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## List It or Lose It: The Application of Judicial Estoppel When a Debtor Fails to List a Claim

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# **LIST IT OR LOSE IT: THE APPLICATION OF JUDICIAL ESTOPPEL WHEN A DEBTOR FAILS TO LIST A CLAIM**

## **ABSTRACT**

*This Comment addresses the application of judicial estoppel to dismiss a debtor's civil or administrative claim when the debtor fails to list his claim on the required schedule. Part I of this Comment analyzes the general concept of equity and the principles underlying judicial estoppel. Part II analyzes equity and judicial estoppel through the lens of the bankruptcy system. Part III presents my proposed test to determine when it is appropriate for courts to invoke judicial estoppel to dismiss a debtor's undisclosed claim when the trustee has decided to abandon it after it has been discovered. This test considers four factors: (1) the legal sophistication of the debtor; (2) the events prompting disclosure; (3) whether there was any showing of inadvertence or attempts to disclose the claim; and (4) the reasons underlying the decision for the trustee to abandon the claim once discovered. The Comment concludes that a strict approach, as advocated by the proposed test, is the best way to protect the integrity and promote the efficient functioning of the bankruptcy system.*

INTRODUCTION .....	369
I. EQUITY THROUGH JUDICIAL ESTOPPEL .....	371
A. <i>Theory of Equity</i> .....	372
B. <i>The Equitable Remedy of Judicial Estoppel</i> .....	373
C. <i>Concepts of Equity and Judicial Estoppel in the Bankruptcy Context</i> .....	375
II. APPLICATION OF JUDICIAL ESTOPPEL FOR FAILURE TO LIST A CLAIM .....	376
A. <i>Real Party in Interest</i> .....	377
B. <i>Use of Judicial Estoppel for Failure to List a Claim</i> .....	378
1. <i>Strict Circuits</i> .....	378
2. <i>Relaxed Circuits</i> .....	380
C. <i>Form Modernization</i> .....	381
D. <i>Alternative Remedies Through the Bankruptcy Court</i> .....	382
1. <i>Deny or Revoke Discharge</i> .....	382
2. <i>Loss of Undisclosed Asset</i> .....	383
3. <i>Criminal Prosecution</i> .....	383
III. PROPOSED TEST: AIRING CLOSER TO A PRESUMPTION OF BAD FAITH .....	384
A. <i>How Sophisticated Is the Debtor? Is She Represented?</i> .....	384
B. <i>Who Discovered the Claim? What Prompted Disclosure?</i> .....	385
1. <i>Debtor Realized and Reported to Bankruptcy Court or to Attorney</i> .....	385
2. <i>Defendant in the Civil Action</i> .....	386
3. <i>The Bankruptcy Trustee</i> .....	386
4. <i>Was Disclosure Prompted by a Threat of Judicial Estoppel?</i> .....	387
C. <i>Was There Any Showing of an Intent to Disclose the Claim?</i> ..	388
1. <i>Oral Disclosure</i> .....	388
2. <i>Misplaced on Schedules</i> .....	388
3. <i>Has the Debtor Listed Other Claims of a Similar Type?</i> ....	389
D. <i>What Are the Reasons the Trustee Abandoned the Claim After It Had Been Discovered?</i> .....	389
1. <i>Amount of the Pending Claim in Relation to Debt</i> .....	389
2. <i>Claim Has Matured and Become Unattractive to the Trustee and Estate</i> .....	390
E. <i>Recap of the Proposed Considerations</i> .....	391
F. <i>How the Proposal Fits with The Two Goals of Bankruptcy</i> ....	392
1. <i>Maximizing Distribution to the Creditors</i> .....	392
2. <i>Providing a Fresh Start to the Debtor</i> .....	392

G. <i>Proposed Adjustments That Can Curb Non-Disclosure</i> .....	393
1. <i>Increased Access to Legal Resources</i> .....	393
2. <i>Further Clarify the Language on Official Form 106 A/B         and the Individual Filing Instructions</i> .....	393
3. <i>Section 341 Meeting of the Creditors</i> .....	394
4. <i>Civil Attorneys Search for Bankruptcy Filings</i> .....	394
CONCLUSION: THE FUTURE OF JUDICIAL ESTOPPEL .....	395

## INTRODUCTION

The United States bankruptcy system has two primary goals: to provide a good faith debtor a fresh start—a life free from the financial burdens of his pre-bankruptcy past—and to maximize the value of the bankruptcy estate distributed to the creditors.<sup>1</sup> It is important for any system to have clearly established goals and principles because they determine how the system functions and act as benchmarks measuring the system’s success. The United States bankruptcy system seeks to strike a balance between a creditor’s rights to payment and society’s interest in allowing people to take personal and entrepreneurial risks.<sup>2</sup> These co-equal values guide the policies and practices of the United States bankruptcy system.<sup>3</sup>

A fundamental component of bankruptcy is the debtor’s duty to fully disclose her assets. Without such disclosure, the estate would need to go through great expense to investigate and determine the financial situation of the debtor.<sup>4</sup> The modern Bankruptcy Code’s requirement for debtors to provide an explanation of their assets can be traced back to the Act of Henry the VII in 1541.<sup>5</sup> Similarly, the Bankruptcy Act of 1800—and every bankruptcy act that followed it—also included provisions and penalties for debtors hiding or attempting to hide assets.<sup>6</sup> The need for debtors to accurately disclose their assets

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<sup>1</sup> *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554–55 (1915) (“[T]he purpose of the Bankrupt Act [is] to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start a fresh free from the obligations and responsibilities consequent upon business misfortunes.”); Richard V. Butler & Scott M. Gilpatric, *A Re-Examination of the Purposes and Goals of Bankruptcy*, 2 AM. BANKR. INST. L. REV. 269, 269 (1994).

<sup>2</sup> *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

<sup>3</sup> *See Williams*, 236 U.S. at 554–55.

<sup>4</sup> The more the estate must expend on the identification and distribution of assets, the less money that the creditors would receive. *See Ben Branch, The Costs of Bankruptcy: A Review*, 11 INT’L REV. FIN. ANALYSIS 39, 45 (2002) (costs, such as administration costs and legal fees, necessarily take away from the value of a bankruptcy estate).

<sup>5</sup> *See Louis E. Levinthal, The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1, 1–20 (1919).

<sup>6</sup> *See Bankruptcy Act of 1800*, 2 Stat. 19, 6 Cong. Ch. 19 (repealed 1841); *Bankruptcy Act of 1898*, Pub.

should be readily apparent; distributing assets to creditors without a full understanding of the value of the estate would lead to unjust results and a degradation of the bankruptcy system.<sup>7</sup> Such an outcome would directly defeat the purpose of bankruptcy, which is intended not just to discharge debt but also to provide the most appropriate distribution of the estate's assets to creditors.

In the modern bankruptcy system, debtors are required to file bankruptcy schedules that detail, among other things, their assets, liabilities, current income, and expenditures.<sup>8</sup> When a debtor initially fails to list or amend his bankruptcy schedule to reflect his interest in property, he is hiding assets from the estate and, therefore, the creditors.<sup>9</sup> These omissions—whether intentional or inadvertent—threaten the integrity of the federal bankruptcy system.<sup>10</sup> Although every omission on filers' forms threatens the integrity of the bankruptcy system, it is not necessarily the case that all omissions should be treated equally. Assets come in different shapes and sizes. To name just a few, debtors can own houses, boats, stocks, interests in inheritance, or interest in a business.<sup>11</sup> Also included in the debtor's property—but possibly not as readily known by filers—are lawsuits and administrative claims for which the debtor is a plaintiff,<sup>12</sup> suits where the debtor is the defendant but has made counterclaims,<sup>13</sup> and potential claims where the injurious conduct had occurred prior to the petition date and where the debtor had taken some steps to show an intention to pursue a cause of

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L. No. 696, § 17, 30 Stat. 544, 550 (repealed 1978); Act of Feb. 5, 1903, Pub. L. No. 57-62, ch. 487, sec. 4, § 14(b), 32 Stat. 797, 797-98 (repealed 1978) (amending Bankruptcy Act of 1898); Act of July 12, 1960, Pub. L. No. 86-621, sec. 2, § 17(a), 74 Stat. 408, 409 (repealed 1978) (amending Bankruptcy Act of 1898); and Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, sec. 102(g)(3), § 1325(a), 119 Stat. 23, 33 (codified as amended at 11 U.S.C. § 1325(a)(7) (2019)).

<sup>7</sup> Leia A. Clement, Comment, *A Study on Bankruptcy Crime Prosecution Under Title 18: Is the Process Undermining the Goals of the Bankruptcy System?*, 31 EMORY BANKR. DEV. J. 409, 409-10 (2015).

<sup>8</sup> 11 U.S.C. § 521(a)(1) (2019). Section 521 is the statutory authority that requires debtors to file schedules of assets and liabilities. *Id.* The statute's requirements are implemented through Bankruptcy Rule 1007(b). FED. R. BANKR. P. 1007(b).

