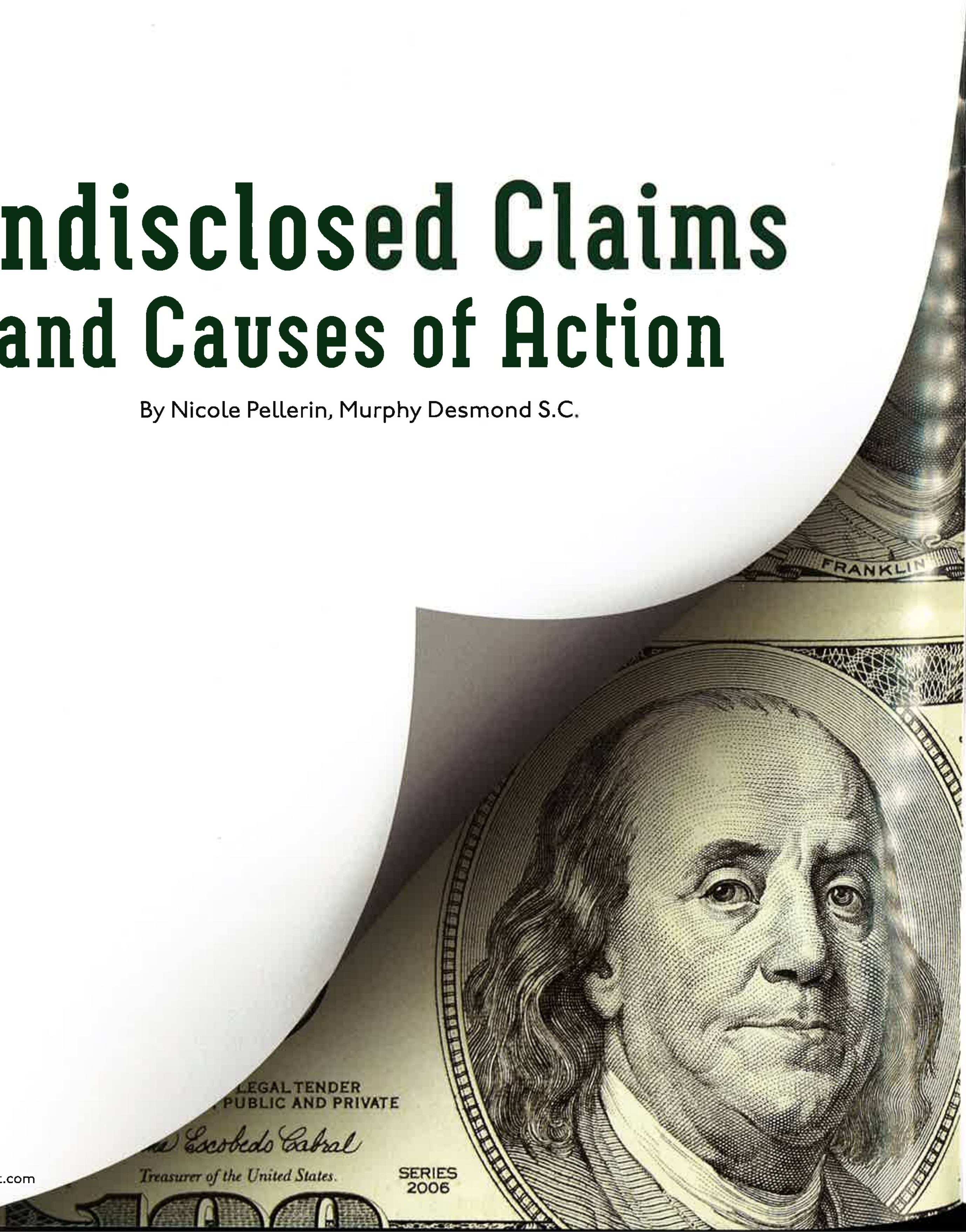
Undisclosed Claims and Causes of Action

By Nicole Pellerin, Murphy Desmond S.C.



It happens. A debtor files bankruptcy, the § 341 meeting is held, the trustee asks all the questions a trustee is supposed to ask, and determines from the debtor's responses and schedules that there are no assets available for liquidation and distribution to creditors. The trustee issues a no-asset report, the debtor receives his discharge and the case is closed. Then, a year – or two or three – later, the trustee is contacted by an attorney for some defendant sued by the debtor. The attorney wants the trustee to sign off on a settlement that has been negotiated by the parties, or, the attorney asks the trustee to abandon the claim. Sometimes, the attorney wants the trustee to become involved in the action because it is often easier to negotiate and settle with a trustee who doesn't have the same emotional investment in the claim as the debtor. But, sometimes, it is the debtor or her counsel calling wanting the trustee to jump in and take over prosecution of the claim because the defendant got wind of the debtor's prior bankruptcy and knows the debtor failed to list the claim. And now, the defendant is trying to get the suit thrown out for: 1) lack of standing (after all, the undisclosed claim still belongs to the bankruptcy estate); and/or 2) judicial estoppel.

