

# You Can Have the House if I Can Have the Dog:

*Divorce Issues  
in Bankruptcy*

***Charles D. Bullock***

Stevenson & Bullock, PLC; Southfield, Mich.

***Lisa Sommers Gretchko***

Howard & Howard Attorneys P.C.; Royal Oak, Mich.

***Hon. Margaret Dee McGarity***

U.S. Bankruptcy Court (E.D. Wis.); Milwaukee

***F. John Steffen, Jr.***

Steffen & Kelly PC; Elgin, Ill.

# DISCOVER



AMERICAN BANKRUPTCY INSTITUTE  
**JOURNAL**  
journal.abi.org

---

ABI's Flagship Publication

---



***Delivering Expert Analysis  
to Members***

**With *ABI Journal* Online:**

- Read the current issue before it mails
- Research more than 10 years of insolvency articles
- Search by year, issue, keyword, author or column
- Access when and where you want – even on your mobile device
- Receive it **FREE** as an ABI member

**Find the Answers You Need**  
**journal.abi.org**

---

44 Canal Center Plaza • Suite 400 • Alexandria, VA 22314-1546 • phone: 703.739.0800 • abi.org

Join our networks to expand yours:   

© 2012 American Bankruptcy Institute All Rights Reserved.

**YOU CAN HAVE THE HOUSE IF I CAN HAVE THE DOG:  
DIVORCE ISSUES IN BANKRUPTCY**

Charles D. Bullock

*Stevenson & Bullock, PLC; Southfield, Mich.*

Lisa Sommers Gretchko

*Howard & Howard Attorneys PLLC; Royal Oak, Mich.*

Hon. Margaret Dee McGarity

*U.S. Bankruptcy Court (E.D. Wis.); Milwaukee*

F. John Steffen, Jr.

*Steffen & Kelly, PC; Elgin, Ill.*

---

**INTRODUCTION**

This presentation addresses key issues in the intersection of divorce and bankruptcy, including the automatic stay, preference exposure, and fraudulent transfer issues that can arise out of transfers made in connection with divorce proceedings.

**AUTOMATIC STAY ISSUES**

The filing of a bankruptcy operates as a stay against all acts to acquire property of the debtor or to recover a claim against the debtor that arose prepetition. The 2005 amendments to the Bankruptcy Code expanded Bankruptcy Code §362(b) (2) so that many family law matters are excepted from the stay. That said, matters relating to property division are *still* subject to the automatic stay embodied in Bankruptcy Code §362(a).

Actions taken in family court that violate the stay are void. *See, e.g., In re Willard*, 15 B.R. 898 (B.A.P. 9th Cir. 1981) (state court dissolution judgment made final in violation of the stay was void to the extent it transferred property of the estate, but nondebtor wife could enforce it as to property that was no longer property of the estate); *In re Clouse*, 446 B.R. 690 (Bankr. E.D. Pa. 2010) (post-nuptial agreement entered into after confirmation of Chapter 13 plan, which required transfer of property of the estate, violated stay); *In re Morgan*, 286 B.R. 678 (Bankr.

E.D. Wis. 2002) (state court property division awarding property of the estate to nonfiling spouse was void); *see also*, *In re Balzano*, 399 B.R. 428 (Bankr. D. Md. 2008) (stay did not apply to real estate titled only in name of debtor's non-filing spouse); *see also*, *In re Hall-Walker*, 445 B.R. 873 (Bankr. N.D. Ill. 2011) (attorney for debtor's former husband sanctioned for bringing contempt action against the debtor in state court to remove former husband's name from mortgage).

The nondebtor spouse cannot invoke the stay to avoid effects of state court property division. *Lopez v. Lopez*, 478 N.W.2d 706 (Mich. App. 1991).

- **Exceptions to the Automatic Stay for Family Law Matters:** For cases filed on or after October 17, 2005, 11 U.S.C. § 362(b)(2) excepts from the scope of the automatic stay several proceedings that typically occur in a divorce proceeding. The specific items excepted from the automatic stay are listed in §362(b)(2) and include actions to establish paternity, to establish or modify support, to collect domestic support obligations from property that is not property of the estate, concerning child custody and visitation, concerning domestic violence, to withhold income, including income that is property of the estate, for payment of a domestic support obligation, concerning certain licenses, and the reporting of overdue support for certain purposes. *See* 11 U.S.C. § 362(b)(2). *See also*, *In re Marino*, 437 B.R. 676 (B.A.P. 8th Cir. 2010) (action under Minnesota Domestic Abuse Act preventing debtor from entering his former home did not violate stay); *In re Peterson*, 410 B.R. 133 (Bankr. D. Conn. 2009) (no relief from stay necessary to set DSO or deduct from earnings); *In re Dagen*, 386 B.R. 777 (Bankr. D. Colo. 2008) (no stay violation for recovery of postpetition support from wages as these were not property of estate after confirmation of plan).

Obtaining a property division, however, continues to require modification of the automatic stay. *See* 11 U.S.C. § 362(b)(2)(A)(iv). *See also, In re Levenstein*, 371 B.R. 45 (Bankr. S.D. N.Y. 2007) (debtor's interest in real estate titled solely in name of nondebtor wife was sufficient to invoke stay while divorce was pending, interpreting N.Y. law as to debtor's interest in divisible property); *In re O'Brien*, 367 B.R. 240 (Bankr. D. Mass. 2007) (attorney's fees categorized as DSO could be recovered from exempt retirement accounts without regard to stay); *In re Ladak*, 205 B.R. 709 (Bankr. D. Vt. 1997) (attempted modification of property settlement in divorce decree violated stay); *In re Harris*, 310 B.R. 395 (Bankr. E.D. Wis. 2004) (action by the debtor's former husband to reduce his maintenance obligation to recover the amount of debts assumed by the debtor in the divorce decree, and subsequently discharged, violated the stay because it attempted to effect an improper setoff of discharged debts). While withholding of income for payment of a domestic support obligation is an exception to the stay under §362(b)(2), an order compelling payment of a support obligation from assets other than income may be a stay violation.

