The Application of Judicial Estoppel in Insurance Claims - Episode #130

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John Czuba: Welcome to the *Insurance Law Podcast*, the broadcast about timely and important legal issues affecting the insurance industry. I'm John Czuba, managing editor of *Best's Recommended Insurance Attorneys*. We're very pleased to have with us today attorney Karen Karabinos, from the law firm of Drew, Eckl & Farnham, with offices in Atlanta and Brunswick, Georgia.

Karen has been litigating cases for more than 25 years, with the last 16 focused on the complexities of property insurance law. She has successfully handled more than 75 trials and hearings and annually conducts 50 depositions and examinations under oath. She also represents insurance companies in first party coverage litigation, extra contractual claims and property subrogation cases.

Karen, we're very pleased to have you with us today.

Karen Karabinos: Thank you very much.

John: Today, Karen will be speaking on the application of judicial estoppel and insurance claims. Karen, for our first question today, can you briefly discuss what judicial estoppel means?

Karen: Certainly. The doctrine of judicial estoppel was the result of courts searching for a way to deal with a situation where a party to a legal proceeding assumed a certain position and succeeds in maintaining that position in that court case, and then later seeks to take a contrary position in another legal proceeding simply because that party's interests have changed.

This is a principle that the United States Supreme Court first recognized all the way back in 1895.

Over the years, the Supreme Court has refined and further defined the doctrine. Basically, what we're using now are factors that were set forth by the Supreme Court in 2001 to help courts and opposing parties to determine whether or not the doctrine of judicial estoppel should apply to prevent a party from taking inconsistent positions to gain an advantage in legal proceedings.

Just to give you an idea of what a court is going to look at, they're going to look at three different factors. First, they will look and consider whether a party's later position in a lawsuit is clearly inconsistent with the party's earlier position in a previous lawsuit.

Second, the courts will inquire whether the party has succeeded in persuading a court to accept that party's earlier position, so that judicial acceptance of that inconsistent position in a later lawsuit would create the perception that either the first or the second court was misled.

The final factor that the court looks at is whether the party, seeking to now assert an inconsistent position, would derive some type of unfair advantage, or impose an unfair detriment on the opposing party if they were not estopped.

It looks like that a majority of the courts across the country follow these factors in determining whether to apply the doctrine, but the doctrine is not favored in every jurisdiction. For example, as a general rule, in the state of Tennessee, they do not favor the application of the judicial estoppel doctrine, but they will apply it only when a statement of fact is willfully false.

That is where the party knowingly and deliberately commits perjury. As a result, in Tennessee, a statement that falls short of, one, being a willfully false statement is insufficient to invoke the doctrine of judicial estoppel.

In North Carolina, the courts hold that judicial estoppel is an equitable gap filling doctrine that provides the courts with a means to prevent individuals who would play fast and loose with the judicial system.

The courts in Alabama, Florida, and South Carolina, where we all practice here in the Southeast, also apply judicial estoppel to prevent a party from adopting a position in conflict with one previously taken. The courts are applying the doctrine not only to protect litigants from allegedly improper or deceitful conduct to opposing parties, but also to protect the integrity of the judicial process and the courts.

John: Karen, can you tell us how judicial estoppel impacts an insurance claim?

Karen: The doctrine of judicial estoppel is frequently raised in a lawsuit involving an insurance claim when an insured has successfully persuaded a bankruptcy court to discharge his or her debts, and that discharge is based on inaccurate and sometimes even a fraudulent picture of the insured's financial affairs.

In the insurance claim, the debtor, or the insured is seeking to recover monetary damages for property that he or she either failed to disclose to the bankruptcy court, or undervalued it.

What we do is we look at two different types of bankruptcy cases that may be involved with an insurance claim, and the first is a Chapter 7 bankruptcy. That is the vehicle in which a debtor seeks a full and complete discharge of their outstanding debts.

As you might imagine, when you're filing a bankruptcy case, you have to disclose all of your assets and liabilities. The bankruptcy code specifically requires that debtors file a list of their creditors. Unless the bankruptcy court orders otherwise, the debtors must also file a schedule of their assets and liabilities, a schedule of current income and current expenditures, and even a statement of their financial affairs.

What we see in the insurance world, in these types of bankruptcies, is a debtor who fails to schedule assets, or misrepresents the value of assets, but then in a subsequent lawsuit against an insurance company, they seek to recover for damages or loss of that property that they either failed to disclose or undervalued.

There's another type of bankruptcy that we see that can be used with regard to an insurance claim, and that is a bankruptcy filed under Chapter 13. That is the vehicle in which a debtor seeks to reorganize his debts. He's not seeking a complete discharge where he's not going to have to pay, but he's reorganizing his debts.

The bankruptcy courts hold, just a like a Chapter 7 debtor, that a person who files a Chapter 13 petition for bankruptcy has a duty to disclose their assets and any changes in the assets. This is a continual duty that an insured or debtor has in the bankruptcy court.