<sup>9</sup> Legal claims are considered property under the Code. Property of the estate is established by statute. Section 541(a)(1) reads:

- (a) The commencement of a case under section 301, 302, or 303 of this title . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
  - (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541(a)(1).

<sup>10</sup> *Guay v. Burack*, 677 F.3d 10, 19 (1st Cir. 2012).

<sup>11</sup> *See* 11 U.S.C. § 521(a)(1).

<sup>12</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 8, [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf) (Question 33).

<sup>13</sup> *Id.* (Question 34).

action.<sup>14</sup> This Comment explores the consequences that result from a debtor omitting assets on his Official Form 106 A/B or Statement of Financial Affairs (“SOFA”).<sup>15</sup>

Circuits are split as to whether a debtor’s failure to disclose a legal claim should be presumed to have been done in bad faith and subsequently dismissed on the basis of judicial estoppel.<sup>16</sup> This Comment will show why courts should adopt a more stringent analysis, leaning closer to a presumption of bad faith, when deciding whether to invoke judicial estoppel for a debtor’s failure to list a claim. Particularly, this Comment will lay out the four primary factors that courts should consider when determining whether the invocation of judicial estoppel is appropriate. Courts should consider: (1) the legal sophistication of the debtor; (2) the events prompting disclosure; (3) any showing of inadvertence or attempts to disclose her claim; and (4) the reasons underlying the decision for the trustee to abandon the claim once discovered. This four-factor test will clarify when to invoke judicial estoppel in the bankruptcy context. This checklist can be used by judges when determining whether to invoke judicial estoppel, by defense attorneys when deciding whether to raise the affirmative defense of judicial estoppel, and by debtors’ attorneys when developing the best defense against a motion for summary judgment based on judicial estoppel.

## I. EQUITY THROUGH JUDICIAL ESTOPPEL

Bankruptcy courts are often viewed as courts of equity, although to varying degrees.<sup>17</sup> How we view equity and its role in the judicial system affects which

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<sup>14</sup> For example, an individual who had a no-fault car accident one week before filing their bankruptcy petition would be required to list the potential claim on Official Form 106A/B. It is unclear where the filer would place this potential claim on the SOFA. *Martineau v. Wier*, 934 F.3d 385, 391 (4th Cir. 2019). The timing and conduct required to render pre-bankruptcy events the type required to be placed on a debtor’s SOFA is not entirely clear. *Id.* at 392 n.4.

<sup>15</sup> The redesign was a part of the Forms Modernization Project, an initiative which started in 2007 with the goal to make bankruptcy forms more accessible to non-lawyers. U.S. COURTS, 2015 COMMITTEE NOTE 1, 1 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106note.pdf](https://www.uscourts.gov/sites/default/files/form_b106note.pdf) (discussing Official Form 106 A/B).

<sup>16</sup> See *infra* Section II.B.

<sup>17</sup> C.S. Pryor, *Third Time’s the Charm: The Coming Impact of the Restatement (Third) Restitution and Unjust Enrichment in Bankruptcy*, 40 PEPP. L. REV. 843, 844 (2013). Historically, the courts of equity and law were two distinct bodies. The founders of the United States made a controversial decision to merge the courts of equity and law. Article III, Section II, of the United States Constitution authorizes the Courts of the United States to hear all cases in both law and equity. Remedies obtained in through law are in rem and primarily enforced through money damages. Equitable remedies operate in personam and are most seen in the form of injunctions, specific performance, or vacatur. Courts typically award equitable remedies after a showing that the legal remedy is inadequate at correcting the harm experienced. See *generally* Letter from Thomas Jefferson to Philip Mazzei (Nov. 1785) (on file with National Archives) (discussing the relationship between law and equity); Aaron Friedberg, *The Merger of Law and Equity*, 12 ST. JOHN’S L. REV. 317, 317 (1938) (same).

equitable remedies will be considered appropriate in any given situation.<sup>18</sup> It is important to balance our views of equity with the goals and practicalities of the bankruptcy system. To that end, this Comment first analyzes the numerous goals and policies underlying the concept of equity and the use of the equitable remedy of judicial estoppel.

### A. *Theory of Equity*

Samuel Bray identifies two characteristics of equity that are uniquely applicable for the purposes of this Comment.<sup>19</sup> First is the concept that equity seeks to act as a “nice adjustment” involving a “small-scale moral reading of the law.”<sup>20</sup> Considering equity in light of the “nice adjustment” approach would be to understand that the universal application of law is often defective.<sup>21</sup> Some situations exist that the law simply could not anticipate or where the strict application of the law results in truly uncomfortable outcomes.<sup>22</sup> There are a few ways to deal with the unanticipated. The legislature could: (1) attempt to rapidly update the laws; (2) give the courts the discretion to identify and provide immediate relief from the harsh effect of the law; or (3) that universal laws provide clarity and stability and disallow any equitable adjustments.<sup>23</sup> Doing nothing in these extraordinary situations—or, more accurately, allowing the law to operate strictly as written—seems to conflict with basic senses of morality, fairness, and justice. Alternatively, rapidly and continuously updating laws to account for and accommodate these unanticipated situations is a practical impossibility. This Comment argues that it is far more effective to allow the courts to make the adjustments themselves.

The other trait of equity is that it commands individuals to act in a certain way; Bray calls this “judicial command.” While judgments through law would merely generate in rem awards, equity-based judgments generate in personam decrees compelling an individual to act in a certain fashion.<sup>24</sup> Judicial command

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<sup>18</sup> See Samuel L. Bray, *Equity: Notes on the American Reception*, in EQUITY AND LAW: FUSION AND FISSION 4–5 (John C.P. Goldberg, Peter Turner and Henry E. Smith, eds., 2019).

<sup>19</sup> *Id.* at 5.

<sup>20</sup> *Id.* at 2.

<sup>21</sup> *Id.*

<sup>22</sup> An English court used equity to take off the sharp edges of the law. See, e.g., *Patel v. Ali* [1984], CH 283 (Eng.) (Defendant had signed a contract to sell her home, but the circumstances of life would have made moving from the home practically impossible. Plaintiff sought specific performance of the contract which is almost always granted due to the unique nature of real property. The court felt compelled to consider defendant’s unfortunate circumstances and awarded monetary damages instead of specific performance.).

<sup>23</sup> Bray, *supra* note 18, at 2.

<sup>24</sup> Bray, *supra* note 18, at 3.

is limited by certain practicalities, such as the cost to enforce the decree and whether enforcement is even possible.

Courts consider the factual circumstances when determining whether equity should act as a “nice adjustment” or as a “judicial command.”<sup>25</sup> Any given set of circumstances may require uniquely designed remedies to cure the particular harms addressed by the court. In turn, the judge must have the discretion to assess the situation and determine which choice to make. This does not come without concern: a judge’s discretion to cure harms has the potential to lead to unwieldy and inconsistent results.<sup>26</sup>

### *B. The Equitable Remedy of Judicial Estoppel*

Judicial estoppel is an equitable remedy ordinarily applied to preserve the integrity of the judicial system by preventing litigants from benefitting when asserting inconsistent positions in court proceedings.<sup>27</sup> The Supreme Court has established a general three-part test to determine if the use of judicial estoppel is appropriate, discussed in detail below.<sup>28</sup> Historically, there have been two positions that have been thought to underlie the use of judicial estoppel.<sup>29</sup> One position is the Sanctity of the Oath, and the other is the preservation of the integrity of the judicial process (the “Judicial Integrity” position).<sup>30</sup> While at first glance these policies appear heavily intertwined, the two policy positions have different goals and can lead to very different applications of judicial estoppel in practice.<sup>31</sup>

The Sanctity of the Oath position is primarily concerned about the mere fact that a statement was made by a declarant while under oath and penalty of perjury and that the statement was false.<sup>32</sup> Under the Sanctity of the Oath position, accidentally making a false statement under oath would be viewed with similar scrutiny as intentionally making a false statement because, in taking an oath, the declarant has put herself under a weighty moral obligation to state the full truth. Accidentally making a false statement under oath is evidence for a lack of regard

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<sup>25</sup> Bray, *supra* note 18, at 6–7.

<sup>26</sup> See Bray, *supra* note 18, at 4; see also Pryor, *supra* note 17, at 485 (“equity is a roguish thing because its rules vary with the length of the chancellor’s foot.”).

<sup>27</sup> See Guay v. Burack, 677 F.3d 10, 16 (1st Cir. 2012).

<sup>28</sup> See discussion *infra* page 375.

<sup>29</sup> Rand G. Boyers, *Precluding Inconsistent Statements: The Doctrine of Judicial Estoppel*, 80 NW. U. L. REV. 1244, 1250–51 (1986).

<sup>30</sup> *Id.* at 1251.

<sup>31</sup> *Id.* at 1251–52.