Actions to collect support when payment is provided for by a chapter 13 plan may not be a violation of the stay but may be a violation of the order of confirmation. *In re Gellington*, 363 B.R. 497 (Bankr. N.D. Tex. 2007) (income withholding by state for child support did not violate stay but was improper as violation of order confirming plan that provided for support arrearage).

- **Automatic Stay Issues Involving Contempt Action in State Court:** If incarceration is used to compel debtor to pay support from property of the estate, or to take other action that might violate bankruptcy law, especially if support arrearage will be paid through a plan, the action violates stay. *In re Johnston*, 308 B.R. 469 (Bankr. D. Ariz. 2005), *aff'd in part, rev'd in part*, 321 B.R. 262 (D. Ariz. 2005) *aff'd in part, rev'd in part*, 595 F.3d 937 (9th Cir.

2010); *In re Caffey*, 384 B.R. 297 (Bankr. S.D. Ala. 2008), *aff'd*, 384 Fed. Appx. 882 (11th Cir. 2010); *In re Farmer*, 150 B.R. 68 (Bankr. N.D. Ala. 1991); *In re Suarez*, 149 B.R. 193 (Bankr. D. N.M. 1993). Both the DSO creditor and his or her attorney may be subject to sanctions for violating the stay in bringing the action in state court, or for failing to take corrective action once the party or attorney is aware of the violation. *See, e.g., In re Caffey*, 384 B.R. 297 (Bankr. S.D. Ala. 2008), *aff'd*, 384 Fed. Appx. 882 (11th Cir. 2010); *In re Bailey*, 428 B.R. 694 (Bankr. N.D. W. Va. 2010). *But see, Matter of Rogers*, 164 B.R. 382 (Bankr. N.D. Ga. 1994) (no violation for failure of creditor to act affirmatively as debtor's incarceration was the act of state court, not the creditor). *But see, In re Rucker*, 458 B.R. 287 (Bankr. D. S.C. 2011) (debtor incarcerated prepetition; chapter 13 eligibility unlikely).

The court in *In re O'Brien*, 153 B.R. 305 (D. Or. 1993), held that a contempt action was not stayed for violation of an order to sign mortgages entered into before the bankruptcy. This is probably distinguishable from an order for payment.

The Ninth Circuit has determined that the stay does not enjoin state criminal prosecutions, even if the underlying purpose of the criminal proceedings is debt collection. *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000) (criminal prosecution for non-payment of child support). In *In re Maloney*, 204 B.R. 671 (Bankr. E.D.N.Y. 1996), the automatic stay was not violated by a state court commitment order requiring a chapter 7 debtor to remain incarcerated for 90 days for failing to comply with the terms of a prior state court contempt order requiring him to make payments to his former wife as an equitable distribution of marital property. The commitment order was of a punitive, criminal nature. *See also, In re Rook*, 102 B.R. 490 (Bankr. E.D. Va. 1989), *aff'd*, 929 F.2d 694 (4th Cir. 1991) (incarceration to compel payment violates stay but incarceration to vindicate the dignity of the court does not); *In re Storozhenko*, 459 B.R. 697

(Bankr. E.D. Mich. 2011) (criminal and civil contempt distinguished); *accord Stovall v. Stovall*, 126 B.R. 814 (N.D. Ga. 1990); *In re Allison*, 182 B.R. 881 (Bankr. N.D. Ala. 1995). Compare *In re Vines*, 224 B.R. 491 (Bankr. M.D. Ala. 1998) (municipal court did not violate automatic stay by remitting debtor to jail for refusing to comply with orders requiring her to cease harassing her former spouse and his new wife), with *In re Pearce*, 400 B.R. 126 (Bankr. N.D. Iowa 2009) (creditor's contacts with criminal authorities to urge prosecution for theft by contractor for purpose of debt collection was not protected by stay exception for governmental action). The *Storozhenko* court held the complainant's motivation in seeking criminal contempt was irrelevant.

In *In re Kearns*, 161 B.R. 701 (D. Kan. 1993), modified, 168 B.R. 423 (D. Kan. 1994), the record was unclear as to whether the stay was violated by a contempt order in state court against the debtor, but the state court judge was entitled to judicial immunity from sanctions.

- **Duration of the Automatic Stay:** The automatic stay continues until property is no longer property of the estate, until case is closed or dismissed, or debtor is discharged. 11 U.S.C. § 362(c). In the routine Chapter 7 case for an individual, the automatic stay is generally in effect about three months. In Chapters 12 and 13, it remains in effect until the plan is completed, typically three years, or up to five years for cause with court order. In a Chapter 11, stay is in effect until the plan is confirmed. After the stay expires or is terminated, the discharge injunction under § 524(a) applies.

- **Relief from the Automatic Stay:** The automatic stay regarding property may be lifted for cause, including allowing state court to adjudicate rights of the spouses in property, even though distribution of property of the estate is under the jurisdiction of the bankruptcy court. 11 U.S.C. § 362(d); *In re Claughton*, 140 B.R. 861 (Bankr. W.D. N.C. 1992), *aff'd*, 33

F.3d 4 (4th Cir. 1994); *In re Roberge*, 188 B.R. 366 (E.D. Va. 1995), *aff'd*, 95 F.3d 42 (4th Cir. 1996); *In re Robbins*, 964 F.2d 342 (4th Cir. 1992); *In re Dryja*, 425 B.R. 608 (Bankr. D. Colo. 2010) (stay lifted to allow state court to proceed with property division).

