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Cause No. 78481-7 _____
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SUPREME COURT
OF THE STATE OF WASHINGTON

PETER H. ARKISON, CHAPTER 7 TRUSTEE
FOR MICHELLE CARTER,

Appellant,

v.

ETHAN ALLEN, INC.; RENKINS TRADING, INC.,
a/k/a RENKINS, INC.; ETHAN ALLEN INTERIORS;
and JOHN DOE CORPORATIONS 1-5,

Respondents.

BRIEF OF APPELLANT

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A. ASSIGNMENT OF ERROR:

1. ASSIGNMENT OF ERROR.

The trial court erred in entering the order of January 13, 2006, granting the defendant's motion for summary judgment and dismissing the plaintiff's claims, and in entering the order of February 10, 2006, denying the bankruptcy trustee's motion for reconsideration.

2. ISSUES PERTAINING TO ASSIGNMENT OF ERROR

a. Is a Chapter 7 bankruptcy trustee, acting in his representative capacity and for the benefit of a Chapter 7 debtor's creditors, judicially estopped from administering a debtor's personal injury claim that is property of the bankruptcy estate, solely because the debtor failed to disclose the existence of the claim in her bankruptcy proceeding?

b. Is the equitable doctrine of judicial estoppel properly applied when it results in harm to innocent creditors in a bankruptcy proceeding while relieving a tortfeasor from having to defend a claim on its merits?

B. STATEMENT OF THE CASE

The lower court decision in this case, which rests on an equitable doctrine, was incorrect and unjustifiable. The trial court in this case penalized innocent parties for an act over which they had no control and granted a huge windfall to a tortfeasor on a technicality. The decision

denies a bankruptcy trustee the ability to realize on a valuable asset, and thus adds insult to injury for creditors who, through no fault of their own, were swept into a bankruptcy proceeding. The trial court's ruling should be reversed.

The Appellant is Peter H. Arkison, the Chapter 7 Bankruptcy Trustee for Michelle Carter ("Arkison" or "the Trustee"). He appeals the King County Superior Court's summary dismissal on judicial estoppel grounds of Michelle Carter's personal injury action. That dismissal was based on the following undisputed facts:

According to the Complaint she filed in Superior Court, Michelle Carter ("Carter") was injured on August 10, 2002, when she was struck in the face by a couch being delivered to her home by agents of Respondent Ethan Allen Home Interiors ("Ethan Allen"). CP 1.

Just over two weeks later, and on August 26, 2002, Carter filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Washington, No. 02-20324. CP 67. Arkison was appointed Chapter 7 trustee by the Office of the United States Trustee, to liquidate the assets of the Carter bankruptcy estate and distribute the proceeds to creditors. CP 87.

In her schedule of liabilities filed in the bankruptcy case, Carter listed unsecured debts at the time of her bankruptcy totaling over \$220,000. CP 76-79.

Although she was required to list all assets, including contingent and unliquidated claims of every nature, Carter failed to disclose the tort claim arising out of her prepetition injuries. CP 125. It appearing to Arkison that there were no assets to administer for creditors, he filed a report of no distribution (commonly known as a “no-asset” report). CP 125. Carter received a discharge of her debts on December 3, 2002. CP 91. The bankruptcy case was closed as a matter of course on December 19, 2002. CP 89; CP 125.

On June 16, 2005, Carter commenced a lawsuit in King County Superior Court against Ethan Allen and others, for damages due to the injuries sustained prior to her bankruptcy filing. CP 1. Arkison learned of the claim in October 2005. CP 125. He informed the Office of the United States Trustee, who in turn obtained a Bankruptcy Court order on November 7, 2005, reopening the bankruptcy estate and reappointing Arkison as Trustee to administer the previously undisclosed claim for the benefit of Carter’s creditors. CP 97; CP 125.

Ethan Allen thereafter filed a summary judgment motion to dismiss the complaint, arguing that Carter was judicially estopped from

pursuing her claim because she had failed to disclose the claim's existence in her bankruptcy case, and therefore the position she was now taking by litigating the claim in state court was inconsistent and gave rise to an estoppel. CP 14.

The Trustee appeared in the Superior Court action. CP 108. He then moved for an order substituting himself as plaintiff, since the claim belonged to the bankruptcy estate and the Trustee was therefore the real party in interest. CP 129. The motion to substitute was granted without opposition. CP 146.

The Trustee opposed the summary judgment motion, because a bankruptcy trustee controls prepetition causes of action for the benefit of the bankrupt debtor's creditors, and because a trustee cannot be adversely affected by a debtor's failure to disclose the existence of an asset. CP 110.

Following oral argument¹, Superior Court Judge Michael Spearman rejected the Trustee's position and granted Ethan Allen's motion to dismiss the case with prejudice. CP 144; CP 148. The Trustee brought a motion for reconsideration, CP 150, which was denied by order dated February 10, 2006. CP 158. The Trustee filed a timely Notice of Appeal on March 6, 2006. CP 161.

¹ The summary judgment hearing was not reported or otherwise recorded.

The Trustee has petitioned this Court for direct review under RAP 4.2. That petition is pending before this Court.

C. SUMMARY OF ARGUMENT

The trial court erred in two fundamental ways when it dismissed this case. These errors amounted to an abuse of the court's discretion. The dismissal of the lawsuit should be reversed and the case remanded for trial.

First, the court failed to acknowledge the rights of a Chapter 7 trustee upon the filing of a bankruptcy petition, and the clear and basic distinctions between a debtor and his or her trustee. A trustee controls pre-bankruptcy injury claims as a matter of law. The trustee is thus entitled to administer such claims for the benefit of a debtor's creditors. The Trustee did not prepare Carter's bankruptcy schedules and is neither responsible for nor bound by the representations made therein. The Trustee therefore cannot be judicially estopped by Carter's failure to disclose the claim in her bankruptcy proceeding. The court's ruling to the contrary reflects a misunderstanding of federal bankruptcy law and a misapplication of case law.

