No. 92780-4

SUPREME COURT
OF THE STATE OF WASHINGTON

BENJAMIN C. ARP,

Respondent,

v.

JAMES H. RILEY and "JANE DOE" RILEY, husband and wife and the marital community composed thereof; and SIERRA CONSTRUCTION CO., INC. a Washington State Corporation,

Petitioners.

ANSWER TO MEMORANDUM OF AMICUS CURIAE NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES IN SUPPORT OF PETITION FOR REVIEW

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A. INTRODUCTION

Petitioners Riley and Sierra Construction, Inc. ("Sierra Construction") filed the petition for review in this case. Respondent Benjamin C. Arp filed an answer and contingent cross-petition, asking this Court, should it grant review, to accept an additional issue. Sierra Construction timely filed a reply. Following briefing by the parties, the National Association for Chapter 13 Trustees ("NACTT") filed a motion for leave to file an amicus memorandum on review. The Court granted that motion, allowing the parties until May 6, 2016 to answer it. Sierra Construction now files its answer.

B. ARGUMENT WHY REVIEW SHOULD BE GRANTED

NACTT makes two main points in its memorandum. First, NACTT asserts that the Court of Appeals' opinion is flawed in concluding that Arp had no duty to disclose because, in that court's view, the cause of action was not property of the estate. NACTT contends that, instead, the court should have concluded Arp had a duty to disclose irrespective of whether the cause was property of the bankruptcy estate. Second, NACTT contends that the Court of Appeals erroneously found that Arp's concealment of the cause of action was harmless because it was not bankruptcy estate property. Sierra Construction agrees with both points. Sierra Construction also asserts that subsequent case law has compounded

the flaw of the Court of Appeals' decision, further demonstrating the need for review by this Court.

Simply stated, as the NACTT documents (and as Chapter 13 bankruptcy trustees their view is insightful), absent review, the published Court of Appeals opinion contains a glaring misstatement of Chapter 13 law that this Court must correct. Review is merited. RAP 13.4(b).

(1) The Duty to Disclose Is Broader than the Scope of the Bankruptcy Estate

NACTT's first point is that bankruptcy debtors have a duty to disclose any assets that *may* be property of the bankruptcy estate. Disclosure is not contingent upon a final and irrefutable determination that the asset is in fact bankruptcy estate property. NACTT Memo. at 5. Sierra Construction agrees and notes that the Ninth Circuit has already held that an asset must be scheduled in bankruptcy "regardless of whether the law is unsettled on the question of whether [the asset] becomes property of the estate." *In re JZ L.L.C.*, 371 B.R. 412, 417 (B.A.P. 9th Cir. 2007).

The merit of the Ninth Circuit's rule, and the view advanced by Sierra Construction, and affirmed by NACTT, is that requiring disclosure of potential assets allows the debtor, trustee, and creditors to contest whether an asset is bankruptcy estate property. A rule that requires

disclosure only when an asset is undoubtedly property of the bankruptcy estate transforms the debtor into the final arbiter of whether an asset is property of the bankruptcy estate. The flawed consequence of such a rule is that if a debtor wrongly decides that an asset is not property of the bankruptcy estate, the debtor's error will never come to light and the bankruptcy court will never become aware of the asset. This failure will occur even if the debtor acts in good faith and with the purest motives when he or she incorrectly decides the asset is not property of the bankruptcy estate and, thus, need not be disclosed.

Instead, as NACTT argues, the better rule is to require disclosure of any asset that may *arguably* be property of the bankruptcy estate, and to allow interested parties to make their case to the bankruptcy court. It can scarcely be argued that debtors are in a better position than bankruptcy judges to determine the proper application of the bankruptcy code. Indeed, the difficulty and uncertainty in applying the bankruptcy code to the facts of this case—a difficulty acknowledged by the Court of Appeals[1]—is ample evidence that debtors are, as a group, categorically unqualified from making unreviewable decisions about whether an asset is property of the bankruptcy estate.

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[1] *Arp v. Riley*, 192 Wn. App. 85, 94, 366 P.3d 946, 950 (2015).

The Fifth Circuit has adopted this exact rule under this exact reasoning:

> At oral argument, Flugence's attorney stated that there is still ambiguity, because the order says property of the estate shall revest after discharge, but it is unclear whether the cause of action ever was property of the estate. Even so, our decisions have settled that debtors have a duty to disclose to the bankruptcy court notwithstanding uncertainty. The reason for the rule is obvious: Whether a particular asset should be available to satisfy creditors is often a contested issue, and the debtor's duty to disclose assets—even where he has a colorable theory for why those assets should be shielded from creditors—allows that issue to be decided as part of the orderly bankruptcy process.

In re Flugence, 738 F.3d 126, 130 (5th Cir. 2013). Ironically, the Court of Appeals cited, mid-sentence, this portion of the *Flugence* order for the proposition that post-*petition* property needed to be disclosed, but then concluded that post-*confirmation* assets did not require disclosure. *Arp*, 192 Wn. App. at 93. The Fifth Circuit made clear in *Allen v. C & H Distributors, L.L.C.*, 813 F.3d 566, 570 (5th Cir. 2015), however, that the duty to disclose identified in *Flugence* extends to post-confirmation assets in addition to post-petition assets.[2]

[2] *Allen* was decided December 23, 2015, only five days prior to the Court of Appeals' decision in this case, and well after the completion of briefing by the parties. As a result, it is possible the Court of Appeals was unaware of the Fifth Circuit's decision in *Allen*, when the Court of Appeals disclaimed any duty to disclose post-confirmation property as stated in *Allen* and, through *Allen,* also in *Flugence*. Nevertheless, the Court of Appeals' decision reflects an inaccurate depiction of the Fifth Circuit's view on the debtor's duty to disclose post-confirmation property.

