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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re Case No. 95-52713
PAUL W. CUMMINS and
ROBIN S. CUMMINS,
Debtor(s). Chapter 13

_____ /

**ORDER GRANTING DEBTORS' MOTION
FOR PARTIAL SUMMARY JUDGMENT**

I. INTRODUCTION

In 1995, the California Employment Development Department ("EDD") filed a creditor claim against debtors, Paul and Robyn Cummins, in Bankruptcy Court. Cummins, in turn, filed an objection to the claim, which came before the Court for hearing on May 4, 2000. In connection with their objection, the Cummins filed a motion for partial summary judgment seeking to bar EDD from asserting that Cummins' yearly wage expenses from 1989 through 1994 were substantially greater than \$24,000. For the reasons hereafter stated, the motion is granted. **II. FACTUAL BACKGROUND**

Debtors Paul and Robin Cummins operated a pool cleaning and

1 repair service from January 1, 1986 through May 1, 1995. EDD, the
2 state agency responsible for computing employment tax liability and
3 penalties, conducted two audits of the Cummins' business. The first
4 audit covered the period January 1, 1989 through September 30,
5 1992. The second audit covered the period October 1, 1992 through
6 June 30, 1996. Based on these audits, EDD determined that the
7 Cummins under reported wage expenses in order to reduce their
8 liability to EDD.

9 In May 1995, during the second audit period, debtors filed for
10 bankruptcy under Chapter 13. Approximately four months later, in
11 August of 1995, EDD filed a claim in the Cummins' bankruptcy case
12 for employment taxes in the amount of \$243,788.53 for the period
13 January 1, 1986 through May 1, 1995. This tax figure was based on
14 the debtors' wage expenses as determined by EDD during the same
15 period.

16 Two years later, in 1997, the Santa Clara County District
17 Attorney prosecuted the Cummins for tax evasion. Although charges
18 against Robin Cummins were dismissed, Paul Cummins was convicted
19 of violating Revenue and Tax Code Section 19706 for failing to file
20 tax returns for the years of 1989 through 1994. The California
21 Franchise Tax Board (FTB), the agency responsible for computing
22 state income taxes, was a complaining witness in this proceeding,
23 and investigated the Cummins' tax returns during the years in
24 question.

25 During the criminal prosecution, EDD informed FTB that it
26 believed that debtors' wage expenses from 1989 through 1994 were
27 in excess of \$250,000. This number was extracted from EDD's
28 calculation of debtors' wage expenses for the full period of EDD's

1 1995 bankruptcy claim (1986-1995). Despite its knowledge of EDD's
2 estimate, FTB asserted that debtors' wage expenses were
3 approximately \$24,000 per year, noticeably smaller than EDD's
4 estimate. Mr. Cummins consequently incurred \$52,086 in criminal
5 penalties based upon the court's use of FTB's \$24,000 wage expense
6 figure.

7 **III. THE LEGAL STANDARD FOR SUMMARY JUDGMENT**

8 Federal Rule of Civ. Proc. 56 is made applicable in adversary
9 proceedings by Bankruptcy Rule 7056. The party moving for summary
10 judgment has the burden of showing the absence of any genuine issue
11 as to all the material facts, which, under applicable principles
12 of substantive law, entitle him to judgment as a matter of law.
13 6 James W. Moore, et al., Moore's Federal Practice ¶ 56.15[3] (2d
14 ed. 1995). The nonmovant's version of the facts must be accepted
15 and all inferences from the underlying and undisputed facts are to
16 be drawn in favor of the nonmovant. Bishop v. Wood, 426 U.S. 341,
17 96 S.Ct. 2074 (1976); United States v. Diebold, Inc. 369 U.S. 654,
18 82 S.Ct. 993 (1962).