Second, the trial court improperly penalized the bankruptcy trustee and the creditors of the bankruptcy estate for the bankrupt debtor's actions. The court turned the equitable doctrine of judicial estoppel on its

head, punishing innocent parties while granting a windfall to the alleged tortfeasor. The result was highly inequitable and contrary to any legitimate policy.

The Trustee maintains in this appeal, simply, that it is *always* an abuse of discretion to dismiss, on judicial estoppel grounds, an action being prosecuted by a Chapter 7 bankruptcy trustee, where the sole basis for dismissal is that the debtor did not disclose the existence of the claim.

D. ARGUMENT

1. STANDARD OF REVIEW

The Trustee appeals a grant of summary judgment. An appellate court reviewing a summary judgment places itself in the position of the trial court and considers the facts in a light most favorable to the nonmoving party. *Young v. Key Pharmaceuticals, Inc.*, 112 Wash.2d 216, 225-226, 770 P.2d 182 (1989).

Because a court invokes judicial estoppel at its discretion, this Court reviews the trial court's application of the doctrine of judicial estoppel to the facts of this case for an abuse of discretion. *Cunningham v. Reliable Concrete Plumbing, Inc.*, 126 Wash.App. 222, 227, 108 P.3d 147 (2005). A court abuses its discretion when it bases its decision on untenable grounds or untenable reasons. *State ex rel. Carroll v. Junker*, 79 Wn.2d 12, 26, 482 P.2d 775 (1971).

2. CARTER'S PREPETITION CLAIM BELONGS TO THE TRUSTEE.

The Trustee's right to administer Carter's injury claim, free of any defense of judicial estoppel, is guaranteed by federal bankruptcy law. Upon the filing of a Chapter 7 bankruptcy case, all of the debtor's property is placed under the control of the bankruptcy trustee, including any property that a debtor fails to disclose. An undisclosed asset existing at the time of a bankruptcy filing remains under the trustee's authority and subject to the jurisdiction of the Bankruptcy Court, notwithstanding the closing of the bankruptcy case or the entry of a discharge. Nothing the debtor does or does not do with respect to the disclosure of the asset may impact the trustee's right to administer the asset.

a. Prepetition Causes of Action are Property of the Bankruptcy Estate.

When a bankruptcy case is commenced, an estate is created consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 USC § 541(a)(1).² The debtor must

² All citations to the Bankruptcy Code, Title 11 U.S.C., are to the Code as it existed prior to the extensive 2005 amendments. Those amendments became effective on October 17, 2005, and apply (with limited exceptions not applicable here) only to bankruptcy cases filed on or after that date.

surrender to the trustee all property of the bankruptcy estate for administration in the bankruptcy case. 11 USC § 521(4).

Causes of action belonging to a debtor at the commencement of a bankruptcy case are indisputably property of the debtor's bankruptcy estate under 11 USC § 541(a)(1). *See, e.g., Sierra Switchboard Co. v. Westinghouse Elec. Corp.*, 789 F.2d 705 (9th Cir. 1986). The injury complained of in this case occurred prior to Carter's August 22, 2002, Chapter 7 filing. The claim is therefore property of Carter's bankruptcy estate.

b. Assets That Are Not Disclosed and Not Administered Remain in the Estate and Subject to the Trustee's Control.

Debtors have an ongoing duty to file bankruptcy schedules of assets and debts and to insure their accuracy and completeness. 11 USC § 521(1); *In re Searles*, 317 B.R. 368, 378 (9th Cir. BAP 2004). If a debtor schedules and thereby discloses property of the estate, and the trustee does not elect to administer that property by the time of closing of the estate, the property is automatically deemed administered in the bankruptcy case and is "abandoned" to the debtor, *i.e.*, removed from the bankruptcy estate and returned to the debtor. 11 USC § 554(c).

Any property of the estate that is not abandoned under 11 USC § 554, but has not been administered in the bankruptcy case, remains property of the bankruptcy estate. 11 USC § 554(d).

It necessarily follows that property of the estate that has not been disclosed by the debtor, and thus is not deemed abandoned at the close of the bankruptcy case, remains at all times property of the estate subject to administration by the trustee, notwithstanding the close of the bankruptcy case. *Cusano v. Klein*, 264 F.3d 936, 945-946 (9th Cir. 2001), and cases cited therein (“If he [the debtor Cusano] failed properly to schedule an asset, including a cause of action, that asset continues to belong to the bankruptcy estate and did not revert to Cusano.”)

The administrative closing of Carter’s bankruptcy case by the Clerk of Court in December 2002 did nothing to alter the status of the injury claim. Cases which are closed may be reopened, as Carter’s was, to administer an undisclosed asset. 11 USC § 350(b).

c. Carter Did Not Disclose the Third Party Claim.

It was undisputed below that Carter did not disclose her injury claim to the Trustee and the Bankruptcy Court prior to case closing. Whether or not she acted intentionally is not relevant to this appeal. The only important fact is that the claim was not properly scheduled, which means the claim was never abandoned. The claim against Ethan Allen has thus remained property of Carter’s bankruptcy estate continually since Carter’s 2002 bankruptcy filing.

d. The Trustee was Substituted as Real Party in Interest to Prosecute the Claim.

Immediately prior to the dismissal of the case, the trial court granted the Trustee's motion to substitute as real party in interest. Ethan Allen did not oppose the motion. The trial court thus recognized—and Ethan Allen conceded—that Carter's claim was property of the bankruptcy estate and was properly prosecuted by the Trustee in his capacity as representative of Carter's creditors.

