

# NOTES

## **BREAKING UP IS HARD TO DO . . . ESPECIALLY WHEN BANKRUPTCY IS INVOLVED: A LOOK AT THE UNFAIR RESULTS THAT OCCUR WHEN BANKRUPTCY INTERVENES IN DOMESTIC RELATIONS CASES**

### INTRODUCTION

Visualize a couple who are happily married. When they took their vows, they were young, inexperienced, and had no idea what the future held for them. Now, fast-forward twenty years to today. They are sitting in court arguing over every last detail of their proposed divorce. Chances are that you are picturing the parties sitting in a state courtroom, in front of a state court judge who decides matters of family law and divorce. However, this is not the case. These parties are sitting in bankruptcy court, arguing in front of a federal bankruptcy judge, presently unable to return to state court to resolve their issues.<sup>1</sup>

A problem arises in certain instances when divorce and bankruptcy collide, overlapping one another to the point where the law becomes murky and seemingly impossible to clear up. In particular, when property acquired during the course of the marriage is held in only one spouse's name, and that spouse files for bankruptcy protection before the state court enters a final judgment in the parties' divorce, the non-debtor spouse's interests in that property are far from certain. Had bankruptcy not intervened, the state court would have solidified each spouse's rights in the property. Yet, in some states, the courts have held that where no final divorce judgment has been entered, the non-debtor spouse's rights in the property are

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<sup>1</sup> The automatic stay under 11 U.S.C. § 362(a) stays all proceedings against the debtor including divorce proceedings:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a) of the Securities Investor Protection Act of 1970, operates as a *stay, applicable to all entities*, of the commencement or continuation, including, the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title. (emphasis added).

11 U.S.C. § 362(a)(1) (2006); *see* *Eden v. Robert A. Chapski, Ltd. (In re Eden)*, 405 F.3d 582, 588 (7th Cir. 2005) (finding state divorce action against debtor stayed under 362(a) unless the action in state court is for establishment or modification of an order for alimony, maintenance, or support); *Davis v. Cox (In re Cox)*, 356 F.3d 76, 80 (1st Cir. 2004) (discussing how automatic stay under 362(a) immediately went into effect after the filing of the bankruptcy petition, preventing the state court from holding the divorce trial).

inchoate,<sup>2</sup> and will eventually become rights no greater than those of a general unsecured creditor in the debtor spouse's bankruptcy.<sup>3</sup>

The hypothetical above presents three problems. First, the trustee in bankruptcy's strong arm powers under 11 U.S.C. § 544 may be used to cut off the non-debtor spouse's interests altogether.<sup>4</sup> Second, if the trustee cuts off the non-debtor spouse's interests, then he may bring the property back into the estate and leave the non-debtor spouse with a general unsecured claim in the bankruptcy. Under this scenario, there exists a distinct possibility that the non-debtor spouse will receive far less than he or she would have received absent the bankruptcy. Third, where the property falls under an exemption by either state law or section 522 of the Bankruptcy Code (hereinafter "Code"), the property may be brought into the estate, only to be kept from all creditors, and eventually ending up in the hands of the debtor.<sup>5</sup> This can happen regardless of whether the non-debtor spouse paid the lion's share for the property to begin with.

This note contends that the rights of the non-debtor spouse in the marital property should not be diminished through bankruptcy. Bankruptcy should be used to protect the debtor's livelihood and to provide the debtor spouse with a fresh start. Courts should not allow bankruptcy to be used as the proverbial "sword", or as an offensive attack measure by which to hurt the non-debtor spouse. By allowing bankruptcy to be used in this manner, the courts are providing incentive for

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<sup>2</sup> *In re Cole*, 202 B.R. 356, 360 (Bankr. S.D.N.Y. 1996) (explaining spouses rights do not vest under New York state law until a final judgment is entered in the divorce proceeding and are considered "inchoate."); *see In re Anjum*, 288 B.R. 72, 76 (Bankr. S.D.N.Y. 2003) (stating non-debtor spouse's rights are "inchoate" until a final judgment of divorce is entered); *see also In re Vann*, 113 B.R. 704, 706 (Bankr. D. Col. 1990) (finding rights of wife in the marital property are "inchoate" in Colorado until a dissolution of the marriage is commenced and she takes affirmative action to perfect her interest in the marital property).

<sup>3</sup> *In re Cole*, 202 B.R. at 360 (pointing out if bankruptcy intervenes before the state court enters a final judgment, then the non-debtor spouse is left with a general unsecured claim); *In re Anjum*, 288 B.R. at 76 (declaring when final judgment has not been entered in the divorce proceeding, the non-debtor spouse's claim can be no greater than that of a general unsecured creditor); *In re Palmer*, 78 B.R. 402, 406 (Bankr. S.D.N.Y. 1987) (holding non-debtor spouse's claim is an entitlement of the estate and only allows her to become a general unsecured creditor in the debtor spouse's bankruptcy); *see also In re Price*, 154 B.R. 344, 346 (Bankr. N.D. Fl. 1993) (holding non-debtor's claim which may be established under equitable distribution is only that of a general unsecured creditor); *In re Polliard*, 152 B.R. 51, 55 (Bankr. W.D. Pa. 1993) (reasoning since the Bankruptcy Code does not expressly provide for the non-debtor spouse to have a right of distribution in the bankruptcy superior to that of the general unsecured creditors, he or she is considered a general unsecured creditor).

<sup>4</sup> *See Davis*, 356 F.3d at 92 (stating cases exist where courts have concluded that the filing of a bankruptcy petition has cut off the unrecorded equitable rights of the non-debtor spouse); *see also Perlow v. Perlow*, 128 B.R. 412, 415 (Bankr. E.D.N.C. 1991) (allowing Trustee in Bankruptcy to use his strong arm power under 11 U.S.C. § 544 to cut off the non-debtor spouse's rights because the filing of a divorce does not create a lien on the property); *In re Vann*, 113 B.R. at 706 (finding unless non-debtor spouse takes affirmative action to perfect his or her interest in the property, the Trustee has a superior interest under his hypothetical lien creditor rights stemming from § 544).

<sup>5</sup> *Davis*, 356 F.3d at 88 (discussing debtor-husband's ability to take an IRA, which is exempt under Maine state law, and keep it away from the non-debtor wife and creditors leaving them no recourse to try to obtain the asset).

divorcing parties to file bankruptcy petitions to wound their former spouse, not for the protections for which the Code was enacted.<sup>6</sup> The result of many of these filings is an unfair outcome, which this note contends can and should be avoided.

Part I of this note discusses the jurisdiction of the federal district and bankruptcy courts over domestic relations matters. An archaic judicially-made exception to federal subject matter jurisdiction takes some domestic relations cases out of the realm of the federal courts. This exception, combined with the doctrine of abstention, can determine if and when a federal court may hear domestic relations matters. Part II of this note explains the effect that the automatic stay under 11 U.S.C. § 362 has on domestic relations cases in bankruptcy. Furthermore, to gain an understanding of the extent of the inequity that has taken place in the area of law where pending divorce proceedings and voluntary bankruptcy overlap, the applicable state laws must also be examined. Part III of this note analyzes the three different types of state property distribution laws, Equitable Distribution, Community Property, and Strict Title, and their effect on the outcome of the bankruptcy with regard to the non-debtor spouse's rights to marital property. Part IV examines cases in which the non-debtor spouse did not receive property equal to what his or her share would have been absent the bankruptcy. Part V delves into the First Circuit case of *Laurie Davis Cox v. Thomas Cox*.<sup>7</sup> The court, in this benchmark case, dealt with the apparently unfair results by imposing a constructive trust which was said to hold the non-debtor spouse's interest in the marital property outside of the bankruptcy estate. Part VI analyzes the current state of the law and suggests possible remedies to the situations at hand. Finally, Part VII sets forth possible statutory language which can be added to the Bankruptcy Code to solve this dilemma.

## I. JURISDICTION OF THE BANKRUPTCY COURTS OVER DOMESTIC RELATIONS ISSUES

### A. *Article III and the Domestic Relations Exception to Federal Jurisdiction under Ankenbrandt v. Richards*<sup>8</sup>

Traditionally, the United States federal courts have uniformly declined jurisdiction in cases involving divorce, alimony, or child custody.<sup>9</sup> Article III,

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<sup>6</sup> 11 U.S.C. § 101, *et seq.* (2006).

<sup>7</sup> 356 F.3d 76, 94 (1st Cir. 2004) (affirming bankruptcy court order disbursing escrow funds as per divorce order, reversing and remanding as to bankruptcy court order denying disbursement of IRA).

<sup>8</sup> 504 U.S. 689 (1992).

<sup>9</sup> Naomi R. Cahn, *Family Law, Federalism, and the Federal Courts*, 79 IOWA L. REV. 1073 (1994) (exploring tradition in the United States federal court system of declination to hear divorce, alimony, or child custody cases); see *In re Burrus*, 136 U.S. 586, 593-94 (1890) ("The whole subject of the domestic relations of husband and wife, parent and child, belongs to the laws of the States and not to the laws of the United

section 2 of the United States Constitution prescribes which cases the federal courts have original jurisdiction over.<sup>10</sup>

Under Article III, federal courts only have original subject matter jurisdiction over two types of cases.<sup>11</sup> First, they have original subject matter jurisdiction over cases involving "federal questions." These are cases which the Constitution, the laws of the United States, or United States Treaties prescribe as federal cases.<sup>12</sup> Second, federal courts have original jurisdiction over cases which arise under "diversity jurisdiction," or cases involving citizens or parties of different states.<sup>13</sup> Family law and domestic relations cases involving divorce, alimony, and child custody may arise in federal court under both federal question and diversity jurisdiction.<sup>14</sup>

While it appears that federal courts should have jurisdiction over domestic relations cases involving either federal questions or diversity jurisdiction, the

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States."); see also *Ankenbrandt*, 504 U.S. at 703 (finding the federal courts divested of the power to issue divorce, alimony, or child custody decrees).

<sup>10</sup> U.S. CONST. art. III, § 2, cl. 1.