19 "[The] party seeking summary judgment always bears the initial
20 responsibility of informing the ...court of the basis for its
21 motion, and identifying those portions of `the pleadings,
22 depositions, answers to interrogatories, and admissions on file,
23 together with the affidavits, if any,' which it believes
24 demonstrate the absence of a genuine issue of material fact."
25 Celotex Corp. v. Catrett, 477 U.S. 317, 323, 106 S.Ct. 2548 (1986);
26 quoting Fed. R. Civ. P. 56(c). If the movant meets this burden of
27 production the nonmoving party must go beyond the pleadings and by
28 affidavit, deposition, answers to interrogatories, and admissions

1 on file, designate specific facts showing that there is a genuine
2 issue for trial. Id. The nonmoving party may satisfy its burden of
3 showing that there is a material question of fact in dispute
4 through affidavit or declaration, but such declaration "shall
5 contain only facts, shall conform as far as possible to the
6 requirements of [Fed. R. Civ. P.] 56(e), ...and shall avoid
7 conclusions and argument."

8 **IV. DISCUSSION**

9 Paul Cummins' criminal penalty was based on income tax
10 liability. Since wage expenses are deducted from gross income,
11 FTB's lower wage expense figure yielded a higher income tax figure,
12 resulting in a higher criminal penalty against Paul Cummins.
13 Employment taxes, in contrast, are based on wage expenses.
14 Therefore, EDD's higher wage expense figure yielded higher
15 employment taxes, resulting in a greater tax claim in the Cummins'
16 bankruptcy case.

17 The Cummins' objection pertains to EDD's use of a high wage
18 expense figure in their bankruptcy case following FTB's use of a
19 substantially lower wage expense figure in Paul Cummins' criminal
20 prosecution. The Cummins argue that EDD should be held to FTB's
21 \$24,000 wage expense figure used in the criminal prosecution. EDD
22 should not be permitted to assert a higher wage expense figure as
23 a basis to assert a larger claim in the debtors' bankruptcy case,
24 particularly after FTB used a low wage expense figure to inflict
25 higher penalties in the criminal case. Debtors base their argument
26 on the principle of judicial estoppel.

27 **A. Purpose of Judicial Estoppel**

28 The doctrine of judicial estoppel prevents a party from

1 asserting a claim in a legal proceeding that is inconsistent with
2 a claim made by that party in a previous proceeding. See Rissetto
3 v. Plumbers and Steamfitters Local 343, 94 F.3d 597, 600 (9th Cir.
4 1996) ("Judicial estoppel sometimes known as the doctrine of
5 preclusion of inconsistent positions, precludes a party from
6 gaining an advantage by taking one position, and then seeking a
7 second advantage by taking an incompatible position."). As a
8 general principle, the purpose of judicial estoppel is to protect
9 the integrity of the judicial process. See id. at 601. Furthermore,
10 judicial estoppel "is an equitable doctrine, invoked by the court
11 at its own discretion, and driven by the facts of the specific
12 case." Johnson v. State of Oregon, 141 F.3d 1361, 1368 (9th Cir.
13 1998).

14 Federal law governs the application of judicial estoppel in
15 federal court. See Rissetto, 94 F.3d at 603. The majority of
16 circuits adhere to the "Prior Success" Rule, which requires the
17 court in the earlier litigation to actually adopt the inconsistent
18 position. The minority rule, in contrast, does not place the same
19 requirement on the court in the earlier litigation. Instead, the
20 doctrine applies to a litigant "if by his change of position he is
21 playing 'fast and loose' with the court." Id. at 601.

22 The Ninth Circuit has not settled formally on either of the
23 two rules outlined above. Id. Rather, because judicial estoppel
24 is factually driven, courts in the Ninth Circuit tend to apply the
25 rule that conforms most closely to the facts of a particular case.
26 Accordingly, the Ninth Circuit uses the "Fast and Loose" rule only
27 when a litigant has not had prior success, or when the inconsistent
28 position was not adopted in the earlier litigation. For reasons

1 that will be discussed below, the Court will apply the "Prior
2 Success" Rule to this case because the criminal court in the first
3 proceeding adopted FTB's \$24,000 figure.

