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After the Love (and the Money) Is Gone: The Intersection Between Bankruptcy and Divorce

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I. Property of the Estate: In Chapter 7 cases, 11 U.S.C. § 541 defines what is property of the estate upon the filing of the bankruptcy. The estate includes, with some exceptions, all legal and equitable property of the debtor at the commencement of the case. The property of the estate includes any property that the debtor acquires or has the right to acquire within the 180 days after the date of filing as a result of a property settlement agreement, with the debtor's spouse, a non-final or final judgment of divorce. 11 U.S.C. §541(a)(5)(B). State law determines the nature of property rights when considering whether something constitutes bankruptcy estate property under § 541(a). *In re Radinick*, 419 B.R. 291, 294 (Bankr. W.D. Pa. 2009).

A. Community Property States: Community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, Wisconsin) present some unique issues in determining the scope of the bankruptcy estate. In community property states, property of the estate also includes "[a]ll interests of the debtor and the debtor's spouse in community property at the commencement of the case that is—(A) under the sole, equal or joint management and control of the debtor; or (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable." 11 U.S.C. §541(a)(2). Generally, the entirety of the community property becomes property of the estate—not just the debtor-spouse's ½ interest in that property. *In re Victor*, 341 B.R. 775 (Bankr. D. N.M. 2006).

B. Community property states classify all property as either community, separate, or mixed. Nuances vary from state-to-state. Community property is usually owned by the spouses equally and separate property is usually owned by a spouse individually. Generally, property acquired by the effort, skill, or industry of either spouse during marriage is community property. Property acquired before (or after the termination of) marriage, and property acquired by gift or inheritance is separate property. Property acquired with separate property is separate property. Property acquired with community property is community property. States are split on the classification of increases or gains to separate property (such as interest or increases in value) that occur during marriage. The "American Rule" states—Arizona, California, Nevada, New Mexico, and Washington—generally treat this property as separate property. The "Spanish Rule" states—Louisiana, Idaho, Wisconsin, and Texas—generally treat this property as community.

C. Spouses may opt-out of or modify the community property system through prenuptial or postnuptial agreement or through donations or transmutations during marriage.

D. In classifying assets, community property states generally provide for a presumption that all property of both spouses is community property—often regardless of title. The burden is on the spouses to rebut this presumption by showing the property is separate. Courts have routinely held the presumption applies in the bankruptcy setting—a notion consistent with more general community property and public policy principles. *In re Brace*, 566 B.R. 13 (Bankr. App. 9th Cir. 2017); *In re Field,* 440 B.R. 191 (Bankr. D. Nev. 2009); *In re Victor*, 341 B.R. 775 (Bankr. D. N.M. 2006)

E. Not all community property will form part of the bankruptcy estate. Rather, §541 requires that it must be either "(A) under sole, equal or joint management and control of the debtor; or (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable." Together, (A) and (B) will capture most community property.

1. §541(a)(2)(A)—Rules relating to the management and control of community property vary considerably by state. Property under the sole management of a spouse is subject to the exclusive management of that spouse. Equal management property can be managed by either spouse, acting alone. Joint management property requires the concurrence of both spouses.
2. Texas. Texas has a "two-fund" or "dual management" approach. "During marriage each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single." Tex. Fam. Code §3.102. Any comingled property or any property that does not otherwise fall under the general rule is subject to joint control of both spouses.

3. The other states. All other community property states have a default rule of equal management for community property. However, this rule is subject to numerous exceptions. For example, transactions involving real estate often require the joinder of both spouses. More importantly, many types of property fall under the sole management of one spouse. Management of community interest in LLCs, corporations, and partnerships often falls under the sole management of the spouse in whose name the property is listed. Similarly, personal property that is registered or titled in the name of one spouse is usually subject to that spouse's sole management either as a matter of statute or as a result of basic notions of privity and of title.

    i. For example, in *In re Victor*, 341 B.R. 775 (Bankr. D. N. M. 2006) the court discussed trailers that were community property under New Mexico law. The trailers were used by the non-filing spouse in his separate business and

were titled in his name. As such, they fell under the nonfiling spouse's sole control and were not property of the estate under §541(a)(2)(A). They did, however, become property of the estate under §541(a)(2)(B) because the debts on the trailers were incurred during marriage and were community debts.

4. §541(a)(2)(B). The availability of community property for seizure and sale by creditors varies by state. Generally, states take one of two approaches: the community debt system or the managerial system.

    i. Community debt systems. Arizona, Washington, New Mexico and Wisconsin utilize the community debt system. Under this approach, the ability of a creditor to reach community or separate property depends on the classification of the debt as community or separate. Community property can be used to satisfy community property. Creditors of separate debts can usually reach separate property and, sometimes, community property.

    ii. Managerial systems. California, Louisiana, Idaho, Texas, and Nevada each use some form of managerial system. Under this approach the property subject to the management (sole, joint, or dual) or a spouse is liable for his debts. In states other than Texas, this usually means that all community property and all of the debtor's separate property is available to creditors.

    iii. *In re Trammell*, 399 B.R. 177 (N.D. Tex. 2007) illustrates the interaction of the various rules and one of the relatively rare circumstances where a community asset is not property of the estate. Husband (non-debtor) was the record owner of a community Honda. Husband financed the car from Honda and was the only signatory to the loan. Because the car was titled in husband's name it was under his sole management under Texas law and did not form part of the estate under §541(a)(2)(A). Because debtor wife did not sign any of the loan documents she was not personally liable for the debt and the property was not included in the estate under §541(a)(2)(B).