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority—to all Cases affecting Ambassadors, other public Ministers and Consuls—to all Cases of admiralty and maritime Jurisdiction—to Controversies to which the United States shall be a Party—to Controversies between two or more States—between a State and Citizens of another State—between Citizens of different States; between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Federal Courts' jurisdiction is limited to that prescribed by Article III, § 2 of the Constitution. *Id.* Congress has imposed additional limitations on federal jurisdiction through federal statutes, such as the amount in controversy, narrowing the scope of federal jurisdiction even further. 28 U.S.C. § 1332(a) (2006) (limiting federal courts' ability to hear diversity cases under Article III to those which the amount in controversy is at least \$75,000). Having narrowed the scope, Congress has not allowed anything outside of Article III, § 2 to have original federal subject matter jurisdiction. See *Rieser v. District of Columbia*, 580 F.2d 647, 656 n.13 (D.C. Cir. 1978) (discussing restrictions Congress has placed on the federal jurisdiction proscribed by Article III); *cf.* *Palmore v. United States*, 411 U.S. 389, 396 (1973) (explaining Congressional statutes limiting federal court jurisdiction under Article III shall be strictly construed, showing federal courts' jurisdiction is more limited than that proscribed by Article III).

<sup>11</sup> U.S. CONST. art. III, § 2, cl. 1 (giving federal courts subject matter jurisdiction over federal question and diversity cases).

<sup>12</sup> *Id.* (granting federal courts authority to hear cases arising under federal law).

<sup>13</sup> *Id.* (granting federal courts authority to hear cases where parties are citizens of different states or countries).

<sup>14</sup> Michael Ashley Stein, *The Domestic Relations Exception to Federal Jurisdiction: Rethinking an Unsettled Federal Courts Doctrine*, 36 B.C.L. REV. 669, 669 (1995) (stating existence of "domestic federal question cases" which claim constitutional or other federal statute violations tied in with domestic relations issues, in addition to the many domestic relations cases which arise under diversity jurisdiction); see also *Hooks v. Hooks*, 771 F.2d 935, 941 (6th Cir. 1985) (allowing federal suit against husband and other defendants under 28 U.S.C. § 1983 based upon deprivation of custody of plaintiff's children without due process of law); *Lewis v. Michigan*, No. 1:00-CV-603, 2000 U.S. Dist. LEXIS 14294, at \*7-8 (W.D. Mich. Sept. 25, 2000) (finding federal court jurisdiction over habeas corpus claims which involve minimal domestic relations questions are federal questions over which the district court has jurisdiction).

Supreme Court has carved out the "Domestic Relations Exception," which generally requires all federal courts to decline hearing cases involving divorce, alimony, and child custody.<sup>15</sup> The Supreme Court first introduced the Domestic Relations Exception as *dicta* in 1859<sup>16</sup> and later adopted it in 1890, in the case of *In re Burns*.<sup>17</sup> Since then, the American court system has been rooted in the principle that matters involving domestic relations are best handled by the appropriate state court.<sup>18</sup>

More recently, in 1992, the Court in *Ankenbrandt v. Richards*<sup>19</sup> narrowed the scope of the Domestic Relations Exception to bar only those cases involving the issuance of divorce, alimony, and child custody decrees.<sup>20</sup> Although neither the *Barber* Court nor the *Burns* Court gave sufficient explanation or reasoning for the exception, Justice White, writing for the majority in *Ankenbrandt*, confirmed and briefly explained its continuing existence.<sup>21</sup> He held the exception to be a product of statutory interpretation of the federal diversity statute<sup>22</sup> and not one rooted in Article III itself.<sup>23</sup> Justice White explained that federal courts are not equipped to monitor or work closely with state social workers, whose involvement in the domestic

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<sup>15</sup>*Ankenbrandt*, 504 U.S. at 715 (acknowledging extensive history of federal courts' abstention from hearing domestic relations cases, especially under diversity jurisdiction, and directing future courts to abstain as well); *see also In re Burrus*, 136 U.S. 586, 593–94 (1890) (declaring whole subject of domestic relations, between husband and wife and between parent and child, to be in sole jurisdiction of States' Courts); *Barber v. Barber*, 62 U.S. 582, 584 (1859) ("We disclaim altogether any jurisdiction in the courts of the United States, upon the subject of divorce, or for the allowance of alimony . . .").

<sup>16</sup>*Barber*, 62 U.S. at 584 (disclaiming all federal jurisdiction over divorce, alimony, and child custody cases).

<sup>17</sup>136 U.S. at 593–94 (relegating domestic relations issues totally to state court jurisdiction)

<sup>18</sup>*Ankenbrandt*, 504 U.S. at 694–95, 704 (refusing to ignore the exception because of its existence and acceptance by all courts for nearly 150 years); *see also* Thomas H. Dobbs, Note, *The Domestic Relations Exception is Narrowed After Ankenbrandt v. Richards*, 28 WAKE FOREST L. REV. 1137, 1137–38 (1993) (showing Supreme Court's continued stance to uphold Domestic Relations Exception which has governed federal courts in the area of domestic relations for over a century and a half); *see e.g.*, *Lloyd v. Loeffler*, 694 F.2d 489, 492 (7th Cir. 1982) (stating domestic relations exception has historical pedigree and over a century of Congressional silence amounts to legislative adoption of the judicially-made exception).

<sup>19</sup>504 U.S. at 703 (limiting Domestic Relations Exception to decrees of divorce, alimony and child custody).

<sup>20</sup>*Id.* ("[W]e have no trouble today reaffirming the validity of the exception as it pertains to divorce and alimony decrees and child custody orders.")

<sup>21</sup>*Id.* at 704 (concluding domestic relations exception exists and only encompasses cases involving issuance of divorce, alimony, and child custody decrees).

<sup>22</sup>28 U.S.C. § 1332 (2006)(a)(1) provides:

The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$ 75,000, exclusive of interest and costs, and is between— (1) Citizens of different States;

*Id.*

<sup>23</sup>*Ankenbrandt*, 504 U.S. at 697–700 ("We thus are content to rest our conclusion that a domestic relations exception exists as a matter of statutory construction . . . [based] on Congress' apparent acceptance of this construction of the diversity jurisdiction provisions in the years prior to 1948 . . ."); *e.g.* Dobbs, *supra* note 18, at 1157–58 (restating findings from *Ankenbrandt*).

relations cases is frequently required.<sup>24</sup> Additionally, White wrote that as a matter of judicial expertise, state courts have a century and a half of specialization in this area while the federal courts have none.<sup>25</sup>

Justice Blackmun, in a concurrence in *Ankerbrandt*, stated that a domestic relations case may be put into one of four categories for the purpose of determining whether a federal court must abstain from hearing the case under the Domestic Relations Exception.<sup>26</sup> The categories are (1) "core" cases or cases involving declaration of status such as marriage, annulment, divorce, custody, and paternity (2) "semi-core" cases or cases involving declarations of rights arising from status such as alimony, child support, and division of property (3) secondary cases which were brought to enforce status, rights, or obligations and (4) cases that do not involve status or obligations, but are tied to domestic relations nonetheless, such as tort suits between family members.<sup>27</sup> Even though this categorization is mere dicta, the courts have embraced this terminology of "core" and "secondary" domestic relations cases.

District and circuit courts appear to be in agreement that under the current law, they are barred from hearing "core" suits which arise under diversity jurisdiction.<sup>28</sup>

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<sup>24</sup> *Ankerbrandt*, 504 U.S. at 703–04 (finding state courts more suited to handle domestic matters which involve monitoring of social workers and require state law expertise).

<sup>25</sup> *Id.* at 704 (acknowledging special proficiency of state tribunals for over past century in handling issues arising out of divorce, alimony, child custody); see *Dunn v. Cometa*, 238 F.3d 38, 41 (1st Cir. 2001) (announcing aim of domestic relations exception is to prevent federal courts from "meddling" in areas which are governed by state law and state institutions); see also *Elk Grove Unified Sch. Dist. v. Newdow*, 542 U.S. 1, 12 (2004) ("So strong is our deference to state law in this area that we have recognized a "domestic relations exception" that "divests the federal courts of power to issue divorce, alimony, and child custody decrees.").

<sup>26</sup> *Ankerbrandt*, 504 U.S. at 716–17 (Blackmun, J., concurring) (setting forth four categories of domestic relations cases and finding cases in forth category—cases that do not involve status or obligations—to be outside of exception and possibly under federal jurisdiction); see also Stein, *supra* note 14, at 669–70 (reiterating Justice Blackmun's concurrence in *Ankerbrandt*, which promulgated four categories of domestic relations cases).

<sup>27</sup> *Ankerbrandt*, 504 U.S. at 716–17 (Blackmun, J., concurring) (listing four categories of domestic relations cases); see also Stein, *supra* note 14, at 669–70 (devising list of four categories of domestic relations cases based on Justice Blackmun's concurrence in *Ankerbrandt*).

<sup>28</sup> Stein, *supra* note 14, at 679 (explaining District Courts agree they do not have original subject matter jurisdiction to hear "core" domestic relations cases); see *Minasyan v. Gonzales*, 401 F.3d 1069, 1076–77 (9th Cir. 2005) (discussing domestic relations exception and deference given to state law); *Danforth v. Celebrezze*, 76 Fed. Appx. 615, 616 (6th Cir. 2003) (following general rule of federal courts and affirming they cannot hear matters involving domestic relations); *Flejter v. Smith*, 61 Fed. Appx. 257, 258 (7th Cir. 2003) (upholding District Court's declination of case involving custody rights because they were barred from hearing case under domestic relations exception); *Dunn*, 238 F.3d at 41 (holding District Courts are barred from hearing cases involving issuance of divorce, alimony, and child custody decrees); *Vulcan Materials Co. v. City of Tehuacana*, 238 F.3d 382, 386 n.2 (5th Cir. 2001) (determining domestic relations exception only to bar federal courts from hearing core cases); *Stone v. Wall*, 135 F.3d 1438, 1440–41 (11th Cir. 1998) (claiming narrow reading of domestic relations exception cases only proscribes abstention in instances where case involves issuance of divorce, alimony, or child custody decrees and is based on diversity jurisdiction); *Wigington v. McCarthy*, No. 96-7134, 1997 U.S. App. LEXIS 22687, at \*6 (10th Cir. 1997) (restating Supreme Court's holding in *Ankerbrandt* and noting "core" cases are beyond jurisdiction of federal courts);

However, the Supreme Court did not explain whether cases that fall into the other three categories under Justice Blackmun's concurrence may be heard by federal courts.<sup>29</sup> The Court also declined to expound on whether the exception applies to any federal question cases at all.<sup>30</sup> Without clear guidance from the Supreme Court, the circuit courts disagree as to which non-core cases they may hear.<sup>31</sup> For example, some courts apply the Domestic Relations Exception to federal question cases while others strictly apply it to diversity cases.<sup>32</sup> Simply put, outside of the "core" cases which are barred, a tremendous lack of uniformity exists. In order to determine if a certain "non-core" case is barred, the law of the specific circuit must be consulted.