<sup>32</sup> *Id.*



of the sanctity of taking an oath.<sup>33</sup> Doing so usurps the court's ability to facilitate the fact-finding process of the judicial system—arguably, one of the court's most important functions. Total adherence to the Sanctity of the Oath position results in an absolute bright-line rule approach when deciding whether to invoke judicial estoppel.

The Judicial Integrity position leaves more room for leniency when dealing with false statements made inadvertently while under oath. This position is based on the idea that the judicial system is threatened whenever there is a potential for inconsistent results in two like proceedings.<sup>34</sup> For this position, the potential for harm arises when the court adopts and acts on a litigant's first position and where the acceptance of the second position would lead to an inconsistent outcome.<sup>35</sup> The Judicial Integrity position underlies courts' rationales for deciding whether to invoke judicial estoppel.

In *New Hampshire v. Maine*, the Supreme Court recognized that the primary policy underlying the remedy of judicial estoppel is Judicial Integrity. The Supreme Court acknowledged that the traditionally accepted purpose of judicial estoppel has been to “protect the integrity of the judicial process” from parties taking inconsistent factual positions.<sup>36</sup> The Court provided three guiding factors to consider when deciding whether to invoke judicial estoppel: (1) whether a party's later position is clearly inconsistent with its earlier position; (2) whether the party has succeeded in persuading a court to accept a position in such a way that acceptance of an inconsistent position would make the court feel as if it were misled; (3) whether the party seeking to assert an inconsistent position would receive an unfair advantage or impose an unfair detriment to the opposing party.<sup>37</sup> Lastly, the Court noted that “additional considerations may inform the doctrine's application in specific factual contexts” and that it may be appropriate to abstain from the use of judicial estoppel when inconsistent positions taken are due to inadvertence or mistake.<sup>38</sup> The equitable remedy of judicial estoppel is the court's mechanism to protect against fraudsters whose conduct harms the integrity of the judicial system, as opposed to the remedy of equitable estoppel, which seeks to protect opposing parties from misconduct.<sup>39</sup>

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<sup>33</sup> *See id.*

<sup>34</sup> *Id.* at 1252.

<sup>35</sup> *Id.* at 1252–53.

<sup>36</sup> *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001) (quoting *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 598 (6th Cir. 1982)).

<sup>37</sup> *Id.* at 750.

<sup>38</sup> *Id.* at 751.

<sup>39</sup> *See Boyers, supra* note 29, at 1245.

The integrity of the judicial system is harmed when outsiders perceive the system to be unfair; people will perceive a system to be unfair when fraudsters and reckless filers are viewed as being allowed to assert inconsistent positions while under oath that result in the concealment of estate assets. While the system is actually harmed when fraudsters complete their scheme or filers are careless in their disclosures, the integrity of the bankruptcy system is just as harmed when there is a greater potential for fraudsters and reckless debtors to conceal assets without being subject to sufficient recourse.

Applications of judicial estoppel in the bankruptcy context should mimic its application in similar non-bankruptcy contexts. *McNemar* is one clear example of a court's willingness to invoke judicial estoppel in a non-bankruptcy context. In *McNemar*, an employee was judicially estopped because the employee had made two clearly inconsistent assertions.<sup>40</sup> Particularly, the employee was judicially estopped from bringing an Americans with Disabilities Act (ADA) claim against his employer because he asserted on his disability forms that he was totally disabled and, in order to proceed with the ADA claim, he would have needed to assert that he was physically able to perform the job.<sup>41</sup> Courts should consider this straightforward case when deciding whether to invoke judicial estoppel for a debtor's failure to list a claim.

### *C. Concepts of Equity and Judicial Estoppel in the Bankruptcy Context*

The role that equity plays in the remedies available to bankruptcy court is contested. On one hand, the Bankruptcy Act of 1898 vested bankruptcy courts "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings."<sup>42</sup> On the other hand, scholars and the Supreme Court both recognize that the use of equitable remedies bankruptcy courts "must and can only be exercised within the confines of the Bankruptcy Code."<sup>43</sup>

Some important questions to consider are: for what purposes do the courts seek to invoke the doctrine of judicial estoppel when a debtor fails to list a claim on Official Form 106A/B? Is the goal to punish the debtor for having taken inconsistent positions? Is it being invoked to stimulate full disclosure, or deter

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<sup>40</sup> *McNemar v. Disney Store*, 91 F.3d 610, 619–20 (3d Cir. 1996).

<sup>41</sup> *Id.* at 619.

<sup>42</sup> Bankruptcy Act of 1898, Pub. L. No. 696, § 17, 30 Stat. 544, 545 (repealed 1978).

<sup>43</sup> See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1, 2 (2005).

the concealment, of debtors' assets? What if the process is actually too confusing for filers because the forms the disclosure forms are disorganized and unclear; would a court's willingness to invoke judicial estoppel actually prompt more disclosure?<sup>44</sup> If the courts are using judicial estoppel for the purpose of punishment "it should not be hard to understand why borrowing an equitable remedy specially fashioned for the preservation of the integrity of the judicial system to punish inconsistent pleadings will fail to achieve either the former or the latter."<sup>45</sup>

## II. APPLICATION OF JUDICIAL ESTOPPEL FOR FAILURE TO LIST A CLAIM

The first part of the court's analysis when deciding whether to invoke judicial estoppel is to determine the real party in interest and then determine whether judicial estoppel would be appropriate. It is necessary to determine the real party in interest because property not disclosed on Official Form 106A/B remains property of the estate, even after the case has been closed.<sup>46</sup> Disclosures do not define the estate because the estate is defined by statute; indeed, the estate is automatically brought into existence upon the debtor's initial filings.<sup>47</sup> It follows that a debtor's claim becomes property of the estate when a debtor files her bankruptcy petition.<sup>48</sup> If a debtor fails to list any of her claims, those claims—like other property disclosed—are still considered property of the estate. While that debtor likely has Article III standing, she may not properly pursue the claim because she is not the real party in interest; the real party in interest is the bankruptcy trustee as trustee for the estate.<sup>49</sup>

The next two Sections will briefly explore the real-party-in-interest analysis and then will analyze the current trends regarding the use of judicial estoppel.

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<sup>44</sup> See *infra* Section. II.C. (discussing how the form modernization act has taken steps but did not entirely remedy confusion arising from disorganized bankruptcy financial disclosure documents).

<sup>45</sup> Slater v. U.S. Steel Corp., 820 F.3d 1193 (11th Cir. 2016), *overruled by* 871 F.3d 1174 (11th Cir. 2017) (Tjoflat, J. concurring) (Agreeing with the bankruptcy court but not agreeing that the purpose of judicial estoppel is "punishing oath-breaking").

<sup>46</sup> Property that has not been scheduled is not abandoned and remains property of the estate when the case has been closed. 11 U.S.C. § 554(c) (2019) ("Unless the court orders otherwise, any property scheduled under section 521(a)(1) of this title . . . not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title."); *id.* § 554(d) ("Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.").

<sup>47</sup> *Id.* § 554(e)

<sup>48</sup> *Id.* § 541 ("Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, . . . or any lien void under section 506(d) of this title . . . is preserved for the benefit of the estate but only with respect to property of the estate.").

<sup>49</sup> See *Martineau v. Wier*, 934 F.3d 385, 391 (4th Cir. 2019).

### A. *Real Party in Interest*

The question underlying the real-party-in-interest analysis is whether a debtor has the proper standing to pursue claims that he previously failed to list on his bankruptcy disclosures. Because standing is a constitutional inquiry regarding the appropriateness of a particular litigant to bring a particular *legal* action, courts need not consider this when performing an analysis for judicial estoppel.<sup>50</sup> Case law suggests that debtors almost always have Article III standing in cases that invoke judicial estoppel; however, the better question in the context of equity is who constitutes the real party in interest.<sup>51</sup> As the Fourth Circuit explained in *Martineau*, Article III analysis is separate and distinct from the real-party-in-interest analysis.<sup>52</sup>

When determining the real party in interest, courts must also consider whether the trustee abandoned the claim. Generally, abandonment occurs when the trustee makes a determination that the distribution of particular property would be overly burdensome to the estate and files a notice of abandonment, or when scheduled property has been left over after the estate has been fully distributed and the case has been closed by the trustee.<sup>53</sup> Courts have taken varying positions on what constitutes abandonment of a claim. For instance, in *Ashmore*, the Second Circuit declined to decide the question of whether oral disclosure of a claim—not listed on the Schedule B—and the trustee’s subsequent refusal to pursue the claim constituted abandonment.<sup>54</sup> The most obvious examples occur when the trustee formally abandons the claim by providing a report to the court. In *Martineau*, the court explained that when the trustee filed the appropriate notice of abandonment for the claim, the debtor became the real party in interest again.<sup>55</sup> Additionally, the court explained that once a claim has been abandoned by the trustee, bankruptcy law operates as if the debtor had been the real party in interest from the beginning of litigation to the present.<sup>56</sup> When a debtor fails to disclose a claim and then pursues the undisclosed claim, the court ought to allow the bankruptcy trustee to be substituted in for the debtor and should not invoke judicial estoppel.<sup>57</sup>

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<sup>50</sup> See *id.*

<sup>51</sup> See *id.*

<sup>52</sup> *Id.*

<sup>53</sup> See *In re Quanta Res. Corp.*, 739 F.2d 912, 915–16 (3d Cir. 1984).

