



What Happens in Bankruptcy Stays in Bankruptcy, Right? Not Always.

What Every Litigator Should Know about Claims Disclosure

by Charlotte Ritz and Tara Elgie

Unless you represent debtors or creditors in bankruptcy cases on a regular basis, you may think that bankruptcy law has little, if any, relevance to your civil-litigation cases. And, for the most part, you're probably right. But if the plaintiff in a case that you are handling has ever filed for bankruptcy, you should determine whether the claims currently being prosecuted were disclosed in the bankruptcy proceedings. If the claims were not disclosed, and the plaintiff knew or should have known of their existence, the claims may be barred or the claim may belong to a bankruptcy trustee, not the plaintiff.

Regardless of whether you represent the plaintiff or defendant in an action, the sooner you determine whether any parties have failed to disclose claims in a bankruptcy proceeding, the better. If you represent a plaintiff whose claims were not disclosed in bankruptcy, you may be able to keep the claims alive by taking the steps outlined below. If you represent the defendant in such a case, you may be able to secure a dismissal or increase your client's settlement leverage based on the doctrines discussed below.

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Bankruptcy Disclosure Requirements

A voluntary bankruptcy case begins when the debtor files a petition for relief under the Bankruptcy Code.¹ Once a petition is filed, the debtor's "bankruptcy estate" is created.² Subject to certain exceptions set forth in the Code, the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case,"³ including any claims that the debtor may have against third parties.⁴ Some courts have found that the bankruptcy estate includes "not only claims that had accrued and were ripe at the time the petition was filed, but also those claims which accrued postpetition, but that are 'sufficiently rooted in the pre-bankruptcy past.'"⁵

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A debtor in bankruptcy must submit a schedule of assets setting forth all of the debtor's "legal or equitable interests."⁶ The debtor is required to disclose all "contingent and unliquidated claims of every nature," including both filed and unfiled causes of action against any person or entity.⁷ This disclosure requirement exists so that the trustee in bankruptcy may analyze the debtor's potential claims to determine whether they should be pursued for the benefit of the debtor's creditors,⁸ and to inform creditors and the court in making decisions throughout the bankruptcy case. Failure to disclose the existence of potential claims against a third party can result in the severe consequences described below.

Consequences of Failing to Properly Disclose Claims in Bankruptcy

If a debtor fails to disclose claims in bankruptcy, the debtor may be barred from asserting the claims later. When a petition is filed, the debtor's causes of action become part of the bankruptcy estate, even if they are not disclosed.⁹ In general, in a chapter 7 case only the bankruptcy trustee, as the representative of the estate, has standing to assert the debtor's claims against third parties.¹⁰ The debtor does not regain standing to bring such claims in any court or proceeding unless and until they have been "abandoned" within the meaning of the Bankruptcy Code, in which case they revert to the debtor.¹¹ In order for the trustee to affirmatively abandon property, the trustee must give notice of the proposed abandonment and an opportunity for a hearing to all creditors and the United States Trustee.¹² At the close of a bankruptcy case, certain claims may be deemed abandoned, but only if they were previously disclosed.¹³

Absent a court order holding otherwise or a formal abandonment of claims by the trustee after notice and a hearing,¹⁴ claims that were not properly disclosed on the debtor's schedule of assets will *not*

be abandoned back to the debtor.¹⁵ Instead, they will remain the property of the estate, and generally only the trustee will have standing to assert them.¹⁶ Consequently, if a debtor later attempts to assert claims that were not disclosed in a bankruptcy proceeding, the action may be dismissed based on the debtor's lack of standing.¹⁷

Claims that were not disclosed in bankruptcy proceedings also may be barred by the doctrine of judicial estoppel. This doctrine seeks to "prevent a litigant from asserting a position that is inconsistent with one asserted in the same or a previous proceeding,"¹⁸ "prevent litigants from playing 'fast and loose' with the Courts,"¹⁹ and "protect the integrity of the judicial process."²⁰

In the Fourth Circuit, courts generally require the presence of the following elements before invoking the principle of judicial estoppel: (1) the party sought to be estopped is seeking to adopt a position that is inconsistent with a stance taken in prior litigation; (2) the position is one of fact, not law; (3) the prior inconsistent position was accepted by the Court; (4) the party against whom judicial estoppel is to be applied intentionally misled the Court to gain unfair advantage.²¹ The fourth factor—whether the litigant intentionally misled the court to gain unfair advantage—is the determinative one.²² Some courts have concluded that the first three factors are satisfied where the Debtor fails to list a potential claim on the schedules, and fails to amend the schedules once the claim becomes known.²³

Potential Relevance to Your Cases

In light of the above, when a client asks you to file a lawsuit on his or her behalf, you must inquire as to any prior bankruptcy proceedings. If the client has previously filed for bankruptcy, you should review documents filed in that bankruptcy case to determine whether your client's claims arguably