In deciding whether to modify the stay to allow the property division to go forward in the state court, the bankruptcy court will consider the effect on the estate. *See In re Anderson*, 463 B.R. 981 (Bankr. N.D. Ill. 2011) (relief from stay granted to collect DSO fees from property that was not property of estate); *In re Secrest*, 453 B.R. 623 (Bankr. E.D. Va. 2011) (no cause to lift stay when property could be more efficiently administered through sale by trustee rather than by property division in state court); *In re Taub*, 413 B.R. 55 (Bankr. E.D. N.Y. 2009) (stay lifted to allow state court to determine spouses' rights in property, which would resolve certain issues relevant to chapter 11 plan confirmation); *In re Trout*, 414 B.R. 916 (Bankr. S.D. Ga. 2009) (cause existed to lift stay for support creditor to exercise state law remedies against obviously solvent debtor); *In re Goss*, 413 B.R. 843 (Bankr. D. Ore. 2009) (stay not lifted for debtor's former wife to enforce property division when it would defeat debtor's means to effectuate chapter 13 plan and there was equity in property on which she held lien); *In re Aulicino*, 400 B.R. 175 (Bankr. E.D. Pa. 2008) (stay lifted for debtor's former husband to enforce property division because trustee could not avoid transfer as hypothetical BFP); *In re Jacobson*, 231 B.R. 763 (Bankr. D. Ariz. 1999) (stay lifted so nondebtor spouse of chapter 13 debtor could continue action to enforce support obligation and preserve right to collect interest, but not to collect arrearage, which was to be paid through plan; plan to be modified because earnings were still property of estate); *In re Sokoloff*, 200 B.R. 300 (Bankr. E.D. Pa. 1996) (stay lifted so wife could enforce her right to support and to litigate issues of the parties' marital relationship or custody of their children; but stay not lifted with regard to issues of wife's attorney's fees, equitable

distribution, or other aspects of the state court action); *In re Davis*, 133 B.R. 593 (Bankr. E.D. Va. 1991) (stay was lifted so state court could adjudicate rights of parties in property; the trustee could intervene in state court action to protect the estate’s interests); *see also, In re Dzielak*, 435 B.R. 538 (Bankr. N.D. Ill. 2010) (trustee could represent estate’s interest in divorce action).

- **Filing Fee for Motions Seeking Relief from the Automatic Stay:** A motion for relief from stay requires a \$176 filing fee. No fee is required for a stipulation for relief. Child support creditors who file the appropriate form, AO Form B281, are exempt from the fee. *See* Appendix to 28 U.S.C. § 1930(b), Bankruptcy Court Miscellaneous Fee Schedule Item 20.

- **Co-debtor Stay:** The chapter 13 co-debtor stay, which protects non-filing co-debtors, was not changed by the 2005 amendments to the Bankruptcy Code. *See* 11 U.S.C. § 1301. A creditor is stayed from commencing or continuing a civil action to collect a consumer debt from a co-debtor who is liable on a debt or who secured a debt of the debtor. Thus, a chapter 13 debtor’s former wife, whom the debtor had agreed in a prepetition divorce decree to hold harmless from a certain debt for which only she was personally liable, could not be a “co-debtor” within meaning of § 1301 because the debtor was not also liable to the creditor. *In re Jett*, 198 B.R. 489 (Bankr. E.D. Ky. 1996). The co-debtor stay applies only to consumer debts, and federal tax liability is not consumer debt. *In re Dye*, 190 B.R. 566 (Bankr. N.D. Ill. 1995).

**AVOIDING POWERS**

Divorces can create unintended potential for avoidance liens and other transfers. Generally, the avoiding power may be exercised by a bankruptcy trustee or the debtor in order to avoid (i.e. undo) various types of transfers.

- a. **Preferences:** Bankruptcy Code §547 enables a debtor or bankruptcy trustee to avoid and recover preferential transfers. Section 547(b) defines a preferential transfer as a transfer of a

debtor's interest in property made to or for the benefit of a creditor, on account of antecedent debt, while the debtor was insolvent and within 90 days before the bankruptcy filing date (or 1 year prepetition if the transfer was made to an insider) that enabled that creditor to receive more than he or she would have in a Chapter 7 liquidation of the debtor.

In the context of a divorce, preferential transfers can take various forms, such as payment of money, perfection of a security interest, obtaining a judgment lien or any other kind of transfer.

- **§547(c)(7) Protects Domestic Support Obligations (DSO) from Avoidance as Preferences—but Does *Not* Protect Non-DSOs:**

Bankruptcy Code §547(c)(7) provides a defense to the extent that such transfer was a bona fide payment of a debt for a domestic support obligation (hereinafter, a “DSO”). Thus, DSO payments are generally protected from preference avoidance when the payor spouse files bankruptcy.

However, Non-DSO payments (or Non-DSO transfers of property) are susceptible to avoidance as preferential transfers if the debtor was insolvent and if the transfer occurred during the “preference period”—which is 1 year for insiders and 90 days for non-insiders. The longer preference period for insiders raises an additional issue, namely the definition of “insider”. Bankruptcy Code §101(31) defines “insider” to include a “relative” of the debtor. If the Non-DSO transfer consists of a payment or property transfer to a person who is still a “spouse” at the time of the transfer then the payor spouse will argue that the recipient spouse is an “insider” and thus the preference period should be the 1 year prepetition. Whenever a payment to a divorced (or divorcing) spouse is challenged as a preference, the recipient spouse will want to argue that he or she is not an insider of the debtor and, consequently, the preference period should be 90

days rather than one year. To win this argument, the recipient spouse will want to show that the divorce was bona fide (as opposed to a “sham” or collusive divorce), and that he or she was not related to the debtor at the time the payment was received. The former spouse will also want to show that there was not a close relationship during the one-year prior to the bankruptcy and that he or she did not have exert control over the debtor. This approach proved successful for the former spouse in *In re Hill*, 342 B.R. 183, 199 (Bankr. D. NJ 2006) wherein the court held that a former spouse was not considered to be an insider. (However, in *Hill* the court found that the transfers at issue were made for the benefit of the daughters of the divorcing couple, and that those daughters were insiders because they were relatives of the debtor. *Id.*)