In *Allen*, the plaintiffs' filed for bankruptcy on July 14, 2009, their Chapter 13 Plan was confirmed on September 29, 2009, and their cause of action accrued on October 21, 2009, nearly two months after confirmation. *Id.* at 570. Nevertheless, the Fifth Circuit paraphrased the above-quoted provision of *Flugence* to explain the requirement of the post-*confirmation* duty to disclose. *Id.* at 572 ("[D]ebtors have a duty to disclose to the bankruptcy court whether post-*confirmation* assets are treated as property of the estate or vested in the debtor.") (quoting *Flugence*, emphasis supplied, internal quotation omitted).

Recognizing a debtor has a duty to disclose any potential asset also places the onus where it belongs: on the debtor seeking the protections of bankruptcy. *In re Gremillion*, 547 B.R. 196, 202 (Bankr. E.D. La. 2016) ("It is the responsibility of every Debtor to fully disclose all assets, especially those that might lead to the discovery of additional value for the estate. It is not the obligation of the creditors, trustee or court to ferret out assets.").

(2) The NACTT Correctly Notes that the Cause of Action Admittedly Affected Arp's Bankruptcy, Which Would Compel Disclosure, Even if the Asset Is Not Property of the Bankruptcy Estate

In its final point, the NACTT ably describes the myriad ways that an asset may impact a Chapter 13 bankruptcy, even if that asset is not

property of the bankruptcy estate. The issue raised by NACTT is that the existence of the cause of action may have impacted the decisions of creditors throughout the bankruptcy if they had been aware of its existence. If Arp had obtained a recovery or settlement in this case, he would logically have had more money. After Arp was in possession of that sum, he would have had additional money from which he could pay his unsecured creditors. As the NACTT notes, Arp's increased ability to pay his creditors would have existed even if the underlying cause of action had not been property of the bankruptcy estate. NACTT Memo at 8-9. In other words, the money to fund payments required under a Chapter 13 Plan can come from sources other than bankruptcy estate property. 11 U.S.C. § 1325; *Mort Ranta v. Gorman*, 721 F.3d 241, 253 (4th Cir. 2013) ("Section 1325(a)(6) simply states that a [Chapter 13] debtor must be able to make the payments required by the plan; it does not state that only 'disposable income' may be used to make payments. "); *In re Deutsch*, 529 B.R. 308, 312 (Bankr. C.D. Cal. 2015) (contributions from debtor's family members could be taken into account to determine if debtor could make proposed plan payments). As a result, if Arp's creditors had been notified of the existence of this case through proper disclosure, they could have judged for themselves whether to seek modification of Arp's Chapter

13 Plan to provide that he make additional payments in the event that Arp made any recovery in this case.

Arp's creditors' ability to seek modification of the Chapter 13 Plan exists irrespective of whether the cause of action is property of the bankruptcy estate. Further, Arp's creditors would also not necessarily have been any less successful in obtaining modification of the Chapter 13 Plan if the bankruptcy court ultimately determined the cause of action was not property of the bankruptcy estate. However, their ability to seek modification exists only if Arp discloses the potential asset. Hence, the duty to disclose exists independent of whether the asset is ultimately determined to be property of the estate.

(3) Subsequent Inconsistent Washington Court of Appeals Decisions Demonstrate the Need for this Court to Establish Uniformity in the Application of Judicial Estoppel

When considering Sierra Construction's petition, the Court should also note that Court of Appeals case law following the underlying judgment has compounded the error exhibited by the Court of Appeals' opinion. As stated, the Court of Appeals concluded in this case that judicial estoppel did not apply to bar Arp's claim because the cause of action arose after confirmation of his Chapter 13 Plan. The Court also concluded that, although the Plan itself required disclosure, the trial court erred in applying judicial estoppel because the record did not evidence the

trial court exercised its discretion in determining whether the facts of this case required the application of judicial estoppel.

The Court of Appeals recently revisited the doctrine of judicial estoppel in the context of bankruptcy in *Urbick v. Spencer Law Firm, LLC,* 192 Wn. App 483, 491, 367 P.3d 1103, 1106 (2016). In that case, the Court of Appeals repeated its error in this case by again suggesting debtors have no duty to disclose post-confirmation assets. *Id.* at 491. Importantly, the court also affirmed the application of judicial estoppel without any apparent record establishing the trial court intended to exercise independent discretion when applying the doctrine after first concluding the factors were met. *See id.* Following *Urbick*, it is impossible to determine what record the trial court must consider, and how the trial court must memorialize its findings, for judicial estoppel to be correctly applied.

C. CONCLUSION

This Court should accept review for the reasons indicated in Sierra Construction's petition for review. RAP 13.4(b). Should the Court grant review, however, it should deny Arp's contingent cross-petition and affirm the trial court's judgment applying judicial estoppel and conclude that Arp lacked standing as a result of his breach of the duty to disclose the underlying cause of action during bankruptcy.

DATED this 6th day of May, 2016.

Respectfully submitted,

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DECLARATION OF SERVICE

On said day below, I served in the manner set forth below a true and accurate copy of the Answer to Memorandum of Amicus Curiae National Association of Chapter 13 Trustees in Support to Petition to Review in Supreme Court Case No. 92780-4 to the following counsel of record:

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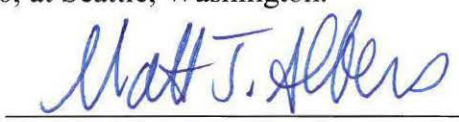
I declare under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

DATED: May 6, 2016, at Seattle, Washington.



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Answer to Memorandum of Amicus Curiae National Association of Chapter 13 Trustees in Support to Petition for Review

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