Although the Domestic Relations Exception originally only applied to the district courts, in more recent years, many courts have determined the exception applicable in the bankruptcy setting as well.<sup>33</sup> While debate has ensued over whether Congress meant to codify the Domestic Relations Exception in section 362(B)(2) of the Code, which states an exception to the automatic stay, bankruptcy courts will nevertheless decline to hear proceedings which tread too greatly into the area of family law.

### B. *The Doctrine of Abstention.*

#### 1. Federal Court's Judicially-Made Abstention Doctrine

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Williams v. Lambert, 46 F.3d 1275, 1283 (2d Cir. 1995) (explaining only "core" cases are excluded from federal jurisdiction under domestic relations exception); Kahn v. Kahn, 21 F.3d 859, 861 (8th Cir. 1994) (stating domestic relations exception prevents federal courts from hearing cases involving divorce, alimony, and child custody); Maynard v. Craft, No. 1:03CV144, 2003 U.S. Dist. LEXIS 16415, at \*2-3 (W.D.N.C. Sept. 18, 2003) (finding federal courts only barred from hearing cases involving issuance of divorce, alimony, or child custody decrees).

<sup>29</sup> See *Ankenbrandt*, 504 U.S. at 704 (omitting any discussion about enforcement cases that would fall into Justice Blackmun's third category); see also Stein, *supra* note 14, at 686-89 (explaining Supreme Court was silent on issue of cases brought to enforce rights and obligations).

<sup>30</sup> See *Ankenbrandt*, 504 U.S. at 704 (failing to discuss whether domestic relations exception applies at all to federal question cases).

<sup>31</sup> See HENRY J. SOMMER & MARGARET DEE MCGARITY, *COLLIER FAMILY LAW AND THE BANKRUPTCY CODE* ¶ 5.01 (2005) [hereinafter *COLLIER*] (displaying conflicts between circuits as to which cases the exception applies to); see e.g. Stein, *supra* note 14, at 679-80 (describing federal courts' approach to non-core suits as "chaotic" and finding inter-circuit conflicts as to the application of the domestic relations exception to core enforcement, domestic relations torts, and federal question cases).

<sup>32</sup> See *COLLIER*, *supra* note 31, at ¶ 5.01 n.4 (noting difference in treatment of Domestic Relations Exception amongst courts).

<sup>33</sup> See *Carver v. Carver*, 954 F.2d 1573, 1578-79 (11th Cir. 1992) (finding bankruptcy court should have declined to hear an adversary proceeding regarding a stay violation in case involving divorce because domestic relations exception applied); see also *Cummings v. Cummings*, 244 F.3d 1263, 1267 (11th Cir. 2001) (directing bankruptcy court to lift the automatic stay to allow for the divorce court to determine question of spousal support); *In re MacDonald*, 755 F.2d 715, 717 (9th Cir. 1985) (explaining bankruptcy court should not get involved in matters involving family law).

An alternative ground for the federal court to decline to hear a case is provided in the judicially-made doctrine of abstention.<sup>34</sup> Abstention allows the federal courts the ability to abstain from hearing cases that would be better heard in state court.<sup>35</sup> Generally, abstention is appropriate in three situations.<sup>36</sup> First, a federal court may use abstention if the case presents a "federal constitutional issue which might be mooted or presented in a different posture by a state court determination of pertinent state law."<sup>37</sup> Generally, courts use this type of abstention when a state law determination may obviate the need for the issue to be determined under federal constitutional law.<sup>38</sup> By abstaining and allowing the state court to determine the issue of state law, the federal court relieves itself of the unnecessary burden of determining a matter which is obviated by the state law determination. Second, a court may abstain from hearing a case if "difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the case at bar" are involved.<sup>39</sup> Finally, abstention must be exercised in cases where federal jurisdiction has been invoked for the purpose of restraining state criminal proceedings.<sup>40</sup>

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<sup>34</sup> *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 813–14 (1976) (finding abstention an appropriate method for federal courts to decline to hear a case in certain instances); *Burford v. Sun Oil Co.*, 319 U.S. 315, 333 n. 29 (1943) (holding abstention proper when federal judicial restraint is "required by conditions of general welfare"); see also *Ankenbrandt*, 504 U.S. at 704–05 (explaining circumstances under which a court may use abstention to decline to hear a case); Dobbs, *supra* note 18, at 1151–53 (noting frequent use of abstention doctrines by courts when declining jurisdiction over domestic relations cases).

<sup>35</sup> See *Colorado River Water*, 424 U.S. at 815 (explaining possible situations where abstention is allowed); *Younger v. Harris*, 401 U.S. 37, 53–54 (1971) (requiring abstention in criminal cases where federal jurisdiction has been invoked to restrain state criminal proceedings); *Louisiana Power & Light Co. v. City of Thibodaux*, 360 U.S. 25, 30–31 (1959) (affirming District Court's use of judicial discretion in staying the proceedings until a state court made a finding on state law); *Burford*, 319 U.S. at 333–34 (holding abstention appropriate in cases where a federal interpretation of state law, dangerous to state policies, is required); *Railroad Comm'n v. Pullman Co.*, 312 U.S. 496, 501–02 (1941) (deciding actions in federal court which require decisive determination of state law are better relinquished to state court); see e.g. BLACK'S LAW DICTIONARY 8 (8th ed. 2004) (defining abstention to be "a federal court's relinquishment of jurisdiction when necessary to avoid needless conflict with a state's administration of its own affairs.").

<sup>36</sup> See *Colorado River Water*, 424 U.S. at 813–16 (noting abstention's place as an exception to exercise of federal jurisdiction and discussing three types of cases in which federal abstention may be used); Susan Block-Lieb, *Permissive Bankruptcy Abstention*, 76 WASH. U. L. Q. 781, 786–87 (1998) (stating three types of cases in which federal abstention may be used).

<sup>37</sup> *Colorado River Water*, 424 U.S. at 814; see also *Pullman*, 312 U.S. at 501–02 (suggesting district courts "stay its hands" absent definitive state court determination).

<sup>38</sup> *City of Meridian v. Southern Bell Telephone & Telegraph Co.*, 358 U.S. 639, 640–41 (1959) (explaining one situation in which abstention by the federal courts should be used); see also *Spector Motor Serv Inc., v. McLaughlin*, 323 U.S. 96, 105 (1944) (noting "deeply rooted" doctrine for federal courts not to pass on questions of constitutionality unless such adjudication is unavoidable, and that "federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law").

<sup>39</sup> *Colorado River Water*, 424 U.S. at 814; see also *Louisiana Power*, 360 U.S. at 30–31 (finding District Court properly stayed proceeding until interpretation of statute by Louisiana Supreme Court).

<sup>40</sup> *Colorado River Water*, 424 U.S. at 816; see also *Younger*, 401 U.S. at 53–54 (reaffirming narrow availability of injunctive relief against state criminal prosecutions).

Under the abstention doctrines, a federal court may abstain from hearing any "non-core" domestic relations case that falls into one of these three categories.<sup>41</sup> Unlike the courts in "core" Domestic Relations Exception cases, the federal courts in some abstention cases have independent discretion to determine whether to hear the case or not.<sup>42</sup> Under the first two categories of abstention cases, abstention is simply permissive, allowing the courts room to decide on their own.<sup>43</sup> However, the district court's decision may be reviewed by the court of appeals and the Supreme Court, who will overturn the district court's decision to abstain if the case does not fall into one of the three categories.<sup>44</sup> Review of the district court's choice to abstain is very strict and abuse of the lower court's abstention powers is not taken lightly. By no means do courts frequently use the doctrine of abstention.<sup>45</sup> District courts have a "virtually unflagging obligation . . . to exercise jurisdiction given them"<sup>46</sup> and may only use abstention as a rare exception to their normally obligatory exercise of jurisdiction.

## 2. Abstention Doctrine in the Bankruptcy Context

While the abstention doctrines used by federal district courts are rooted in judicially-made law<sup>47</sup>, abstention in bankruptcy practice is a separate doctrine which

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<sup>41</sup> The court must abstain from hearing the "core" cases due to the Domestic Relations Exception as discussed above.

<sup>42</sup> Under the *Younger* Abstention Doctrine, or the third category mentioned by the *Colorado River Water* court, a District Court must abstain if the facts of the case fit the category. *Younger*, 401 U.S. at 53 (discussing federal intervention and state criminal prosecutions).

<sup>43</sup> The Court held that abstention of the District Court is permissive at most, only stating that the District Courts "may" abstain. Nothing in the opinion finds that the District Court "must" abstain in cases which fall in the first two categories. *Colorado River Water*, 424 U.S. at 813 (extrapolating District Court "may" abstain from exercising jurisdiction over cases which fall within the categories of permissible abstention laid out under *Pullman*, *Burford*, *Louisiana Power*, *Younger*, and *Colorado River* itself). *But see Colorado River Water*, 424 U.S. at 817 n.22 ("Where a case is properly within this category of cases, there is no discretion to grant injunctive relief.").

<sup>44</sup> *See generally* *Deakins v. Monaghan*, 484 U.S. 193, 204 (1988) (reversing Eighth Circuit Court of Appeals affirmation of the District Court's decision to abstain because the case at hand did not fall into one of the three *Colorado River Water* categories of permissible abstention); *Addiction Specialists, Inc. v. Twp. of Hampton*, 411 F.3d 399, 411 (3rd Cir. 2005) (citing District Court's abuse of the abstention doctrine in its declination to hear parts of the case which fall outside of the three *Colorado River Categories*). *But see* *Tex. Ass'n of Bus. v. Earle*, 388 F.3d 515, 521 (5th Cir. 2004) (finding District Court's decision to abstain correct because the case was well within the third category from *Colorado River Water*, that involving federal jurisdiction invoked in a criminal proceeding to restrain state action).

<sup>45</sup> *See Colorado River Water*, 424 U.S. at 813 (stating abstention doctrine is the exception and not the rule); *see, e.g., Ankenbrandt*, 504 U.S. at 705 (finding exercise of federal jurisdiction required in every feasible situation and abstention a rarely used exception to that rule); *New Orleans Pub. Service, Inc. v. Council of New Orleans*, 491 U.S. 350, 359 (1989) (restating Court's position that District Courts have a virtually unflagging obligation to adjudicate claims within their jurisdiction).

