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Judicial Estoppel: Key Defense In Discrimination Suits

Law360, New York (September 12, 2008) -- An important defense has become increasingly useful in protecting employers against employee lawsuits. The defense of judicial estoppel, as recognized most powerfully in the employment litigation setting in *Cannon-Stokes v. Potter*, 453 F.3d 446 (7th Cir. 2006), bars a plaintiff's employment discrimination action where the plaintiff previously failed to disclose the legal claim as an asset in a bankruptcy proceeding.

When used, judicial estoppel prevents a plaintiff from later proceeding on the claim after failing to acknowledge its existence while having his debts discharged in the bankruptcy.

While *Cannon-Stokes* opened the door to a new defense for employers in the Seventh Circuit (encompassing Illinois, Indiana and Wisconsin), it also raised questions as to the impact it would have and whether effective counter-arguments would emerge to limit its application.

However, in the two years since *Cannon-Stokes* was decided, both the Seventh Circuit and the U. S. District Courts in Illinois have consistently applied the judicial estoppel defense, barring legal claims that were omitted in prior bankruptcy petitions, making it a viable defense in employment litigation. See, *Becker v. Verizon North, Inc.*, 2007 U.S. App. LEXIS 9879, at *5 (7th Cir. April 25, 2007) (plaintiff's "failure to disclose her [employment] claims during the bankruptcy proceeding judicially estops her from pursuing them now"); *Thompson v. O'Bryant*, 2008 U.S. Dist. LEXIS 35317 (N.D. Ill. April 30, 2008) (judicial estoppel barred plaintiff from pursuing claims that were not listed in prior bankruptcy); *Matthews v. Potter*, 2008 U.S. Dist. LEXIS 25021 (N.D. Ill. Mar. 24, 2008) (summary judgment for employer where plaintiff did not list Title VII claims in prior bankruptcy until after employer raised defense).

Mechanics Of The Judicial Estoppel Defense

Judicial estoppel is an equitable doctrine based on the principle that litigants may not exploit the judicial process by advancing a position in one court proceeding and then taking the opposite stance in another proceeding.

The application of judicial estoppel arises most often where a litigant obtains a discharge of debt in a Chapter 7 bankruptcy (or enters a repayment plan under Chapter 13) and then later sues a former employer in an employment-related lawsuit.

Therefore, an employee may not assert that he has no potential legal claims, obtain discharge of his debt through bankruptcy court, and then later pursue in another court the legal claim that he denied existed.

The purpose of the doctrine is to require bankruptcy filers to truthfully disclose any assets in the bankruptcy estate at the time of the bankruptcy filing.

When a debtor files for Chapter 7 bankruptcy, any legal claims he may have become property of the bankruptcy estate. These claims need not have been previously filed in court, but only must have accrued at the time of the bankruptcy filing.

Accordingly, bankruptcy filers have an absolute duty to disclose all assets or property interests they may have, including any actual or possible legal claims.

In addition, the debtor has an ongoing duty to amend his disclosures during the entire time the bankruptcy is pending. For this disclosure, the typical bankruptcy schedule asks the debtor to identify all “contingent and unliquidated claims of every nature.” The debtor’s response of “None” signals potential for application of the judicial estoppel defense.

Claims Must Accrue Prior To Discharge Of Debts

Often, the critical debate in judicial estoppel cases is whether the employee’s potential claim has accrued at the time his debts are discharged and the bankruptcy is closed. A plaintiff does not need to know he has a legal cause of action for the claim to have accrued.

When the conduct underlying a claim and the resulting injury both occur prior to filing of the bankruptcy petition, the debtor now has a property interest in the claim, even if he has not yet discovered all the facts supporting the claim.

In the employment setting, claims typically accrue no later than the date an employee is discharged or constructively discharged. See e.g., *West v. H&R Block*, 2003 U.S. Dist. LEXIS 22778, at *8 (N.D. Ill. Dec. 12, 2003) (unscheduled employment discrimination claim accrued no later than date debtor was constructively discharged).

Intentional Omission Of Claims Not Required To Establish Judicial Estoppel

Employers generally do not have to establish that the debtor purposefully omitted the potential legal claim from the bankruptcy filing to successfully assert the judicial estoppel defense.

The Seventh Circuit recently held that the debtor's "subjective intent does not matter," and judicial estoppel bars the claim whether or not the debtor intended to omit his claim from the bankruptcy pleadings. *Becker v. Verizon North, Inc.*, 2007 U.S. App. LEXIS 9879, at *5 (7th Cir. Apr. 25, 2007).

Some courts have resisted the application of judicial estoppel when a debtor inadvertently or mistakenly failed to disclose a potential legal claim in a bankruptcy proceeding.

However, most courts have found that failure to disclose is only considered inadvertent or mistaken when the debtor lacked knowledge of the factual basis of the claim or had no motive (or financial incentive) to conceal its existence.

Later attempts by plaintiffs to re-open a bankruptcy case and amend the petition to disclose legal claims as assets generally are not successful in preventing the use of judicial estoppel.

Such eleventh hour attempts at candor are typically prompted by the employer's raising of the judicial estoppel defense, and do not carry much favor with courts.

The reopening and amending of bankruptcy petitions could also result in other serious consequences for the litigant, including possible revocation of the prior discharge of debts.