II. Property of the Estate when Divorce is Pending on Petition Date: There are states where the property vests with each spouse upon the filing of the divorce petition and there

are other states where the property does not vest until the entry of the final judgment of dissolution of marriage.

A. States where property vests in spouses upon filing of the Petition for Dissolution.

1. Under New Hampshire law, the non-filing spouse had an interest in property upon the filing of the petition for dissolution of marriage. In *re Skorich*, 482 F.3d 21, 25–26 (1st Cir. 2007). The debtor and non-filing spouse sold property and placed into escrow before bankruptcy filing.

   Debtor filed bankruptcy, stay relief was granted and family court awarded entire amount of escrow to non-filing spouse. After the filing of the divorce, the debtor and non-debtor spouse held a contingent equitable interest in the property. The trustee's contingent equitable interest was lost when the state court awarded the funds to the nondebtor spouse.

2. Under Pennsylvania law, one spouse's right to equitable distribution of marital property vests immediately upon initiation of divorce action, coupled with request for equitable distribution of marital assets. *In re Radinick*, 419 B.R. 291 (Bankr. W.D. Pa. 2009)

3. Under Maine law, Maine's legislative intent is that the filing of a divorce case, rather than the entry of judgment at the end of the case, will significantly affect each spouse's property rights. *Davis v. Cox*, 356 F.3d 76, 86 (1st Cir. 2004).

4. Under Wyoming law, upon the filing of the divorce petition, the divorcing parties have a vested inchoate property interest in property solely in the name of the other spouse. *In re White*, 212 B.R. 979, 983 (B.A.P. 10th Cir. 1997). "Where the divorce is pending when the bankruptcy petition is filed, the divorcing spouses' respective property interests are vested but subject to subsequent definition. For that reason, what constitutes property of the estate is undefined. Once the state court or bankruptcy court defines the respective interests, it becomes clear what property is within the exclusive purview and jurisdiction of the Bankruptcy Court."

5. Under Kansas law, the filing of a petition for divorce or separate maintenance creates a species of common or co-ownership in one spouse in the jointly acquired property held by the other, the extent of which is determined by the trial court pursuant to K.S.A.1972 Supp. 60–1610(b). *Matter of Marriage of Cray*, 254 Kan. 376, 383, 867 P.2d 291, 297 (1994); *Cady v. Cady*, 224 Kan. 339, 344, 581 P.2d 358, 363 (1978).

B. States where property vests in spouses upon Final Judgment of Dissolution of marriage.

1. Under Florida law, title to disputed assets shall vest only by the judgment of a court. Fla. Stat §61.075. A final judgment by the state court is needed to consummate a marital dissolution agreement. *In re Hoyo*, 340 B.R. 100, 103 (Bankr. M.D. Fla. 2006).

2. Under New York law, one spouse's rights in marital property owned by the other are inchoate and do not vest until entry of a judgment of divorce. *In re DiGeronimo*, 354 B.R. 625, 637 (Bankr. E.D.N.Y. 2006). The result is that a non-debtor spouse does not have a recognizable property interest in a debtor's property until entry of the divorce judgment. *Id*. Therefore, the debtor's property comes into the bankruptcy estate free from the non-filing spouse's inchoate interest, and the non-filing spouse has a claim to the debtor's property to the same extent as does any other unsecured creditor. Id. Therefore, if the divorce judgment is not entered pre-petition, the trustee's rights as a hypothetical lien creditor cut off the spouse's rights to the debtor's property and the spouse is left with a claim against the estate which is discharged unless it is declared nondischargeable under 11 U.S.C. §§ 523(a)(5) or (15).

3. Under New Jersey law, equitable distribution claims arise upon the entry of the judgment of divorce. *Kane v. Kane*, CIV.A.08-5633FLW, 2009 WL 3208653 (D.N.J. Sept. 30, 2009), *aff'd sub nom. In re Kane*, 628 F.3d 631 (3d Cir. 2010).

4. Under Ohio law, each spouse has a contingent interest in marital property that is not titled in the name of the debtor upon the filing of the petition for dissolution of marriage. *In re Greer*, 242 B.R. 389, 396 (Bankr. N.D. Ohio 1999). Until a formal distribution of the parties' property is made, the interest a spouse acquires in the other's separately titled property is strictly contingent, and therefore subject to later divestment if the state court. *Id*. The contingency of the interest prevents the bankruptcy trustee from utilizing the property for the benefit of the bankruptcy estate given the fact that federal law y holds that the extent to which an interest in property is limited in the hands of the debtor, it is equally limited in the hands of the bankruptcy estate. *Id*. Thus, if the property is awarded to the non-filing spouse the bankruptcy trustee's interest in the property would be divested. *Id*.

C. Community Property States: Spouses in community property states own all community property concurrently and, therefore, have a present vested interest in all community property that is in existence on the filing date. However, divorce terminates the community property regime—sometimes

retroactively to the date of filing for divorce. When the community property regime terminates, the spouses (or former spouses) usually remain co-owners of the former community property until partition or other division. The courts have drawn a distinction between former community property and property that has been partitioned.

1. *In re Robertson*, 203 F. 3d 855 (5th Cir. 2000) summarized this distinction as follows: "According to the relevant court decisions we have found, "community property" as used to define property of the estate in section 541(a)(2) includes community property and former community property that has not been partitioned as of the petition date but does not include former community property which has been divided and reclassified as separate property by state law before that date. Courts addressing the issue have held that community property which has not been legally divided as of the commencement of the bankruptcy case passes to the debtor's estate."