<sup>46</sup> *Colorado River Water*, 424 U.S. at 817.

<sup>47</sup> *See generally Colorado River Water*, 424 U.S. at 814; *Younger*, 401 U.S. at 53–54; *Burford*, 319 U.S. at 333–34; *Pullman*, 312 U.S. at 501.

finds its base in the language of 28 U.S.C. § 1334.<sup>48</sup> Under section 1334(c), abstention is permissive in some instances and mandatory in others. A district court may abstain from hearing any matter, arising under title 11 of the United States Code, which, in the interest of justice or comity to the state courts, would be better heard in state court.<sup>49</sup> This permissive abstention provision allows the bankruptcy courts the ability to determine which matters really belong in state court. Consequently, federal courts rarely want to become involved in domestic relations issues. Bankruptcy courts as well as district courts frequently invoke their discretion to abstain from hearing bankruptcy proceedings involving pending state domestic relations issues.<sup>50</sup>

Section 1334(c)(1) really only sets forth three general criteria for a federal court to use when deciding whether to abstain from hearing a proceeding.<sup>51</sup> A court may exercise its discretion to abstain in the interest of justice, comity with state courts,

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<sup>48</sup> 28 U.S.C. §§ 1334(c)(1)–(c)(2) (2006) provides:

(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State Courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(c)(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

*Id.*; see Block-Lieb, *supra* note 36, at 808, 815 (reviewing cases which interpreted section 1334(c)(1) to be the source of bankruptcy abstention doctrine); see also *In re Pan American Corp.*, 950 F.2d 839, 845 (2d Cir. 1991) (examining history of 28 U.S.C. §1334(c)(1) and declaring legislative intent to codify the judicially-made abstention doctrines for bankruptcy cases).

<sup>49</sup> 28 U.S.C. § 1334(c)(1) (2006) ("Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.").

<sup>50</sup> *In re Dennis*, 218 B.R. 52, 55 (Bankr. E.D. Ark. 1997) (holding permissive abstention by bankruptcy court appropriate to allow state court to adjudicate domestic relations issues); *In re French*, 139 B.R. 476, 482 (Bankr. D. S.D. 1992) (maintaining appropriateness of bankruptcy court's use of abstention to avoid invasion into family matters which are better heard in state court); see e.g., Carlos J. Cuevas, *Permissive Bankruptcy Abstention and Domestic Relations*, AM. BANKR. INST. J., Feb. 2001, at 10 (elucidating federal courts generally grant motions for permissive abstention in bankruptcy cases involving domestic relations issues).

<sup>51</sup> See 28 U.S.C. § 1334(c)(1) (2006). Section 1334(c)(1) states:

Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

*Id.*

or in respect for state law.<sup>52</sup> With these three themes in mind, courts have created a list of twelve factors to which they look to determine if abstention is the proper course of action.<sup>53</sup> To make a determination, courts will balance and weigh these factors: (1) the effect or lack thereof on the efficient administration of the estate if a court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable state law, (4) the presence of a related proceeding commenced in state court or other non-bankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted "core" proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden on the docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of non-debtor parties.<sup>54</sup> This list is a universally accepted guide that has never been distinguished by any court.<sup>55</sup>

In addition to the permissive abstention provision, section 1334(c)(2) contains a mandatory abstention provision.<sup>56</sup> Under that provision, a district court must abstain from hearing proceedings which could not have been brought in federal court absent

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<sup>52</sup> *Id.*

<sup>53</sup> *In re Republic Reader's Serv., Inc.*, 81 B.R. 422, 429 (Bankr. S.D. Tex. 1987) (summarizing twelve factors courts should use to determine whether to abstain); *see also* *New England Power & Marine, Inc. v. Town of Tyngsborough, Mass. (In re Middlesex Power Equip. & Marine, Inc.)*, 292 F.3d 61, 69–70 (1st Cir. 2002) (using twelve factors in review of bankruptcy court's decision to abstain from hearing contempt motion against town regarding state court adjudication of tax liens); *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.)*, 912 F.2d 1162, 1167 (9th Cir. 1990) (looking at twelve factors set forth in *In re Republic Reader's Serv., Inc.*, to determine if abstention was proper (*citing In re Republic Reader's Serv., Inc.*, 81 B.R. at 429)).

<sup>54</sup> *See Republic Reader's Serv.*, 81 B.R. at 429 (listing factors to weigh when deciding if abstention should be used).

<sup>55</sup> *See New England Power*, 292 F.3d at 69–70 (using factors from list to decide if abstention was appropriate); *see also In re LaRoche Indus., Inc.*, 312 B.R. 249, 253 (Bankr. D. Del. 2004) (listing twelve factors used to determine whether court should abstain); *In re Cody, Inc.*, 281 B.R. 182, 189 (Bankr. S.D.N.Y. 2002) (deciding which factors from list weigh in favor of abstention).

<sup>56</sup> 28 U.S.C. § 1334(c)(2) (2006). Section 1334(c)(2) states:

Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

*Id.*; *see also* Linda Greer, Comment: *The Use of Abstention and the Automatic Stay to Allow State Courts to Decide Domestic Relations Matters*, 6 BANK. DEV. J. 371, 376–77 (1989) (describing bankruptcy abstention under 28 U.S.C. § 1334(c)).

the bankruptcy because of lack of federal jurisdiction.<sup>57</sup> In *Allied Mechanical Plumbing Corp. v. Dynamic Hostels Housing Dev. Fund*,<sup>58</sup> the Bankruptcy Court for the Southern District of New York laid out the requirements for a finding of mandatory abstention in bankruptcy courts.<sup>59</sup> A bankruptcy court must abstain from hearing the case if these six elements are met: (1) a party in the bankruptcy proceeding makes a timely motion for abstention by the bankruptcy court, (2) the adversary proceeding is based upon a state law claim or cause of action, (3) the adversary proceeding is related to the bankruptcy case, but may not have arisen in or under the bankruptcy case, (4) the adversary proceeding is one that could not have been commenced absent jurisdiction under section 1334, (5) an action must have been commenced and remains pending in a state court forum, and (6) the pending state court action is one that can be "timely adjudicated" in that forum.<sup>60</sup>

Very rarely are bankruptcy courts forced to abstention from hearing domestic relations cases.<sup>61</sup> In fact, there is only one case where a bankruptcy court was forced, under the mandatory abstention provision, to abstain from hearing a domestic relations matter.<sup>62</sup> To further display the rarity of domestic relations cases where section 1334(c)(2) required the bankruptcy court to abstain, it is important to note that since *Hursa* was decided in 1989, only one court has followed that opinion, and not even that court determined that abstention was mandatory.<sup>63</sup> Thus, when a spouse files for bankruptcy before the final judgment in the divorce, the bankruptcy court will not likely be forced to abstain from hearing that part of the case. Non-debtor spouses who wish for the state court, instead of the bankruptcy court to make the determination as to the property distribution in their divorce, will have to come up with a strong argument as to why the bankruptcy court should abstain anyway.

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<sup>57</sup> 28 U.S.C. §1334(c)(2) (2006)

<sup>58</sup> 62 B.R. 873 (Bankr. S.D.N.Y. 1986).

<sup>59</sup> *Id.* at 877–79 (laying out elements of mandatory abstention under section 1334(c)(2)).

<sup>60</sup> *Id.* (outlining six factors to be addressed by court in considering request for mandatory abstention under 28 U.S.C. § 1334(c)(2)).

<sup>61</sup> Compare *Kohn v. Hursa (In re Hursa)*, 87 B.R. 313, 322–23 (Bankr. D. N.J. 1988) (applying mandatory abstention to chapter 7 bankruptcy) with *In re Mills*, 163 B.R. 198, 202 (Bankr. D. Ka. 1994) (distinguishing cases from *Hursa* which applied mandatory abstention).

<sup>62</sup> See *In re Hursa*, 87 B.R. at 322–23 (abstaining from hearing adversary proceeding regarding division of marital property); see also Greer, *supra* note 56, at 377 (stating Bankruptcy Court in District of New Jersey is only court to have applied mandatory abstention in a domestic relations case).

<sup>63</sup> The Bankruptcy Court for the District of New Jersey, which decided *Hursa*, is the only court to have given the opinion a positive analysis. The Court revisited the issue in 1992, and refused to find that abstention was mandatory because the bankruptcy estate's interest in the property was a "core proceeding" in the bankruptcy case. See *In re Becker*, 136 B.R. 113, 116–17 (Bankr. D. N.J. 1992) ("The determination of the extent of a bankruptcy estate's interest in property in which the debtor had an interest therefore arises under the Bankruptcy Code. It also arises only in bankruptcy cases. For both reasons, such a determination is a core proceeding.").

## II. THE AUTOMATIC STAY UNDER SECTION 362(a) AND ITS EFFECT ON DOMESTIC RELATIONS CASES

Every practitioner knows that the automatic stay falls into place concurrently with the filing of a bankruptcy petition, effectively stopping all actions to collect the debtor's assets in their tracks. Described as an "instrument of sweeping breadth and tremendous power,"<sup>64</sup> the automatic stay, under 11 U.S.C. § 362(a), in fact prevents the commencement or continuance of any judicial, administrative, or other action against the debtor that was or could have been commenced before the commencement of the bankruptcy case.<sup>65</sup> The stay also bars all actions to recover a claim against the debtor which arose before the commencement of the bankruptcy case.<sup>66</sup> All enforcement, collection, perfection, set-off, and tax court actions against the debtor or the property of the estate are stayed as well.<sup>67</sup> This broad blanket provision, by which Congress intended to protect the assets of the debtor<sup>68</sup>, has a tremendous effect on all pending and future actions, especially those involving domestic relations.

Congress did allow for some very specific exceptions to the automatic stay in domestic relations cases. Those exceptions, codified under section 362(b), allow for the commencement of actions to establish paternity and establish, modify, or collect alimony, maintenance, and support.<sup>69</sup> While these exceptions are an important tool for the non-debtor spouse, they do not apply to the problem situation at hand.

### A. Divorce Proceedings and Proceedings Seeking Property Division

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<sup>64</sup> COLLIER, *supra* note 31, at ¶ 5.03[1] (describing automatic stay as a broad instrument which effectively stops all actions to collect from the debtor including most family-related proceedings).

<sup>65</sup> See 11 USC § 362(a)(1) (2006).

[A] petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities . . . the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.

*Id.*; see also COLLIER, *supra* note 31, at ¶ 5.03[1] (discussing automatic stay in domestic relations cases).