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would be barred by the legal doctrines discussed above. If you learn that the claims are potentially barred and the bankruptcy case is ongoing, you can move the bankruptcy court for permission to amend your client's bankruptcy schedules and then ask the trustee or the Court to formally abandon the claims at issue. In order to make these requests in a bankruptcy case that has already been closed, you would need to first move to reopen the case. The case will not be reopened automatically upon request. Rather, bankruptcy courts have discretion in deciding whether to reopen a case to allow a debtor to disclose claims.²⁴ Similarly, courts will not permit a motion to reopen a bankruptcy case where it appears that doing so would be futile and a waste of judicial resources.²⁵ You should also be careful to properly value the claims when adding them to the amended schedules.²⁶

If you have been asked to serve as defense counsel in a legal action, you also must find out whether the plaintiff has ever filed for bankruptcy. You can do this by conducting a search of public bankruptcy dockets, informally asking opposing counsel, or through formal discovery requests. Then you should carefully analyze all pleadings and orders filed in any prior or ongoing bankruptcy proceedings to determine whether you have a basis to argue that the plaintiff's claims are barred by the doctrines discussed above. If a basis exists, you can then file a dispositive motion, or seek to deal directly with the trustee in the bankruptcy case, who usually is motivated to obtain a reasonable recovery for creditors and may provide an easier way to settle than dealing with the plaintiff and plaintiff's counsel. ☒

1. 11 U.S.C. § 301.

2. 11 U.S.C. § 541(a).

3. 11 U.S.C. § 541(a)(1).

4. *Field v. Transcontinental Ins. Co.*, 219 B.R. 115, 119 (E.D. Va. 1998).

5. *Id.* (concluding that a bad faith claim against an insurance company arising from a prepetition accident was a prepetition cause of action even though the request for indemnification, and subsequent denial, did not occur until after the petition date), *aff'd* 1999 U.S. App. LEXIS 2367 (4th Cir. Va. 1999); *Steyr-Daimler-Puch of America Corp. v. Pappas*, 852 F.2d 132, 136 (4th Cir. 1988) (estate includes all legal or equitable interests of the debtor in property, including choses of action).

6. 11 U.S.C. § 521(a)(1)(B)(i); *In re Wilmoth*, 412 B.R. 791, 795

(Bankr. E.D. Va. 2009).

7. Fed. R. Bankr. P. 9009; Official Bankr. Forms 6, Schedule B; *In re Wilmoth*, 412 B.R. at 795.

8. *In re Wilmoth*, 412 B.R. at 795.

9. *Luzardo v. America's Servicing Co. (In re Jose Gregorio Caminero Luzardo)*, 2008 Bankr. LEXIS 4344 at *6 (Bankr. E.D. Va. 2008).

10. *Steyr-Daimler*, 852 F.2d at 136; *Luzardo*, 2008 Bankr. LEXIS 4344 at *6; *see also* 11 U.S.C. § 323.

11. *Luzardo*, 2008 Bankr. LEXIS 4344 at *6.

12. Fed. R. Bankr. P. 6007(a).

13. 11 U.S.C. § 554(c); *In re Wilmoth*, 412 B.R. at 795.

14. 11 U.S.C. § 554(a), (b), (d).

15. *See, e.g., In re Wilmoth*, 412 B.R. at 795.

16. *In re Luzardo*, 2008 Bankr. LEXIS 4344 at *6.

17. *See, e.g., In re Luzardo*, 2008 Bankr. LEXIS 4344 at *6.

18. *Whitten v. Fred's Inc.* 601 F.3d 231, 241 (4th Cir. 2010).

19. *Whitten v. Fred's Inc.*, 601 F.3d at 241; *Canterbury v. J.P. Morgan Mortg. Acquisition Corp.*, 2010 U.S. Dist. LEXIS 134278, *10 (W.D. Va. 2010).

20. *Id.*

21. *See e.g., Bland v. Doubletree Hotel Downtown*, 2010 U.S. Dist. LEXIS 18514, at *8-9 (E.D. Va. Mar. 2, 2010) (quoting *Folio v. City of Clarksburg*, 134 F.3d 1211, 1217 (4th Cir. 1998)); *see also Whitten v. Fred's Inc.*, 601 F. 3d at 241.

22. *See Bland*, 2010 U.S. Dist. LEXIS 18514, at *9-10; *In re Thompson*, 344 B.R. 461 (Bankr. W.D. Va. 2004) (denying motion to reopen and declining to apply judicial estoppel where debtor's failure to disclose cause of action was not in bad faith and where confirmed chapter 13 plan had been successfully completed by the debtor and her discharge entered)

23. *Bland*, 2010 U.S. Dist. LEXIS 18514, at 10, n. 3.

24. *In re Wilmoth*, 412 B.R. at 795 (applying excusable neglect standard to deny motion to amend schedules where debtor failed to disclose the existence of a personal injury claim and later moved to re-open his case to schedule the claim and list it as exempt on Schedule C).

25. *In re Walker*, 198 B.R. 476, 478 (Bankr. E.D. Va. 1996).

26. *Bland*, 2010 U.S. Dist. LEXIS 18514, at *15 (finding that the debtor acted in bad faith when she initially failed to disclose a cause of action and subsequently amended the schedules to list the claim at one dollar, noting "the Court cannot ignore or discount the undisputed fact that [the debtor] valued the claim at such a negligible amount while seeking a bounty in this litigation"). ☒