For example, in a case before the 11th Circuit in 2010, a debtor failed to identify a pending lawsuit in which she sought monetary compensation. The 11th Circuit held that that pending lawsuit was an asset that qualified as property of the bankruptcy estate and should have been disclosed via an amendment to the position in bankruptcy.

The court went further on to hold that the debtor's failure to timely amend her Chapter 13 reorganizational plan to reflect that pending lawsuit constituted an inconsistent position under oath, and thus, the 11th Circuit upheld the application of the doctrine of judicial estoppel.

In a lawsuit between an insured and the insurance company, a court can apply its equitable discretion to judicially stop an insured from inserting an insurable interest in property when the insured did not disclose that interest in that property before a bankruptcy court, which then prompted the bankruptcy court to discharge the insured's debts because there were no assets to pay any of the creditors.

The rationale is that the insured's failure to reveal assets operates as a denial that such assets actually exist, and therefore, deprives the bankruptcy court of the full information it needs to evaluate and rule upon a bankruptcy petition, and again deprives the creditors of resources that may satisfy unpaid obligations.

These misrepresentations, or failure to disclose assets in an insured's prior bankruptcy, and then using those same assets to seek insurance coverage, can also provide a basis for a denial of the insurance claim under a policy exclusion for fraud and concealment.

John: Karen, have you handled any insurance claims in which judicial estoppel was an issue?

Karen: Yes, I've had several. The first was back in 2005, here in Georgia. The case was *Le'Roy Battle versus Liberty Mutual*. My partner Mike Bagley and I represented Liberty Mutual in a lawsuit brought by its insured Mr. Battle.

Mr. Battle, for some reason, had two policies of insurance. One was with Liberty Mutual and the other was with Georgia Underwriting Association. Both policies provided coverage for a Columbus, Georgia home. Mr. Battle's mother had conveyed him that house in 1985, but he also had two other pieces of property in Columbus, Georgia as well.

The insurance claim stemmed from a January 31st, 2002 fire that damaged that Columbus house that his mother had given him. An investigator with both the local fire department and also with the insurance companies determined that the fire was intentionally set by a human act.

After both insurance companies denied the fire claim, Mr. Battle filed suit. We answered the complaint on behalf of Liberty Mutual, in which we denied liability and counterclaimed against Mr. Battle for fraud, and Georgia Underwriting Association did the same thing.

During the litigation, we found out that seven years before the fire loss -- the fire loss was in 2002 -- back in 1995, Mr. Battle had filed a Chapter 7 petition for bankruptcy here with the Northern District of Georgia.

We reviewed his bankruptcy petition, which showed that the Columbus property, the one that was involved in the fire, was not listed on his schedule of assets, although there were two other pieces of real property that were, and both of those other pieces of property were secured by mortgages. Mr. Battle also listed more than $118,000 in unsecured debts.

What happened was that the bankruptcy court allowed the mortgage company to foreclose on one piece of property, and then Mr. Battle reaffirmed the mortgage on the other real property, basically saying, "I'm going to continue to pay the mortgage on that property."

Because of the lack of additional assets, the bankruptcy trustee reported to the court that there was no other property available for distribution, and the bankruptcy court subsequently released Mr. Battle from all of his debts and closed the estate.

After Mr. Battle filed suit, we moved for summary judgment and we argued that Liberty Mutual was not liable because Mr. Battle was judicially estopped from claiming an ownership interest in the property, because he had failed to list that Columbus, Georgia property as an asset in his bankruptcy case. The trial court granted the motions for summary judgment on the application of the doctrine of judicial estoppel, and then Mr. Battle appealed to the Georgia Court of Appeals.

The Court of Appeals noted that Mr. Battle had successfully plead that he did not own the Columbus, Georgia property, and as a result, his debts were discharged. The Court said that that position was clearly inconsistent with his current claim with the insurance companies that he owned that property.

The Court of Appeals held that the discharge of Mr. Battle's debts yielded a substantial and unfair advantage to Mr. Battle, and he was able to shield the house from his creditors and maintain an insurable interest in that Columbus, Georgia property and bring the lawsuit against the insurance companies.

As a result of all this, he was able to put himself in an untenable position through those efforts to manipulate the courts to his advantage.

The Georgia Court of Appeals had, for the first time, ruled that the purpose of judicial estoppel was not only to protect the integrity of the judicial process, but also to prevent a debtor from taking an unfair advantage, which resulted in a bankruptcy court not having assets to pay any unsecured creditors.

A lot of people argued that the insurance company needs to show that they were prejudiced because of the inconsistent positions. The Georgia Court of Appeals, which is also echoed by other jurisdictions that apply the doctrine of judicial estoppel, said the insurance companies do not need to prove that they themselves were prejudiced in order to invoke the judicial estoppel.

John: Karen, when should an insurance company consider the possible application of judicial estoppel?

Karen: At the very beginning of a property damage claim. Judicial estoppel can provide not only a valid defense if a suit is later filed, but also a bankruptcy petition contains a rich source of information regarding possible fraud or misrepresentation.

John: What evidence should an insurance company look for?