<sup>66</sup> 11 U.S.C. § 362(a)(1) (staying "the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case . . .").

<sup>67</sup> 11 U.S.C. §§ 362(a)(2)–(a)(8) (staying all lien, tax, enforcement and collection actions against debtors).

<sup>68</sup> See e.g. COLLIER, *supra* note 31, at ¶ 5.03[1] n.2 (citing H.R. REP. No. 95-595, at 340 (1977) which contains legislative history of the 1978 Bankruptcy Code and the reasons for the inclusion of the automatic stay provisions under section 362(a)); see also H.R. REP. No. 95-595, at 340 (1977) (conversing over issues involved in the enactment of the provisions of the automatic stay).

<sup>69</sup> 11 U.S.C. § 362(b)(2) (excluding proceedings for paternity, alimony, maintenance and support from automatic stay); see also Waller v. Kriss (*In re Kriss*), 217 B.R. 147, 158 (Bankr. S.D.N.Y. 1998) (granting wife relief from the stay to collect support payments).

Courts generally agree that the automatic stay applies to all domestic relations proceedings other than those for alimony, maintenance, and support.<sup>70</sup> Since the Code makes no exception to the stay for pending divorce proceedings and property division proceedings, it follows that these two types of proceedings are well within the scope of the stay.<sup>71</sup> Courts usually consider these actions stayed, however they will proceed to determine if the circumstances call for the stay to be lifted.<sup>72</sup> One must always remember, however, that the automatic stay does not bar suits which are initiated by the debtor.<sup>73</sup> For example, if the debtor commences divorce proceedings against the non-debtor spouse, then that action will not be stayed under section 362. Nevertheless, there is a strong possibility that any cross-claims or counter-claims filed against the debtor in conjunction with his suit against the non-debtor spouse will be stayed under section 362(a).<sup>74</sup>

#### B. Relief From the Automatic Stay Under Section 362(d)(1)

Section 362(d)(1) provides for relief from the automatic stay *for cause*.<sup>75</sup> In order for a court to grant relief, a party in interest must move for the relief.<sup>76</sup> In addition to making the motion, the party must be able to show cause for the modification to the stay.<sup>77</sup> Determinations of whether the party has shown cause are

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<sup>70</sup> See *Carver v. Carver (In re Carver)*, 954 F.2d 1573, 1579 (11th Cir. 1992) (finding automatic stay applicable in all domestic relations cases unless they involve actions for alimony, maintenance, or support) *see also* *Roberge v. Buis (In re Roberge)*, No. 95-3133, 1996 U.S. App. LEXIS 22038, at \*5 (4th Cir. Aug. 27, 1996) (lifting stay to allow state court to determine equitable distribution of marital property); *Vaughn v. First Nat'l Bank (In re Vaughn)*, No. 93-7032, 1993 U.S. App. LEXIS 34000, at \*3-4 (10th Cir. Dec. 23, 1993) (holding automatic stay applicable to stop pending divorce and lifting stay to allow state court to determine outcome of divorce).

<sup>71</sup> The exceptions under section 362(b) only mention actions for alimony, maintenance, and support, failing to discuss any possible exception for pending divorce or property division proceedings. 11 U.S.C. § 362(b) (2006). *See generally* *Rogers v. Rogers*, 671 P.2d 160, 164-65 (Utah 1983) (declaring state court judgment on property division entered after filing of bankruptcy null and void because action was stayed under section 362 of the Code). *But see* *Crowley v. Crowley*, 715 S.W.2d 934, 938-39 (Mo. 1986) (considering automatic stay applicable to divorce proceedings, but allowing state court judgment in divorce to stand with regard to alimony and support aspects of judgment).

<sup>72</sup> COLLIER, *supra* note 31, at ¶ 5.03(1) (explaining most courts assume automatic stay effectively stops all divorce and property division proceedings, but they will consider whether the stay should be lifted to allow those proceedings to continue); *see also* *In re Howell*, 311 B.R. 173, 179-80 (Bankr. D. N.J. 2004) (denying non-debtor spouse's motion to lift stay, stating property of estate must be protected by stay).

<sup>73</sup> 11 U.S.C. § 362(a) (barring proceedings initiated against the debtor, but failing to expressly bar any suits filed by the debtor).

<sup>74</sup> *Id.* Cross and counter-claims fall into the categories of actions under §362(a)(1) because they are considered proceedings brought against the debtor. Some may be allowed though because they could not have been brought before the commencement of the bankruptcy action.

<sup>75</sup> 11 U.S.C. § 362(d)(1) (2006) (allowing grant of relief from stay if party moves for relief and can show cause for relief requested).

<sup>76</sup> *Id.* ("On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . .").

<sup>77</sup> *Id.* (stating after notice and hearing court shall grant relief from the stay for cause).

made on a case by case basis because the Code does not contain a definition of the term.<sup>78</sup>

If the pending state action is unrelated to the bankruptcy case or does not affect the administration of the bankruptcy or the property of the estate, then the court will usually lift or modify the stay to allow the state action to continue.<sup>79</sup> As this is typically the case with marriage dissolution actions, it is not the case with property division proceedings. Property division proceedings almost always affect the property interest of the debtor or the property of the estate. For this reason, most courts are reluctant to modify the stay to allow a state court to determine the property division.<sup>80</sup> In the occasional instance where courts have modified the stay to allow the state property division proceeding, the courts have generally found the property division to be part of alimony or support, hence excepted from the stay.<sup>81</sup> Thus, the automatic stay will most likely be a road block to the non-debtor spouses' attempts to protect their interests in the marital property after the debtor spouse has filed bankruptcy.

### III. STATE FAMILY LAW: DETERMINING PROPERTY RIGHTS AND PROPERTY OF THE ESTATE

Essential to any bankruptcy proceeding is a determination as to which property becomes property of the estate under 11 U.S.C. § 541.<sup>82</sup> Anything that becomes property of the estate goes into the big pot from which creditors will receive payment for their claims in a chapter 7 case.<sup>83</sup> In a chapter 13 case, this property

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<sup>78</sup> See Greer, *supra* note 56, at 379–80 (stating Code does not contain a definition of "for cause" and courts make determination on a case by case basis).

<sup>79</sup> See Greer, *supra* note 56, at 380 (citing *MacDonald* for proposition that a state court action which does not affect administration of the bankruptcy or property of estate should be allowed to continue); see also *In re MacDonald*, 755 F.2d at 717 ("It is appropriate for bankruptcy courts to avoid incursions into family law matters 'out of consideration of court economy, judicial restraint, and deference to our state court brethren and their established expertise in such matters.'). *But cf.* *Schulze v. Schulze*, 15 B.R. 106, 109 (Bankr. S.D. Ohio 1981) (lifting stay for divorce, custody, and property division proceedings and finding those actions only remotely related to the bankruptcy case).

<sup>80</sup> *In re Harris*, 310 B.R. 395, 398–99 (Bankr. E.D. Wis. 2004) (explaining stay does protect debtor and debtor's property from property division proceedings and modifications to state property division decisions); *In re Zick*, 123 B.R. 825, 828 (Bankr. E.D. Wis. 1980) (holding wife's motion for modification of property division under divorce action to be violation of stay which court refused to lift); *cf. In re Ladak*, 205 B.R. 709, 712 (Bankr. D. Vt. 1997) (finding party seeking modification to property settlement in violation of automatic stay).

<sup>81</sup> See generally *In re Callahan*, No. 91-4557 Section "I" (5), 1992 U.S. Dist. LEXIS 7971, at \*9 (E.D. L.A. 1992) (allowing state court to determine issue of marital property division which was tied to support payments); *Schulze v. Schulze*, 15 B.R. 106, 109 (Bankr. S.D. Ohio 1981) (lifting automatic stay to allow pending state court property division proceeding to determine non-debtor spouse's portion of the marital property).

<sup>82</sup> 11 U.S.C. § 541 (2006) (setting forth which property becomes property of the estate as of date of filing petition and which property does not become property of estate due to exceptions either under Code or under state law).

<sup>83</sup> See 11 U.S.C. § 726 (entitled "Distribution of the property of the estate").

will be used to determine what the creditors would have gotten in a chapter 7, making sure that the reorganization is fair to all creditors.<sup>84</sup> A determination of what makes up the property of the estate is the most important piece of the problem cases at hand. Unless the non-debtor spouse has a lien on the property, if the property is found to be part of the estate, he or she will become a general unsecured creditor in the bankruptcy<sup>85</sup>, with no ties to the specific piece of property. However, if the property is not found part of the estate, then that property is unaffected by the bankruptcy, leaving the non-debtor spouse possible recourse to obtain the specific property. If the non-debtor spouse has a vested interest in the property, then that interest might not enter the bankruptcy estate. Even so, the interests of the husband and wife are determined under state marital property law, not the Federal Bankruptcy Code; even after a bankruptcy is filed, one must look to the applicable state's law to discover each party's rights and interests.<sup>86</sup>

#### A. Marital Property

Once a couple marries, they then may obtain property which state law categorizes as "marital property."<sup>87</sup> Marital property generally consists of all property that a married couple acquires during their marriage.<sup>88</sup> Many state's laws include property which is acquired by either spouse, separately or together, in their definition of marital property. The marital property can be any type of asset including the primary residence<sup>89</sup>, an individual retirement account<sup>90</sup>, and a family business.<sup>91</sup> In addition, the marital property may be held either solely in one spouse's name, or jointly in both of their names.<sup>92</sup> Simply having the title to the

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<sup>84</sup> See 11 U.S.C. § 1325(a)(4) ("[T]he value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 . . .").

<sup>85</sup> See *supra* note 3 and accompanying text.

<sup>86</sup> See *Butner v. United States*, 440 U.S. 48 (1979) (finding applicable state law which creates property interests must be followed by the bankruptcy court).

<sup>87</sup> Marital property is a term which has different meanings under different state divorce law. The statutory law of the state where the case exists must be consulted to find a specific definition. See *Davis v. Cox*, 356 F.3d 76, 85 (1st Cir. 2004) (viewing state legislative history in determining what property constitutes "marital property").

<sup>88</sup> BLACK'S LAW DICTIONARY at 564 (defining marital property generally as "property acquired during marriage and that is subject to distribution or division at the time of marital dissolution").

<sup>89</sup> See *In re Hilsen*, 119 B.R. 435, 439 (Bankr. S.D.N.Y. 1990) (counting primary residence, which was an apartment, as marital property).