Additionally, courts have rejected the argument that the plaintiff relied upon the advice of his attorney when failing to disclose the potential claim in the bankruptcy filing.

Standing May Be A Threshold Inquiry

Some courts have averted the judicial estoppel analysis by making a threshold determination that the plaintiff lacks standing to even pursue the employment claim.

When a debtor files for Chapter 7 bankruptcy, most of his assets become the property of the bankruptcy estate, including any actual or potential legal claims that the debtor may have against a third party. Even if the debtor fails to disclose a legal claim as an asset, the claim still becomes the property of the estate to be administered by the bankruptcy trustee.

Therefore, the trustee becomes the real party in interest for any claims that accrued prior to the bankruptcy discharge and is the only party with standing to sue on the claim.

Under certain circumstances, the bankruptcy trustee may decide to abandon the legal claim pursuant to 11 U.S.C. § 554, and the debtor may then pursue the claim on his own behalf.

In such cases, the debtor's victory may be short lived as the judicial estoppel defense then stands front and center to bar the debtor from further pursuing the legal claim.

At the outset of a case, an employer should consider raising the standing (or real party in interest) argument in a motion to dismiss for lack of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1).

If unsuccessful, the employer then has an opportunity to take a second bite at the apple by raising the judicial estoppel defense at summary judgment.

Judicial Notice

Most courts have treated judicial estoppel as an affirmative defense under Federal Rule of Civil Procedure 8(c), which the employer must raise in a summary judgment motion.

On occasion, courts have also entertained the judicial estoppel defense along with the standing argument in a motion to dismiss.

In such motions, employers should ask the court to take judicial notice of the filings from the plaintiff's bankruptcy action under Federal Rule of Evidence 201 and attach the bankruptcy schedules to the motion.

Judicial Estoppel Defense Has Been Recognized In Many Jurisdictions

The doctrine of judicial estoppel originates primarily from the U. S. Supreme Court's decision in *New Hampshire v. Maine*, 532 U.S. 742 (2001). In that case, the Supreme Court held the doctrine's purpose to be protection of "the integrity of the judicial process by prohibiting parties from deliberately changing positions according to the exigencies of the moment." *Id.*

While the Supreme Court did not address judicial estoppel in the context of a party's failure to disclose a legal claim in prior bankruptcy proceedings, it did set forth three non-exhaustive factors that a court may consider in determining the application of the judicial estoppel doctrine:

- (i) "a party's later position must be clearly inconsistent with its earlier position;"
- (ii) acceptance of an inconsistent position in a later proceeding may "create the perception that either the first or the second court was misled;" and
- (iii) the party asserting an inconsistent position may gain an unfair advantage in the litigation if not estopped. *Id.*

At least seven other circuits in addition to the Seventh Circuit (First, Third, Fifth, Eighth, Ninth, Tenth and Eleventh Circuits) have allowed judicial estoppel to bar a plaintiff's legal claim where he has denied the existence of the claim in a prior bankruptcy proceeding. See, *Payless Wholesale Distributors, Inc. v. Alberto Culver (P.R.) Inc.*, 989 F.2d 570 (1st Cir. 1993); *Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. GM Corp.*, 337 F.3d 314 (3rd Cir. 2003); *Jethroe v. Omnova Solutions, Inc.*, 412 F.3d 598 (5th Cir. 2005); *United States ex rel. Gebert v. Transport Administrative Services*, 260 F.3d 909 (8th Cir. 2001); *Hamilton v. State Farm Fire & Casualty Co.*, 270 F.3d 778 (9th Cir. 2001); *Eastman v. Union Pac. R.R.*, 493 F.3d 1151 (10th Cir. 2007); *Barger v. Cartersville*, 348 F.3d 1289 (11th Cir. 2003).

Judicial Estoppel Not Applied In Some Circumstances

The most common scenario where courts have refused to apply judicial estoppel is where the legal claim did not accrue, or the plaintiff did not have notice of a potential legal claim, until after the bankruptcy proceedings were closed.

In such case, the debtor has no obligation to list the claim and the bankruptcy estate has no right of possession over such a claim. In addition, some courts have found that a plaintiff's claim for injunctive relief (i.e., a request for reinstatement of employment), in contrast to a claim for monetary relief, is not barred under judicial estoppel.

There, the courts have reasoned that a claim for injunctive relief adds nothing of value to the bankruptcy estate, even where plaintiff properly discloses the claim.

Finally, there is some debate among courts on whether judicial estoppel should bar an action brought by the bankruptcy trustee on behalf of the bankruptcy estate when the claim is initially omitted and then later disclosed by a debtor.

The argument in favor of applying judicial estoppel against the trustee is to prevent the debtor from recovering (in the event the monetary judgment exceeds the debt) where he would otherwise be barred by judicial estoppel.

The Future Of The Judicial Estoppel Defense

The basic principle underlying bankruptcy is to obtain a discharge of one's personal debts in exchange for all of one's assets.

However, failing to disclose the asset of a legal claim and then later attempting to recover on the claim is a misapplication of the legal process.

Courts have shown that they will not permit such actions and have allowed use of judicial estoppel as a powerful defense.

With the growing acceptance of the judicial estoppel defense and the related standing inquiry, employers should first determine, at the outset of employment litigation, whether

the plaintiff previously filed a bankruptcy petition that could potentially bar the instant litigation.

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