3. THE TRUSTEE IS NOT JUDICIALLY ESTOPPED FROM PURSUING CARTER'S CLAIM.

Despite the court's recognition of the Trustee's status, and even though the Trustee had absolutely nothing to do with Carter's actions, the trial court then improperly penalized the Trustee and Carter's creditors for Carter's nondisclosure. In doing so, the court plainly committed reversible error.

The trial court's decision was an abuse of discretion because a trustee cannot be implicated by misrepresentations made by a debtor on his or her bankruptcy schedules. The court wrongly used the equitable doctrine of judicial estoppel as a sword to punish the Trustee and the creditors of the bankruptcy estate for the actions of Carter. It misapprehended the nature of bankruptcy cases and the differing roles of trustees and debtors. It followed Washington Court of Appeals decisions that are either distinguishable or incorrectly decided.

a. The Doctrine of Judicial Estoppel.

The doctrine of judicial estoppel is described generally in *Hamilton v. State Farm Fire & Casualty Company*, 270 F.3d 778, 782 (9th Cir. 2001): “Judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position, and then later seeking an advantage by taking a clearly inconsistent position. *Rissetto v. Plumbers & Steamfitters Local 343*, 94 F.3d 597, 600-601 (9th Cir.1996); *Russell v. Rolfs*, 893 F.2d 1033, 1037 (9th Cir.1990). This court invokes judicial estoppel not only to prevent a party from gaining an advantage by taking inconsistent positions, but also because of ‘general consideration[s] of the orderly administration of justice and regard for the dignity of judicial proceedings,’ and to ‘protect against a litigant playing fast and loose with the courts.’ *Russell*, 893 F.2d at 1037.” *See, also, Cunningham v. Reliable Concrete Plumbing, Inc.*, 126 Wash. App. 222, 108 P.3d 147 (2005) (citing *Hamilton*).

In *Hamilton*, a debtor failed to disclose an insurance claim in his Chapter 7 case. As a result of that nondisclosure, the debtor’s bankruptcy discharge was vacated and his bankruptcy case dismissed. The debtor later sued the insurer. The lower court dismissed the suit because the debtor took contradictory positions when he failed to disclose the claim in bankruptcy but later pursued it. The Ninth Circuit affirmed, stating that

the “essence of judicial estoppel” in a bankruptcy context is to protect the integrity of the bankruptcy system, which depends on full and complete disclosure by debtors of their assets, and to protect the debtor’s creditors, who plan their actions based upon what is disclosed by the debtor. 270 F.3d at 785.

b. Elements of Judicial Estoppel.

Judicial estoppel is at its core an equitable, flexible doctrine. *In re An-Tze Cheng*, 308 B.R. 448, 452 (9th Cir. BAP 2004). It is informed by “the existence of a ‘clearly inconsistent’ position that was accepted by a court in a fashion that would create an impression that the courts are being misled and an unfair advantage or unfair detriment that would result without an estoppel.” *Id.*, citing *New Hampshire v. Maine*, 532 U.S. 742, 750-751, 121 S.Ct. 1808, 149 L.Ed. 2d 968 (2001).

While such general statements provide guidance for trial courts in Washington, state appellate decisions differ as to what factors ought to be present for judicial estoppel to arise in any particular case. The United States Supreme Court, which had the opportunity to articulate a set of fixed factors in *New Hampshire v. Maine*, declined to do so, instead commenting that the circumstances when judicial estoppel is appropriate “are probably not reducible to any general formulation of principle.” *Id.* at 750, quoting *Allen v. Zurich Insurance Co.*, 667 F.2d 1162, 1166 (4th

Cir. 1982). Although it stated that the factors are neither “inflexible prerequisites” nor “an exhaustive formula”, the Court nevertheless identified three factors that “typically inform the decision whether to apply the doctrine in a particular case”. *Id.* Those factors are:

1. The party’s later position must be clearly inconsistent with its earlier position;
2. The party must have succeeded in persuading a court to accept the earlier position, such that judicial acceptance of the inconsistent position in the later litigation would create the perception that one or the other of the courts was misled; and
3. The party would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.

Id. at 750-751.

Washington decisions subsequent to *New Hampshire v. Maine* that purport to limit or fix what principles must be applied in judicial estoppel cases are inconsistent with the U.S. Supreme Court’s ruling.

The clearest statement in the Washington State Supreme Court as to the elements of judicial estoppel was *Markley v. Markley*, 31 Wash.2d 605, 198 P.2d 486 (1948), which cited with approval—but as dicta—six elements for judicial estoppel listed in an article in 19 Am.Jur.: (1) The inconsistent position first asserted must have been successfully

maintained; (2) a judgment must have been rendered; (3) the positions must be clearly inconsistent; (4) the parties and questions must be the same; (5) the party claiming estoppel must have been misled; and (6) it appears unjust to allow the party to change its position. 31 Wash.2d at 614-615.

In *Johnson v. Si-Cor, Inc.*, 107 Wash.App. 902, 28 P.3d 832 (2001), Division 3 of the Court of Appeals discussed in detail the *Markley* factors, and acknowledged that the factors—including privity and reliance—have been repeated in cases including *Witzel v. Tena*, 48 Wn.2d 628, 295 P.2d 1115 (1956) and *Sprague v. Sysco Corporation*, 97 Wash.App. 169, 982 P.2d 1202 (1999), *rev. den.* 140 Wn.2d 1004, 999 P.2d 1262 (2000). But *Johnson* then rejected the six element test, instead concluding that “judicial estoppel applies only if a party’s prior inconsistent position benefited the party or was adopted by the court.”

In *Cunningham, supra*, Division 1 cited *Johnson* without analysis, and held that the presence of either a benefit to the litigant or adoption by the court would permit application of judicial estoppel. “Both are not required.” 126 Wash.App. at 230.