<sup>54</sup> *Ashmore v. CGI Grp., Inc.*, 923 F.3d 260, 282 (2d Cir. 2019).

<sup>55</sup> *Martineau*, 934 F.3d at 392.

<sup>56</sup> *Id.*

<sup>57</sup> See *id.*

### B. *Use of Judicial Estoppel for Failure to List a Claim*

When it comes to the application of judicial estoppel in the bankruptcy context, the circuits fall into two camps. On one side are the appropriately labeled ‘strict’ circuits; these courts presume that any nondisclosure made by a debtor was done in bad faith, resulting in the automatic dismissal of a debtor’s claim. On the other side are the ‘relaxed’ circuits; these courts are more concerned with the debtor’s intentions and will not invoke judicial estoppel if the debtor’s failure to disclose his claim was the result of mistake or inadvertence.

The first two prongs of the *New Hampshire v. Maine* test are generally met when a debtor fails to list a claim on his schedule. The first prong of the test is satisfied when a party’s later position is clearly inconsistent with its earlier position. In this context, the first prong is satisfied when a debtor fails to list a claim on his schedule because the courts find such an omission to be the equivalent of an assertion that the claim does not exist.<sup>58</sup> This reasoning likely stems from the fact that debtors have an affirmative duty—in part because of the sanctity of their oath—to disclose all of their assets, including pending or potential claims.<sup>59</sup> The second prong is satisfied when the party has succeeded in persuading a court to accept the inconsistent position.<sup>60</sup> Courts accept the position that there are no pending or future claims when it accepts the schedule for filing or when they discharge a debt and close the case.<sup>61</sup>

#### 1. *Strict Circuits*

In *Guay*, the First Circuit rejected a common prong of the judicial estoppel analysis: that the debtor had to actually have derived an unfair advantage from her inconsistent positions.<sup>62</sup> This approach is most closely aligned with the Sanctity of the Oath position.<sup>63</sup> In this case, the joint-filed debtors—while in the middle of bankruptcy proceedings—filed a lawsuit against multiple defendants.<sup>64</sup> When they converted to a chapter 7 case, the court ordered the debtors to update their schedules as part of a standard protocol; the debtors failed

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<sup>58</sup> *Ah Quin v. County of Kauai Dep’t of Trans.*, 733 F.3d 267, 271 (9th Cir. 2013).

<sup>59</sup> *See Guay v. Burack*, 677 F.3d 10, 14 (1st Cir. 2012).

<sup>60</sup> *New Hampshire v. Maine*, 532 U.S. 742, 750 (2001).

<sup>61</sup> *Jones v. Bob Evans Farms, Inc.*, 811 F.3d 1030, 1033 (8th Cir. 2016).

<sup>62</sup> *See Guay*, 677 F.3d at 17 (noting that whenever an unfair advantage does exist, such a finding will provide a strong basis for applying judicial estoppel).

<sup>63</sup> *See supra* Section I.A.

<sup>64</sup> *Guay*, 677 F.3d at 14.

to file any amended asset schedule detailing the claim they were pursuing.<sup>65</sup> When the civil court learned of the debtors' nondisclosure on their bankruptcy schedules, the court informed the trustee. The trustee then decided it was in the best interest of the estate to abandon the claim.<sup>66</sup> Although the court found that the debtors did not potentially stand to gain any unfair advantage because of their inconsistent positions, the court held judicial estoppel was appropriate.<sup>67</sup> The court noted that "the integrity of the bankruptcy process is sufficiently important that we should not hesitate to apply judicial estoppel even where it creates a windfall for an undeserving defendant."<sup>68</sup>

In *Marshall*, the debtor listed in her filings two civil actions and an Internal Revenue Service administrative proceeding in which she was the defendant, but she failed to list three different claims where she was the plaintiff.<sup>69</sup> The D.C. Circuit Court affirmed the district court's invocation of judicial estoppel. The court reasoned that if the debtor knew to disclose claims in which she was a defendant, then she must have understood that she was required to list administrative proceedings where she was the plaintiff.<sup>70</sup> The defendant's failure to list her claim was thought to be so egregious that the court noted, "[w]e could end our opinion here. Cases such as this one are legion in the other circuits."<sup>71</sup>

In *Hermann*, the Tenth Circuit affirmed a district court's invocation of judicial estoppel and subsequent dismissal of debtor's claim. *Hermann* involved a joint filing in which the husband had two claims deriving from a single car accident in December 2009: a personal injury claim and a claim against his employer for unreasonable denial of workers' compensation.<sup>72</sup> The court found that when the debtors filed their bankruptcy petition in June 2010, there was no dispute that one of the debtors believed he was wrongly denied his claim for workers' compensation.<sup>73</sup> The extent of the debtor's disclosure of claims was the existence of a "Potential Personal Injury Award."<sup>74</sup> At a creditor's meeting

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<sup>65</sup> *Id.* at 17–18.

<sup>66</sup> *Id.* (While the court found that the debtors did in fact have conversations about their pending claim with their lawyer, a lawyer for the defendant, as well their chapter 7 trustee.).

<sup>67</sup> *Id.* at 18.

<sup>68</sup> *Id.* at 19.

<sup>69</sup> *Marshall v. Honeywell Tech. Sys.*, 828 F.3d 923, 931 (D.C. Cir. 2016)

<sup>70</sup> *Id.* (reasoning that if defendant was not aware that she was supposed to list administrative proceedings, then there would have been no other explanation for why she listed the IRS administrative proceeding on her Statement of Financial Affairs).

<sup>71</sup> *Id.* (noting that the district judge "quite properly invoked judicial estoppel to grant summary judgment").

<sup>72</sup> *Hermann v. Hartford Cas. Ins. Co.*, 675 Fed. App'x 856, 857 (10th Cir. 2017).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at 860.

in August 2010, the trustee further inquired into the status of the debtors' potential personal injury claim, but the trustee did not receive much substantive information.<sup>75</sup> In particular, the debtors did not disclose the wrongful denial of coverage claim.<sup>76</sup> Thus, the court concluded that the use of judicial estoppel was appropriate because the debtors had mere knowledge of the claim when they filed for bankruptcy and potentially had reason to hide it.<sup>77</sup>

## 2. *Relaxed Circuits*

The Ninth Circuit has taken a much more forgiving approach when considering whether to invoke judicial estoppel. In *Ah Quin*, the court held there was strong evidence the debtor acted inadvertently when she failed to list a claim on her Schedule B or SOFA and, therefore, the application of judicial estoppel was an abuse of the district court's discretion.<sup>78</sup> Unlike the more strict circuits, the Ninth Circuit requires a demonstrable showing of bad faith as well as an actual gaining of an unfair advantage on the part of the debtor.<sup>79</sup> To understand the reasoning in this case, it is important to properly frame the facts and dates involved.

In deciding *Ah Quin*, the Ninth Circuit relied heavily on the last consideration provided by the Supreme Court that "it may be appropriate to resist application of judicial estoppel when a party's prior position was based on inadvertence or mistake."<sup>80</sup> Breaking from the then-majority approach,<sup>81</sup> the Ninth Circuit held that a broader interpretation of inadvertence is appropriate.<sup>82</sup> The court reversed the district court's ruling that the debtor had intentionally concealed the claim from her schedules, in part because the district court relied on the wrong legal standard in reaching its decision.<sup>83</sup> The court explained that the narrow interpretation of "inadvertence or mistake" was too stringent in these circumstances.<sup>84</sup> The fact that the debtor had claimed inadvertence and reopened

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<sup>75</sup> *Id.* at 857–59.

<sup>76</sup> *Id.* at 858–59 (at the time of the creditors' meeting in August 2010, the debtor was receiving medical treatment for the injuries sustained in the accident).

<sup>77</sup> *Id.* at 859.

<sup>78</sup> *Ah Quin v. Cnty. of Kauai Dep't of Trans.*, 733 F.3d 267, 272–73 (9th Cir. 2013).

<sup>79</sup> *See id.* at 277.

<sup>80</sup> *Id.* (quoting *New Hampshire v. Maine*, 532 U.S. 742, 753 (2001)).

<sup>81</sup> That intentional manipulation is inferred when a debtor has both the knowledge of the claim and a motive to conceal them. *Id.* at 271.

<sup>82</sup> *Id.* at 270–72 (Explaining that the then majority interpretation is narrow because the motive to conceal a claim will almost always be present).