When this happens, the first thing to do is to get the case reopened because regardless of the claim's value to the estate, an undisclosed pre-petition asset needs to be disclosed so someone can take ownership of it. But, what if the debtor contends that the claim doesn't belong to the bankruptcy estate? What if the debtor asserts that the claim is a post-petition asset and, therefore, belongs solely to him? This has become a more and more frequent occurrence because of the increase of mass tort and latent or undiscovered injury claims, such as those involving pharmaceutical drugs (Fen-Phen, Lipitor, Yaz) or medical devices (hip implants, intrauterine devices, transvaginal/pelvic mesh). In these cases, the drug is ingested or the device implanted years before the harm occurs or the danger discovered. So, whose claim or cause of action is it to prosecute?

When a bankruptcy petition is filed, an estate is created that consists of all property the debtor owns or in which the debtor has an interest.[1] *Property* is defined broadly and includes "all legal or equitable interests" of the debtor. Therefore, at the time of filing, "virtually all property of the debtor...becomes property of the bankruptcy estate,"[2] including claims and causes of action. And, except for a few and limited types of property set forth in section 541(a), property the debtor acquires after the petition is filed belongs to the debtor.

Though federal law determines *when* a debtor's property interest becomes part of the bankruptcy estate, state law determines *if* a property interest even exists. By and large, congress left the determination of property rights in the assets of a debtor's estate to state law and "[u]nless some federal interest requires a different result, there is no reason why [property] interests should be analyzed differently".[3]

As it relates to claims and causes of action, it's not disputed that if a debtor could have brought suit on her own behalf under state law at the time the case was commenced, the claim or cause of action is property of the bankruptcy estate.[4] However, when it comes to claims involving mass torts or latent injuries, the seemingly bright temporal line imposed by section 541(a) isn't quite so bright. As such, bankruptcy courts have had a difficult time determining whether these types of claims are property of the bankruptcy estate. Several factors have muddied the water: 1) the all-inclusive definition of "property"; 2) the widespread adoption of the discovery rule; 3) the increase of mass tort and latent injury claims; and 4) the difficulty in determining when injury actually occurs. In light of this murkiness, three approaches have developed to determine whether mass tort or latent injury claims belong to a bankruptcy estate: 1) the State Law Accrual Approach; 2) the "Sufficiently Rooted" Approach; and 3) the State Law Cause of Action Approach.

The State Law Accrual Approach is based on the idea that a cause of action cannot arise until it becomes legally enforceable, or accrues. Generally, the date of injury is the benchmark for the accrual of a cause of action. In latent injury claims, however, using the date of injury can have harsh results and foreclose recovery for an injured party inasmuch as a party that suffers a latent injury usually does not know of the wrongful act until the injury manifests itself. If the statute of limitations were to run from the date of the wrongful act, most – if not all – such injured parties would be barred from recovery. To avoid this result, some courts have adopted the "discovery rule," "[b]ecause an individual cannot state a claim until he or she suffers a provable harm due to an identifiable wrongful act, [so] the claim does not arise until these elements are discoverable."[5] The idea is that a cause of action accrues and its attendant statute of limitations begins running when the injury is discovered or should have been discovered with reasonable diligence. However, use of the "discovery rule" isn't universal and many bankruptcy courts reject it as merely triggering the statute of limitations and *not* ownership of the cause of action.

The "Sufficiently Rooted" Approach provides that even if a cause of action accrues post-petition, it may still be property of the estate if it is "*sufficiently* rooted in the pre-bankruptcy past".[6] Using this approach, whether an element of a cause of action accrues post-petition is not dispositive of whether the cause of action is included in the property of the bankruptcy estate. The significance of the post-petition element – in relation to all other facts and circumstances – is considered, along with the timing of the conduct giving rise to the claim for damages. When this approach is used, whether a cause of action was accrued at the commencement of the case is not necessarily relevant because the new and broad definition of "property" includes interests that are contingent, future, speculative, derivative or nonpossessory. However, the "Sufficiently Rooted" Approach is not without its detractors:

> Under the sufficiently rooted test, a bankruptcy estate will include not just causes of action the debtor has when the

About the Author

Nicole Pellerin focuses her legal practice on bankruptcy and insolvency litigation. She represents debtors and creditors in all chapters of bankruptcy and serves as attorney for a Chapter 7 Trustee. In addition, Nicole has represented clients before the Internal Revenue Service, the Wisconsin and Illinois Departments of Revenue and the Department of Workforce Development. She is a member of the firm's Litigation practice group, as well as the Creditors' Rights, Business Bankruptcy & Commercial Litigation team.