There are several cases demonstrating the fact that Bankruptcy Code §547(c) does not shield non-DSO payments or transfers, such as property division<sup>1</sup>. *See, e.g., In re Paschall*, 408 B.R. 79 (E.D. Va. 2009) (buyout of prior marital agreement with transfer of real estate was a preference, and former spouse was insider because estranged parties were still married when transfer occurred); *In re Mantelli*, 149 B.R. 154 (B.A.P. 9th Cir. 1993) (payment to former wife in lieu of jail for civil contempt for destruction of her personal property was preference); *Grassmueck v. Food Indus. Credit Union*, 127 B.R. 869 (Bankr. D. Or. 1991) (payments for car awarded debtor’s spouse in the divorce within 90 days of filing were preferences).

The non-debtor spouse also needs to be alert to the possibility that the bankruptcy trustee might try to avoid payments made to third parties within the 90 days before the bankruptcy. If

---

<sup>1</sup> Depending on state law, the right to receive a property division may not be a claim or antecedent debt at all; it might constitute an equitable interest. Therefore, the nondebtor’s interest in escrowed funds from sale of property prepetition awarded in postpetition property division could not be avoided by trustee. *See In re Skorich*, 482 F.3d 21 (1st Cir. 2007). Accord *In re Smith*, 321 B.R. 385 (Bankr. W.D. N.Y. 2005) (award of attorney’s fees for one spouse out of property as part of property division was not for antecedent debt and was not a preference).

the non-debtor spouse is jointly liable on those debts, then the creditor who gets targeted for a preference will later come after the non-debtor spouse and seek payment for the amount that was avoided as a preference. Often, divorce judgments or settlement agreements have indemnification provisions for this situation. In Chapters 7, 11, and 12 that indemnification provision should be a non-dischargeable obligation, irrespective of whether it is considered to be a DSO or a Non-DSO. However, if that indemnification provision is considered to be a Non-DSO then it would be discharged if the obligor spouse receives a Super Discharge in Chapter 13.

**b. Fraudulent Transfers:** Bankruptcy Code §548 enables a debtor or a bankruptcy trustee to avoid fraudulent transfers of the debtor's property (or obligations incurred by the debtor) within two years before the bankruptcy filing date if: (1) the transfer made (or the obligation incurred) was actually fraudulent, which means that the transfer was made or the obligation was incurred with actual intent to hinder, delay, or defraud creditors or (2) the transfer made (or obligation incurred) was constructively fraudulent, which means that the debtor made the transfer (or incurred the obligation) in exchange for less than reasonably equivalent value and at a time when the debtor was either: (i) insolvent, or rendered insolvent by the transfer made or obligation incurred, (ii) engaged (or about to engage) in a business or transaction for which he or she was left with unreasonably small capital, (iii) intended to incur or believed that he or she would incur debts beyond his or her ability to pay, or (iv) made the transfer (or incurred the obligation) to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

Although Bankruptcy Code §548 has only a two-year "clawback" period, Bankruptcy Code §544 enables a debtor or bankruptcy trustee to use the applicable state fraudulent transfer law to avoid transfers that are considered fraudulent thereunder. Michigan has adopted the

Uniform Fraudulent Transfer Act (M.C.L. 544.31 et seq) which is similar (but not identical) to Bankruptcy Code §548: the “clawback” period under Michigan fraudulent transfer law is six years (See M.C.L. §566.39(a)).

- **The Fact that Transfers are Made Pursuant to a Divorce Does *Not* Shield Them From Avoidance as Fraudulent Transfers.**

The fact that a transfer is made as part of a court-approved divorce decree or court-approved property settlement does *not* necessarily shield that transfer from avoidance as a fraudulent transfer. *Estes v. Titus*, 481 Mich. 573 (2008); *Mejia v. Reed*, 31 Cal 4th 657, 74 P.3d 166 (2003); *Dowell v. Dennis*, 998 P.2d 206 (Okla. Civ. App. 1999); *In re Fordu*, 201 F. 3d 693 (6th Cir. 1998); *Greninger v. Cromwell*, 140 Ore. App. 231, 915 P.2d 479 (1996) all stand for the proposition that fraudulent transfer laws can be used to avoid or undo transfers made pursuant to court-approved divorce decrees and/or property settlements—especially those based on the agreement of the parties. The fact that agreed-upon support obligations or property settlement have been “blessed” by a divorce court does not make that settlement immune from fraudulent transfer laws. As was aptly stated in *Kardynalski v. Fisher*, 135 Ill. App. 3d 643, 482 N.E.2d 117 (1985):

Special scrutiny is applied to transfers between spouses where the debtor spouse is thereby rendered insolvent and unable to satisfy the claims of his creditors....The incorporation of the parties’ agreement into a judicial decree does not alter this result. While judicial approval in such circumstances may represent a determination that the agreement is fair and equitable as between the parties to the divorce, it does not represent a determination that the agreement perpetrated no fraud upon the creditors of one spouse, particularly where the claims of the creditors are not made known to the court or provided for in the decree.