Karen: Like I said, the first thing is the actual bankruptcy petition. Attached to that bankruptcy petition are property schedules that have to be filled out that list all of the assets, real property, and personal property, lawsuits that they own that could be used to pay their creditors.

You look very closely to determine whether the insureds have admitted from the petition that very item that is the basis for the insurance claim, or they're misrepresenting the value of the item at a substantially lower value than they are representing in the insurance claim.

If the insureds have omitted either the item, or misrepresented the item at a lower value, the insured should be prevented from recovering on the basis of the policy exclusion for fraud and concealment as we talked about.

If suit is filed, recovery should be precluded on the basis of judicial estoppel. What we're seeing more frequently are insureds who are undervaluing an asset on the bankruptcy petition, while they inflate the value of the item on an insurance claim.

For example, there's a Kentucky case in which the insureds had represented in their bankruptcy case that they possess personal property that was valued at $4,010. After the insureds' fire loss, the value of their personal property quadrupled.

They represented on their contents list that they submitted to the insurance company that they had fire damaged property valued at $21,384, and all of this was purchased prior to filing the bankruptcy.

That case was appealed to the 6th Circuit who agreed with the trial court's application of the doctrine of judicial estoppel because of those inconsistent positions regarding the value of the property. What happened was that the insurance company only had to pay for the fire damaged personal property, the $4,010, which was the amount the insureds represented in their bankruptcy petition.

A similar result was reached in an Alabama district court case in 2008. In that case, the insured represented in her bankruptcy schedule that the entire value of her household goods that were in existence about 30 days before the loss was only $2,300. After the fire, she filed a claim for the insurance company saying that she had in excess of $41,818 of property.

Some insureds are attempting to avoid the application of judicial estoppel by arguing that, "I used a different measure of valuation when I valued my property in the bankruptcy petition than what I used to value the property in my insurance claim."

An Ohio federal district court case showed that that is really not something that they're going to use as a possible reason not to apply judicial estoppel.

They said that depending on the differences in the contrast in the valuations, their explanation that they have used a different value does not begin to explain how they would have acquired such a vast amount of personal property in a relatively short period of time, especially when the insureds have meager income and have filed for bankruptcy because they don't have enough money to pay for their debts.

It's really important that an insurance company ask how the insureds value the property that they listed on the bankruptcy petitions, as well as on the contents list. It's also important to ask whether the property listed on the contents list were items that were in existence at the time the insured filed for bankruptcy, or were purchased after their debts were discharged by the bankruptcy court.

This would confirm whether the insureds were valuing the exact same property and not adding to the insurance claim personal property that they purchased after filing for bankruptcy.

I know that some insureds may attempt to avoid the application of judicial estoppel by seeking to amend their bankruptcy petition. Insurance companies should watch out for amendments that the insureds may make after their claim is denied, but before suit is filed.

Under the bankruptcy rules, unscheduled assets, newly discovered assets, or concealed assets furnish a basis for reopening a debtor's bankruptcy, even if it's been many years.

Some courts have held that the doctrine of judicial estoppel may not be applied if the insured or debtor successfully amends their bankruptcy petition to include the omitted asset. Where such a motion to reopen the case has been made by the debtor, the courts have held that there no longer is any inconsistent position that would support a finding that they had obtained an unfair advantage.

Here in Georgia, a federal court has held that while the bankruptcy rules do not prescribe a particular time limit in which they have the power to reopen a case, they would still apply judicial estoppel to cases in which the debtor was forced to fess up once exposed by his adversary.

For example, if an insurance company was able to point out that the insured has gotten his or her debts discharged based on his failure to identify a particular asset in a bankruptcy case, but then uses that same asset to try to get insurance proceeds, then as a result of the insurance company denying the claim, they'll go back and reopen the bankruptcy court case in order to disclose that asset.

The federal court here in Georgia says that's not going to be enough. You're still going to be judicially estopped.

John: Can an insurance company deny a claim based on judicial estoppel?

Karen: Judicial estoppel is just that, it's a judicial remedy. It's not a basis for denying a claim, but it is an affirmative defense for the insurance company that should be raised if the insured filed suits following a denial of the claim.

As I noted before, the denial of the insurance claim would likely be based on concealment, or fraud of the insured actually defrauding the insurance company based on the valuation of the assets, as compared to the assets in the bankruptcy court, or concealment of an asset that they did not disclose to the bankruptcy court.

And now are trying to recover monetary damages for that asset that they still have.

John: Karen, thank you so much for joining us today.

Karen: Thank you.

John: That was Karen Karabinos from the law firm of Drew, Eckl & Farnham, with offices in Atlanta and Brunswick, Georgia. Special thanks to today's producer, Frank Vowinkel. Thank you all for joining us for the Insurance Law Podcast. To subscribe to this audio program, go to iTunes, or our web page, www.ambest.com/claimsresource.

If you have any suggestions for a future topic regarding an insurance law, case, or issue, please email us at lawpodcast@ambest.com. I'm John Czuba, and now this message.

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