4 **B. Judicial Estoppel can apply to this case if three**
5 **conditions are met: (1) FTB and EDD were "parties" to a**
6 **proceeding, (2) FTB and EDD were in "Privity," and (3)**
7 **the criminal court in the first proceeding adopted FTB's**
8 **wage expense figure.**

9 Normally, judicial estoppel is used to prevent a party from
10 asserting a position contrary to one asserted by the same party at
11 an earlier proceeding, i.e., Party A is prevented from asserting
12 a position different than one asserted by Party A in an earlier
13 proceeding. However, judicial estoppel can also be applied to
14 prevent a party from asserting a position contrary to one taken by
15 a *different* party during an earlier proceeding, i.e., Party B is
16 prevented from asserting a position different than one asserted by
17 Party A during an earlier proceeding. In this latter situation,
18 federal courts hold that "privity" must exist between Party A and
19 Party B for judicial estoppel to apply. See, e.g., In re 815
20 Walnut Associates, 183 B.R. 423, 432 (E.D. Pa. 1995)(Assignee
21 and assignor were in privity for the purposes of judicial
22 estoppel.); Mellon Bank, N.A. v. Makoroff, 153 B.R. 155, 159 (W.D.
23 Pa. 1993).

24 Since judicial estoppel can apply to a two-party situation,
25 the court must examine the three conditions necessary for such
26 application.

27 **(1) FTB and EDD are both "parties."**

28 As discussed above, "privity" can only exist between two
"parties." The Cummins argue that in this case, as in the latter
situation involving Party A and Party B, FTB was a party to the

1 first proceeding (the criminal prosecution) and EDD was a party to
2 the second proceeding (the bankruptcy case). In an attempt to
3 demonstrate that judicial estoppel does not apply to this case,
4 EDD argues that FTB was not a "party" to the earlier criminal
5 proceeding. However, for reasons discussed below, the Court
6 rejects this argument.

7 The named parties to the first proceeding were Mr.
8 Cummins and the Santa Clara County District Attorney's Office,
9 while the parties to the second proceeding were the debtors and
10 EDD. Although FTB may not have been a named party to the criminal
11 prosecution, the \$52,000 criminal fine levied on the debtor was
12 based on FTB's \$24,000 wage expense figure; FTB's wage expense
13 calculation was necessary and indispensable in the state's
14 prosecution of Mr. Cummins. Consequently, FTB's intimate
15 involvement in the first proceeding provides it with the
16 functional status of a "party" for purposes of judicial estoppel.
17 Accordingly, the next issue becomes whether FTB and EDD are
18 parties in "privity."

19 **(2) FTB and EDD are in "privity."**

20 Privity is defined as mutual or successive relationships
21 to the same right of property, or such an identification of
22 interest of one person with another as to represent the same legal
23 right. Petersen v. Fee Intern., Ltd., 435 F.Supp. 938, 942
24 (W.D.Okl.1975). California authorities are in accord. See, e.g.,
25 Hudson v. Board of Administration of the Public Employees'
26 Retirement System, 59 Cal.App.4th 1310, 1330 (1997)("Privity
27 requires that the party to be estopped be 'so identified in
28 interest with another that he represents the same legal right.'")

1 (citations omitted.)

2 While the Ninth Circuit has not examined privity between
3 two state agencies, the California Supreme Court has held that
4 "the acts of one public agency will bind another public agency
5 only when there is privity, or an identity of interests between
6 the agencies." Lusardi Construction Co. v. Aubry, 1 Cal.4th 976,
7 995 (1992). Where there is a conflict between the interests of
8 the two public agencies, there is no privity.

9 In Lusardi, which involved a contractor's obligation to
10 pay prevailing wages, the California Supreme Court held that there
11 was no "identity of interests between the Tri-City Hospital
12 District and the Director of the Department of Industrial
13 Relations." The Tri-City Hospital District "had an interest in
14 obtaining the lowest possible [labor] cost for construction . . ."
15 while "[t]he interest of [the Director of the Department of
16 Industrial Relations was] in enforcing the prevailing wage laws."
17 See id. at 996 (declining to apply the doctrine of equitable
18 estoppel against the Director). Thus, the two public agencies in
19 Lusardi were not in privity because they had interests that
20 conflicted.