2. Other courts have reached the same conclusion. *See e.g. In re Patterson*, 437 B.R. 858 (D. Ariz. 2010); *In re Mantle*, 153 F. 3d 1082 (9th Cir. 1998).

3. On the other hand, property that has been legally divided before the petition date and reclassified as the separate property of the non-debtor spouse is not property of the estate. *In re Robertson*, 203 F. 3d 855 (5th Cir. 2000).

III. Property Awarded to Debtor Prior to Bankruptcy Filing: Property awarded to the debtor pursuant to a properly entered property division pre-bankruptcy petition is property of the estate. 11 U.S.C. §541(a)(5)(B).

IV. Property Awarded to the Non-Debtor Spouse of property owned by the Debtor. There are cases in which property was awarded to the non-filing spouse prior to the filing of the bankruptcy petition, but the transfer of the property was not properly perfected at the time of the filing of the bankruptcy petition. Courts in these situations have come to different results as to whether the property remains property of the estate.

A. Cases where assets remain property of the bankruptcy estate: In these cases, the courts found that the failure of the non-filing spouse to properly perfect their interests under state law was not enough to defeat the trustee's power as a hypothetical judgment creditor and/or bona fide purchaser for value.

1. In New York, a spouse without legal title does not have an interest in the property prior to obtaining a divorce decree creating such an interest. *Musso v. Ostashko*, 468 F.3d 99, 105–06 (2d Cir. 2006). The divorce decree must be docketed in the county in which real property is located to take priority over a bankruptcy trustee's status as a hypothetical judgment lien creditor or bona fide purchaser for value pursuant to 11 U.S.C. § 544. *Id*.

2. In Florida, the divorce decree sought to award two parcels or real property to the non-filing spouse. *In re Flammer*, 150 B.R. 474, 475 (Bankr. M.D. Fla. 1993). Florida law requires that either a deed or a certified recording of the judgment that accurate identifies the property being transferred to be recorded in the public records of county where property is located. *Id*. Divorce decree adequately described one property, ruled not property of the bankruptcy estate, and did not adequately described another, ruled property of the bankruptcy estate. *Id*.

B. Case where assets were no longer property of the estate: In these cases, the courts found that the divorce decree divests, or changes, the debtor's of ownership of the property.

1. In Vermont, the debtor's interest in a 401K awarded to the non-filing spouse in a pre-bankruptcy petition divorce decree was not property of the estate even where the Qualified Domestic Relations Order ("QDRO") was not entered bankruptcy petition. *In re Forant*, 331 B.R. 151, 158 (Bankr. D. Vt. 2004). Under Vermont law, the final divorce decree extinguishes the marital interest each spouse had in the marital estate and creates new interests "in place of the old." Id.

2. Under Florida law, the non-filing spouse's equitable distribution award vests upon entry of the divorce decree divesting the debtor of his equitable interest in the sale proceeds from marital property and debtor's interest did not become property of the estate. In re Rieger, Case No. 05-33058-PGH, Adv. Pro. No. 05-6170-PGH, 2006 WL 3919951 (Bankr. S.D. Fla. 2006).

3. Under Oregon law, the bankruptcy estate only had bare legal title to a vehicle that was ordered to be transferred to the non-debtor spouse prior to the filing of the bankruptcy. Grassmueck v. Food Indus. Credit Union, 127 B.R. 869, 872 (Bankr. D. Or. 1991).

V. Post-Petition Property of the Estate: Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of

the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree. 11 U.S.C. §541(5)(B).

VI. *Rooker-Feldman* Doctrine: Although Bankruptcy Courts along with other federal courts are generally precluded from sitting in direct review of state court decisions unless Congress has specifically authorized such relief (*Rooker v Fidelity Trust Co*, 263 U.S. 413 (1923) & *D.C. Court of Appeals v Feldman*, 460 U.S. 462 (1983)), A trustee' challenge to a divorce decree is not barred by the traditional preclusion doctrines of res judicata or collateral estoppel, because the trustee was not a party to the divorce proceedings. *In re Erlewine*, 349 F.3d 205, 210 (5th Cir. 2003). The federal full faith and credit statute requires courts to give state court judgments the same preclusive effect that they would enjoy in the courts of the rendering state. *Id*. The trustee nor any other non-spouse creditor would be a party to or in privity with the divorcing parties. *Id*.

- *3991 Transp. Co. v. Alexander (In re 3991 Transp. Co.)*, 610 B.R. 881, (Bankr. N.D. Ill. 2020)

  In an adversary proceeding brought by a corporate debtor seeking to avoid the transfer of certain real property pursuant to a divorce order after a contested dissolution hearing, the U.S. Bankruptcy Court for the Northern District of Illinois granted a motion to dismiss, finding that the Court lacked subject matter jurisdiction under the Rooker-Feldman doctrine. "Allowing a losing party in state court to attempt to avoid that judgment by filing an avoidance action in bankruptcy undermines the finality of state court judgments and usurps the state court's jurisdiction."

Claims pled do not need to be identical for the doctrine to apply. Are the claims pled inextricably intertwined with the state court judgment? *See Remer v. Burlington Area Sch. Dist.*, 205 F.3d 990 (7th Cir. 2000)

Privity: Trustees are not barred from bringing avoidance actions by the Rooker-Feldman Doctrine because the Trustees generally are not parties to divorce proceedings.