<sup>83</sup> *Id.* at 272 (agreeing with plaintiff that the district court's use of a narrow interpretation of "inadvertence" was in error).

<sup>84</sup> *Id.*

her bankruptcy case in order to disclose her pending claim were key factors in the court's decision to apply a broad interpretation of inadvertence.<sup>85</sup> Additionally, if the debtor had not claimed inadvertence as the reason for the omission, then the fact that the debtor reopened the bankruptcy proceeding and amended the appropriate schedules "is generally irrelevant to the analysis of judicial estoppel."<sup>86</sup>

While the court made it clear that full disclosure is important to the operation of the bankruptcy system, the court's ruling should be viewed as relaxed because the court effectively held that bankruptcy courts are not considered to have accepted inconsistent positions as long as a debtor eventually amends his schedules to disclose the claim.<sup>87</sup> If a debtor amends his filings at any point before his case is closed or dismissed, the Ninth Circuit will find that the second prong of the *New Hampshire v. Maine* test was not met.<sup>88</sup> To satisfy the third prong of that test, the debtor must obtain an actual advantage from the omission, as opposed to the "potential advantage" threshold used in the First Circuit.<sup>89</sup>

### C. Form Modernization

To properly contextualize this Comment, it is important to note that a majority of bankruptcy forms have been or are planned to be modernized as part of the Forms Modernization Act, which was initiated in 2008. Official Form 106 A/B, which is the form for individual filers to disclose their assets and liabilities, was amended in 2015. The modern bankruptcy forms provide much-needed clarity in substance and design and were redesigned to make filings more accessible to non-lawyers.<sup>90</sup> The 2015 Committee Notes reads:

The new form categories and the examples provided in many of the categories are designed to prompt debtors to be thorough and list all of their interests in property. The debtor may describe generally items of

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<sup>85</sup> *Id.* The court further explained that "[w]hen a plaintiff-debtor has *not* reopened bankruptcy proceedings, a narrow exception for good faith is consistent with *New Hampshire* and with policies animating the doctrine of judicial estoppel." *Id.* (emphasis in original). This interpretation seems to only shift where the presumption of bad and could be read as: if a debtor fails to reopen or amend her bankruptcy proceeding there is a presumption of bad faith.

<sup>86</sup> *Id.* at 273.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 287.

<sup>89</sup> *Id.* at 287.

<sup>90</sup> Compare U.S. COURTS, BANKRUPTCY OFFICIAL FORM 6(b) (2007), [https://www.uscourts.gov/sites/default/files/b\\_006b\\_1207f.pdf](https://www.uscourts.gov/sites/default/files/b_006b_1207f.pdf), with U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf). Compare U.S. COURTS, BANKRUPTCY OFFICIAL FORM 7 (2007), with U.S. COURTS, BANKRUPTCY OFFICIAL FORM 107 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b\\_107.pdf](https://www.uscourts.gov/sites/default/files/form_b_107.pdf).



minimal value (such as children's clothes) by adding the value of the items and reporting the total.<sup>91</sup>

A redesigned version of Official Form 107: Statement of Financial Affairs became effective on April 1, 2019. The redesign was also a part of the Forms Modernization Project.

The form provides examples of types of legal actions, and requires the debtor to indicate the status of any action. The form adds the requirements that a debtor include any property levied on within a year of filing for bankruptcy and that the debtor provide the last four digits of any account number for any setoffs.<sup>92</sup>

These forms are significantly easier to read than their predecessors, and thus the room for debtors to plead ignorance when failing to disclose a claim has diminished.

#### *D. Alternative Remedies Through the Bankruptcy Court*

The use of judicial estoppel is a proportional response to nondisclosure when considering the goals of judicial estoppel in relation to the goals of bankruptcy and the internal mechanisms available through the Code.<sup>93</sup> When dealing with the problem of nondisclosure of claims, the internal mechanisms available to the bankruptcy system are insufficient to protect its efficiency and integrity. First, the denial or revocation of discharge cannot be adequately relied upon because of the Code's statute of limitations. Second, the option of subrogating the claim is not reliable because trustees may determine that the claim is no longer of value to the estate. Lastly, criminal prosecution is not a reliable remedy because criminal referrals by the U.S. Trustee Department are often not prosecuted by the Department of Justice.<sup>94</sup> For these reasons, judicial estoppel is an important tool for protecting the integrity of the bankruptcy system.

##### *1. Deny or Revoke Discharge*

An alternative to judicial estoppel is to deny or revoke the debtor's discharge.<sup>95</sup> The primary reason that individuals file a petition in bankruptcy is

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<sup>91</sup> U.S. COURTS, 2015 COMMITTEE NOTE 1, 2 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106note.pdf](https://www.uscourts.gov/sites/default/files/form_b106note.pdf) (discussing Official Form 106 A/B).

<sup>92</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 107 1, 2 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b107\\_en.pdf](https://www.uscourts.gov/sites/default/files/form_b107_en.pdf).

<sup>93</sup> 11 U.S.C. § 727 (2019) (discussing grounds for denial or revocation of discharge).

<sup>94</sup> See *infra* section II.D.3.

<sup>95</sup> See 11 U.S.C. § 727. The court may deny the discharge of a petitioner's debts if the court finds that the debtor withheld property with the intent to conceal or defraud a creditor or officer of the estate. *Id.* § 727(a)(2).

to obtain a discharge of their debts, otherwise known as the fresh start objective of bankruptcy.<sup>96</sup> Because a debtor who fails to obtain a discharge is still liable to his creditors for the debts incurred, the threat of denial or revocation can act as a powerful deterrent of fraudulent behavior. However, the Code only permits a request for a revocation of discharge to be considered if it is filed within one year of the discharge or the date the case is closed.<sup>97</sup> It is not uncommon for legal claims to be pending for several years. If a civil court becomes aware of a debtor's failure to disclose the particular claim he is pursuing outside of the one-year statute of limitations, there is a strong case for the courts to invoke judicial estoppel.

## 2. *Loss of Undisclosed Asset*

If an individual is petitioning the bankruptcy court for chapter 7 relief, then the trustee can liquidate the undisclosed asset pursuant to his authority under the Code.<sup>98</sup> The trustee has the authority to liquidate the undisclosed asset because it was not disclosed on the debtor's schedules and, as a result, is not a protected asset; unprotected assets are specifically to be liquidated by the trustee.<sup>99</sup> This is the proper solution when the trustee becomes aware of the claim and decides that it would be in the best interest of the estate to pursue. If the trustee and the creditors decide it is against the best interest of the estate to pursue the claim, and the debtor is allowed to pursue the claim to obtain a favorable judgment—particularly a monetary judgment—justice was not done. To allow this conduct would fly in the face of equity and undoubtedly diminish the integrity of the courts.

## 3. *Criminal Prosecution*

The use of criminal prosecutions should not be considered an adequate mechanism to protect the integrity of the bankruptcy system, particularly in the context of the nondisclosure of a claim.<sup>100</sup> Every individual filer is required to sign an affirmation that all the information that she has provided is “true and correct.”<sup>101</sup> The affirmation is made under penalty of perjury and carries the

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The trustee, a creditor, or the United States trustee may request revocation of a discharge. *Id.* § 727(d).

<sup>96</sup> Kitty J. Lin, *What Are the Consequences if I Am Caught Intentionally Lying on My Bankruptcy Petition?*, FREMONT BANKR. ATTY. BLOG, (Mar. 12, 2013), <http://www.fremont-bankruptcy-attorney.com/blog/2013/what-are-the-consequences-if-i-am-caught-intentionally-lying-on-my-bankruptcy-petition/>.

<sup>97</sup> 11 U.S.C. § 727.

<sup>98</sup> *Id.* § 704(a)(1).

<sup>99</sup> Lin, *supra* note 96.

<sup>100</sup> 18 U.S.C.A. §§ 152–157 (West) (discussing grounds for criminal prosecution).

<sup>101</sup> *See, e.g.*, U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 1 (2015), <https://www.uscourts.gov/>

potential for up to \$250,000 fine or imprisonment for up to twenty years.<sup>102</sup> While the threat of prosecution may be intimidating, a law is only as good as its enforcement. It is estimated that 10–25% of bankruptcy cases include some aspect of fraud; however, only about 200 cases—about .05%—are prosecuted annually.<sup>103</sup> Such low prosecution rates do not dissuade fraudsters from trying to play fast and loose with the bankruptcy courts. Indeed, the low rate of prosecution for bankruptcy in the face of the high estimates of fraud undermines the integrity of the bankruptcy system.<sup>104</sup> It is entirely reasonable to view judicial estoppel as a harsh response for a failure to disclose a claim, but such a response may be appropriate for two reasons. First, the use of judicial estoppel is a proportional response to reckless or fraudulent conduct considering the lack of adequate alternatives available to the bankruptcy system. Second, it is unclear why criminal prosecution, which results in a fine or imprisonment, should be viewed by commentators as a less severe remedy in this context than the invocation of judicial estoppel.

