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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

When Product Liability Claims Are Hidden From Bankruptcy

By **Chad Eggspuehler and Melissa Kelly**
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Chad Eggspuehler

Melissa Kelly

Judicial estoppel is often employed to dismiss product liability actions when defense counsel discover that a plaintiff failed to disclose his or her potential claims during a prior bankruptcy proceeding. In this context, judicial estoppel protects the integrity of the bankruptcy proceeding and prevents a litigant from later taking an inconsistent position to obtain a strategic benefit: first, concealing the claims from the bankruptcy estate to maintain control over the claims as assets, and then asserting those claims in a different court to obtain damages.

Yet, large product liability disputes — particularly those consolidated in multidistrict litigation proceedings — present a unique choice-of-law wrinkle. The underlying product claims generally arise under state law, but what about the equitable defense of judicial estoppel? Do federal or state judicial estoppel principles apply?

The federal appellate circuits are split on this issue, leading to uncertainty as to which judicial estoppel principles apply. While at least six federal circuits apply federal principles, others apply state law. And if state-law judicial estoppel principles apply, that adds another level of uncertainty.

State standards may differ, with some states (e.g., Minnesota) declining to recognize the defense altogether. Consequently, the availability of judicial estoppel as a defense turns on (1) where the case is heard, and, if governed by state law, (2) which state's judicial estoppel principles apply.

In light of this conflict, strategy in consolidated litigation must adapt to the forum hearing dispositive motions, with an eye toward the state substantive law in play.

The Circuit Split: Protecting Federal Proceedings vs. Deference to State Law

The setup is always the same. An insolvent debtor, with knowledge of a potential product liability claim, initiates federal bankruptcy proceedings to obtain a discharge of debt, but fails to disclose the potential claim during the bankruptcy proceedings.

Whether the nondisclosure is inadvertent or intentional, the result is the same: windfall to the debtor, because the bankruptcy court, estate and interested parties proceed on the assumption that there is no such claim, and that asset is left out of the estate's schedule of assets and repayment plan.

Judicial estoppel can be an easy road to dismissal of a previously undisclosed product liability claim. Under traditional judicial estoppel principles, that debtor cannot assert the product liability claim at a later date; the failure to disclose the asset to the bankruptcy court extinguishes the claim for later proceedings.

Yet, depending on where the plaintiff files the claim, or which MDL forum the case may be assigned to, judicial estoppel may not be available under the applicable choice-of-law standard. For cases heard in federal court, choice-of-law for a judicial estoppel defense depends on the governing circuit law.

The majority view, adopted by the Third, Fourth, Sixth, Seventh, Ninth and Tenth Circuits, holds that judicial estoppel is an equitable doctrine governed by federal common law. See, e.g., G-I Holdings Inc. v. Reliance Ins. Co., 586 F.3d 247, 261 (3d Cir. 2009); Guinness PLC v. Ward, 955 F.2d 875, 899 n.20 (4th Cir. 1992); Edwards v. Aetna Life Ins. Co., 690 F.2d 595, 598 n.4 (6th Cir. 1982); Ogden Martin Sys. of Indianapolis Inc. v. Whiting Corp., 179 F.3d 523, 527 n.1 (7th Cir. 1999); Rissetto v. Plumbers & Steamfitters Local 343, 94 F.3d 597, 603–04 (9th Cir. 1996); Eastman v. Union Pac. R.R. Co., 493 F.3d 1151, 1156 (10th Cir. 2007).

The Second Circuit also appears to follow this approach. BPP Illinois LLC v. Royal Bank of Scotland Group PLC, 859 F.3d 188, 191–94 (2d Cir. 2017) (applying federal common law). These circuits recognize an overriding federal interest in safeguarding the integrity of both the initial federal bankruptcy proceeding and the current federal forum hearing the dispute.

See, e.g., Ryan Operations G.P. v. Santiam-Midwest Lumber Co., 81 F.3d 355, 358 n.2 (3d Cir. 1996) (Sarokin, J., concurring) ("A federal court's ability to protect itself from manipulation by litigants should not vary according to the law of the state in which the underlying dispute arose"). Here, application of judicial estoppel turns on the respective circuit's formulation of the defense; with some variation, this typically requires irreconcilably inconsistent litigation positions, bad faith, reliance by the previous forum on the earlier position and an assessment of the appropriate sanction. E.g., G-I Holdings, 586 F.3d at 262.