- *Ingalls v. Erlewine (In re Erlewine)*, 349 F.3d 205 (5th Cir. 2003)

"[T]he divorce decree is not entitled to preclusive effect because the Trustee was not a party to the state court divorce proceedings, nor was he in privity with any party. For the same reason, the *Rooker-Feldman* doctrine is inapplicable." ***Ingalls v Erlewine***, 210 (citing *Johnson v. De Grandy*, 512 U.S. 997, 1006, 129 L. Ed. 2d 775, 114 S. Ct. 2647 (1994) (refusing to apply the *Rooker-Feldman* doctrine against a litigant who was not a party to the prior state action))

The interests of the Debtor in the divorce proceeding and of the Trustee in the

instant case are, however, quite distinct. As we observed in *Coleman v. Alcock*, another case involving a bankruptcy trustee's attempt to avoid a transfer, "We are of the view that the Trustee is not bound, either on res judicata or judicial collateral estoppel, by the prior state court proceedings. The Trustee is, of course, a successor of the Bankrupt for many purposes. *But he is much more both in the extraordinary rights with which the Bankruptcy Act* invests him, and as a general representative of the creditors." 272 F.2d 618, 621-22 (5th Cir. 1959) (emphasis added). As the interests of the Debtor's creditors were not represented in the divorce action, preclusion doctrines do not bar the Trustee from vindicating the creditors' interests in this subsequent avoidance action.

VII. Trustee Claw-Back of Marital Assets

The most common avoidance action related to bankruptcy cases arises from transfers of marital assets that are challenged as fraudulent transfers where one party either (i) appears to have received no consideration for the transfer, or (ii) transferred assets to hinder creditors.. However, absent issues of collusion, intentional misconduct, sandbagging, or some other irregularity, bankruptcy courts will generally find that the divorce decree conclusively establishes reasonable equivalent value. *In re Erlewine*, 349 F.3d 205, 212–13 (5th Cir. 2003); *In re Zerbo*, 397 B.R. 642, 654 (Bankr. E.D.N.Y. 2008)(Absent extrinsic fraud or collusion among the divorcing parties, the division of marital assets which is agreed to by the parties, and is contemporaneously or subsequently approved by a matrimonial court, and incorporated into a divorce decree, conclusively establishes reasonably equivalent value).

A. Collusion exception: *In re Beverly*, 374 B.R. 221, 227 (B.A.P. 9th Cir. 2007), *aff'd in part*, *denied in part*, 551 F.3d 1092 (9th Cir. 2008), an attorney, anticipating a large judgment on a community debt, used the marital settlement agreement with his wife in his pending divorce to shoulder the debt while stripping himself of assets with which to pay the debt. In collusion with his wife, he transferred his interest in $1 million of nonexempt funds in exchange for her interest in his $1.1 million exempt retirement fund. *Id*. The court avoided the transfer even after it was approved by the state court finding that the transfer was done with the actual intent to hinder, delay and defraud creditors.

   In cases where the transfers were made pursuant to a settlement, an uneven transfer of assets has more potential to be avoided, because the potential for collusion is more apparent.

B. Unjustified unequal distribution: An unjustified unequal distribution of marital properties or liabilities constitutes a "transfer" that may be avoided under Florida's Uniform Fraudulent Transfer laws. *In re Lankry*, 263 B.R. 638, 643–44 (Bankr. M.D. Fla. 2001). The Court found it inappropriate to create a shelter for divorcing spouses to unjustifiably depart from the equitable distribution principle in order to defraud one spouse's creditors. *Id*.

C. Constructive Fraud: 11 U.S.C. §548(a)(1)(B)

--debtor received less than reasonably equivalent value

Merely dividing property unevenly between spouses may not be enough to support an avoidance action. Bankruptcy Courts often find that debtors obtained "reasonably equivalent value" from their former spouse as a matter of law in the divorce action that divided marital property. This prevents trustees from avoiding transfers under 548(a)(1)(B) in many cases. State Courts routinely divide marital property on reasons other than purely economic grounds, and Bankruptcy Courts are reluctant to avoid such transfers unless it can be shown that a transfer was made with intent to hinder creditors.

- *Batlan v Bledsoe (In re Bledsoe)*, 569 F.3d 1106 (9th Cir. 2009)

  In the absence of a particularized allegation of fraud, reasonably equivalent value was conclusively given for the transfer pursuant to the divorce judgment. "[A]s a matter of law, the debtor received 'reasonably equivalent value' from a state-court resolution judgment". In Bledsoe, the Ninth Circuit refused to let a bankruptcy trustee collaterally attack the transfers made pursuant to a dissolution judgment where "the state-court judgment granted Defendant items valued at $93,737, while Debtor received items valued at only $788" as no particularized fraud was alleged.