### III. PROPOSED TEST: AIRING CLOSER TO A PRESUMPTION OF BAD FAITH

#### A. *How Sophisticated Is the Debtor? Is She Represented?*

The instructions on filings can be confusing, and considering the number of pro se debtors,<sup>105</sup> it would not be practical to think that every unrepresented debtor will be able to understand and follow every rule set forth or implied in the Code.<sup>106</sup> In fact, the Code leaves room for good faith mistakes, but it does not seek to accommodate careless or reckless filers. Some circuits treat pro se filers with a little less scrutiny compared to represented filers.<sup>107</sup> While it is

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sites/default/files/form\_b106ab.pdf (Declaration About an Individual Debtor's Schedules); U.S. COURTS, BANKRUPTCY OFFICIAL FORM 107 1, 12 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b\\_107.pdf](https://www.uscourts.gov/sites/default/files/form_b_107.pdf) (Statement of Financial Affairs for Individuals Filing for Bankruptcy).

<sup>102</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 1 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf) (Declaration About an Individual Debtor's Schedules).

<sup>103</sup> Clement, *supra* note 7, at 422 (“nearly 375,000 out of 1.5 million bankruptcy filings per year may violate bankruptcy crime provisions of title 18.”).

<sup>104</sup> Clement, *supra* note 7, at 409.

<sup>105</sup> Following BAPCPA, pro se filings accounted for about 6% of total bankruptcy filings. Ed Flynn & Phil Crewson, *Data Show Trends in Post-BAPCPA Bankruptcy Filings*, DOJ (2008), [https://www.justice.gov/archive/ust/articles/docs/2008/abi\\_200808.pdf](https://www.justice.gov/archive/ust/articles/docs/2008/abi_200808.pdf). However, some states have a significantly higher amount of pro se bankruptcy filers. See *Pro Se Case Filings 1/1/2019 Through 9/30/2019*, U.S. BANKR. COURT FOR THE DISTRICT OF ARIZ. 1 (2019) (showing that 18.55% of bankruptcy filings in the district were pro se. An average of about 257 filings per month).

<sup>106</sup> Slater v. U.S. Steel Corp., 891 F.3d 1329, 1329 (11th Cir. 2018).

<sup>107</sup> See *id.* at 1329–30 (describing the factors for the courts to consider when determining whether an omission of a claim was intended to make a mockery of the judicial system).

reasonable for the courts to provide some leniency when considering judicial estoppel for pro se filers, the courts should be careful not to place too much weight on the fact that the debtor filed pro se.

While the total number of pro se bankruptcy filings has trended downwards over the past few years, the number is still significant.<sup>108</sup> Between 2008 and 2009, about half of all individual bankruptcy filers have at least completed high school.<sup>109</sup> It is important to note that pro se filers are provided actual notice that they will not be treated with any leniency because they are filing without an attorney,<sup>110</sup> and they are “strongly urged” to obtain representation.<sup>111</sup> Such notice and recommendation is a clear indication to filers that they are expected to proceed through the bankruptcy process with the attention-to-detail required of attorneys, particularly with regard to the completeness and accuracy of their disclosures.

When an individual is represented by an attorney throughout the bankruptcy process, the courts have different questions to address. Naturally, the presence of representation would lead the court to believe that debtor and her attorney combined have adequate knowledge and sophistication to navigate the bankruptcy system and should be aware that they are required to list any of the debtor’s pending claims.

## *B. Who Discovered the Claim? What Prompted Disclosure?*

### *1. Debtor Realized and Reported to Bankruptcy Court or to Attorney*

If a debtor becomes aware of his omission and takes swift steps to either reopen his case or amend his filings to disclose his claim, courts should consider such conduct to be evidence that the omission was inadvertent.<sup>112</sup> It is not enough that the debtor merely informs the trustee of the claim and amends his Official Form 106A/B and SOFA; it is also important that the debtor makes the disclosure as early into the life of the claim as possible. Naturally, when a

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<sup>108</sup> Jonathan Fisher, *Who Files for Personal Bankruptcy in the United States?*, 53 J. CONSUMER AFF. 2003, 2011, 2012 (2019).

<sup>109</sup> *Id.* at 2012 (Table 2, describing the profile of pro se bankruptcy debtors).

<sup>110</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 101 1, 8 (2017), [https://www.uscourts.gov/sites/default/files/b\\_101\\_1217.pdf](https://www.uscourts.gov/sites/default/files/b_101_1217.pdf).

<sup>111</sup> *Id.*

<sup>112</sup> *See Ah Quin v. County of Kauai Dep’t of Trans.*, 733 F.3d 267, 277–78 (9th Cir. 2013) (finding the fact that the defendant was the one to identify her own failure to list the claim and that she was also the one to inform the opposing party in her civil claim that she was in a bankruptcy proceeding to be strong evidence of a good faith mistake).

trustee substituted as a real party in interest in a mature case, the greater the number of opportunities that are lost for the estate to control the litigation strategy, and to reap any potential benefits; for instance, possible decreased costs of litigation, settlement opportunities, or developing a professional relationship with opposing counsel.<sup>113</sup>

## 2. *Defendant in the Civil Action*

When the defendant in the debtor's civil action is the one to report the debtor's failure to list his claim, courts should be more willing to presume bad faith. By the time opposing counsel figures out that the debtor failed to disclose the claim to the court, it is likely that the debtor had multiple opportunities to amend his disclosure; such circumstances is strong evidence that the failure to disclose the claim on their filing was more than a simple mistake. When a debtor repeatedly asserts that his disclosures need not be amended and opposing counsel disclosed the claim to the courts or trustee, it is more than reasonable to believe that the debtor had no intention of disclosing their claim, even though they were aware that they had an affirmative duty to disclose the claim. When the civil defendant discovers the debtor's omission, the courts should find such discovery to be evidence of bad faith.

## 3. *The Bankruptcy Trustee*

The bankruptcy trustee is responsible for the accounting and distribution of the estate's assets. To properly discharge their duties, it is common practice for trustees to perform due diligence to locate potentially hidden assets.<sup>114</sup> There are four primary mechanisms available to the trustee to perform their due diligence: "(1) private trustees review bankruptcy cases; (2) the United States Trustee Program field offices review bankruptcy cases; (3) the United States Trustee Program receives tips . . . and (4) the United States Trustee Program performs debtor audits."<sup>115</sup> It is difficult for a bankruptcy trustee to identify a debtor's civil or administrative claims because of the lack of uniformity between the courts. While a PACER search may help to locate any federal claims, many civil claims are brought in state court, and cannot be readily located without great expenditure of time and money from the estate. The trustee would be required to search individual counties throughout the country in order to locate one particular claim. By the time the bankruptcy trustee discovers the existence of a

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<sup>113</sup> See *id.* at 290–91 (Bybee, J., dissenting).

<sup>114</sup> See Clement, *supra* note 7, at 413–14.

<sup>115</sup> Clement, *supra* note 7, at 413.

debtor's undisclosed claim, a lot of time and resources have likely been expended. A bankruptcy trustee's discovery of an undisclosed debtor's claim should strongly suggest that the debtor did not intend to amend their disclosure, and therefore should be considered evidence of bad faith.

#### 4. Was Disclosure Prompted by a Threat of Judicial Estoppel?

When a debtor moves to reopen their bankruptcy case and amend her schedules in response to a motion for summary judgment on the grounds of judicial estoppel, the courts are, and should be, more willing to judicially estop the debtor's claim. *Ah Quin* explains that "when a plaintiff-debtor has *not* reopened bankruptcy proceedings, a narrow exception for good faith is consistent with *New Hampshire* and the doctrine of judicial estoppel."<sup>116</sup> Although the court took issue with the fact that the debtor moved to reopen her bankruptcy case only after the threat of judicial estoppel was raised, the court still held that there was enough evidence, when viewing the facts in the light most favorable to the respondent, to support a finding that failure to disclose was inadvertent.<sup>117</sup> It is important to consider what prompted the amendment or reopening because it can serve as a window into understanding the intent behind the debtor's failure to disclose.

The courts must be careful not to utilize a standard that would incentivize debtors to disclose their claims only after they are caught concealing them by an opposing party.<sup>118</sup> Such an incentive structure would result in protracted litigation and would place an undue strain on the courts. Naturally, any filer with intentions to defraud the court will assert the defense of inadvertence. Too lenient a standard, and fraudsters will start making intentional omissions look a lot like a genuine mistake. This would severely harm the integrity of the bankruptcy system.

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<sup>116</sup> *Ah Quin*, 733 F.3d at 272 (emphasis in original).

<sup>117</sup> *Id.* at 278.

<sup>118</sup> *See Guay*, 677 F.3d at 21 (stating that letting the debtors "rely on their belated report of unpaid obligations under these circumstances would neither serve the equities of this case nor create the proper incentive for future debtors to disclose assets . . .").

