Product Liability - USA

Using a plaintiff's prior bankruptcy favourably in a product liability action

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Consider the following hypothetical situation: a plaintiff recently brought a product liability action against your client. She alleges that she suffered a stroke two years ago as a result of taking an anti-depressant manufactured by your client. You quickly learn through an investigation that, following her stroke, but prior to filing suit, the plaintiff filed for Chapter 7 bankruptcy protection, having become overwhelmed by medical bills incurred as a result of her injury. At first blush, a bankruptcy filing may not seem relevant to the plaintiff's tort-based claims. However, the fact that the plaintiff filed for bankruptcy after her cause of action accrued may provide a course for dismissal of the case or for other relief that could have a positive impact on the case for your client.

This update describes how a plaintiff's prior bankruptcy filing can be used by defence counsel to achieve a favourable result in a product liability case, and provides an overview of the legal principles underlying these potential outcomes.

Under federal bankruptcy law, when a debtor files a Chapter 7 bankruptcy petition, all of the debtor's property – tangible and intangible – becomes the property of the bankruptcy estate. This includes judgments in the debtor's favour, pending lawsuits filed by the debtor and any causes of action that accrued before the filing of the bankruptcy petition.(1) Federal courts have made clear that a lawsuit does not have to be filed before the commencement of a bankruptcy proceeding for a cause of action to constitute 'property' under the Bankruptcy Code. Rather, a cause of action merely needs to have accrued under state law before the debtor's filing of a voluntary petition.(2)

Once an accrued cause of action becomes part of a bankruptcy estate, the debtor loses all ownership interest in that cause of action and no longer has standing to pursue it. Instead, the bankruptcy trustee becomes the only party in interest with standing to pursue the claims on behalf of the estate unless and until the trustee formally administers or 'abandons' the asset back to the debtor.(3)

Thus, defence counsel may be able to bring a summary judgment motion based on the debtor's lack of standing where, as in the hypothetical case above, the debtor files a lawsuit based on a cause of action that belongs to the bankruptcy estate. However, a number of questions must be addressed when assessing the viability of such a motion:

- Did the debtor file for bankruptcy under Chapter 7 or Chapter 13 of the Bankruptcy Code? Courts have held that, unlike Chapter 7 debtors, debtors which file under Chapter 13 have standing to litigate claims that have accrued before filing – even though those claims technically belong to the bankruptcy estate.(4) Thus, a summary judgment motion based on lack of standing is available only in cases involving filings under Chapter 7.
- Did the cause of action accrue before or after the debtor filed for Chapter 7 bankruptcy protection? If the claim accrued after the bankruptcy filing, the claim is not part of the bankruptcy estate, and courts have held that the debtor has standing to pursue that cause of action on his or her own.(5)
- If the bankruptcy case has been closed, did the debtor disclose the existence of his or her accrued cause of action to the bankruptcy court, as he or she was required to do under the Bankruptcy Code?(6) If the debtor properly disclosed the cause of action in his or her bankruptcy schedules, the closing of the bankruptcy case caused an 'abandonment' of the property by operation of law in the debtor's favour, such that a motion for summary judgment based on lack of standing would not be viable.(7) If, on the other hand, a debtor failed to disclose the existence of a potential lawsuit to the bankruptcy court, the trustee has not been given the opportunity to administer or abandon the asset and the cause of action remains the property of the bankruptcy estate – even after the bankruptcy case is closed.(8)

When these criteria are satisfied, courts have gone so far as to dismiss cases on summary judgment based on a debtor's lack of standing.(9) However, even when courts have declined to dismiss cases outright, they have recognised that the standing issue must be remedied and have given the debtor an opportunity to reopen the bankruptcy estate (if it has been closed) and to seek the involvement of the trustee in the litigation (10) – which itself can change the posture of the case.

For example, courts have held that, under these circumstances, the trustee should be substituted in for the debtor as the actual plaintiff in the pending lawsuit.(11) Additionally, if the debtor's lawsuit was originally filed in state court, there may be a basis to remove the suit to federal court under Section 1334(b) of Title 28 of the United States Code, which grants federal courts jurisdiction over civil actions "arising in or related to" cases brought under the Bankruptcy Code.(12)

In addition to lack of standing, defendants may also have a basis for seeking summary judgment based on the doctrine of judicial estoppel, which has been applied to bar suit when a debtor fails to disclose a potential cause of action as an asset to the bankruptcy court and later brings a lawsuit based on that cause of action in another court.(13) The likelihood of success of this argument will turn largely on the law of the jurisdiction regarding judicial estoppel and the individual facts of the case, such as the extent of a debtor's knowledge about the existence of and potential value of the accrued claim.

In sum, although a plaintiff's prior bankruptcy filing may initially appear to be of relatively little importance in a product liability case, it is worth giving the plaintiff's bankruptcy filing a second look. It may well hold the key to the dismissal of the plaintiff's claims, or other outcomes which could have a favourable impact on the defence of a case.