- **Fraudulent Transfers and Divorce:** Awarding property of one spouse to the other in connection with a divorce decree is a transfer which may be fraudulent as to creditors in

some cases. The fact that a transfer is made as part of a court-approved divorce decree or court-approved property settlement does *not* necessarily shield that transfer from avoidance as a fraudulent transfer. *Estes v. Titus*, 481 Mich. 573 (2008); *Meija v. Reed*, 31 Cal 4<sup>th</sup> 657, 74 P.3d 166 (2003); *Dowell v. Dennis*, 998 P.2d 206 (Okla. Civ. App. 1999); *In re Fordu*, 201 F. 3d 693 (6<sup>th</sup> Cir. 1998) (debtor had interest in lottery proceeds assigned to estranged wife of debtor by marital settlement agreement that could be set aside by trustee); *In re Beverly*, 374 B.R. 221 (B.A.P. 9th Cir. 2007), *aff'd*, 551 F.3d 1092 (9th Cir. 2008) (settlement that awarded exempt assets to debtor and nonexempt asset to nondebtor found fraudulent); *Greininger v. Cromwell*, 140 Ore. App. 231, 915 P. 2d 479 (1996) all stand for the proposition that fraudulent transfer laws *can* be used to avoid or undo transfers made pursuant to court-approved divorce decrees and /or property settlement—especially those based on the agreement of the parties. Where, however, a transfer is made (or obligation incurred) in the context of a fully litigated property settlement or support obligation, the general reluctance of bankruptcy courts to undo state court decrees makes it less likely that a fraudulent transfer claim will succeed. *See, e.g. Matter of Erlewine*, 349 F.3d 205 (5th Cir. 2003) (contested divorce resulting in unequal division of community property was valid as a matter of law; however, Rooker-Feldman doctrine, issue and claim preclusion did not apply to trustee). Transfers made at the time of divorce have been held to be fraudulent transfers. *See, e.g., In re Hill*, 342 B.R. 183 (Bankr. D. N.J. 2006) (debtor’s marital settlement agreement transferred property to former spouse with actual intent to defraud creditors); *In re Boba*, 280 B.R. 430 (Bankr. N.D. Ill. 2002) (transfer at divorce while retaining beneficial interest was fraudulent; discharge denied); *In re Lankry*, 263 B.R. 638 (Bankr. M.D. Fla. 2001) (unjustified, unequal division of marital assets or liabilities at dissolution might be avoidable; summary judgment denied); *In re Pilavis*, 233 B.R. 1 (Bankr. D. Mass. 1999) (marital

settlement agreement lacked indicia of arms length transaction); *In re Clausen*, 44 B.R. 41 (Bankr. D. Minn. 1984) (allowing the debtor's spouse to receive all property of the parties by default constituted a fraudulent conveyance); *In re B.L. Jennings, Inc.*, 373 B.R. 742 (Bankr. M.D. Fla. 2007) (former spouse's complicity in fraudulent transfer supported conspiracy claim).

• **How is the Concept of “Reasonably Equivalent Value” Analyzed Regarding Transfers As Part of Divorce?**

In *In re Hinsley*, 201 F.3d 638 (5th Cir. 2000) the Court held that intangible benefits do not constitute reasonably equivalent value. *See also In re Neal*, 461 B.R. 426 (Bankr. N.D. Ohio 2011) (debtor's agreement to property division that favored former husband in exchange for avoiding litigation was not reasonable equivalent value); *In re Perts*, 384 B.R. 418 (Bankr. E.D. Va. 2008) (transfer to former spouse pursuant to marital settlement agreement fell outside reasonable range). However, in *In re Bledsoe*, 350 B.R. 513 (Bankr. D. Or. 2006), *aff'd*, 569 F.3d 1106 (9th Cir. 2009) the court held that a state court property division without evidence of fraud or collusion established reasonably equivalent value.

• ***Estes v. Titus*, 481 Mich. 573 (2008) --Michigan's Version of the Uniform Fraudulent Transfer Act Applies to a Transfer of Property via a Property Settlement Incorporated in a Divorce.**

Because Bankruptcy Code §544 permits the debtor or trustee to use state fraudulent transfer law, debtors and trustees will often use it to avoid transfers, especially those made outside the 2-year claw-back period in Bankruptcy Code §548. Consequently, bankruptcy attorneys need to know whether transfers made in a divorce are avoidable under state law. *Estes v. Titus* is an important Michigan case on this issue.

In *Estes v. Titus*, the husband was serving a life sentence for murder, so the divorcing couple agreed to a division of the marital assets that strongly favored the wife. The husband's

creditor was the murder victim's widow, who filed a wrongful death claim against the murderer in 2002. When the murderer and his wife divorced in 2003, the widow alleged that the transfer of vast majority of the marital assets to the murderer's wife constituted a transfer made with actual intent to hinder and delay the widow's ability to collect on her wrongful death claim against the murderer. The Michigan Supreme Court held that Michigan's version of the Uniform Fraudulent Transfer Act (M.C.L. §566.31 et seq.) applies to property transfers made in the context of a divorce and, consequently, the husband's creditor could pursue the husband's ex-wife for fraudulent transfer. The Court held that such a fraudulent transfer claim does not constitute an impermissible collateral attack upon the divorce judgment itself, and that relief under the Uniform Fraudulent Transfer Act is not premised on any irregularity in the divorce proceeding. 481 Mich at 588. Because Michigan's fraudulent transfer statute defines "assets" to exclude property held as tenants by the entireties, the Court held that a transfer of entireties property from one spouse to another as part of a divorce cannot be a fraudulent transfer under the Michigan's fraudulent transfer statute, except with respect to a creditor that has a claim against both spouses. *Id.* at 580.