### C. Was There Any Showing of an Intent to Disclose the Claim?

#### 1. Oral Disclosure

In *Guay*, the court acknowledged that the debtors had conversations with their counsel, opposing counsel, as well as the trustee.<sup>119</sup> But the court held that oral disclosure does not satisfy the necessary requirement of listing the claim on the form.<sup>120</sup> One could argue that by providing an oral disclosure, the debtors certainly knew the claim was worthy of disclosing and that they should have taken steps to amend their filings, especially in light of being ordered by the court to update their filings when converted to chapter 7. On the other hand, it could very easily be the case that when individuals provide oral disclosure to the trustee or their representative, it is the debtors' belief that they had done everything they need to do in terms of disclosure. An unsophisticated debtor could easily interpret a trustee's lack of direction in response to an oral disclosure as an assertion that the claim does not need to be placed on the written schedule. While oral disclosures may be evidence of inadvertence, a debtor that orally discloses the existence of his claim to a trustee should be aware that his is required to list that claim on his bankruptcy schedules.

#### 2. Misplaced on Schedules

In *Ashmore*, the pro se debtor placed his pending litigation on his SOFA but not on his Schedule B. Unlike in *Guay*, the debtor had listed the claim in his bankruptcy filings.<sup>121</sup> The debtor in *Ashmore* provided the caption, docket number, and description of his claim in his SOFA,<sup>122</sup> and it took the debtor four years to amend his Schedule B.<sup>123</sup> This is a situation where the omission on the Schedule B was not an attempt by the debtor to play fast and loose with the system; after all, a debtor would not list such detailed information of his claims on one form if he is attempting to hide them from the court on another form. There also was a letter of communication between the debtor and the trustee putting forth an agreement to distribute any proceeds awarded for that claim.<sup>124</sup> Any court or trustee who is provided such detailed information of a claim should be on notice of the claim's existence and should coordinate with the debtor to ensure that the claims get properly scheduled. In fact, the court viewed the

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<sup>119</sup> *Id.* at 14.

<sup>120</sup> *Id.*

<sup>121</sup> *Ashmore v. CGI Grp., Inc.*, 923 F.3d 260, 266 (2d Cir. 2019).

<sup>122</sup> *Id.*

<sup>123</sup> *Id.* at 275.

<sup>124</sup> *Id.*

trustee's failure to bring the letter agreement to the bankruptcy court as a possible dereliction of her duty as a Bankruptcy Trustee under Bankruptcy Rule 9019(a).<sup>125</sup> In conclusion, when a debtor has misplaced her claim on the bankruptcy schedules, the courts should consider the omission on the proper schedule to be a mistake and should caution against the application of judicial estoppel.

### 3. *Has the Debtor Listed Other Claims of a Similar Type?*

Another factor that is probative of the intent behind the debtor's failure to list a claim is whether the debtor had listed claims of a similar type.<sup>126</sup> The reasoning in the *Marshall* case is helpful here.<sup>127</sup> This seems to be an appropriate approach in reconciling this issue. While the dissent's interpretation of the omission was not unreasonable, it leaves too much room for active fraudsters to play fast and loose with the bankruptcy system; it is difficult to understand how an individual who lists a claim in which he is a defendant would not be aware that he ought to list a claim where he is a plaintiff.<sup>128</sup> These circumstances tip the balance in favor of judicial estoppel.

### D. *What Are the Reasons the Trustee Abandoned the Claim After It Had Been Discovered?*

#### 1. *Amount of the Pending Claim in Relation to Debt*

Courts should restrain from judicially estopping the plaintiff from pursuing his claim in the event of a debtor's inadvertent failure to disclose a claim and the amount of the claim falling within the exemption amount. First, if the debtor could have simply exempted the amount of the claim and chose not to, it would be stronger evidence that the omission was inadvertent. A debtor does not have financial motivation to conceal this claim because it would be out of reach from creditors anyway.<sup>129</sup> There is a greater concern for mid- and large-size claims,

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<sup>125</sup> *Id.* at 276 (“That Edwards initially failed to disclose the Letter Agreement to the bankruptcy court is probative not of Ashmore’s bad faith . . . but, if anything, of Edwards’s dereliction of duty under Bankruptcy Rule 9019(a), which requires the court to approve a compromise or settlement with notice to the creditors.”) (internal quotations omitted).

<sup>126</sup> See *Marshall v. Honeywell Tech. Sys.*, 828 F.3d 923, 931 (D.C. Cir. 2016).

<sup>127</sup> See *supra* page 380.

<sup>128</sup> Particularly when the current form specifically uses the word “lawsuit” in its instructions. U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 8 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf).

<sup>129</sup> 11 U.S.C. § 522 (2019).



and, thus, courts should be more skeptical when debtors raise the defense of inadvertence to explain those larger omissions.

## 2. *Claim Has Matured and Become Unattractive to the Trustee and Estate*

When a trustee abandons a claim, the court should consider the reasons for the abandonment. In some situations, the trustee would have abandoned the claim even if it were initially disclosed, while other claims may be abandoned for reasons directly related to the initial non-disclosure.<sup>130</sup>

In *Guay*, the trustee's abandonment was the result of the debtors' perceived abuse of the bankruptcy system, and the court therefore did not give any credit to the debtors simply because the trustee had abandoned the claim.<sup>131</sup> Similarly, in *Ah Quin*, the dissent emphasized the fact that the trustee abandoned the claim only after the district court dismissed it on judicial estoppel grounds.<sup>132</sup> The dissent's argument was particularly persuasive: if the trustee had the full opportunity to evaluate the claim and chose to abandon it as a reasonable application of its business judgment, then the debtor does not unfairly gain an advantage.<sup>133</sup> If the trustee abandons a claim because it did not have a full opportunity to evaluate the claim, then the reasonable conclusion would be that the debtors have obtained the "unfair advantage" of being able to pursue a claim to which they did not have a legal right.<sup>134</sup>

If a debtor fails to schedule a claim and has no other assets, the debtor will likely receive a no-asset discharge.<sup>135</sup> Had the creditors been aware of any actual or potential litigation, they might have chosen to object to the proposed no-asset discharge.<sup>136</sup> Additionally, when a debtor fails to list a claim on her schedule, the debtor's case continues to mature every day that goes by; at a certain point—if the court determines that a debtor is not the real party in interest—it will be the responsibility of the trustee to determine if or how to proceed with the claim.<sup>137</sup> Because of this delay, the trustee may be unable to find counsel willing to take over the claim, or the claim may become so unattractive that the trustee will need to abandon it—as it will no longer benefit the estate. This results in a

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<sup>130</sup> *Guay v. Burack*, 677 F.3d 10, 14 (1st Cir. 2012).

<sup>131</sup> *See id.* at 15.

<sup>132</sup> *Ah Quin v. Cnty. of Kauai Dep't of Trans.*, 733 F.3d 267, 290 (9th Cir. 2013) (Bybee, J., dissenting).

<sup>133</sup> *Id.* at 290–91.

<sup>134</sup> *Id.*

<sup>135</sup> *See* U.S. COURTS, CHAPTER 7—BANKRUPTCY BASICS, <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics>.

<sup>136</sup> *Ah Quin*, 733 F.3d at 289–90 (Bybee, J., dissenting)

<sup>137</sup> *Id.*

loss for the estate, the creditors, the trustees, and the debtor, providing an unmeritorious windfall for the defendant in the civil action.

*E. Recap of the Proposed Considerations*

While the circuits have shifted away from an automatic presumption of bad faith for failing to disclose a claim, the courts should be extremely cautious of becoming overly accommodating to omissions in bankruptcy schedules. Courts should primarily consider: (1) the legal sophistication of the debtor; (2) the events prompting disclosure; (3) any showing of inadvertence or attempts to disclose the claim; and (4) if the bankruptcy trustee decided to abandon the debtor's pending claim, the reasons underlying that decision.

To illustrate, courts should view claims of mistaken nondisclosure with more skepticism in cases where any of the following circumstances occur:

- (1) the debtor is represented by counsel and has a mid- to high-level of sophistication with the legal system;
- (2) the debtor reopens the bankruptcy case only after the defendant in the civil case moved the court or threatened to have the claim judicially estopped;
- (3) the defendant or trustee reports the bankruptcy filing to the civil courts or vice versa;
- (4) the trustee abandons the claim because the delayed disclosure has made the claim overly burdensome to pursue;
- (5) the debtor discloses any other lawsuits that she was a party to on her schedules;
- (6) the debtor makes no attempt to disclose the claim to the trustee, whether orally or through informal written communications;
- (7) the debtor does not disclose the claim anywhere on his filing;
- (8) the debtor does not claim that the omission was the result of inadvertence or mistake;
- (9) the debtor fails to amend her schedules when prompted after a conversion to another chapter; or

(10) the claim is for a money amount, particularly if the debtor attaches a large dollar amount to the claim.