In *Garrett v. Morgan*, 127 Wash.App. 375, 112 P.3d 531 (2005), Division 2 required consideration of the three factors from *New Hampshire v. Maine*. 127 Wash.App. at 379. Thus, *Garrett* differs from

Cunningham and *Johnson* in that Division 2 would require both an acceptance or adoption of the party's first inconsistent position *and* a benefit to that litigant.

The case now before this Court permits the Court to establish an analytic framework for trial courts addressing judicial estoppel issues in Washington. This Court should direct trial courts to consider all three factors set out in *New Hampshire v. Maine*. Pronouncements as in *Cunningham* and *Johnson* that any one factor is dispositive should be disapproved.

c. The Trustee Has Made No Inconsistent Statements and is Not Otherwise Bound by the Debtor's Representations.

None of the three elements of judicial estoppel set out in *New Hampshire v. Maine* are present in this case.

The first of the *New Hampshire v. Maine* factors looks to whether the "party" made inconsistent statements. The trial court erred both when it failed to recognize that the Trustee, although the proper plaintiff, was not the "party" responsible for any inconsistency, and when it failed to acknowledge that it is perfectly appropriate for a bankruptcy trustee and a debtor to take inconsistent positions in litigation.

The Trustee did not know of the existence of the claim during the 2002 bankruptcy proceedings and therefore has never taken any

inconsistent position with respect to the claim. Applying judicial estoppel to the Trustee is not necessary to foster a policy of honest disclosure because the Trustee was never dishonest with the court.

The trial court mistakenly failed to distinguish between the Trustee and Carter. Courts that apply judicial estoppel in the bankruptcy context do so when it is deemed equitably appropriate to prevent a *debtor* from litigating an undisclosed claim for his or her benefit. *See, e.g., Hamilton, supra*, 270 F.3d at 785, quoting *In re Coastal Plains*, 179 F.3d 197, 208 (5th Cir. 1999): “The courts will not permit a debtor to obtain relief from the bankruptcy court by representing that no claims exist and then subsequently to assert those claims *for his own benefit* in a separate proceeding” (emphasis added). While the doctrine may therefore under certain circumstances bar a debtor in bankruptcy from taking inconsistent positions, a debtor’s trustee is a different person with a different constituency (*i.e.*, the debtor’s creditors) who is neither responsible for nor bound by a debtor’s false representation that a claim does not exist.

Indeed, it is expected that a Chapter 7 bankruptcy trustee may take a position different from that of the debtor:

As it is fundamental that the interests of a debtor and the trustee can be adverse, it is likewise fundamental that they are entitled to take inconsistent positions....It follows that a position taken by a trustee in litigation that is inconsistent with an earlier position taken by the debtor in litigation to which the trustee is not party,

normally is not an inconsistency that warrants imposition of judicial estoppel. In other words, ***it would be extraordinary for the trustee in the garden-variety bankruptcy to be estopped on account of something the debtor did for its own account during the case.***

Cheng, 308 B.R. at 454-455 (emphasis added). The bankruptcy trustee is a fiduciary charged with liquidating claims and other assets for the benefit of creditors. The trustee's interests are often adverse to those of the debtor, whose goal is to obtain a discharge while retaining as much property as the law allows. Given their often conflicting goals, it makes no logical sense for a court to bind a bankruptcy trustee to a nondisclosure that the debtor has made in order to further his or her self-interest during a bankruptcy case.

This Court recognized that distinction in *American States Insurance Company v. Symes of Silverdale, Inc.*, 150 Wn.2d 462, 78 P.3d 1266 (2003), where the bankruptcy trustee was not bound by the debtor's principal's post-bankruptcy act of setting fire to a restaurant:

A trustee, as representative of the bankruptcy estate, acquires all the rights of the debtor in an insurance policy issued to the debtor, subject to all defenses and obligations that may have existed at the time the bankruptcy estate was created. *In re Feiereisen*, 56 B.R. 167, 169 (Bankr.D.Ore.1985). But "the Trustee and the Debtor are neither the same entity nor alter egos of each other." *In re Buckeye Countrymark, Inc.*, 251 B.R. 835, 840 (Bankr.S.D.Ohio 2000). If the debtor has no authority to act on behalf of the bankruptcy estate, a debtor's intentional wrongdoing is not attributable to the trustee. *Feiereisen*, 56 B.R. at 169-70. Accordingly, a bankruptcy trustee is not barred from recovering under debtor's insurance policy if the

debtor's principal intentionally sets fire to the debtor's premises after the debtor filed a chapter 11 petition for bankruptcy.

150 Wn.2d at 467-468. With respect to actions taken *as part of the bankruptcy case*, then, the debtor and the trustee are clearly not in a predecessor/successor relationship where the bad acts of the first are attributable to the second.

As *Symes of Silverdale* recognizes, there is a critical distinction between circumstances where a trustee is in "privity" with a debtor, and therefore bound by a debtor's *pre-bankruptcy* acts, and acts taken during the case where it would be inappropriate to bind the bankruptcy estate. Property of the bankruptcy estate includes all of the debtor's interest in property "as of the commencement of the case." 11 USC § 541(a)(1). A bankruptcy trustee thus takes whatever property rights a debtor has at the time of the debtor's bankruptcy filing. If prior to filing, a debtor has acted in a manner that creates a legal or equitable defense to a cause of action (*e.g.*, missed a deadline, signed a waiver or release), the trustee may indeed be bound, because the claim had been compromised and devalued prior to the moment of the bankruptcy filing. Once the bankruptcy case is filed, though, the debtor can do nothing to compromise the value of a prepetition asset.