<sup>90</sup> See *Cox*, 356 F.3d at 85 (deeming Advest IRA account which was acquired during marriage but held in husband's name to constitute "marital property").

<sup>91</sup> See *In re Anjum*, 288 B.R. 72, 78 (Bankr. S.D.N.Y. 2003) (holding dry-cleaning business was marital property because it was acquired after date parties were married and before divorce was filed).

<sup>92</sup> *Cox*, 356 F.3d at 85 (determining Advest Individual Retirement Account held solely in name of husband was marital property even though it was held only in one name); *In re Greenwald*, 134 B.R. 729, 730-31 (Bankr. S.D.N.Y. 1991) (considering investment accounts held solely in name of debtor-husband marital property in which non-debtor wife had some interest); see also *In re Forant*, 331 B.R. 151, 156 (Bankr. D.

property in one spouse's name does not exempt the property from being considered marital property under most states' laws. Generally, from the state property distribution determination, the bankruptcy courts will decide what part of the property will be attributed to the debtor spouse, becoming part of the bankruptcy estate under section 541.

*B. State Property Law: Equitable Distribution, Community Property, and Strict Title States*

Overall, states' laws fall into one of two categories, determining how the marital property will be distributed.<sup>93</sup> Based on their laws, states are either classified as equitable distribution states or community property states<sup>94</sup> Historically, there was a third category that courts referred to as "strict title."<sup>95</sup> Under strict title statutes, rights in marital property were determined only by the title to the property. South Carolina, Florida, West Virginia, and Mississippi traditionally were strict title states.<sup>96</sup> By 1993, all strict title states had made the switch to equitable distribution.<sup>97</sup> The Supreme Court of Mississippi, the last of these states to abandon "strict title" distribution, explained that the abandonment was required because strict title statutes led to unfair results.<sup>98</sup>

All three categories of marital property distribution statutes were derived from either common law or civil law.<sup>99</sup> Both equitable distribution and strict title distribution evolved from the common law while the community property statutes

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Vt. 2004) (explaining Vermont law considers all property acquired during marriage marital property irrespective of name on title).

<sup>93</sup> COLLIER, *supra* note 31, at ¶ 37.01 (discussing state marital property distribution schemes such as equitable distribution, community property, and strict title).

<sup>94</sup> *Id.*

<sup>95</sup> See generally, Stephen J. Brake, *Equitable Distribution v. Fixed Rules: Marital Property Reform and the Uniform Marital Property Act*, 23 B.C. L. REV. 761, 762–63 (1982) (explicating history of three systems of property distribution in United States); see *Ferguson v. Ferguson*, 639 So.2d 921, 925–27 (Miss. 1994) (recognizing history of strict title property distribution in Mississippi); *Long v. Long*, 734 So.2d 206, 208 (Miss. 1999) (stating *Ferguson* set forth criteria used when determining equitable distribution under Mississippi law).

<sup>96</sup> *Ferguson*, 639 So.2d at 925–27 (Miss. 1994) (explaining history of property distribution under strict title theory and describing court's finding where distribution under strict title led to unjust results).

<sup>97</sup> *Id.* at 925–27; see also *Canakaris v. Canakaris*, 382 So.2d 1197, 1201 (Fla. 1980) (giving judges discretion to make equitable distributions of marital property regardless of strict title provision); *Parrot v. Parrot*, 292 S.E.2d 182, 183–84 (S.C. 1982) (taking marital contributions into account when determining division of marital property); *LaRue v. LaRue*, 304 S.E.2d 312, 321 (W. Va. 1983) (explaining use of equitable distribution under West Virginia law); *Williams v. Williams*, 354 S.E.2d 64, 66 (Va. 1987) (examining equitable distribution under Virginia law).

<sup>98</sup> *Ferguson*, 639 So.2d at 926 (noting examples of unfair results in marital property distribution situations).

<sup>99</sup> Susan Klebanoff, Comment, *To Love and Obey 'Til Graduation Day—The Professional Degree in Light of the Uniform Marital Property Act*, 34 AM. U. L. REV. 839, 841 (1985) (discussing evolution of state property distribution law from common law and civil law).

came from the Roman civil law.<sup>100</sup> Forty-one states and the District of Columbia currently use equitable distribution to divide marital property.<sup>101</sup> Only a small minority of nine states still use community property distribution statutes.<sup>102</sup> Because the results obtained under each of the three categories vary, each category must be looked into separately.

### 1. Community Property States

Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin are community property states.<sup>103</sup> While the laws of these nine states vary,<sup>104</sup> the basis for their classification as community property states is the same, the Roman civil law.<sup>105</sup> Roman civil law did not consider man and wife to be one fictional entity, with only one set of rights.<sup>106</sup> To the contrary, civil law acknowledged husband and wife as separate people, each with his or her own rights and abilities to own property.<sup>107</sup> Consequently, the nine states listed above distinguish property of married couples by putting it in one of two categories.<sup>108</sup> Property is either (1) separate property or (2) community property.<sup>109</sup> Basically, any property acquired before the marriage, during the marriage by gift or inheritance, or when living in a common law property state, is considered separate property of the one spouse who acquired it.<sup>110</sup> Everything else, generally all assets acquired during the course of the marriage by either spouse, is community

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<sup>100</sup> FAMILY LAW LITIGATION GUIDE WITH FORMS § 12.01 (Mathew Bender & Co., Inc. ed. 2005) (investigating history of equitable distribution, community property, and strict title).

<sup>101</sup> *Id.* (listing Alabama, Alaska, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, West Virginia, Wyoming and Washington, D.C. as equitable distribution jurisdictions).

<sup>102</sup> *Id.* (listing Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin as community property states).

<sup>103</sup> *Id.*; see COLLIER, *supra* note 31, at ¶ 4.01 (listing nine states as community property states).

<sup>104</sup> *Cf.* ARIZ. REV. STAT. § 25-211 (2005); CAL. FAM. CODE § 760 (2005); IDAHO CODE § 32-712 (2005); LA. REV. STAT. ANN. § 9:2801 (2005); NEV. REV. STAT. § 125.150 (2004); N.M. STAT. ANN. § 40-4-7 (2005); TEX. CODE ANN. §§ 3.002, 7.001 (2005); WASH. REV. CODE § 26.09.080 (2005); WIS. STAT. § 766.31 (2005).

<sup>105</sup> See Greer, *supra* note 56, at 388-89 (examining history of community property law and finding its roots in Roman civil law).

<sup>106</sup> See RICHARD A. BALLINGER, PROPERTY RIGHTS OF HUSBAND AND WIFE, UNDER THE COMMUNITY OR GANANCIAL SYSTEM § 4 (Fred B. Rothman & Co. 1981) (1895) (introducing history of the community property distribution laws of United States).

<sup>107</sup> See *id.* (explaining how French code excluded from community those which each spouse possessed prior to marriage or obtained by succession or donation).

<sup>108</sup> See *supra* note 104 and accompanying text.

<sup>109</sup> See *id.* (referring to types of property as "community" and "separate" or "marital" and "individual").

<sup>110</sup> See *id.* (defining what is included as or excluded from community property when property is divided).

property.<sup>111</sup> Each spouse is said to have an undivided one-half interest in that community property.<sup>112</sup> While that is usually true, most community property statutes do not set that 50/50 requirement in stone, allowing courts room to create a more just outcome.<sup>113</sup> Distinguishable from other forms of property co-ownership such as joint tenancy and tenancy by the entirety, a spouse who owns property as community property under marriage cannot unilaterally sever or transfer the interest.<sup>114</sup> However, in many community property states, intent of the parties also plays a role in the classification of the property. If the parties expressly owned the property as joint tenants, then the property will no longer be considered simply community property.<sup>115</sup>

The Code sets out in section 541(a)(2) that all community property in which the debtor has an interest becomes property of the estate.<sup>116</sup> Under that same section, the non-debtor spouse's interest in the community property also becomes property of the estate.<sup>117</sup> In the situation where a spouse being sued for divorce files bankruptcy, there is no question that the community property becomes part of the estate. The main question one must ask at that point is, "What rights and claims does the non-debtor spouse have?" To answer this question, one must look to the specific state's community property laws. A discussion in that detail is beyond the scope of this note.

However, the law generally protects the non-debtor spouses' rights to their half of the community property in community property states. The community property will become property of the estate under section 541. Under section 541(a)(2), the

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<sup>111</sup> COLLIER, *supra* note 31, at ¶ 4.01 (generalizing community property statutes of the nine states); *see generally* WILLIAM A. REPPY, JR. & CYNTHIA A. SAMUEL, COMMUNITY PROPERTY IN THE UNITED STATES 2 (2d ed. 1982) (stating community property systems view the wealth possessed by a husband and wife to be common, belonging to both halves of the marriage).

<sup>112</sup> *See* Greer, *supra* note 56, at 388–89 (delving into theme of community property states and their varying laws); *see, e.g.*, COLLIER, *supra* note 31, at ¶ 4.01 (stating each spouse has a one-half undivided interest in the community property).

<sup>113</sup> *See supra* note 104 and accompanying text.

<sup>114</sup> *See* COLLIER, *supra* note 31, at ¶ 4.01 (differentiating community property rights from those under joint tenancy and tenancy by the entirety).

<sup>115</sup> *See generally*, BALLINGER, *supra* note 106, at 4 (displaying parties' ability to obtain property as joint tenants and tenants by the entirety in community property states).

<sup>116</sup> 11 U.S.C. § 541(a)(2) (2006) provides:

All interests of the debtor and the debtor's spouse in community property as of 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.

*Id.*

<sup>117</sup> *Id.*

trustee may sell the property free and clear of the non-debtor spouse's interest.<sup>118</sup> Here, though, the non-debtor spouse has some protections. First, the trustee must give the non-debtor spouse the opportunity to purchase the bankruptcy estate's interest in the property.<sup>119</sup> If the non-debtor spouse chooses not to purchase the estate's half of the property, then the trustee will sell the property free and clear of the non-debtor spouse's interest. The proceeds are then divided between the estate and the non-debtor spouse.<sup>120</sup>

## 2. Equitable Distribution States

Excluding the nine community property states listed above, the other forty-one states and the District of Columbia have equitable distribution statutes,<sup>121</sup> which stem from the common law.<sup>122</sup> Equitable distribution jurisdictions view marriage as a partnership with the equitable distribution statutes as a means for ending that partnership.<sup>123</sup> At the heart of the theory is the idea that because both parties contribute differently to the marital property, each should receive his or her fair

<sup>118</sup> 11 U.S.C. § 363(h) (2006). In order for the Trustee to be able to sell free and clear of the non-debtor spouse's interest, the court must find: (1) partition in kind is impracticable; (2) sale of the undivided interest would realize significantly less for the estate; (3) the benefit to the estate outweighs the detriment to the co-owner; and (4) the property is not used in the production of energy.