- *3991 Transp. Co. v. Alexander (In re 3991 Transp. Co.)*, 610 B.R. 881, (Bankr. N.D. Ill. 2020)

  In discussing cases where courts have decided not to invoke the Rooker-Feldman doctrine, the Court stated that these cases generally involve dissolution judgments entered pursuant to settlement between the divorcing parties rather than judgments entered by the court after a contested trial. "The state courts did not make independent decisions as to the equitable division of marital property but relied upon the agreement of the spouses. *See In re Knippen*, 355 B.R. 710 (Bankr. ND. Ill. 2006); *In re Kimmell*, 480 B.R. 876 (Bankr. N.D. Ill. 2012); *See also Strasen v. Strasen*, 897 F.Supp 1179 (E.D. Wisc. 1995) (finding that Rooker-Feldman does not apply when the state court merely approves a dissolution settlement). These cases do not involve an independent judgment by the state court. Moreover, where the judgment is entered pursuant to the parties' agreement, the potential for collusion is apparent. The better view followed by both the Fifth and Ninth Circuits is that a federal bankruptcy court should not avoid a transfer where a state court makes an independent judgment that the transfer was the proper division of marital property after a contested divorce hearing." *3991 Tranp. Co.* at 886 (citing *In re Bledsoe*, 569 F.3d 1106 (9th Cir. 2009); *In re Erlewine*, 349 F.3d 205 (5th Cir. 2003))

- *In re Fordu, 201 F.3d 693 (6th Cir. 1999)*)

The court held that a trustee could bring an actual and constructive fraud claim against a former spouse even though the agreement was incorporated into a divorce decree. Prior to the divorce petition, the wife won a lottery ticket entitling her to $388,888, payable over time. The settlement agreement provided that (1) the debtor convey his entire right, title and interest in the marital residence to the wife; (2) neither spouse would be responsible for alimony; (3) The Wife waived her claim to an interest in a restaurant business venture that the Debtor was about to undertake; and (4) the Debtor would relinquish any and all rights he may have had in the lottery proceeds, except for one-half of the proceeds of one of the lottery installments. The Sixth Circuit reversed the bankruptcy court's dismissal of the actual and constructive fraudulent transfer claims brought by the trustee for the husband under Ohio law.

D. Actual Fraud: 11 U.S.C. §548(a)(1)(A)

--actual intent to hinder, delay, or defraud

A transfer made pursuant to a divorce can be avoided as an actually fraudulent transfer by either (i) direct evidence of fraud or (ii) reviewing the transfer in light of the badges of fraud, one of which is "a close relationship between the transferor and the transferee."

- *Doeling v. O'Neill (In re O'Neill)*, 550 B.R. 482, (Bankr. D.N.D. 2016)

> "Nearly all courts that review dissolution judgments in the context of a section 548 analysis agree that the fact that a transfer occurs in the context of a divorce proceeding does not immunize the transfer from a section 548 attack by the bankruptcy trustee. *E.g., Lovald v. Claussen (In re Claussen)*, 387 B.R. 249, 257 (Bankr. D.S.D. 2007) (citations omitted); *Goldstein v. Lange (In re Lange)*, 35 B.R. 579, 583 (Bankr. E.D. Mo. 1983); *see also Gordon v. Love (In re Pullen)*, No. 09-61108-MGD, 2013 Bankr. LEXIS 4302, 2013 WL 5591919, at *6 (Bankr. N.D. Ga. Aug. 7, 2013); *Fogel v. Chevrie (In re Chevrie)*, No. 99 B 6542, 2001 Bankr. LEXIS 97, 2001 WL 120132, at *10 (Bankr. N.D. Ill. Feb. 13, 2001) (collecting cases); *Webster v. Hope (In re Hope)*, 231 B.R. 403, 415 (Bankr. D.D.C. 1999) (collecting cases); *In re Sorlucco*, 68 B.R. at 753. These courts leave open the possibility that the Trustee may avoid transfers made in compliance with dissolution judgments if he shows evidence of actual fraud, collusion, sandbagging or any irregularity."

In *Doeling v. O'Neill*, the Debtor transferred his interest in real estate to his ex-wife in exchange for a release of liability to certain debt as part of a divorce settlement. However, the amount of debt was not equal to the value of the

property that he transferred. The Court held that the Trustee could recover the difference in value ($29,062.50) from defendant ex-wife as an avoided fraudulent transfer.

- Gordon v. Love (In re Pullen), Nos. 09-61108-MGD, 11-05620, 2013 Bankr. LEXIS 4302, 2013 WL 5591919 (Bankr. N.D. Ga. Aug. 7, 2013)

Debtor quitclaimed his half-interest in real property to his ex-wife through a divorce settlement. Trustee sought to avoid and recover the half interest so that the property could be sold pursuant to 11 U.S.C. § 363(h). To demonstrate fraud, Trustee relied on the Debtor's testimony under oath in an evidentiary hearing on the ex-wife's motion for contempt in the divorce proceeding. The Debtor had stated that he and his ex-wife were still residing in the property together. The findings in the contempt order included findings that the parties divorce action was orchestrated and agreed to by the Debtor and his ex-wife in order to shield the parties' assets from the Debtor's creditors. The Court also noted that the Debtor had continued to make mortgage payments on the property to continued to pay for certain maintenance.

> The close relationship between Debtor and Defendant gives rise to a badge of fraud. A badge of fraud exists where there is a close relationship between the transferor debtor and the transferee. *Gen. Trading Inc*., 119 F.3d at 1499; *see also Banner Constr. Corp. v. Arnold*, 128 So. 2d 893, 896 (Fla. Dist. Ct. App. 1961) ("The recognized indicia or badges of fraud include the fact that the parties to the disputed transfer are related, one to the other, by blood or marriage."); *In re Ingersoll*, 124 B.R. 116, 122 (M.D. Fla. 1991)(transfer between a father and son amounts to a badge of fraud). In *Harper*, the court affirmed a finding that a badge of existed fraud where the transferee was debtor-transferor's ex-wife. *Harper v. United States*, 769 F. Supp. 362, 367 (M.D. Fla. 1991). Here, Debtor and Defendant had a close personal relationship because they continued to live together post-divorce. They agree that they ate meals together, went shopping together, and took vacations together.

