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Moving in the Right Direction: Reed v. City of Arlington

Deborah B. Langehennig, Chapter 13 Trustee, Austin
Published in the Norton Bankruptcy Law Advisor, January 2012

Updated Case Summaries by Brian T. Cumings,
Graves Dougherty Hearon & Moody, Austin, Texas

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In *Reed v. City of Arlington*, the United States Court of Appeals for the Fifth Circuit, in an en banc decision, vacated and essentially reversed a panel decision authored by Chief Judge Edith Jones construing the boundaries of judicial estoppel in bankruptcy. The en banc court, in its opening paragraph, cast the characters in this case as the "blameless bankruptcy trustee," the "innocent creditors" and the "integrity of the bankruptcy system" that must be protected from the debtor who concealed his most valuable asset.[2] This decision will prove to be important for bankruptcy practitioners if it signals a correction in judicial estoppel jurisprudence that has tumbled out of control in bankruptcy cases.

In judicial estoppel decisions in the last decade or so, courts have not consistently protected the bankruptcy estate from deceptive or forgetful debtors. When a debtor fails to disclose a cause of action in a bankruptcy case and then brings that action in another forum, courts apply a three factor test to determine whether the non-disclosure judicially estops the debtor to maintain the action: (1) the debtor is judicially estopped only if the debtor's current position is clearly inconsistent with the position taken in the previous (bankruptcy) case; (2) the court must have accepted the previous position; and (3) the non-disclosure must not have been inadvertent."[3] The progression of judicial estoppel decisions in the Fifth Circuit illustrates the many variations in the application of judicial estoppel principles.

<u>The Development of Judicial Estoppel in Bankruptcy</u>

In *Coastal Plains*,[4] a tortious interference claim brought against an unsecured creditor by the bankruptcy debtor's successor survived a defense of judicial estoppel but was time barred. Contract claims held by the successor were barred by judicial estoppel. "It goes without saying that the Bankruptcy Code and Rules impose upon bankruptcy debtors an express, affirmative duty to disclose all assets, *including contingent and unliquidated claims."*[5] The court rejected the argument that the nondisclosure was unintentional and inadvertent, stating that "the debtor's failure to satisfy its statutory disclosure duty is 'inadvertent' only when, in general, the debtor either lacks knowledge of the undisclosed claims *or* has no motive for their concealment."[6]

In *Superior Crewboats*,[7] the Fifth Circuit overturned a district court decision denying a motion to dismiss a personal injury suit brought after the plaintiff converted his Chapter 13 case to Chapter 7, when the potential cause of action had not been disclosed as an asset in the bankruptcy schedules. Judge Edith Jones, in writing the opinion, criticized both the Debtors' "guile" and the district court's decision enabling the debtors "to have their cake and eat it too" – "retain[ing] the enormous benefit of a bankruptcy discharge while standing in line to receive funds from the injury lawsuit after the creditors are paid."[8]

Not long after *Superior Crewboats*, the Fifth Circuit decided another judicial estoppel decision in favor of the defendant in *Jethroe v. Omnova Solutions, Inc.*,[9] in which the court barred the debtor's employment discrimination case. Since the debtor was aware of her claim, the court inferred that the nondisclosure was intentional.[10] The debtor was actively involved in litigation of the discrimination case before and during the bankruptcy case and the failure of debtor's counsel to advise the debtor about the disclosure obligation did not save the debtor from estoppel.

Title search: Moving in the Right Direction: Reed v. City of Arlington

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