• **Transfers Made Via Divorce Settlement vs. Transfers Made Via Divorce Litigation—Which is More Susceptible to Avoidance?**

*Estes v. Titus* dealt with a stipulated property settlement. Again, however, when a transfer is made (or an obligation is incurred) in the context of a fully litigated property settlement or support obligation, the general reluctance of bankruptcy courts to undo state court decrees makes it less likely that a fraudulent transfer claim will succeed. See, e.g., *In re Erlewine*, 349 F. 3d 205, 212-213 (5th Cir. 2003). Courts also seem inclined to protect property settlements (and other obligations) established via a default judgment entered in a contested divorce from being challenged as a constructively fraudulent transfer, although it is unlikely that

a court would provide the same protection where allegations of an actually fraudulent transfer are made. See, e.g. *In re Bledsoe*, 569 F. 3d 1106 (9th Cir. 2009). The concept of issue preclusion becomes complicated when bankruptcy follows divorce, and courts tend to hold that the bankruptcy trustee's interests are not in privity with the debtor's interests and, consequently, the divorce decree or property settlement do not have preclusive effect on the bankruptcy trustee—thus enabling the trustee to maintain a fraudulent transfer claim. See, e.g. *In re Erlewine*, 349 F. 3d 205, 210 (5th Cir. 2003); *In re Hope*, 231 B.R. 403, 419-420 (Bankr. D. Dist. Col. 1999)

Thus, if the spouses stipulate to support or property division, then there is a greater risk that the bankruptcy court will give credence to a fraudulent transfer claim. That said, even when the support or property settlement arise by stipulation of the husband and wife, some courts seem less likely to find a fraudulent transfer when the marriage has been dissolved and there were significant concessions or transfers on both sides. See, e.g., *In re DeVito*, 111 B.R. 529 (Bankr. W.D. Pa.1990); *In re Riso*, 102 B.R. 280 (Bankr. D.N.H. 1989). However, if the court finds actual intent to hinder, delay, or defraud creditors it is more likely to rule that a property settlement agreement constitutes a fraudulent transfer even where there is a bona fide divorce. See, e.g. *In re Hill*, 342 B.R. 183 (Bankr. D.N.J. 2006).

At least one court has held that, in the context of a bona fide divorce (as opposed to a “sham” or collusive divorce), the proper inquiry to be used in testing a stipulated property division is a “surface determination” that the division of marital property was within the range of likely distribution that a state divorce court would have ordered if the matter had been actually litigated. See, e.g. *In re Dunham*, 2000 WL 33679421 (Bankr. D.N.H.); *In re Sorlocco*, 68 B.R. 748, 753 (Bankr. D. N.H. 1986).

In light of the foregoing, if the spouses reach a settlement and decide not to take the matter to trial, then the counsel for the spouse who is to receive a transfer (or the benefit of an obligation incurred by the other spouse) should draft the settlement to show the concessions made by both sides, and the basis for the transfers made, (or obligations incurred). The case law demonstrates that any settlement entered pursuant to a procedure that was not fully litigated is more vulnerable to attack as a fraudulent transfer and, consequently, counsel for the recipient spouse needs to be alert to this issue.

- **Sham Divorces/Collusive Divorces:** When filing for bankruptcy, debtors whose obligations are primarily consumer debts must complete the means test, which determines how much disposable income a debtor has left over at the end of each month after paying all ongoing expenses. This test takes both the debtor's income and his or her spouse's income into account (even if the spouse is not filing for bankruptcy). If the income is too high, then a debtor may be forced to file a chapter 13 case, which can be more onerous than one under chapter 7.

In order to frustrate the means test, some debtors try to divorce their spouses immediately prior to the bankruptcy to avoid having to "count" that spouse's income. A chapter 7 trustee is charged with investigating all of the affairs of the debtor, and a divorce petition that is suspiciously close to the bankruptcy petition will raise questions in the trustee's mind.

A sham divorce can be viewed as bankruptcy fraud, which can lead to fines, case dismissal and potential criminal liability. A sham or collusive divorce is generally held to constitute an actual fraudulent transfer (i.e. one made with actual intent to hinder, delay, or defraud creditors) and some courts have denied the debtor a discharge based on a sham (or collusive) divorce. See, e.g. *In re Boba*, 280 B.R. 430 (Bankr. N.D. Ill. 2002); *In re Williams*, 159 B.R. 648 (Bankr. D.R.H. 1993).

Bankruptcy Courts and trustees are particularly alert to the potential for “sham” or collusive divorces and/or property settlements. Bankruptcy Courts and bankruptcy trustees will carefully examine the divorce case to consider whether the divorce itself, the support payments, or the property settlement are a sham. Sham or collusive divorces generally constitute actually fraudulent transfers because they usually involve actual intent to hinder, delay, or defraud creditors and, as such, are avoidable under Bankruptcy Code §548(a)(1)(A) and M.C.L. § 566.34(1)(a). See, e.g. *In re Pilavis*, 233 B.R. 1 (Bankr. D. Mass. 1999); *In re Williams*, 159 B.R. 648 (Bankr. D. R.H. 1993).

- **Lien Avoidance:** The Bankruptcy Code considers a lien (even a lien to secure payment of a divorce-related obligation) to be a “transfer” of part of the debtor’s interest in an asset. Consequently, liens granted (or imposed by court order) in the context of divorce proceedings can be avoided or “undone”—even though the lien would be entirely valid absent the bankruptcy.

The debtor or bankruptcy trustee can avoid any lien that is not perfected as of the bankruptcy filing date. See 11 U.S.C. §544. However, the non-dischargeability of the debt means that the debtor remains obligated to pay it even after the lien securing its payment is avoided in bankruptcy. Consequently, when the underlying debt is nondischargeable, the bankruptcy trustee (as opposed to the debtor) is most likely to be the party seeking to avoid the lien.

If the lien is being avoided so as to make that property available to pay creditors, then the “mechanisms” for lien avoidance described above—preferences and/or fraudulent transfers—still apply. Once a lien in estate property is avoided (whether under §547 or §548), it is preserved for the benefit of the estate. See 11 U.S.C. §551.

