing to result in denial of discharge of a debt under Section 523(a)(2).

The case will be argued, with a decision handed down before the Court's term ends in late June. With *Appling*, the high court will decide three bankruptcy cases this term.

On Nov. 6, the justices heard oral argument in *Merit Management Group LP v. FTI Consulting Inc.*, 16-784 (Sup. Ct.), dealing with the safe harbor in Section 546(e). In *U.S. Bank NA v. The Village at Lakeridge LLC,* 15-1509 (Sup. Ct.), argued on Oct. 31, the Supreme Court will prescribe the standard of appellate review for non-statutory insider status. Decisions in those cases could come down in the next few weeks.

On the issue in *Appling*, the courts of appeals are evenly split. The Eleventh and Fourth Circuits hold that a false oral statement about one asset is a statement of "financial condition" that must be in writing to result in denial of discharge of a debt under Section 523(a)(2). The Fifth and Tenth Circuits ruled to the contrary, holding that misrepresenting one asset can result in nondischargeability of the debt owing to the creditor to whom the misrepresentation was made.

Among the lower courts, a majority follow the Eleventh and Fourth Circuits.

In the Eleventh Circuit case that the justices will review, a client told his lawyers that he expected a large tax refund that would enable him to pay his legal bills. Based on that representation, the lawyers continued working.

Although the refund was smaller than represented, the client spent it on his business, falsely telling his lawyers that he had not received the refund. The lawyers continued working. Later, they obtained a judgment they could not collect when the client filed bankruptcy.

The bankruptcy judge held that the claim for legal fees was not discharged. The ruling in bankruptcy court was upheld in district court, but the Eleventh Circuit reversed in a Feb. 15 opinion authored by Circuit Judge William Pryor. *Appling v. Lamar, Archer Cofrin LLP (In re Appling)*, 848 F.3d 953 (11th Cir. Feb. 15, 2017).

The high court will be interpreting Sections 523(a)(2)(A) and 523(a)(2)(B). Under (a)(2)(B), a debt will not be discharged if it resulted from a materially false written statement "respecting the debtor's . . . financial condition."

Under (a)(2)(A), a debt will not be discharged if it resulted from "a false representation or actual fraud, other than a statement respecting the debtor's . . . financial condition."

The creditor who lost in the Eleventh Circuit filed a petition for *certiorari* in April. In June, the justices invited the Solicitor General "to file a brief in this case expressing the views of the United States."

In a brief on Nov. 9, the Solicitor General recommended that the high court hear the case because there is a deepening circuit split over an "important and recurring" question. The government also took the position that the Eleventh Circuit was correct in holding that a false oral statement about one asset should not result in nondischargeability of a debt.

If the justices reverse the Eleventh Circuit, bankruptcy law will mean that someone who utters a big lie can win a discharge of debt when making a small lie can mean a nondischargeable debt.

Here are the examples. If the debtor says orally, "I have a $10 million net worth," that statement will not make a debt nondischargeable because all circuits would agree it's a statement about "financial condition" that must be in writing before resulting in nondischargeability.

By way of contrast, assume the debtor owns many properties and says orally, "One property I own is worth $10 million." In the Fifth and Tenth Circuits, the statement could make the debt nondischargeable if it were false because those courts of appeals believe that the representation would not concern "financial condition" because it says nothing about the debtor's overall net worth.

In the Fifth and Tenth Circuits, a debtor could safely misrepresent his or her net worth without the risk of dischargeability, but the same debtor in those circuits would end up with a nondischargeable debt for misrepresenting only one asset. In other words, the Supreme Court will decide whether a smaller lie is more dangerous to dischargeability than a big lie.

Like *Merit Management*, *Appling* gives the Supreme Court another opportunity to decide a bankruptcy case by focusing more on the perceived purpose as opposed to the language of the statute. Like the Eleventh Circuit, perhaps the justices will recognize that human beings are prone to puffery and that creditors should take oral statements about financial condition with a grain of salt, regardless of whether the statement concerns one asset or overall financial condition.

Chicago Believes that Inaction Doesn't Violate the Automatic Stay – *In re Walker*, 17-33957 (Bankr. N.D. Ill. Dec. 20, 2017)

The City of Chicago lost the latest battle over the collection of parking fines, but the bankruptcy judges in the Windy City remain split over the underlying legal issue. In the immediate future, the Seventh Circuit will decide whether the city wins or debtors get their impounded cars back automatically after filing chapter 13 petitions.

Chicago's persistence in collecting parking fines may eventually lead the Supreme Court to decide whether inaction is a violation of the automatic stay.

In *Thompson v. General Motors Acceptance Corp.,* 566 F.3d 699 (7th Cir. 2009), the Seventh Circuit held that passively holding property amounts to an exercise of control and therefore violates the automatic stay under Section 362(a)(3). Under *Thompson*, Chicago was being required to turn over cars belonging to chapter 13 debtors that had been impounded before filing on account of unpaid parking fines.