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Endnotes

(1) See 11 USC Section 541(a)(1) (bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case"); *Parker v Wendy's Int'l, Inc*, 365 F3d 1268, 1272 (11th Cir 2004) ("[V]irtually all of a debtor's assets, both tangible and intangible, vest in the bankruptcy estate upon the filing of a bankruptcy petition."); *La World Exposition v Fed Ins Co*, 858 F2d 233, 245 (5th Cir 1988) ("The scope of the term 'property of the estate' is very broad. Section 541 (a)(1)'s reference to 'all legal or equitable interests of the debtor in property' includes causes of action belonging to the debtor at the time the case is commenced." (citations omitted)).

(2) See, eg, *Wissman v Pittsburgh Nat'l Bank*, 942 F2d 867, 869 (4th Cir 1991) ('possible claim' that was not yet pending as a lawsuit at the time that debtors commenced bankruptcy proceedings became property of the bankruptcy estate when debtors filed their petition); *Erickson v Baxter Healthcare, Inc*, 94 F Supp 2d 907, 912 (ND Ill 2000) ("A cause of action is property, and has been so regarded for purposes of the Bankruptcy Code." (citations omitted)).

(3) See, eg, *Calabrese v McHugh*, 170 F Supp 2d 243, 256 (D Conn 2001) ("Where an unscheduled claim remains the property of the bankruptcy estate, a debtor lacks standing to pursue that claim after emerging from bankruptcy and the claim must be dismissed."); *Lawrence v Jackson Mack Sales, Inc*, 837 F Supp 771, 779 (SD Miss 1992) ("[A] cause of action belonging to a debtor that existed at the time of the filing of a bankruptcy petition becomes property of the bankruptcy estate and may only be prosecuted by the trustee of the bankruptcy estate, the real party in interest under Rule 17(a) of the Federal Rules of Civil Procedure.").

(4) *In re Henneghan*, No 03-11853-SSM, 2005 WL 2667185, at *6 (ED Va June 22, 2005) (collecting cases).

(5) See, eg, *Thompson v Quarles*, 392 BR 517, 524 (SD Ga 2008) ("[A]t the time of filing, a Chapter 7 debtor gets a 'fresh start,' and property acquired post-petition is not property of the estate.").

(6) See generally 11 USC § 521, 541 & 1306; Fed R Bankr P 1007-1009.

(7) See 11 USC Section 554(c) ("Unless the court orders otherwise, any property scheduled under section 521(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."); *In re Lewis*, 273 BR 739, 743 (Bankr ND Ga 2001) ("[H]ad the Debtor properly disclosed her unliquidated tort claim at the time she filed her bankruptcy case, the Wrongful Death Defendants would not have had standing to move for dismissal of her case or object to her discharge.").

(8) 11 USC Section 554(d) ("[P]roperty of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.").

(9) See, eg, *Baxley v Pediatric Servs of Am, Inc*, 147 F App'x 59, 60-61 (11th Cir 2005) (affirming summary judgment for defendant because plaintiff lacked standing to pursue potential claims she had failed to disclose to the bankruptcy court); *Welsh v Quabbin Timber, Inc*, 199 BR 224, 229 (D Mass 1996) (granting summary judgment for defendant, and stating: "It follows ineluctably from the foregoing that Welsh's undisclosed claims against the Bank, if any, remained in his bankruptcy estate after his discharge and, accordingly, he lacks standing to assert them in his own name in the present action."); *Fair v Biogen Idec Inc*, No 11-1509, 2012 WL 2417722, at *1 (Mass Super Ct June 12, 2012) (granting motion to dismiss and holding that plaintiff's failure to disclose her accrued cause of action relating to injuries allegedly sustained due to use of drug manufactured by defendants "extinguishes her standing to pursue personal compensation").

(10) See, eg, *Erickson*, 94 F Supp. 2d at 914 (holding that widow of hemophiliac who received tainted plasma factor lacked standing to pursue survival claims related to her husband's injuries that had accrued prior to her commencement of Chapter 7 bankruptcy proceedings, but giving plaintiff sixty days to seek the involvement of the trustee).

(11) See, eg, *In re Engelbrecht*, 368 BR 898, 906 (Bankr MD Fla 2007) (holding that the Chapter 7 bankruptcy trustee "is entitled to be substituted as the proper party-plaintiff in the pending state court action against the Defendant"); *In re Davis*, 158 BR 1000, 1004 (Bankr ND Ind 1993) (imposing sanctions based upon debtor's filing of an amended complaint which did not substitute the bankruptcy trustee as the proper plaintiff "although Debtors' lack of standing was pointed out to counsel at the pre-trial conference").

(12) See 28 USC Section 1452(a) and Sections 1334(a) and (b); *In re Phoenix Diversified Inv Corp*, 439 BR 231, 238 (Bankr SD Fla 2010) ("[I]f the Trustee is successful more money will be included in the estate and be available for distribution for creditors. Potential augmentation of the estate is sufficient to establish 'related to' jurisdiction.").

(13) See, eg, *Moses v Howard Univ Hosp*, 606 F3d 789, 798 (DC Cir 2010) ("It appears that every circuit that has addressed the issue has found that judicial estoppel is justified to bar a debtor from pursuing a cause of action in district court where that debtor deliberately fails to disclose the pending suit in a bankruptcy case.").