E. Preferences: Section 547, allows the trustee to avoid transfers of a debtor's interest in property made within 90 days (1 year for insiders) before the filing of the bankruptcy petition if, among other things, the transfer was "to or for the benefit of a creditor" and "for or on account of an antecedent debt owed by the debtor before such transfer was made." *In re Skorich*, 482 F.3d 21, 25 (1st Cir. 2007). In the context of married and/or divorcing couples, a trustee should understand state law to determine the definition of "interest in

property" must look to both the timing of the transfer vis-a-vis the filing of both the divorce petition and the bankruptcy petition.

1. In *Skorich*, the debtor and the non-debtor spouse filed a petition for dissolution of marriage. During the course of the divorce proceedings, the family court ordered that jointly owned real property be sold and placed into escrow. Shortly after the proceeds were placed into escrow, the debtor and non-filing spouse had legal interest in the proceeds and, because of the divorce filing, had a contingent equitable interest in all of the proceeds from the sale. *Id*. The non-filing spouse received relief from

   the automatic stay and the family court awarded all of the proceeds from the escrow to the non-filing spouse. Therefore, the non-filing spouse's contingent interest in the property matured and the debtor's contingent interest in the property never matured. The First Circuit concluded that the non-filing spouse did not have a "claim" against the debtor as a "creditor"; nor was the transfer of legal title to the escrow agents "on account of antecedent debt." Therefore, the transfer was not avoidable pursuant to Section 547.

2. *In re Dupuis*, 265 B.R. 878, 880 (Bankr. N.D. Ohio 2001), the debtor and non-filing spouse obtained a divorce decree which, in part, required that debtor pay $15,000 to the non-filing spouse within one year for his interest in the marital property. The payments were made within the one year prior to the filing of the bankruptcy. The court held that the payments from the debtor to the non-filing spouse, even though required by state court order, could be avoidable by the trustee as preference payments. The court left open for trial a determination as to whether the non-filing spouse (former spouse) was an insider under the nonexclusive definition provided in §101(31).

3. *In re Chira*, 353 B.R. 693, 725 (Bankr. S.D. Fla. 2006), *aff'd*, 378 B.R. 698 (S.D. Fla. 2007), *aff'd*, 567 F.3d 1307 (11th Cir. 2009), held that a former spouse could be an insider where the relationship between the debtor and the former spouse gives the non-debtor spouse the position to exercise some degree of control and influence over a debtor. The influence can be of a coercive or hostile nature, rather than just a cooperative relationship. In *Chira*, the non-filing spouse withheld or threatened to withhold the debtor's visitation with the parties' minor child to the non-filing spouse's economic advantage.

4. *In Matter of Holloway*, 955 F.2d 1008, 1012 (5th Cir. 1992), it was the closeness of the relationship between the debtor and the former spouse, including loans that were not commercially reasonable, that supported the finding that the non-filing spouse was an insider.

VIII. Exemptions: An administrative issue for Chapter 7 trustees is which party can claim property as exempt. Two atypical situations is where the spouses disagree as to which exemption scheme should be used and the other is where only one spouse files for bankruptcy.

A. A debtor may remove property from the estate; assets that are claimed as exempt either under federal law or, in an opt-out state, under applicable state law. 11 U.S.C. § 522(b)(1); Rule 4003. The filing of a joint bankruptcy by two spouses creates a jointly administered estate. Rule 1015(b).

B. Both spouses file –In a case of a husband and wife which are being jointly administered, in states that allow an option to elect state or federal exemptions, the parties must agree to the exemption scheme or, if no agreement, then the state law exemptions shall apply. 11 U.S.C. §522(b)(1)

1. Both spouses file – The exception to the general rule: Although § 522(b)(1), generally prohibits the spouses from electing to exempt property under two different election schemes. If both spouses file in an opt-out estate but one spouse has not resided in the state for more than 730 days then at least one court has found that the prohibition on debtor spouses applying different exemption schemes under § 522(b)(1) does not apply. In *In re Connor*, 419 B.R. 304, 307 (Bankr. E.D.N.C. 2009), the husband had resided in the North Carolina, an opt out state, for the 730 days prior to the filing of the bankruptcy, but the wife did not. North Carolina does not allow debtors to elect federal exemptions, but the North Carolina exemption scheme did not apply to the wife because she had not resided in the jurisdiction for the 730-day period. The court concluded that §522(b)(1) did not apply where separate exemption schemes were the result of statutory requirements rather than voluntary elections.

C. One spouse files: In cases where only one spouse files the bankruptcy, then the spouse that files the bankruptcy has the sole right to claim exemptions. *Burman v. Homan (In re Homan)*, 112 B.R. 356 (9th Cir. BAP 1989) (Property purchased during marriage and solely occupied by non-filing wife could not be exempted by wife in husband's bankruptcy).

IX. Tenants by the Entireties ("TBE"): In some states TBE can be the most powerful exemption that a debtor can use in the bankruptcy. *In re Robedee*, 367 B.R. 901, 907 fn. 6 (Bankr. S.D. Fla. 2007). An individual debtor can exempt from property of the estate the debtor's interest in TBE property to the extent that such interest is exempt from process under applicable nonbankruptcy law. 11 U.S.C. §522(b)(3)(B).

A. The 730-day look back period contained in 11 U.S.C. §522(b)(3)(A) does not apply to property being claimed exempt (or immune). Therefore, a debtor that has moved to a TBE state, absent a find of an intent to hinder, delay or defraud creditors, can immediately avail themselves of the TBE exemption. *In re Robedee*, 367 B.R. 901, 907 (Bankr. S.D. Fla. 2007).