Then, the city came up with a theory that persuaded Bankruptcy Judge Donald R. Cassling. In *In re Avila*, 566 B.R. 558 (Bankr. N.D. Ill. 2017), he held in March that the city only had a possessory lien.

Since the city had no consensual lien if it were to give up the possessory lien, Judge Cassling held that retention of a vehicle fell within the exception to the automatic stay under Section 362(b)(3). That section provides that the stay does not apply to "any act to perfect, or to maintain or continue the perfection of, an interest in property . . . ."

Because he held that the city was not required to turn over a car automatically, Judge Cassling in substance put the onus on the debtor to file a turnover motion and offer adequate protection. In practical effect, filing a chapter 13 petition would not

automatically or quickly give a car back to its owner and would require the debtor to incur additional legal expense.

In an opinion on Dec. 20, Bankruptcy Judge Jack B. Schmetterer of Chicago said that *Avila* was "incorrect" and explained why he henceforth will require the city to turn over impounded cars. However, Judge Schmetterer did not divest the city of its lien or leave Chicago without remedy.

Judge Schmetterer pointed out how the Seventh Circuit said in *Thompson* that a creditor must first return property "and then, if necessary, seek adequate protection of its interests." He then explained why the exception to the automatic stay in Section 362(b)(3) did not apply.

The exception only applies to "an act," not to an "act or omission," Judge Schmetterer said. According to him, the "plain statutory language does not say" that possession required to maintain a possessory lien affords the protection of Section 362(b)(3).

In *Thompson*, Judge Schmetterer found the means for Chicago to preserve its rights while turning over a car. He referred to the discussion in *Thompson* where the appeals court said that a creditor worried about the loss in value before a hearing on adequate protection could file an emergency motion under Bankruptcy Rule 4001(a)(2).

To preserve its lien, the city must file an emergency motion to modify the automatic stay and request adequate protection, Judge Schmetterer said.

The procedure to protect its lien will not come without cost to the city, however. Judge Schmetterer said the "crux of the matter" is Chicago's desire to avoid the payment of a filing fee for an emergency motion every time a debtor requests turnover of an impounded car.

Whether Chicago ultimately wins or loses also might be decided if the Supreme Court tackles a split of circuits that the Tenth Circuit deepened in 2017. In *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate."

The Tenth Circuit aligned itself with the District of Columbia Circuit. The Seventh, Second, Ninth and Eighth Circuits hold to the contrary and say that retaining property after demand for turnover does violate the automatic stay.

Although there was no petition for rehearing *en banc* in *Cowen*, the issue is going to the Tenth Circuit on a direct appeal from *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-5006, 2017 BL 235622 (Bankr. D. Kan. July 7, 2017), where Bankruptcy Judge Robert E. Nugent of Wichita, Kan., was forced to rule contrary to two prior

decisions of his own that the automatic stay did not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit.

Presumably, the debtor in *Garcia* will seek *en banc* review because the outcome otherwise seems controlled by *Cowen*. There may be a delay, however, because the case has been sent for mediation in January. The case in the Tenth Circuit is *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-3247 (10th Cir.).

Tenth Circuit Direct Appeal to Decide Whether the Automatic Stay Is Really Automatic - *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-611 (10th Cir.)

The Tenth Circuit has just granted a direct appeal involving a deepening split where a minority of two circuits held that the automatic stay is not automatic.

In *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate." *Cowen* was important, because it means that debtors in chapters 7, 11, 12 and 13 cannot recover their repossessed vehicles in six states without mounting a turnover action. It also means that businesses in chapter 11 cannot immediately resume operations if property was repossessed before filing.

In substance, the Tenth Circuit held that the automatic stay is not really automatic. Latching onto the words "any act" in Section 362(a)(3), the appeals court held that inaction is not an act and thus cannot violate the automatic stay.

The Tenth Circuit in *Cowen* sided with the D.C. Circuit. The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold the opposite, having ruled that a lender or owner must turn over repossessed property immediately or face a contempt citation.

The case being directly appealed to the Tenth Circuit is *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-5006, 2017 BL 235622 (Bankr. D. Kan. July 7, 2017), decided in July by Bankruptcy Judge Robert E. Nugent of Wichita, Kan. Forced to rule contrary to two prior decisions of his own, Judge Nugent reluctantly held that the automatic stay did not prevent a statutory worker's compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit. In other words, the lien attached to after-acquired property despite the policy evident in Section 552(a).

The chapter 13 trustee in *Garcia* appealed and obtained a certification of direct appeal from the district court without opposition. On Nov. 20, the Tenth Circuit granted a direct appeal.

The trustee's petition for direct appeal said that *Cowen* "deepened an existing split in the Circuit Courts" and "has been criticized by a bankruptcy court and commentators." The trustee cited the American Bankruptcy Institute among those who criticized *Cowen*.