<sup>119</sup> See COLLIER, *supra* note 31, at ¶1.03 (explaining steps that Trustee must take when selling property in which the estate only owns a partial interest because that property is community property partially owned by the non-debtor spouse).

<sup>120</sup> See *id.*

<sup>121</sup> See ALA. CODE § 30-2-51 (2005); ALASKA STAT. § 25.24.160 (2004); ARK. CODE ANN. § 9-12-315 (2002); COLO. REV. STAT. § 14-10-113 (2005); CON. GEN. STAT. § 46B-81 (2000); DEL. CODE ANN tit. 13, § 1513 (2000); D.C. CODE ANN § 16-910 (2001); FLA. STAT. § 61.075 (2005); GA. CODE ANN. § 19-5-13 (2004); HAW. REV. STAT. § 580-47 (2005); 750 ILL. COMP. STAT. 5/503 (2005); IND. CODE ANN. § 31-15-7-4 (2005); IOWA CODE § 598.21 (2005); KAN. STAT. ANN. § 23-201 (1999); KY. REV. STAT. ANN. § 403.190 (1999); ME. REV. STAT. ANN. tit. 19-A, § 953 (1998); MD. CODE ANN. FAMILY LAW § 8-201 (2004); MASS. GEN. LAWS. CH. 208, § 34 (2005); MICH. COMP. LAWS § 552.19 (2005); MINN. STAT. § 518.58 (2005); MO. REV. STAT. § 452.330 (2004); MONT. CODE ANN. § 40-4-202 (2005); NEB. REV. STAT. § 42-365 (2004); N.H. REV. STAT. ANN § 458:16-A (1992); N.J. STAT. ANN. § 2A:34-23 (2000); N.Y. DOM. REL. LAW § 236 (1999); N.C. GEN. STAT. § 50-20 (2005); N.D. CENT. CODE § 14-05-24 (2004); OHIO REV. CODE ANN. § 3105.171 (2003); OKLA. STAT. tit. 43, § 121 (2001); ORE. REV. STAT. § 107.105 (2003); 23 PA. CONS. STAT. § 3505 (2005); R.I. GEN. LAWS § 15-5-16.1 (2004); S.C. CODE ANN. § 20-7-472 (2004); S.D. CODIFIED LAWS § 25-4-44 (2004); TENN. CODE ANN. § 36-4-121 (2005); UTAH CODE ANN. § 30-3-5 (1998); VT. STAT. ANN. TIT. 15 § 751 (2003); VA. CODE ANN. § 20-107.3 (2004); W. VA. CODE § 48-7-101 (2005); WYO. STAT. ANN. § 20-2-114 (2005).

<sup>122</sup> See Greer, *supra* note 56, at 389 ("The remaining forty-two states are common law property states . . . [where] [u]pon divorce . . . property classified as marital property is divided equally.").

<sup>123</sup> Rosenman & Colin LLP v. Jarrell (*In re Jarrell*), 251 B.R. 448, 451 n.4 (Bankr. S.D.N.Y. 2000) (finding marriage to be economic partnership with assets to be shared based on parties' contributions without regard to title of property); Bellanich v. Bellanich, 936 P.2d 141, 144 (Ala. 1997) (declaring philosophy behind equitable distribution regards marriage as partnership to which both spouses contribute); see also JOHN TINGLEY & NICHOLAS B. SVALINA, MARITAL PROPERTY LAW § 40:01 (1995) (setting forth general aspects of equitable distribution law).

share, regardless of whose name is on the actual title.<sup>124</sup> Another main piece of the equitable distribution scheme is a disregard for the party's marital fault.<sup>125</sup> In the most general terms, states adopted equitable distribution because they felt that the common law partnership fiction combined with division based on a party's fair share leads to the most just, fair, or equitable result.<sup>126</sup>

As with all property division in divorce cases, the court will distribute the marital property based on the specific state's statute.<sup>127</sup> Although the statutes have a common theme, each may contain differences, leaving few common ties. As with the community property states, an important question as far as property division is concerned is when do each spouse's rights vest in the marital property? On its own, the equitable distribution seems to be a fairly straight-forward approach to division of marital property. The state family court decides the rights of the parties based on various factors. Some of these factors are listed in the statutes while others are not. These states feel that the outcome under equitable distribution is just that, "equitable" or fair. But, in states where the non-titled spouse's rights are inchoate until the state family court makes a final judgment, the outcome can be as inequitable as possibly imaginable. If the titled spouse files for bankruptcy protection before the final judgment in the divorce action, he or she may make out like a bandit, stealing the property right out from under the non-titled spouse.

#### IV. THE CASES: INEQUITABLE RESULTS UNDER EQUITABLE DISTRIBUTION

Although cases involving divorce and bankruptcy are nothing new to courts' dockets, the last few years have brought several cases which are illustrative of the

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<sup>124</sup> See generally *Yonadi v. Comm'r of Internal Revenue Serv.*, 21 F.3d 1292, 1299–1300 (3d Cir. 1994) (explaining spouses receive share of marital property based on their contribution to marital property, regardless of need or liability); *Chalmers v. Chalmers*, 320 A.2d 478, 483 (N.J. 1974) (concluding parties should receive their fair share of marital property based on contributions they made to marital property under New Jersey's equitable distribution statute); *O'Brien v. O'Brien*, 66 N.Y.2d 576, 590 (1999) (displaying view that upon divorce, each party is entitled to his or her "fair share" of marital assets based on contribution to marital property).

<sup>125</sup> See *Letsch v. Letsch*, 409 N.W.2d 239, 243 (Minn. Ct. App. 1987) (holding court must make property distribution determination under equitable distribution without regard to marital fault of either party); *O'Brien*, 66 N.Y.2d at 1300 (seeing marital fault as irrelevant to equitable distribution determinations because to consider it would go against the underlying theory and take too much of court's time); *Blickstein v. Blickstein*, 99 A.D.2d 287, 292 (2d Dep't 1984) (stating general rule that marital fault is not relevant in equitable distribution determination, although some extraordinary circumstances may exist as to make it relevant).

<sup>126</sup> See JOHN TINGLEY & NICHOLAS B. SVALINA, *supra* note 123, at § 40:01 ("Most jurisdictions have enacted statutes calling for property to be divided equitably, justly, fairly, or the like . . .").

<sup>127</sup> See generally *Boyce v. Boyce*, 541 A.2d 614, 616 (D.C. 1988) (applying D.C. Code §16-910, their equitable distribution statute, to determine fair distribution of marital property); *In re Marriage of Baculis*, 430 N.W.2d 399, 404 (Iowa 1988) (basing equitable distribution determination on Iowa Code §598.21(1) which is state's equitable distribution statute); *cf. In re Marriage of Powell*, 766 P.2d 827, 831 (Kan. Ct. App. 1989) (discussing courts' application of equitable distribution statutes to determine whether personal injury awards are subject to marital property division under equitable distribution statutes).

current dilemma. Those cases generally all have a similar tone to them. A wife files for a divorce from her husband in state court. While that action is pending, the husband obtains a lawyer who is familiar with the ins and outs of the Bankruptcy Code. That lawyer informs his client that by filing bankruptcy, either under chapter 13 or chapter 7, the client may be able to stick it to his wife and keep more of "his" property in the end. It is important to note that while the majority of reported cases follow this pattern, the roles may also be reversed. Cases where a husband files for divorce and the wife then files bankruptcy also exist, but the instances of their occurrence is more rare. While only a small number of reported cases exist where the wife files bankruptcy while the divorce is pending against her, there is no reason to believe that she would not receive the same advantages as the men in the cases below.

Recently, in *In re Anjum*<sup>128</sup>, Judge Adlai S. Hardin, Jr. of the United States Bankruptcy Court for the Southern District of New York held that a non-debtor wife who was without title to two pieces of marital property became a general unsecured creditor in her husband's chapter 7 bankruptcy case.<sup>129</sup> She did not fare well in the overall outcome of this case. First, the court explained that in a case where bankruptcy intervenes before a final state divorce judgment is reached, the automatic stay prevents the divorce action from continuing.<sup>130</sup> However, in the average case, the non-debtor spouse will apply to the bankruptcy court to lift the automatic stay to allow the parties to continue their litigation of divorce issues in the proper court, the state family court. In this particular case, though, the non-debtor spouse did not have to request the lifting of the stay because the debtor applied for the state court to enter the judgment of equitable distribution of the marital property.<sup>131</sup> Since the stay does not apply to actions that the debtor affirmatively takes,<sup>132</sup> the stay did not apply here.

Once around the automatic stay, the state court entered a judgment in favor of the non-debtor wife in the amount of \$28,250, which represented her portion of the marital property, an automobile and a dry cleaning business.<sup>133</sup> The state family court made this determination by applying New York Domestic Relations Law section 236, New York's equitable distribution statute. After that judgment was entered, the bankruptcy case continued. The bankruptcy court found that under

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<sup>128</sup> 288 B.R. 72 (Bankr. S.D.N.Y. 2003).

<sup>129</sup> *Id.* at 72-73 (finding judgment of divorce gave rise to unsecured pre-petition claim making non-debtor wife general unsecured creditor in husband's bankruptcy).

<sup>130</sup> *Id.* at 78 ("[T]he non-debtor spouse would apply to the bankruptcy court to lift the automatic stay to permit the parties to litigate their spousal rights and obligations (including equitable distribution) through to a judgment under state law in the matrimonial court.").

<sup>131</sup> *Id.* at 78 n.5 (contrasting present case from usual case in which court would lift automatic stay at request of non-debtor spouse "to permit the parties to litigate their spousal rights and obligations . . . under state law in the matrimonial court.").

<sup>132</sup> See 11 U.S.C. § 362(a)(1) (2006) (staying any action or proceeding against debtor, which was or could have been commenced before commencement of case, and any action to recover against debtor).

<sup>133</sup> *In re Anjum*, 288 B.R. at 74.