**DEBTS ARISING IN CONTEXT OF DIVORCE PROCEEDINGS MAY BE NONDISCHARGEABLE PURSUANT TO 11 U.S.C. § 523(a)(2), (4) & (6).**

- **Non-Dischargeability Under 11 U.S.C. §523(a)(2):** A debt that arises from fraud in connection with a divorce or property settlement may be nondischargeable under 11 U.S.C. § 523(a)(2). Procedural rules and time limits for such objections must be followed. Bankruptcy Rules 4004, 4007. See *Sanford Inst. for Sav. v. Gallo*, 156 F.3d 71 (1st Cir. 1998) (justifiable reliance standard); *In re Lang*, 293 B.R. 501 (B.A.P. 10th Cir. 2003) (fraud related to paternity); *In re Lyons*, 454 B.R. 174 (Bankr. D. Kan. 2011) (fraud found in debtor’s failing to inform former husband that she no longer qualified for maintenance); *In re Travis*, 364 B.R. 285 (Bankr. N.D. Ohio 2006) (fraud in obtaining credit cards in former husband’s name); *In re Cooke*, 335 B.R. 269 (Bankr. D. Conn. 2005) (debtor must have known there was insufficient equity in property to pay former wife from proceeds of sale as promised); *In re Zaino*, 316 B.R. 1 (Bankr. D. R.I. 2004) (concealed assets related to support); *In re Ingalls*, 297 B.R. 543 (Bankr. C.D. Ill. 2003) (obligations assumed without intent to pay were nondischargeable); *In re Dixon*, 280 B.R. 755 (Bankr. M.D. Ga. 2002) (time-barred fraud complaint allowed under 11 U.S.C. § 523(a)(3)); *In re Hallagan*, 241 B.R. 544 (Bankr. N.D. Ohio 1999) (failure to comply with state court orders was evidence of debtor’s fraud); *In re Paneras*, 195 B.R. 395 (Bankr. N.D. Ill. 1996) (fraud in incurring joint debt). But see *Corso v. Walker*, 449 B.R. 838 (W.D. Pa. 2011) (fraud not proved because as manager of family finances, debtor was authorized to sign husband’s name to obligations); *In re Stanifer*, 236 B.R. 709 (B.A.P. 9th Cir. 1999) (forensic psychologist failed to prove fraud in inducement to provide services in custody case); *In re Taylor*, 455 B.R. 799 (Bankr. D. N.M. 2011) (fraud not found in debtor’s cohabiting, resulting in cessation of right to support; former husband stated claim as nonsupport divorce related debt for overpayment); *In re Graham*, 194 B.R. 369 (Bankr. E.D. Pa. 1996) (debtor did not materially

misrepresent stability of marriage when he obtained loans from former in-laws); *In re Kruszynski*, 150 B.R. 209 (Bankr. N.D. Ill. 1993) (former wife was allowed after bar date to amend pleadings alleging nondischargeability under § 523(a)(5) to add a second count of fraud under § 523(a)(2)(A); relation back applied because both counts arose in the divorce action); *In re Ellerman*, 135 B.R. 308 (Bankr. N.D. Ill. 1992) (former wife could not show that husband's deceit resulted in financial loss, only that she would have requested more had she known); *In re Shreffler*, 319 B.R. 113 (Bankr. W.D. Pa. 2004) (timing of bankruptcy close to marital agreement is not *per se* fraud); *In re Butler*, 277 B.R. 843 (Bankr. M.D. Ga. 2002) (fraud in entering marital settlement agreement not proven); *In re D'Atria*, 128 B.R. 71 (Bankr. S.D. N.Y. 1991)(failure to fulfill requirements of property settlement did not, without more, prove fraud in entering the agreement). Fraud must be plead with particularity. *In re Demas*, 150 B.R. 323 (Bankr. S.D. N.Y. 1993); see also *In re Bucciarelli*, 429 B.R. 372 (Bankr. N.D. Ga. 2010) (debtor's divorce attorney's fees excepted from discharge for fraudulently inducing the attorney to continue working on divorce case while intending to discharge them in bankruptcy after divorce); see also Laura W. Morgan, Civil Conspiracy and Civil RICO in Divorce Actions, Divorce Lit., Vol. 12/No. 11 (Nov. 2000).

•**Nondischargeability under 11 U.S.C. §523(a)(6):** A debt that arises in connection with a divorce or a property settlement may also be nondischargeable for willful and malicious injury to property of another, such as conversion. 11 U.S.C. § 523(a)(6). See *Matter of Rose*, 934 F.2d 901 (7th Cir. 1991) (debtor's unauthorized taking of cash from joint safe deposit box and resulting obligation in divorce were nondischargeable); *In re Hamilton*, 390 B.R. 618 (Bankr. E.D. Ark. 2008), *aff'd*, 400 B.R. 696 (E.D. Ark. 2009) (failing to care for horses in debtor's possession which were awarded to former spouse was willful and malicious; discharge also