The trustee in *Garcia* may mount a frontal assault on *Cowen*, but the upcoming three-judge panel in the Tenth Circuit might attempt to narrow *Cowen*. To the extent that the three judges rely on *Cowen*, they nonetheless will have laid the groundwork for an *en banc* rehearing to set aside *Cowen* entirely.

Preferably, the Tenth Circuit should address *Cowen en banc*, because attempting to narrow *Cowen* will result in increased complexity and a lack of predictability in how the Tenth Circuit might rule under slightly different circumstances.

To read ABI's discussion of *Cowen* and *Garcia*, click here and here.

Ninth Circuit BAP Backs Away from Automatic Dismissal of 'Marijuana' Cases - *Olson v. Van Meter (In re Olson)*, 17-1168 (B.A.P. 9th Cir. Feb. 5, 2018)

Now that about half the states have some form of legal marijuana sales, Bankruptcy Appellate Panel Judge Maureen A. Tighe of Woodland Hills, Calif., wrote a concurring opinion saying that the court should not reflexively dismiss a bankruptcy just because there is marijuana on the premises.

The debtor was a blind, 92-year-old woman living in an assisted living facility. She owned a small shopping center where one of the tenants was a marijuana dispensary operating legally under state law but not federal law. She filed a chapter 13 petition to halt foreclosure and sell the property.

Sua sponte, the bankruptcy judge dismissed the case because the debtor had received post-petition rent from the dispensary. The unanimous Ninth Circuit Bankruptcy Appellate Panel reversed and remanded on Feb. 5, because the bankruptcy judge had not made adequate findings of fact and stated legal conclusions indicating the grounds for dismissal.

Judge Tighe's concurring opinion is noteworthy. Before dismissing, she explained that the bankruptcy court must find that the debtor is violating the federal Controlled Substances Act. She noted that the debtor's plan "did not necessarily require rental income" from the dispensary.

Rather, the plan called for selling the shopping center and using the proceeds to pay creditors in full. In the meantime, the debtor intended to reject the lease and evict the dispensary.

Judge Tighe focused on 21 U.S.C. § 856(a)(2), which prohibits someone from knowingly and intentionally allowing property to be used for the distribution of drugs. The criminal statute also requires a showing that the primary or principal use of the property is for the distribution of drugs.

Judge Tighe explained why the debtor had not necessarily violated criminal law.

To violate the law, she said, there must be evidence that the debtor herself knew that the tenant operated a dispensary or that she intentionally allowed that use.

The debtor's son was her attorney-in-fact and managed the shopping center. Judge Tighe said the record did not show when the debtor became aware of the illegal activities. In addition, she said, her son's knowledge could not be imputed to the debtor.

In sum, Judge Tighe said that "the presence of marijuana near the case should not cause mandatory dismissal." Her opinion suggests that a debtor might escape dismissal by refusing to accept rent from a marijuana business after filing and move to reject a lease. A problem could arise if the marijuana operator exercises the right under Section 365(h) to remain in possession after rejection.

Judge Tighe was sitting on the BAP by designation.

Marijuana Advisors Are Not Precluded from All Relief in Bankruptcy Courts – *Medpoint Management LLC v. Jensen (In re Medpoint Management LLC)*, 15-1130 (B.A.P. 9th Cir. June 3, 2016)

Although a bankruptcy court cannot entertain the bankruptcy of a company in the medical marijuana business, the court can nonetheless assess damages against creditors for filing an unsuccessful involuntary petition.

Creditors filed an involuntary chapter 7 petition against a company that advised medical marijuana dispensaries in Arizona, where it is legal. After a hearing that dealt only with the legality of the alleged debtor's business, the bankruptcy court dismissed the involuntary petition after concluding that a trustee inevitably would be in the position of violating the federal Controlled Substances Act.

Alternatively, the bankruptcy court dismissed the involuntary petition because the creditors had unclean hands since they knew or should have known that the alleged debtor's business was illegal under federal law.

Although the bankruptcy court never developed a record focusing on the petitioners' bad faith, the bankruptcy judge also denied the alleged debtor's motion for damages under Section 303(i).

The Ninth Circuit Bankruptcy Appellate Panel, in a non-precedential opinion on June 3, reversed the bankruptcy court for failing to allow the alleged debtor to introduce evidence about the petitioners' bad faith.

Although a marijuana business legal under state law is ineligible for bankruptcy relief, the B.A.P.'s opinion means that an alleged debtor advising marijuana dealers is not precluded from obtaining all forms of relief in federal court, such as the imposition of damages for filing an unsuccessful involuntary petition.

The opinion does not necessarily mean that actual marijuana dispensaries can obtain damages for defeating involuntary petitions, because the appeal before the B.A.P. only dealt with an advisor where imposing damages on the creditors would not run the risk of violating federal drug laws.

Still, the B.A.P. opinion implies that the unclean hands of someone in the marijuana business does not preclude all forms of relief from a federal court.