21 In contrast to the agencies in Lusardi, EDD and FTB do
22 have an identity of interests. While the California Legislature
23 envisions different missions for the two agencies¹ (EDD's mission

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25 1 California Unemployment Insurance Code Section 301 provides that EDD is responsible for the "determination of
26 contribution rates and the administration and collection of contributions, penalties and interest, including but not limited to
filing and releasing liens."

27 Under RTC Section 19501: "[t]he Franchise Tax Board shall administer Part 10 (commencing with Section 17001), Part 10.7
28 (commencing with Section 21001), Part 11 (commencing with Section 23001), and this part. For this purpose, it may divide
the state into a reasonable number of districts, in each of which a branch office or offices may be maintained during all or part
of the time as may be necessary." Part 10 refers to the Personal Income Tax; Part 10.7 refers to the Taxpayers' Bill of Rights;

1 is to administer employment tax penalties, while FTB's mission is
 2 to administer income tax penalties), the two nevertheless have an
 3 "identity of interests" in fair and accurate taxing procedures.
 4 Specifically, each agency uses an individual's wage expense figure
 5 to determine, in part, the amount of taxes due. Obviously, the
 6 state could not maintain fair and accurate taxing procedures if
 7 each agency assigned a different wage expense figure to an
 8 individual taxpayer to that taxpayer's detriment. Consequently,
 9 since EDD and FTB have

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 12 an "identity of interests" in accurate tax collection, which
 13 necessarily includes calculation of an accurate wage expense
 14 figure, EDD and FTB are in privity with respect to the issue of
 15 the Cummins' wage expense figure.

16 Since FTB and EDD are "parties" in "privity" with respect
 17 to the issue of the Cummins' wage expense figure, the final
 18 question becomes whether the criminal court in the first
 19 proceeding adopted FTB's wage expense figure.

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 21 **(3) The criminal court in the first proceeding adopted
 FTB's wage expense figure.**

22 The state succeeded in its criminal prosecution of Paul
 23 Cummins. While the court in the criminal proceeding may not have
 24 formally adopted FTB's wage expense amount, it is indisputable
 25 that the court did so implicitly. FTB used its \$24,000 wage
 26 expense figure to determine debtors' income tax liability for the

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28 Part 11 refers to the Bank and Corporation Tax Law; Part 10.2 refers to the Administration of Franchise and Income Tax Laws.

1 periods in question. The court, in turn, used FTB's income tax
2 liability figure to determine the amount of penalties against Paul
3 Cummins. Logically, the court had to adopt FTB's wage expense
4 figure to arrive at the penalty amount.

5 Since the court in the first proceeding adopted FTB's
6 \$24,000 wage expense figure, the Ninth Circuit's "Prior Success
7 Rule" applies, and judicial estoppel bars FTB's party in privity,
8 EDD, from asserting a wage expense figure different than that
9 adopted in the first proceeding.

10 **V. CONCLUSION**

11 The Court grants partial summary judgment in favor of the
12 Cummins on the issue of judicial estoppel. As it is in privity
13 with FTB, EDD is judicially estopped from asserting that the
14 debtors' yearly wage expense figure was greater than \$24,000, the
15 wage expense figure computed by FTB in the first proceeding.

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17 DATED: _____

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21 JAMES R. GRUBE
22 UNITED STATES BANKRUPTCY JUDGE
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1 Case No. 95-52713-JRG
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5 UNITED STATES BANKRUPTCY COURT
6 FOR THE NORTHERN DISTRICT OF CALIFORNIA
7 CERTIFICATE OF SERVICE

8 I, the undersigned, a regularly appointed and qualified Judicial
9 Assistant in the office of the Bankruptcy Judges of the United
10 States Bankruptcy Court for the Northern District of California,
11 San Jose, California hereby certify:

12 That I, in the performance of my duties as such Judicial
13 Assistant, served a copy of the Court's: ORDER GRANTING DEBTORS'
14 MOTION FOR PARTIAL SUMMARY JUDGMENT by placing it in the United States
15 Mail, First Class, postage prepaid, at San Jose, California on the
16 date shown below, in a sealed envelope addressed as listed below.

17 I declare under penalty of perjury under the laws of the United
18 States of America that the foregoing is true and correct.

19 Executed on _____ at San Jose, California.

20 _____
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