The distinction between pre- and post-bankruptcy acts of a debtor, and their binding effect or lack thereof on trustees, was crystallized by the Eleventh Circuit in *Parker v. Wendy's International, Inc.*, 365 F.3d 1268, 1272 fn. 3 (11th Cir. 2004):

Although general bankruptcy law establishes that the trustee does not have any more rights than the debtor has, *Bank of Marin v. England*, 385 U.S. 99, 101, 87 S.Ct. 274, 276, 17 L.Ed.2d 197 (1966) (“The trustee succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition.”); *In re Halabi*, 184 F.3d 1335, 1337 (11th Cir.1999), any *post-petition* conduct by Parker, including failure to disclose an asset, does not relate to the merits of the discrimination claim. This is because the instant the bankruptcy petition was filed, Parker’s claim against Wendy’s became property of the estate under section 541 and Reynolds [the trustee] became the real party in interest. At that point, the debtor ceased to have an interest in the discrimination claim, unless and until the trustee abandoned it. Both *Bank of Marin* and *In re Halabi* are readily distinguishable since those cases deal with *pre-petition* defenses and counterclaims to a cause of action that would have been applicable to the debtor had no bankruptcy case been filed.

See, also, Cheng, supra, holding that judicial estoppel should not be applied against a Chapter 11 debtor-in-possession due to actions taken by a debtor prepetition.³

Because, then, the Chapter 7 trustee controls the claim for the benefit of the estate, is indisputably not the same person as the Chapter 7

³ Debtors in possession in Chapter 11 generally have all the rights and duties of a trustee.

11 USC § 1107(a).

debtor, is not the “party” making any inconsistent statement, and is not held responsible for a debtor’s actions taken during the bankruptcy case, a trustee may never be estopped by a debtor’s failure to disclose the existence of an asset.

d. Court Decisions Support the Trustee’s Position.

Courts around the country that have directly addressed this issue support the Trustee’s position in this appeal.

In *Parker v. Wendy’s International, Inc.*, *supra*, an Eleventh Circuit case with facts nearly identical to the case at bar, the Chapter 7 debtor had pending at the time of filing an employment discrimination claim against Wendy’s. The debtor did not disclose the claim in her bankruptcy case, the trustee filed a no-asset report, and the case was closed. The trustee later learned of the claim and had the bankruptcy case reopened. After the trustee intervened in the discrimination action, Wendy’s filed a motion to dismiss based upon judicial estoppel. Wendy’s contended that the debtor had failed to disclose the action and benefited through that nondisclosure by obtaining a discharge. The district court granted Wendy’s motion over the trustee’s objection, but the Eleventh Circuit reversed.

The appeals court correctly held that judicial estoppel may not be used to prohibit a trustee from pursuing a cause of action due to the actions of the debtor. The court stated that an undisclosed prepetition

cause of action belongs to the trustee, who is the only party able to pursue the claim. Because the trustee did not make any false or inconsistent statements, the trustee “is not tainted or burdened by the debtor’s misconduct.” 365 F.3d at 1273.⁴

The Seventh Circuit Court of Appeals likewise roundly rejected judicial estoppel as a basis for dismissing a debtor’s undisclosed Federal Employers’ Liability Act claim because the debtor was not the owner of the claim, even though the debtor intentionally did not disclose the claim:

⁴ The *Parker* decision suggests that the earlier 11th Circuit case of *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282 (11th Cir. 2002), an opinion cited in the *Cunningham* case, discussed *infra* at pp. 24-25, may no longer be good law. *Parker*, 365 F.3d at 1272 (“Moreover, based on our analysis which follows, it is questionable as to whether judicial estoppel was correctly applied in *Burnes*.”) See, *In re Phelps*, 329 B.R. 904, 907 (Bankr. M.D.Ga. 2005) (“The effect of *Parker* seems to point to the complete abolition of the application of judicial estoppel to causes of action omitted from a debtor’s bankruptcy schedules.”); Klein, Ponoroff and Borrey, *Principles of Preclusion and Estoppel in Bankruptcy Cases*, 79 Am.Bankr.L.J. 839, 884-886 (2005) (discussing the evolution of the 11th Circuit’s opinions culminating in *Parker*, and noting that *Parker* “grappled with the implications of the basic bankruptcy propositions that had been ignored” in prior cases.)

“Decisions that rely on judicial estoppel assume that the tort belongs to the debtor. Only then is one person on both sides of the same issue. Yet why would Biesek [the debtor] own this chose in action? Pre-bankruptcy claims are part of debtors’ estates; this FELA claim therefore belongs to the Trustee, for the benefit of Biesek's creditors.” *Biesek v. Soo Line Railroad Company*, 440 F.3d 410, 413 (7th Cir. 2006).⁵

Recently, U.S. District Judge Martinez of the Western District of Washington rejected the use of judicial estoppel to preclude a bankruptcy trustee from pursuing an undisclosed Fair Credit Reporting Act claim, *Wood v. Household Finance Corporation*, 341 B.R. 770 (W.D.Wash. 2006): “[B]oth the Eleventh Circuit and the Seventh Circuit have determined that there is a difference between a debtor attempting to pursue an action for his own benefit, and a trustee pursuing an action for the benefit of the creditors [citing *Parker* and *Biesek*]....This Court finds those decisions persuasive, and agrees with plaintiff that the *Hamilton* reasoning does not apply to situations where the bankruptcy trustee is pursuing the undisclosed action.”

⁵ The *Biesek* court nevertheless affirmed the dismissal of the debtor’s claim, because the trustee had not asserted a position in the federal court suit after learning of its existence, and the debtor had no authority to litigate a claim that belonged to the bankruptcy trustee.

The Federal Court of Claims likewise rejected a judicial estoppel defense to a Chapter 7 trustee's administration of a Fair Labor Standards Act claim in *Aaron v. United States*, 65 Fed.Cl. 29 (2005). The court noted that if the claim were barred, then the intent behind the reopening of the bankruptcy case to permit trustee administration would be thwarted. The decision rests on the fact that the trustee had never taken an inconsistent position with respect to the claim: "[W]e are not concerned that permitting the claim to continue through the trustee would be a 'perversion of the judicial process' [cite omitted].... Ms. Sullivan [the trustee] became the real party in interest when the bankruptcy petition was filed. Post-petition conduct by Mr. Atterbury [the debtor], including failure to disclose an asset, does not relate to the merits of the claim. Ms. Sullivan 'has never abandoned [the claim and] never took an inconsistent position under oath with regard to the claim.' *Id.* at 32, quoting *Parker, supra*.