denied); *In re Suarez*, 400 B.R. 732 (B.A.P. 9th Cir. 2009) (judgment for harassment of new wife of debtor's former husband was nondischargeable even without compensatory damage award); *In re Alessi*, 405 B.R. 65 (Bankr. W.D. N.Y. 2009) (dissipation of funds earmarked for former spouse in divorce judgment excepted from discharge under § 523(a)(6)); *In re Petty*, 333 B.R. 472 (Bankr. M.D. Fla. 2005) (treble damages awarded against debtor in state court civil judgment for conversion of former wife's share of military pension excepted from discharge); *In re Gray*, 322 B.R. 682 (Bankr. N.D. Ala. 2005) (damages awarded for sexual abuse of debtor's daughter excepted from discharge as to both wife and daughter); *In re Hixson*, 252 B.R. 195 (Bankr. E.D. Okla. 2000) (adversary proceeding unrelated to divorce could be brought by debtor's former wife for assault by debtor/former husband); *In re Shteyssel*, 221 B.R. 486 (Bankr. E.D. Wis. 1998) (debtor-husband's transfer of marital property to son shortly after being served with divorce papers was willful and malicious); *In re Garza*, 217 B.R. 197 (Bankr. N.D. Tex. 1998) (debtor willfully and fraudulently refused to deliver property awarded to former spouse); *In re Arlington*, 192 B.R. 494 (Bankr. N.D. Ill. 1996) (attorney fee award within exception for willful and malicious injury); *In re Sateren*, 183 B.R. 576 (Bankr. D. N.D. 1995) (debtor's sale and conversion of proceeds of cattle and grain awarded former spouse was willful and malicious); *In re Wells*, 160 B.R. 726 (Bankr. N.D.N.Y. 1993) (former wife's embezzlement or conversion of the proceeds of the sale of the marital residence made obligation nondischargeable). But see *In re Patch*, 526 F.3d 1176 (8th Cir. 2008) (debtor's leaving three year old son with boyfriend who had previously abused and eventually murdered him did not rise to level of willful and malicious); *In re Reichardt*, 380 B.R. 596 (Bankr. M.D. Fla. 2006) (debtor's former wife failed to prove obligation was for willful and malicious injury when judgment was for division of marital estate); *In re White*, 363 B.R. 157 (Bankr. D. Idaho 2007) (gelding of horse eventually

awarded to debtor's former husband was not willful and malicious injury as she had equal right to manage and control community property in her possession); *In re Wright*, 184 B.R. 318 (Bankr. N.D. Ill. 1995) (award to former spouse for debtor's dissipation of assets was not a legal wrong equivalent to willful and malicious standard); *In re Zentz*, 157 B.R. 145 (Bankr. W.D. Mo. 1993), *aff'd*, 81 F.3d 166 (8th Cir. 1996) (attorney's fees awarded to former husband on account of former wife's concealment of child were not excepted from discharge as a willful and malicious injury). See also *In re Moffitt*, 252 B.R. 916 (B.A.P. 6th Cir. 2000) (prior action for damages to debtor's former spouse unrelated to divorce entitled to issue preclusion and found excepted from discharge for willful and malicious injury).

- **Nondischargeability Pursuant to 11 U.S.C. §523(a)(4)**: A divorce related debt may also be excepted from discharge for defalcation in a fiduciary capacity. For example, in *In re Lam*, 364 B.R. 379 (Bankr. N.D. Cal. 2007), the debtor had used community property to pay child support when he had separate property available for that purpose, and California law provided a remedy for reimbursement of community property. The state court had granted judgment to the debtor's former wife under the California statute, and the bankruptcy court held the debt excepted under 11 U.S.C. § 523(a)(4). See also *In re Jacobson*, 433 B.R. 183 (Bankr. S.D. Tex. 2010) (Texas statutory trust in favor of spouse later awarded property that had been in possession of other spouse did not give rise to defalcation); *In re Lewis*, 359 B.R. 732 (Bankr. E.D. Mo. 2007) (trust relationship not proved); *In re Hughes*, 354 B.R. 820 (Bankr. S.D. Tex. 2006) (trust must be express or imposed by statute or common law, not by wrongdoing; not proved); *In re Green*, 352 B.R. 771 (Bankr. W.D. La. 2005) (defalcation of former wife's community share of retirement pay proved).

**PREVIOUSLY LITIGATED ISSUES - CLAIM PRECLUSION**

- **Claim Preclusion:** If divorce has been completed, the bankruptcy court cannot change the adjudicated rights of the parties. *In re Comer*, 723 F.2d 737 (9th Cir. 1984) (amount of support arrearage set by family court could not be attacked in bankruptcy court); *In re Tarone*, 434 B.R. 41 (Bankr. E.D. N.Y. 2010) (attorney’s fees awarded to debtor’s former spouse pursuant to divorce was res judicata in bankruptcy case); *In re Kearney*, 433 B.R. 640 (Bankr. S.D. Tex. 2010) (state court’s determination that sanctions arose as continuation of divorce entitled to claim preclusion in bankruptcy court); *In re Perry*, 254 B.R. 675 (Bankr. E.D. Va. 2000) (administrative support order precluded bankruptcy court from determining amount of AFDC reimbursement owed); *In re Ennis*, 178 B.R. 177 (Bankr. W. D. Mo. 1995) (validity of prior divorce could not be relitigated because issue of wife’s mental capacity could have been raised in state court but was not); *In re Zrubek*, 149 B.R. 631 (Bankr. D. Mont. 1993) (award of portion of debtor’s military retirement pay to debtor’s former spouse was *res judicata* even if the divorce court had no statutory authority at that time to do so). *In In re Rosenbaum*, 150 B.R. 990 (Bankr. E.D. Tenn. 1992), *aff’d*, 150 B.R. 994 (E.D. Tenn. 1993), the court held that the debtor could have raised the bankruptcy as a defense in an action to enforce a divorce obligation in state court and did not do so and was bound by *res judicata* as to its enforceability. The previous court determination challenged may also have been in the bankruptcy court. See *In re Cooke*, 455 B.R. 503 (Bankr. W.D. Va. 2011) (finding in previous case that husband’s obligation was a nonsupport obligation was binding in wife’s later chapter 13 case). In *In re Phillips*, 175 B.R. 901 (Bankr. E. D. Tex. 1994), the debtor’s former spouse was bound by confirmed plan even though the divorce was filed post-petition because some of her claims were based on pre-petition conduct. See also *Matter of Swate*, 99 F.3d 1282 (5th Cir. 1996) (bankruptcy court’s

determination that debt was nondischargeable alimony was *res judicata* as to later state court proceeding, which reduced alimony obligation to a lump-sum payment).