A substantial minority of circuit courts of appeals, however, treat judicial estoppel as a substantive defense governed by state law under the Erie doctrine. See, e.g., Monterey Dev. Corp. v. Lawyer's Title Ins. Corp., 4 F.3d 605, 608–09 (8th Cir. 1993); Original Appalachian Artworks Inc. v. S. Diamond Assocs. Inc., 44 F.3d 925, 930 (11th Cir. 1995); Konstantinidis v. Chen, 626 F.2d 933, 937–38 (D.C. Cir. 1980).

In these circuits, the availability of judicial estoppel depends almost entirely on whether the state where the dispute arose permits that defense. For states that allow judicial estoppel, the application of the defense depends on the relevant state-law standard.

Navigating the Estoppel Circuit Split in the MDL Context

This circuit split requires legal gymnastics whenever judicial estoppel becomes an issue in the MDL context. For instance, the defendant in a product liability dispute arising in Minnesota (which does not recognize judicial estoppel), whose case is transferred as part of an MDL to a Florida federal court (a court in the Eleventh Circuit, which applies the minority rule) likely cannot assert a judicial estoppel

defense because the Minnesota state courts have yet to recognize the equitable defense.

See, e.g., State v. Pendleton, 706 N.W.2d 500, 507 (Minn. 2005) (declining "to adopt the doctrine at this time"). At least for a time, the same rule applied to cases arising in Georgia and the District of Columbia. See Original Appalachian Artworks, 44 F.3d at 930 (stating that "Georgia courts have not expressly sanctioned this method of issue preclusion"); Konstantinidis, 626 F.2d at 938 (same, District of Columbia); but see Note, Reassessing the Doctrine of Judicial Estoppel: The Implications of the Judicial Integrity Rationale, 101 Va. L. Rev. 1501, 1515 n.68, 1524 n.95 (2015) (citing Ga. Dep't of Cmty. Health v. Northside Hosp. Inc., 750 S.E.2d 401, 410 (Ga. Ct. App. 2013), and noting that Georgia courts recently began applying their own form of judicial estoppel).

Though this choice-of-law split presents fascinating and conflicting federalism issues ripe for resolution by the Supreme Court of the United States, not every product liability case presents an appropriate vehicle to raise them. Consequently, counsel must adopt an appropriate strategy to preserve the issue for a possible appeal.

First, counsel should properly plead the affirmative defense of judicial estoppel if they intend to pursue that defense, regardless of whether the case is destined for an MDL court in a minority-view circuit. Appropriate discovery inquiries and independent investigation of a plaintiff's prior bankruptcy proceedings will inform the viability of any such defense.

Second, counsel must consider the forum hearing the dispute and try to have the judicial estoppel issue heard on the merits. Judicial estoppel of claims concealed from bankruptcy proceedings often is outcome-determinative and can prevent the need for a trial.

For cases filed in or transferred to federal courts in "majority" circuits, a properly pleaded affirmative defense will enable the defendant to assert judicial estoppel in a dispositive motion, with the argument guided by that circuit's judicial estoppel standard.

For litigants in "minority" circuits, the analysis is more complicated. Does state substantive law permit judicial estoppel, and if so, does the state-law judicial estoppel standard differ from the relevant federal standard, such that the conflict of law matters? If the state-law judicial estoppel standard parallels the federal standard, counsel may invoke judicial estoppel under either or both, because there is no conflict of law.

Finally, for cases heard in "minority" circuits that arise from states that either (1) do not recognize a judicial estoppel defense, or (2) subject judicial estoppel to a stricter standard than the relevant federal precedent, such that the different standard is outcome-determinative, counsel must proceed cautiously in asserting and preserving the judicial estoppel defense.

Raise the issue early and advocate to the MDL court that it should preserve the judicial estoppel issue for post-remand resolution, where the transferor court might be bound by a "majority" circuit precedent. If the relevant state law standard — or the status of the judicial estoppel defense — is unclear, consider seeking certification to the relevant state supreme court.

While the complicated legal landscape may render judicial estoppel defenses futile in certain MDL courts, asserting the defense even where it is unlikely to prevail still preserves the issue for possible appellate review.

Chad M. Eggspuehler and Melissa Z. Kelly are associates at Tucker Ellis LLP in Cleveland, Ohio.