"Judicial estoppel is an equitable doctrine invoked at the court's discretion designed to prevent perversion of the judicial process. It exists to protect the integrity of the judicial process by prohibiting parties from deliberately changing positions according to the exigencies of the moment."

case commences, but also causes of action that accrue post-petition if they are sufficiently rooted in the pre-bankruptcy past giving the court two alternatives, neither of which the court found to be acceptable. Either disregarding the clear temporal line drawn in section 541(a) or ignore the state law that establishes the causes of action.[7]

The State Law Cause of Action Approach relies upon state law and requires that a bankruptcy court decide whether the debtor possessed a cause of action under state law as of the commencement of the case. It does not require that the court compare pre- and post-petition events and it distinguishes the creation of an enforceable claim from the accrual of a claim for statute of limitations purposes. The Fifth Circuit recognized this distinction in *In re Swift*[8] when it rejected the discovery rule as irrelevant and observed that a claim can accrue for ownership before the statute of limitations begins to run.

Assuming the bankruptcy court, using whichever of the three approaches, finds that the cause of action is an asset of the bankruptcy estate, the trustee's next step should be easy – prosecute the cause of action. But, what if the defendant asserts that the debtor is judicially estopped from asserting the claim because of the initial non-disclosure in his bankruptcy papers?

Judicial estoppel is an equitable doctrine invoked at the court's discretion designed to prevent perversion of the judicial process. It exists to protect the integrity of the judicial process by prohibiting parties from deliberately changing positions according to the exigencies of the moment. Application of the doctrine prevents a party that has taken one position in an earlier legal proceeding from maintaining an inconsistent position in a subsequent legal proceeding. There is no hard and fast rule for determining when to apply judicial estoppel and courts must take into account all of the circumstances of a particular case when deciding to apply the doctrine.

As it relates to bankruptcy, judicial estoppel is often raised as a defense by parties the former debtor sues post-petition on an undisclosed pre-petition claim. The idea is that the debtor represented to the bankruptcy court, the trustee and her creditors that she had no cause of action and all parties relied upon that representation, so, the debtor should not be able to later bring the action.[9] Some courts, when finding the debtor is judicial estopped from prosecuting an action, have even gone as far as commenting that the court would not grant the debtor's motion to substitute the bankruptcy trustee as plaintiff in the action if the debtor had so moved.[10] This seems like a particularly harsh result for the estate because a judicial estoppel defense against the debtor should not bar the trustee from prosecuting a cause of action. After all, the trustee is not the party that made the inconsistent representations. Further, it would be unfair and unjust to not only allow an alleged wrong-doer to escape liability, but to also keep any potential recovery from the debtor's creditors. It is noteworthy that in these cases, the trustee was not involved, but it is unclear if that's because she was never informed of the claim or declined to become involved because the recovery was insignificant.

FOOTNOTES:

1 11 U.S.C. §541(a)

2 *In re Yonikus*, 996 F.2d 866, 869 (7th Cir.1993)

3 *Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979)

4 *Matter of Geise*, 992 F.2d 651, 655 (7th Cir. 1993)

5 *In re Wagner*, 530 B.R. 695, 702 (Bankr. E.D. Wis. 2015)

6 *Segal v. Rochelle*, 382 U.S. 375, 380, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966)

7 *In re Holstein*, 321 B.R. 229, 238 (Bankr. N.D.Ill.2005)

8 129 F.3d 792 (5th Cir. 1997)

9 *Goldman v. Rio*, 853 N.Y.S.2d 837, 841 (N.Y. Ct. App. 2008); *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 417 (3rd Cir. 1988); *Jethroe v. Omnova Solutions, Inc.*, 412 F.3d 598 (5th Cir. 2005); *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282 (11th Cir. 2002).

10 See *E.E.O.C., et al. v. J.D. Streett & Co.*, 2006 U.S. LEXIS 78906 (S.D. Ill.) *("Thus, the Trustee is the real party in interest in this action. Wolf [the plaintiff and former debtor] does not ask the Court to allow her to substitute the real party in interest as a plaintiff in this case. However, even if she had made such a request, the Court would deny it.")*