As in the above-cited cases, the Trustee for Carter never took a position with respect to the claim against Ethan Allen that is inconsistent with his desire to administer the claim for the benefit of Carter's creditors. Upon the Trustee's learning of the claim, steps were promptly taken to reopen the bankruptcy case so that the Trustee could fulfill his duty to administer undisclosed property of the bankruptcy estate. Viewed slightly

differently, the Trustee is in fact taking an inconsistent position in litigating a claim Carter failed to disclose, but the Trustee is entitled by law to do so. Either way, it is impermissible, and an abuse of discretion, to burden the Trustee and Carter's creditors with Carter's failure to disclose.

e. Washington Case Law is Either Not Applicable or Wrongly Decided.

Ethan Allen's briefs before the lower court strongly emphasized the *Cunningham* and *Garrett* decisions, which Ethan Allen argued were "controlling precedent". CP 137. The trial court adopted Ethan Allen's position and followed these cases in applying judicial estoppel to the Trustee. CP 151-152. The truth, however, is that *Cunningham* is easily distinguishable and *Garrett* is wrongly decided.

In *Cunningham v. Reliable Concrete Plumbing, Inc.*, 126 Wash. App. 222, 108 P.3d 147 (Division 1, 2005), the debtors failed to disclose in their Chapter 7 case a third party injury claim arising out of a workplace injury. After the bankruptcy case closed, the debtors brought suit against the alleged tortfeasor in state court. The bankruptcy trustee learned of the case and reopened the Chapter 7 proceeding. The state court defendant, however, moved for dismissal of the state court case.

That motion was granted based on judicial estoppel. The Washington Court of Appeals, Division 1, affirmed.

Cunningham simply holds that a debtor is judicially estopped from pursuing his or her own undisclosed prepetition cause of action following the close of the bankruptcy case. Although the decision mentions in its factual recitations the existence of a bankruptcy trustee, the court plainly did not discuss the rights of a trustee but only those of a debtor. There is nothing in the opinion purporting to estop bankruptcy trustees who administer undisclosed claims for the benefit of creditors. The Cunninghams' trustee is not listed in the case caption. The stated appellants were Richard and Marci Cunningham. Richard Cunningham apparently represented himself *pro se*, as he is the only person listed as counsel for the appellants.

Cunningham's conclusions, moreover, rest on the Ninth Circuit's opinion in *Hamilton, supra*. *Cunningham* cites to *Hamilton* repeatedly. *Hamilton*, too, involved not a trustee but a debtor bringing the post-bankruptcy lawsuit "for his own benefit". 270 F.3d at 785.

Cunningham, then, does not apply to cases where the Chapter 7 trustee is administering the claim for the creditors' benefit.

The case of *Johnson v. Si-Cor, Inc.*, 107 Wash.App. 902, 28 P.3d 832 (Division 3, 2001) is similar to *Cunningham* in that the rights of a

Chapter 7 trustee are not discussed. *Johnson* involved a Chapter 13 bankruptcy where the debtors remained in control of their assets throughout the course of the bankruptcy case. The court ultimately held that the debtors were not judicially estopped because their claim arose during their Chapter 13 case and therefore did not have to be disclosed.

In *Garrett v. Morgan*, 127 Wash.App. 375, 112 P.3d 531 (Division 2, 2005), debtors Mr. and Mrs. Davis filed a Chapter 7 case, and shortly thereafter filed a personal injury case in state court. The injury claim was not disclosed. The bankruptcy case was closed. The defendant Morgan later learned of the bankruptcy filing and moved to dismiss the injury lawsuit. The Davises moved to reopen the bankruptcy case, and Mr. Garrett was appointed as bankruptcy trustee. At hearing on the motion to dismiss the lawsuit, the trial court found that the failure of the debtors to list the claim was intentional, and that judicial estoppel “barred the trustee, who stood in the Davises’ shoes, from pursuing the lawsuit against Morgan.” *Id.* at 377. The Court of Appeals affirmed.

Garrett is wrongly decided. The decision should be expressly overruled by this Court. *Garrett* begins with the premise, as in *Cunningham*, that a debtor may be estopped from asserting an undisclosed cause of action. *Garrett*, however, then makes the unsupported leap of tarring the debtor’s bankruptcy trustee with that same brush. *Garrett* nowhere

discusses the fact that an undisclosed cause of action belongs to the bankruptcy trustee not the debtor, the trustee is not bound by a debtor's post-bankruptcy acts, and the trustee is entitled to take a different position in litigation. The decision is devoid of analysis respecting the role of the Chapter 7 trustee. At the end of its opinion when the court lists six facts from which the court concludes the lower court had not abused its discretion, the court does not mention the trustee or acknowledge the trustee's status as representative of the creditor body. 127 Wash.App. at 383.

The rote proposition apparently accepted by Division 2 in *Garrett*—that a trustee “stands in the shoes” of a debtor—is sharply limited by the filing of the bankruptcy petition. See discussion at pp. 16-19, *infra*. *Garrett* includes no analysis on the subject. The *Symes of Silverdale* case, although controlling on the decisions of the appellate Division 2, and *contra* to the outcome in *Garrett*, is neither cited nor discussed.

The decision in *Garrett* cannot stand up to critical scrutiny. It was error for the trial court in this case to reach the identical conclusion as that reached in *Garrett*.

f. Carter's Position was not "Accepted; She Gained No "Advantage" by Nondisclosure.