B. Law established by state where property is located. The six characteristics of TBE are as follows: (1) unity of possession, in that spouses must have joint ownership and control; (2) unity of interest; (3) unity of title, in that spouses' interests in property must have originated from same instrument; (4) unity of time; (5) right of survivorship; and (6) unity of marriage, in that spouses must have been married at time the property became titled in their joint names. *In re Uttermohlen*, 506 B.R. 142 (M.D. Fla. 2012), aff'd, 525 Fed. Appx. 916 (11th Cir. 2013).

C. An issue arises where the debtor files a bankruptcy and the non-debtor spouse subsequently passes away. There is a split of authority on whether the once TBE property is property of the estate. Generally assets are fixed on the date of the filing of the bankruptcy. 11 U.S.C. §541(a). Exemptions are where the debtor acquires or becomes entitled to acquire property by bequest, devise, or inheritance. 11 U.S.C. §541(a)(5)(A).

1. In some cases, courts have found that the 11 U.S.C. §541(a)(5)(A) is not applicable, because the debtor already had the interest in the property and when non-filing spouse dies the debtor receives title by right of survivorship and not as the result of decent, distribution or transfer. *In re Hamacher*, 535 B.R. 180, 183 (Bankr. E.D. Mich. 2015) (citing *In re Alderton*, 179 B.R. 63, 65–66 (Bankr.E.D.Mich.1995) (When one spouse dies, the title automatically goes to the surviving spouse by operation of law and not as a result of decent, distribution or transfer, but by right of survivorship)).
2. In other cases, courts have held that on the debtor on the petition date held that entirety of the property, not a share or divisible party of the property. *In re Taylor*, 6:10-BK-11111-ABB, 2011 WL 9815, at *2 (Bankr. M.D. Fla. Jan. 3, 2011). In). *In re Rerisi*, 172 B.R. 525, 529 (Bankr. E.D.N.Y. 1994), the court held that the trustee could administer assets of the debtor, previously held as TBE, where the non-debtor spouse died within 10 months of the petition date. The debtor did not acquire any ownership rights that the debtor had on the date of the petition, but the non-filing spouse's interest was merely extinguished. *Id*.

D. Failure to Obtain Legal Divorce from Prior Spouse: TBE claim disallowed on the basis that the non-debtor spouse failed to obtain a legal divorce from prior spouse. *In re Gosman*, 362 B.R. 549, 551 fn. 1 (Bankr. S.D. Fla. 2007) citing

Joseph J*. Luzinski, Trustee v. Abraham D. Gosman and Lin Castre Gosman*, Adv. Pro. No. 02–3155–BKC–PGH–A (C.P. No. 355).

X. Trustee's Ability to Sell Assets owned by Debtor and Non-Debtor Spouse: Pursuant to 11 U.S.C. §363(h), a trustee can sell property that is co-owned, on the petition date, by the debtor and non-debtor co-owners regardless of whether the property is owned as tenants in common, joint tenants, or tenant by the entireties under certain circumstances. In the context of spouses, the issue most frequently litigated between a trustee and non-debtor co-owner is whether the benefit to the estate outweighs the detriment to the co-owner. 11 U.S.C. §363(i) gives the co-owner of the property the right of first refusal. This is a very fact intensive issue.

A. *In re Bernier*, 176 B.R. 976, 980 (Bankr. D. Conn. 1995), the court stated that § 363(h)(3) requires an analysis of both economic factors, such as the valuation of the non-debtor spouse's interest, available tax exemptions, etc., and noneconomic factors, including the prospects for acquiring a new home, handicaps, and the existence of minor children. In this case, the court found that there

was not a sufficient showing of hardship to the non-debtor spouse and child, and there would be significant funds to the estate only if both interests in the property were sold. *Id*.

B. *In re Griffin*, 123 B.R. 933, 936 (Bankr. S.D. Fla. 1991), the debtor signed the mortgage as an accomodiation to the co-owner who could not obtain a mortgage in her own name. There was only $5,000.00 of equity in the property which would be divided between the co-owner and the estate. The co-owner's prospects of obtaining new financing for the purchase of the property was very low. *Id*. Therefore, based upon these facts the court found that the balancing test weighed in favor of the co-owner and against the trustee. *Id*.

C. *In re Harris*, 155 B.R. 948, 950–51 (Bankr. E.D. Va. 1993), the court found that the benefit to the estate outweighed the "potentional" detriment to the nondebtor spouse where the property to be sold was owned as tenants by the entities, the where no other assets, most of the debts were joint, a distribution could be made of 42 percent to unsecured creditors, 100 percent to joint creditors and 100 percent to secured creditors. *Id*. The court also looked at the potential alternatives that the debtor and non-debtor spouse had including obtaining a home equity loan or that after the sale they may have as much as $50,000.00. *Id*.

D. *In re Trout*, 146 B.R. 823 (Bankr. D.N.D. 1992), subsequently dismissed, 2 F.3d 1154 (8th Cir. 1993), the debtor had executed a quit-claim deed to the former spouse several years before the filing of the bankruptcy in exchange for forgiveness of debt owed by the debtor to the former. The deed was not

recorded at the time of the filing of the bankruptcy. *Id*. In determining that the determinant to the former spouse outweighed the interest of the estate, the court found that the former spouse had paid over $29,000.00 in satisfaction of her property tax obligations on the property, the non-filing spouse was 77 years of age and probably retired. *Id*. She lived by herself in the residence since her divorce, approximately 10 years prior to the bankruptcy, and was the sole owner for two years prior to the filing. *Id*. The court stated that given her age and the length of time she has remained on the residence, it is likely she intends to live out her golden years there. *Id*. The court opined that the former spouse being forced out of her home at this juncture would cause severe emotional and psychological damage. *Id*.