This list is a comprehensive set of guiding principles that informs the applicability of judicial estoppel in cases where the debtor failed to disclose existence of a claim in her bankruptcy filings. A completely subjective test would not be appropriate because it could not promote the equitable and efficient operations of the bankruptcy system. This proposed test protects not only against fraudsters, but also against reckless creditors who are not treating the bankruptcy system with the necessary attention that it requires.

#### *F. How the Proposal Fits with The Two Goals of Bankruptcy*

##### *1. Maximizing Distribution to the Creditors*

Using the proposed factors to determine the appropriateness of judicial estoppel comports with the first goal of bankruptcy to maximize the value of the estate and provide a fair distribution to the creditors. By adopting a fact-sensitive approach that hovers near a bright-line rule, the bankruptcy system will be in the best position to maximize the value and distribution of the estate to the creditors. By allowing an innocent trustee to be substituted in the undisclosed case, the estate will be able to realize its full value because the trustee will be able obtain a monetary award for the estate. If the courts utilize more of a bright-line approach to non-disclosure of claims, then debtors will be further incentivized to give full and accurate disclosures. The courts will have a workable standard that promotes the integrity of the system and reduce the administrative costs of accounting for and distributing a bankruptcy estate. While mistakes are inevitable, it is very important for debtors to understand that the relief being sought is extraordinary. Accordingly, courts should reasonably expect and require debtors to be extremely considerate when filling out financial disclosures. If courts become overly accommodating to mistakes, fraudsters will pounce on the opportunity to try and manipulate the judicial system.

##### *2. Providing a Fresh Start to the Debtor*

Using the proposed factors to determine the appropriateness of judicial estoppel comports with the second goal of bankruptcy: to provide a fresh start to the debtors. Here, the fresh start is obtained by accurately accounting for and distributing the debtor's estate. Having recovered a hidden asset, the debtor is no longer bound by his pre-bankruptcy burdens and will likely not be subject to any other recourse due to failure to disclose a claim. The debtor can truly begin

his fresh start when all of a debtor's pre-bankruptcy property is disclosed to the estate and the trustee has a full opportunity to distribute the estate's property because there is no chance that his bankruptcy case can be opened or other litigation pursued for non-disclosure related reasons.

### *G. Proposed Adjustments That Can Curb Non-Disclosure*

By the nature of the system, when debtors are readily able to conceal valuable legal claims from the bankruptcy estate, creditors' confidence in the bankruptcy system will be stifled due to the increased risk of non-recovery of debts.<sup>138</sup> This lack of confidence will likely be seen through increased interest rates passed on to the consumers, unless courts utilize a more predictable approach, with more standardized guiding principles, to the invocation of judicial estoppel.<sup>139</sup>

#### *1. Increased Access to Legal Resources*

One way to safeguard the integrity of the bankruptcy system is to increase debtors' access to clear and concise information and quality representation. While personal filings have decreased in the past twelve months, "bankruptcy filings tend to gradually escalate after an economic downturn starts."<sup>140</sup> For example, bankruptcy filings peaked two years after the 2008 recession.<sup>141</sup> Similarly, due to the economic harms resulting from COVID-19, we should expect a gradual increase in filings in the upcoming years.<sup>142</sup> This could include providing easy-to-access bankruptcy toolkits or free informational classes for low-income filers. Ideally, increased access to the bankruptcy system should be guided by increased representation by attorneys from non-profits such as Legal Aid and private attorneys through pro bono work.

#### *2. Further Clarify the Language on Official Form 106 A/B and the Individual Filing Instructions*

Question number 33 on Official Form 106A/B requires the debtor to list "[c]laims against third parties, whether or not [they] have filed a lawsuit or made a demand for payment."<sup>143</sup> As noted above, questions have a greater level of

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<sup>138</sup> Clement, *supra* note 7, at 412.

<sup>139</sup> Clement, *supra* note 7, at 412.

<sup>140</sup> U.S. COURTS, BANKRUPTCY FILINGS FALL 11.8 PERCENT FOR YEAR ENDING JUNE 30, <https://www.uscourts.gov/news/2020/07/29/bankruptcy-filings-fall-118-percent-year-ending-june-30>.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 8 (2015), <https://www.uscourts.gov/sites/>

clarity after the 2015 redesign, and they provide a wider array of examples than the previous form. Still, Official Form 106 A/B's accompanying instructions provide no substantive guidance as to what constitutes a claim in which the debtor is a third party.<sup>144</sup> The word "plaintiff" does not show up in either the individual instructions nor in Official Form 106A/B.<sup>145</sup> For filers unfamiliar with the system, the term "against a third party" leaves room for ambiguity. The instructions could be amended to provide guidance as to the sorts of claims the form is looking for when it states, "whether or not you have filed a lawsuit or made a demand for payment."<sup>146</sup>

### 3. *Section 341 Meeting of the Creditors*

After an individual debtor fills out his Schedule A/B form and SOFA, the next step is the section 341 meeting of the creditors. At the section 341 meeting, the trustee probes further into the responses on debtor's schedules.<sup>147</sup> The trustee probes into the status of any lawsuits to which the debtor may be a party. Furthermore, it is common for the trustee to provide examples of claims that are required to be disclosed, as well as to clarify the requirement of disclosing potential suits.<sup>148</sup> As trustees continue to maintain a standard practice of fully inquiring into debtors' pending and potential claims, the defense of inadvertence to justify the failure to disclose loses significant force.

### 4. *Civil Attorneys Search for Bankruptcy Filings*

It is vital that plaintiffs' attorneys run PACER searches on their clients and inquire into whether they have filed or are planning to file for bankruptcy and receive a discharge. As knowledgeable professionals assisting clients in a confusing industry, attorneys should feel an obligation to perform due diligence checks to determine if judicial estoppel defenses may be raised. It should go without saying that attorneys should ask whether their clients are involved with

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default/files/form\_b106ab.pdf (Question 33).

<sup>144</sup> See U.S. COURTS, INSTRUCTIONS: BANKRUPTCY FORMS FOR INDIVIDUALS (2015), [https://www.uscourts.gov/sites/default/files/instructions\\_individuals.pdf](https://www.uscourts.gov/sites/default/files/instructions_individuals.pdf).

<sup>145</sup> See U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 8 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf); U.S. COURTS, INSTRUCTIONS: BANKRUPTCY FORMS FOR INDIVIDUALS (2015), [https://www.uscourts.gov/sites/default/files/instructions\\_individuals.pdf](https://www.uscourts.gov/sites/default/files/instructions_individuals.pdf).

<sup>146</sup> U.S. COURTS, BANKRUPTCY OFFICIAL FORM 106 A/B 1, 8 (2015), [https://www.uscourts.gov/sites/default/files/form\\_b106ab.pdf](https://www.uscourts.gov/sites/default/files/form_b106ab.pdf).

<sup>147</sup> See *Sample Trustee Questions at Your 341 Meeting of Creditors*, CHRISTIE D. ARKOVICH, <https://www.christiearkovich.com/sample-trustee-questions-at-your-341-meeting-of-creditors.html> (last updated 2020).

<sup>148</sup> Common forms of the question: "Have you recently been injured or had your employment terminated? Do you believe that you may have a claim against your employer?"

the bankruptcy system or have other claims pending. Judicial estoppel can be invoked anytime there are inconsistent positions taken in the court. This means that to prepare the strongest possible case for their clients, attorneys should become knowledgeable about statements and filings made by their clients and opposing parties in other legal proceedings. This seems obvious, but there still appears to be a significant number of filers and attorneys failing to catch these costly mistakes.<sup>149</sup>

As soon as a debtor's non-bankruptcy attorneys become aware of her bankruptcy filings, they can direct her to a bankruptcy attorney to ensure that all the schedules are properly filed. Of course, the trustee gets the first opportunity to pursue the case on behalf of the estate, but, if the trustee decides that it would not be prudent to pursue the claim, then the debtor will be readily able to substitute herself as the real party in interest, so that she can pursue the claim.

#### CONCLUSION: THE FUTURE OF JUDICIAL ESTOPPEL

It is crucially important to ensure that debtors take care to timely and accurately file the required schedules for their bankruptcy proceedings. An overly relaxed approach to the use of judicial estoppel may result in the disruption of markets and the degradation of the integrity of the federal bankruptcy system. Allowing filers to pursue claims that they failed to disclose will destroy the integrity of and public confidence in the bankruptcy system. When individual filers believe that they can hide assets from their bankruptcy estate, their next step will be to see how far they can test the limits. Considering the lack of other adequate protections, the use of judicial estoppel is an appropriate and proportional response to a debtor's non-disclosure of a claim and should be considered a readily available tool at the court's disposal. This Comment's proposed test strikes a balance in favor of the protection of the integrity of the bankruptcy system from reckless debtors and fraudsters, while also taking into consideration the possibility of honest mistakes.

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<sup>149</sup> See *supra* Part II.

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