The second and third elements of judicial estoppel discussed in *New Hampshire v. Maine* are that the party's position must have been "accepted" by the prior court such that judicial acceptance in the second court would create the impression that the first court had been misled, and that the party to be estopped must have thereby gained an unfair advantage or imposed an unfair detriment on the opposing party. Neither element is present in this case.

To apply these elements of judicial estoppel adversely to a bankruptcy trustee, a court must again ignore the distinctions between a trustee and a debtor. The Trustee Arkison did not succeed in persuading the bankruptcy court to accept any position with respect to the claim against Ethan Allen. There thus may be no inference that any court was misled by the Trustee. Further, the Trustee will not derive any type of "unfair advantage" if he is permitted to administer the claim for the benefit of creditors.

Viewing these elements from Carter's perspective rather than the Trustee's, furthermore, does not yield a different outcome. A Chapter 7 debtor gains no advantage or acceptance through nondisclosure when a bankruptcy trustee steps in to administer the claim. The contention

advanced in *Cunningham* that a bankruptcy court “accepts” a debtor’s representation regarding assets when it grants a discharge and closes a bankruptcy as a “no asset” case, is a non-sequitur. Bankruptcy cases may be reopened to administer undisclosed assets. Discharge in bankruptcy affects a debtor’s personal liability, but has nothing to do with the existence of assets or a trustee’s ability and authority to liquidate property of the bankruptcy estate. Because an undisclosed asset is never abandoned back to the debtor and remains at all times property to be administered by a Chapter 7 trustee, a valuable cause of action will benefit the creditors in bankruptcy regardless of whether a discharge has been entered. *In re Lopez*, 283 B.R. 22, 28 (9th Cir. BAP 2002) (holding a bankruptcy court abused its discretion when it denied a motion to reopen a bankruptcy case to permit a Chapter 7 trustee to administer an undisclosed claim, because “[t]hat approach would risk harming creditors in an attempt to punish a former debtor.”)

Just as entry of a discharge or closing of a case despite non-disclosure does not constitute “acceptance” of a debtor’s position, it also confers no “advantage” on the debtor:

Because a trustee cannot be judicially estopped from asserting the claim, there is no way for a debtor to benefit from omitting the asset from the schedules, thereby failing to satisfy an essential element of the defense. Even if a debtor successfully prosecuted an omitted cause of action in his own name and won, any

damages awarded would be property of the estate subject to seizure by the trustee. He occupies no better position by omitting the claim than he would had he disclosed it. Furthermore, if it were found that a debtor perpetrated some sort of fraud by his omission, there are other ways of punishing him that do not deprive his creditors and his dependants of the proceeds of the lawsuit. For example, the bankruptcy court may revoke the discharge when a debtor conceals estate property. 11 U.S.C.A. § 727(d) (West 2004).

In re Phelps, 329 B.R. 904, 907 (Bankr. M.D. Ga. 2005).

See, also, Haley v. Dow Lewis Motors, Inc., 72 Cal.App.4th 497, 511, 85 Cal.Rptr.2d 352, 361 (Cal.App. 3 Dist., 1999), which overruled the dismissal of an undisclosed lawsuit as against a Chapter 7 trustee:

“[J]udicial estoppel is rarely appropriate in a chapter 7 context in a case in which the debtor has failed to schedule a claim.... The debtor will lack standing to sue so the suit can be maintained only if the bankruptcy trustee substitutes in or abandons the claim. There is no possibility of unfair advantage because the bankruptcy court will take appropriate actions to promote the goals of bankruptcy and protect the process.” (cites omitted)

Indeed, a debtor faces punitive action in Bankruptcy Court if he or she fails to disclose an asset. In addition to revocation of discharge as noted above in *Phelps*, the Bankruptcy Court may deny the debtor an exemption claim on property which was not disclosed. *Arnold v. Gill*, 252 B.R. 778, 785 (9th Cir. BAP 2000). A debtor who makes false or fraudulent statements on bankruptcy schedules may also be held criminally liable for bankruptcy fraud. 18 USC § 157 (person who, with

intent to defraud, makes false representations in a bankruptcy case, may be imprisoned for as much as five years). *See, Biesek, supra*, 440 F.3d at 413 (“Instead of vaporizing assets that could be used for the creditors’ benefit, district judges should discourage bankruptcy fraud by revoking the debtors’ discharges and referring them to the United States Attorney for potential criminal prosecution.”)

Any suggestion, then, that a debtor gains an advantage through nondisclosure because he or she will be able to pursue the lawsuit free of creditors claims, without penalty if caught, is nonsense.

4. THE COURT APPLIED AN EQUITABLE DOCTRINE IN AN INEQUITABLE MANNER

The doctrine of judicial estoppel is “grounded on notions of fairness and preventing injustice....It is a maxim of equity that a court seeks to do justice and not injustice. It will not do ‘inequity in the name of equity’.” *In re An-Tze Cheng, supra*, 308 B.R. at 459.

Yet that is precisely what happened here. Carter scheduled over \$220,000 in creditors’ claims. Carter’s creditors, who did nothing wrong, were the ones harmed by the trial court’s ruling, which ostensibly was rendered in order to protect the “dignity” and “integrity” of the bankruptcy system. There is a complete disconnect between the purpose and goals of the doctrine of judicial estoppel and the result in this case. The trial court’s decision is thus indefensible.

What kind of equity and fairness is promoted by preventing a bankruptcy trustee from pursuing an undisclosed tort claim for the benefit of the debtor's creditors? Judicial estoppel is supposed to be applied to prevent unfair advantage or unfair detriment. The creditors of this estate—some \$220,000 worth of claims which remain unpaid—gained no advantage when Carter failed to schedule the injury claim. Likewise, Ethan Allen suffered no detriment due to Carter's failure to disclose. Ethan Allen is not a creditor of the Michelle Carter bankruptcy estate. Ethan Allen took no action and suffered no harm or prejudice due to Carter's failure to schedule the claim. "It is inappropriate for third parties who were otherwise unharmed by the omission to seek to impose additional self-serving punishments on a debtor through the nonbankruptcy courts." *Phelps, supra*, 329 B.R. at 907, fn 3.

