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APPELLATE LAWYER of the WEEK

BY JOHN COUNCIL

Asset Pursuit

The 5th U.S. Circuit Court of Appeals rarely addresses bankruptcy issues in en banc decisions. That's why the full-court ruling won by Todd Hoodenpyle is a big deal for trustees faced with debtors who did not disclose to the bankruptcy court assets won in prior litigation.

In its Aug. 11 opinion in *Diane G. Reed v. City of Arlington*, the en banc court said judicial estoppel does not bar a "blameless" bankruptcy trustee from pursuing and recovering a judgment the debtor did not disclose during bankruptcy.

According to *Reed*, the background in the case is as follows: Kim Lubke, a former firefighter, won a judgment in excess of $1 million in federal court against the city of Arlington as part of a Family and Medical Leave Act (FMLA) claim. Lubke filed for bankruptcy protection but did not disclose his judgment against the city, the 5th Circuit wrote. Lubke received a no-asset discharge and the bankruptcy case was closed. The city appealed the FMLA case to the 5th Circuit.

On June 30, 2006, a three-judge 5th Circuit panel remanded the FMLA case to the U.S. District Court to recalculate damages. The city offered to settle, and in the course of discussing the offer with his client, Lubke's lawyer learned of Lubke's bankruptcy and notified the trustee of Lubke's bankruptcy estate, Diane Reed, about the FMLA judgment, the 5th Circuit wrote. Reed had the bankruptcy case reopened, and Lubke's debt discharge was revoked. Reed substituted herself as the real party in interest in the FMLA litigation and sent the city a written acceptance of its settlement offer so the recovered assets could be distributed to Lubke's creditors.

Todd Hoodenpyle

The city sought leave from the 5th Circuit to argue that Lubke should be judicially estopped from collecting the judgment because he did not disclose the judgment in bankruptcy proceedings, the appeals court wrote. The 5th Circuit denied the motion but directed the district court to determine whether judicial estoppel applied.

The district court held that judicial estoppel should apply to Lubke but that stopping the trustee from pursuing Lubke's judgment would run counter to U.S. Bankruptcy Code provisions and would be inequitable, the 5th Circuit wrote. The city again appealed to the 5th Circuit panel, which reversed the district court on Sept. 16, 2010, finding it had abused its discretion by distinguishing Lubke's conduct from that of the trustee in applying judicial estoppel, concluding the balance of equities "disfavor[ed] permitting this litigation to continue." The trustee moved for en banc rehearing.

In a 13-3 decision, the full 5th Circuit upheld the district court's ruling. "We now affirm the judgment of the district court and state a general rule that, absent unusual circumstances, an innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose in bankruptcy," wrote Judge Carolyn Dineen King for the majority.

But Chief Judge Edith Jones, joined by Judge Edith Brown Clement and Senior Judge Harold DeMoss, dissented because "a broader view should have been taken of the impact of satellite litigation generated by Lubke's deception," among other things.

Hoodenpyle, a partner in Addison's Singer & Levick who represents Reed, says the "opinion is important in the bankruptcy realm because it establishes in the 5th Circuit a general rule that bankruptcy trustees are not punished" by the acts of a nondisclosing debtor. "It really brought the 5th Circuit on par with other circuits, the 11th, 7th and the 10th. . . ."

Michael McConnell, a partner in Fort Worth's Kelly Hart & Hallman who represents the city of Arlington, did not return a telephone call seeking comment.

Arlington solo Roger Hurlbut, who represented Lubke in the FMLA case, says Lubke "testified to the effect that his bankruptcy attorney advised that the judgment against the city did not need to be disclosed in his schedules." But Mike Rogers of Cleburne's Rogers Law Firm, who represented Lubke in the bankruptcy case, disagrees. "If we would have known it, it would have been in his schedules," Rogers says.