XI. Claims Equitable subordination of a DSO Claim: *In In re Chira*, 353 B.R. 693, 729 (Bankr. S.D. Fla. 2006), *aff'd*, 378 B.R. 698 (S.D. Fla. 2007), *aff'd*, 567 F.3d 1307 (11th Cir. 2009), the wife was entitled to a § 507(a)(7) priority claim in the sum of $360,059.66 and a general unsecured claim in the sum of $178,441.69. The bankruptcy court made extensive findings of fact that the creditor-wife "had engaged in a pervasive pattern of underhanded and manipulative conduct, including the violation of various divorce court orders and voluntary settlement agreements, in an effort to harm" the debtor financially and to delay the sale of the parties' major asset to such an extent that the creditor-wife's priority domestic support obligation claim and her general unsecured claim should be subordinated to all other unsecured claims. *Id*.

XII. Concurrent Jurisdiction: Which court decides the divorce issues when there is a pending bankruptcy?

A. In *Carver v. Carver*, 954 F.2d 1573, 1578 (11th Cir. 1992), the 11th Circuit stated that the issues of alimony, maintenance, or support which are not standard debtor/creditor issues, but involve important issues of family law, should be left to the state courts in "deference to our state court brethren and their established expertise in such matters." Id. (citations omitted). State courts have concurrent jurisdiction with the bankruptcy courts to determine whether an obligation is in the nature of support for the purposes of § 523(a)(5). Cummings v. Cummings, 244 F.3d 1263, 1267 (11th Cir. 2001)(Citations omitted).

B. *In re Simeone*, 214 B.R. 537, 544 (Bankr. E.D. Pa. 1997), order clarified, 970654DAS, 1998 WL 295551 (Bankr. E.D. Pa. June 4, 1998), the bankruptcy court determined the equitable distribution issues which were previously bifurcated from the other divorce issues. The court recognized that it is rare that a bankruptcy court will be involved in equitable distribution issues. *Id*.

C. *In re Secrest*, 453 B.R. 623, 628 (Bankr. E.D. Va. 2011), relief from the automatic stay, including for equitable distribution proceedings is within the discretion of the bankruptcy court. The bankruptcy court determined that cause did not exist to grant relief from the automatic stay, but recognized that the state court could proceed provided that there was no order entered transferring property of the estate to the non-debtor spouse. *Id*. Therefore, the non-debtor spouse' claim could only be liquidated in state court for which stay relief was not necessary. *Id*.

XIII. Avoidance of Unrecorded Divorce Decree

In cases where divorced parties neglect to record a divorce decree on their county's real estate records, a trustee may seek to avoid the ordered transfer pursuant to 11 U.S.C. § 544, and the trustee may seek to sell marital property pursuant to 11 U.S.C. § 363(h)

11 U.S.C. § 544(a)(3) – grants trustees the status of bona fide purchaser of real property as of the commencement of the bankruptcy case

11 U.S.C. § 363(h) – " . . . the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case . . ."

- *Pettie v. Brannon (In re Brannon)*, 584 B.R. 417 (Bankr. N.D. Ga. 2018)

The debtor and her ex-husband had resided in real property which was titled in both of their names. The divorce decree provided for a conveyance of the debtor's interest in the property to her ex-husband. However, the debtor did not execute and did not record a quit claim deed transferring her one-half interest. After the debtor filed a Chapter 7 bankruptcy, the trustee sought to avoid any interest that the ex-husband acquired in the property by virtue of the divorce decree. Pursuant to § 544(a)(3), the trustee could avoid any transfer of property that would have been voidable by a bona fide purchaser as of the petition date. Accordingly, the unrecorded divorce decree was unenforceable against the trustee, and the court allowed trustee to avoid the transfer and to sell the jointly-owned property under 11 U.S.C. § 363(h). The Court discussed how in cases where deeds were recorded pre-petition, courts have not permitted a Chapter 7 trustee to avoid a transfer of property under a pre-petition divorce decree. See *Roost v. Wilber (In re Parker)*, 241 B.R. 722 (Bankr. D. Ore. 1999).

XIV. Avoidance of Transfers Made Before Filing for Divorce

The timing of a divorce filing may be a crucial factor in determining whether a transfer may be avoided, because the creation of marital estate gives rise to certain obligations that may serve as consideration a transfer.

- *Nathan v. Libra (In re Libra)*, 584 B.R. 550 (Bankr. E.D. Mich. 2018)

In a case where the debtor had transferred $30,000 from his retirement account to his ex-wife *prior* the filing of their divorce, the court found that the debtor had not received reasonably equivalent value in exchange for the transfer. The defendant argued that she held a one-half interest in the retirement account as a result of their divorce decree. However, the Court found that the timing of the transfer was key, because there was no marital estate at the time of the transfer. The Debtor's ex-wife was only a named beneficiary on the retirement account at the time of the transfer. The Court also found that the defendant could not have waived a right to spousal support in exchange for the transfer, because until the complaint of divorce was filed, the debtor had no presently enforceable obligation of support to the defendant.