The penalty advocated by Ethan Allen and accepted by the trial court benefited only Ethan Allen and punished innocent parties—the Trustee and Carter's creditors. Yet if judicial estoppel is an equitable remedy designed to prevent manipulation and perversion of the judicial system, to employ the doctrine against anyone but the wrongdoer does not promote the system. Instead, it results in a total failure of justice by denying the *victims* access to the system. The windfall goes to the

tortfeasor, who was not a party to the bankruptcy proceeding and not a victim of any wrongdoing.

The Seventh Circuit had no difficulty recognizing this inequity in

Biesek, supra:

Judges understandably favor rules that encourage full disclosure in bankruptcy. Yet pursuing that end by applying judicial estoppel to debtors' self-contradiction would have adverse effects on third parties: the creditors. Biesek's [the debtor's] nondisclosure in bankruptcy harmed his creditors by hiding assets from them. Using this same nondisclosure to wipe out his FELA claim would complete the job by denying creditors even the right to seek some share of the recovery. Yet the creditors have not contradicted themselves in court. They were not aware of what Biesek has been doing behind their backs. Creditors gypped by Biesek's maneuver are hurt a second time by the district judge's decision. *Judicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application.*

410 F.3d at 413 (emphasis added).

The logic advocated by the dissenting judge in *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 422-423 (3rd Cir. 1988), a case that upheld the estoppel of a nondisclosing Chapter 11 debtor, is likewise unimpeachable:

The Code's disclosure requirements are intended to protect those creditors whom a debtor's failure to disclose hidden assets would prejudice. *A fortiori*, a court's response to nondisclosure should do likewise. Not only does the court fail to safeguard the interests of Oneida's unsecured creditors, but it effectively penalizes them by foreclosing the prosecution of claims against the bank that would, if successful, result in a substantial enhancement of the estate and in their receiving more than the approximately thirty

cents on the dollar for which they have been forced to settle. The only real winner in the case as decided is the bank, whom the court has relieved of the responsibility of justifying its allegedly improper behavior.

See, also, Klein, Ponoroff and Borrey, Principles of Preclusion and Estoppel in Bankruptcy Cases, supra at 883-884 (“A common misapplication of judicial estoppel in the bankruptcy context arises when a debtor fails to disclose the existence of a cause of action as an asset of the estate....The rationale [for estoppel] is that the debtor obtained a benefit in the bankruptcy based on the premise that the cause of action did not exist and should not later be allowed to take a contrary position. When, however, courts have succumbed to the allure of this position, it has usually led to a dismissal of the action in a manner that contradicts the maxim that equity will not do inequity—the resulting inequity being that creditors are punished for the debtor’s omission.”)

The issue on appeal, moreover, is not limited to the prosecution of personal injury cases. Defendants have also asserted the false logic of judicial estoppel against a bankruptcy trustee in other types of litigation. *See, e.g., Wood v. Household Finance Corp., supra.* (Fair Credit Reporting Act). If the equitable application of judicial estoppel may be justified in Carter’s case, what distinction will preclude judicial estoppel from defeating a trustee’s recovery of a claim for fraud, or sex abuse, or

collection of a note or account receivable, or an inheritance right? Will a promissory note obligor not have to make payment to the bankruptcy trustee because the debtor did not disclose the existence of the receivable but later sued to recover? What of an undisclosed marital dissolution property settlement? Is the nondebtor ex-spouse absolved from paying the bankruptcy trustee? Will the other heirs of a probate estate not have to share an inheritance with a trustee if the debtor, having failed to disclose the existence of an inheritance interest, later files a claim in the probate case? The answers to these questions will be “yes”, and all undisclosed obligors would be off the hook, to the detriment of a bankruptcy estate’s creditors, should this Court determine that it is not an abuse of discretion to impose judicial estoppel against a bankruptcy trustee in order to punish a debtor’s failure to disclose.

The matter raised in this appeal, moreover, bears a very substantial risk of repetition. Thousands of Chapter 7 bankruptcy cases are filed in the federal bankruptcy courts in Washington annually.⁶ In some of these many cases there will undoubtedly be undisclosed assets that debtors

⁶ For example, 39,863 Chapter 7 cases were filed in the Eastern and Western Districts of Washington in 2005. Press release dated January 25, 2006, Office of the Clerk, U.S. Bankruptcy Court Western District of Washington, <http://www.wawb.uscourts.gov/phorum3/files/uPublicNotices/88.pdf>; Ten Year Trend in Bankruptcy Filings, dated January 5, 2006, United States Bankruptcy Court Eastern District of Washington, <http://www.waeb.uscourts.gov/Statistics/1995-2005.PDF>.

attempt to pursue after their bankruptcy cases are closed. Should the decision below be upheld, and *Garrett* continue to be viewed as good law, creditors in these future cases will be denied recourse and recovery, and tortfeasors will continue to receive the windfall of dismissal.

E. CONCLUSION.

The Trustee is entitled to prosecute Carter's claim. He has controlled it since Carter's bankruptcy filing, and has taken no inconsistent stance. Ethan Allen has an obligation to defend on the merits. It is not entitled in equity to the huge windfall bestowed upon it by the trial court.

The dismissal of the Trustee's claim was an abuse of discretion, as it was based on utterly untenable grounds. The Trustee therefore respectfully requests that this Court reverse the order granting summary judgment to Ethan Allen and dismissing this case, and that it remand this matter to the King County Superior Court for trial.

DATED this 20th day of June, 2006.



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