New York law, the non-titled spouse's rights in the marital property didn't vest until the divorce court entered a final property distribution judgment.<sup>134</sup> In this case, the wife's un-vested rights were considered inchoate at the time of filing of the petition, since they did not vest until the time of the judgment (well after the filing of the petition.) The court found those inchoate rights to be cut off by the trustee's strong arm powers under section 544.<sup>135</sup> Judge Hardin explained that since the wife's rights were trumped by the trustee's hypothetical lien creditor status under the strong arm powers of section 544, the property became property of the estate and the non-debtor wife became a general unsecured creditor in the husband's bankruptcy.<sup>136</sup> As a general unsecured creditor, the non-debtor wife was entitled to a *pro rata* distribution of the assets of the estate along with the other unsecured creditors.<sup>137</sup> Nevertheless, the debtor's bankruptcy estate was found to have no assets with which to pay the creditors' claims.<sup>138</sup> Without assets in the estate, the non-debtor wife's claim was worth nothing and also subject to discharge at the end of the husband's bankruptcy case.<sup>139</sup>

In another case, *Perlow v. Perlow*,<sup>140</sup> the United States District Court for the Eastern District of North Carolina reached a similar result. The husband in that case, filed for divorce and equitable distribution of marital property in state court. While the state court granted him the divorce, the court held the matter of the equitable distribution for a later date. Before the state court entered a final judgment on the equitable distribution, the husband filed for chapter 7 relief. The husband included his wife's claim for equitable distribution of marital property in his petition for relief. He also listed her as a party to the pending state court equitable distribution action in his Statement of Financial Affairs. The bankruptcy court eventually took it upon itself to determine the equitable distribution of the marital property. Because there were no assets in the estate, the court decided that

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<sup>134</sup> *Id.* at 76; see *In re Cole*, 202 B.R. 356, 360 (Bankr. S.D.N.Y. 1996) (stating rights in marital property do not vest under New York law until final divorce judgment is entered).

<sup>135</sup> The Trustee's status as a hypothetical lien creditor trumps the inchoate rights of the non-debtor spouse. See *In re Anjum*, 288 B.R. at 76–77.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 77 ("Since the Bankruptcy Code gives [the non-debtor spouse] no right of distribution superior to that of any other unsecured creditor, [the non-debtor spouse] will be entitled to a pro rata distribution along with other unsecured creditors." (quoting *Polliard v. Polliard (In re Polliard)*, 152 B.R. 51, 55 (Bankr. W.D.Pa. 1993))).

<sup>138</sup> *Id.* at 78.

<sup>139</sup> See 11 U.S.C. § 524(a)(2) (2006) ("operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived").

<sup>140</sup> 128 B.R. 412, 417 (Bankr. E.D.N.C. 1991) (holding bankruptcy code prohibited ex-spouse from pursuing her rights in marital property back to individual assets of debtor because her claim for equitable distribution was discharged along with her ex-spouse's other debts).

the wife's claim had no value.<sup>141</sup> After the bankruptcy court discharged the wife's claim, she appealed to the district court.<sup>142</sup>

Although decided more than a decade before *Anjum*, the district court's opinion in *Perlow* bears a remarkable resemblance to the opinion of the *Anjum* court. To start off, the district court questioned whether the bankruptcy court should have abstained from hearing the equitable distribution case under 28 U.S.C. § 1334(c)(1).<sup>143</sup> Finding that bankruptcy court jurisdiction existed, the district court held that the bankruptcy court should have abstained in the interest of justice under section 1334 from making a determination on the marital property distribution.<sup>144</sup> However, the abstention, the district court contended, was contingent on the wife's filing of a motion requesting the abstention.<sup>145</sup> Because she did not make that motion, the district court agreed that the bankruptcy court was within its powers when it determined the equitable distribution of the marital property.

Next, the district court explained that a claim to equitable distribution is a statutory right which is granted by the state's equitable distribution statute.<sup>146</sup> Under North Carolina's statute, the parties' rights are said to vest when the married couple separates.<sup>147</sup> However, under the statute, a vested right is not a right in property, but only a right to payment, which qualifies as a claim against the bankruptcy estate pursuant to section 101(5)(a).<sup>148</sup> The district court then went on to explain that the trustee's strong arm powers under section 544 of the Code allowed him to act either as a hypothetical bona fide purchaser of the property or hypothetical lien creditor,

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<sup>141</sup> *Id.* at 414 (stating bankruptcy court found the wife's claim for equitable distribution without value).

<sup>142</sup> *Id.* (noting wife appealed from bankruptcy court's order which discharged her claim).

<sup>143</sup> *See id.* at 416 (citing 28 U.S.C. § 1334(c)(1)) (observing a bankruptcy court may have jurisdiction over particular proceeding but may use its discretion to abstain from hearing it out of respect for state law or in the interests of justice); *see also supra* note 48 and accompanying text.

<sup>144</sup> *See Perlow*, 128 B.R. at 416 (concluding Ms. Perlow's claim for equitable distribution would have been more appropriately handled by the state courts" because bankruptcy courts lack expertise in equitable distribution of property, "in the interest of justice).

<sup>145</sup> *Id.* (noting wife's failure to request that the bankruptcy court abstain from exercising jurisdiction over her claim for equitable distribution).

<sup>146</sup> *Id.* at 415 (describing wife's claim for equitable distribution of marital property as a statutory right of spouses under North Carolina law).

<sup>147</sup> *See* N.C. GEN. STAT. § 50-20(k) (2005) ("The rights of the parties to an equitable distribution of marital property and divisible property are a species of common ownership, the rights of the respective parties vesting at the time of the parties' separation."); *Perlow*, 128 B.R. at 415 (quoting N.C. GEN. STAT. § 50-20(b) (2005)) (explaining a spouse's right of equitable distribution of marital property under North Carolina's statute vests when the parties separate).

<sup>148</sup> 11 U.S.C. § 101(5)(a) (2006) (defining "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . ."); *Perlow*, 128 B.R. at 415 (emphasizing that the vested right under the North Carolina statute only creates a right to an equitable distribution of marital property which constitutes a "right to payment" qualifying as a "claim" against the estate pursuant to the Bankruptcy Code's definition of "claim" (quoting 11 U.S.C. § 101)).

bringing the marital property into the estate.<sup>149</sup> Because a judgment lien creditor or bona fide purchaser would have received the property free and clear of the wife's interests, so too does the trustee acting like either one of the two.<sup>150</sup> This process essentially cut off the wife's interests in the particular pieces of marital property and allowed the property to become property of the estate. Eventually, the wife's claim was discharged under section 524 of the Code. Section 524(a) prevented her from pursuing her claim any further<sup>151</sup>, and left her empty-handed, similar to the non-debtor wife in *Anjum*.

The court here seems to be lacking a sound legal judgment. A plain reading of the statute on its face reveals that the rights of the two parties vest at the time of separation. If the right is not one to the property, but instead is merely a right to the equitable distribution of that property, then this statute is unnecessary altogether. One may argue that nothing has vested at all in this situation. Since the wife in this case ended up without any right to the property, then under this ruling, what vested at the time of separation? The court's opinion leaves this question unanswered. In any event, whatever her rights actually were, Ms. Perlow did not receive anything for her share of the property.

While these two "no asset" chapter 7 cases produced results which left the non-debtor spouses drifting in the wind, other outcomes have not been that terrible. In *In re Polliard*,<sup>152</sup> a non-debtor wife fought in bankruptcy court to remain in possession of the marital property while divorce was pending.<sup>153</sup> Just as in *Perlow* and *Anjum*, the state divorce proceeding had not culminated in the reaching of a final judgment at the time of the husband's bankruptcy filing. The bankruptcy court for the Western District of Pennsylvania determined that although the non-debtor spouse's right to seek equitable distribution vested when the divorce was filed, she did not have a vested ownership right in the property at the time of the bankruptcy filing.<sup>154</sup> The court granted the wife's motion for relief from the stay to have the state divorce court determine the equitable distribution of the marital property under

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<sup>149</sup> *Id.* at 416 (explaining under 11 U.S.C. § 544, "the trustee in bankruptcy is clothed with the status of a hypothetical lien creditor and a hypothetical bona fide purchaser of property from the debtor." (quoting *Johnson v. Fisher (In re Fisher)*, 67 B.R. 666, 669 (Bankr. D. Colo. 1986))).

<sup>150</sup> See 11 U.S.C. §§ 544(a)(2)–(a)(3) (2006) (setting forth trustee's status as a hypothetical lien creditor and hypothetical bona fide purchaser).

<sup>151</sup> 11 U.S.C. § 524(a) (2006) (operating as an injunction against any action which is an attempt to recover any discharged debt from the debtor).

<sup>152</sup> 152 B.R. 51 (Bankr. W.D.Pa. 1993) ("We believe the better view, expressed by numerous other courts, is that the non-debtor spouse's interests in the Debtor's share of the marital property, which are the subject of equitable distribution proceedings in a divorce action commenced prior to the bankruptcy filing, are cut off by the bankruptcy filing where the domestic relations court has not, at the time of the bankruptcy, fixed the equitable distribution rights by judgment.").

<sup>153</sup> *Id.* at 55.

<sup>154</sup> *Id.* (holding post-petition equitable division of property does not alter bankruptcy estate's rights in property).

one condition.<sup>155</sup> The court suggested that the trustee attend the state court proceeding and enter an appearance to protect the rights of the other creditors in the husband's bankruptcy.<sup>156</sup> Upon the determination of each spouse's interests in the marital home, the bankruptcy court ordered the trustee to sell the home under section 363(h).<sup>157</sup> After the sale of the home, the wife was left with a claim as a general unsecured creditor in the husband's bankruptcy.

Unlike the cases above, the husband's bankruptcy estate contained assets.<sup>158</sup> The court, in granting the wife's motion for relief from the automatic stay, explained that the wife will receive money from the bankruptcy estate. While this outcome is not as harsh as leaving the non-debtor spouse empty-handed, it did force her to leave her home. In return, it left her with an unsecured claim, which does not include any compensation for the pain and suffering she endured over the course of the ordeal. Additionally, it does not guarantee her the full value of the claim as well.

These cases are current, up-to-date cases that are still good law in New York, North Carolina, and Pennsylvania. The idea that spouses, whether men or women, can work hard to maintain pieces of marital property, yet have all semblance of their interests in that property swept from underneath them is very troubling. Why does the law in some states treat the non-debtor spouse as a second-rate citizen? Shouldn't the husband or wife, mother or father of the debtor's children in many cases, be the first one that the law protects? As we have seen here, that is not the case. If it is any consolation, some jurisdictions understand that a problem exists and have tried to create a fair remedy.

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<sup>155</sup> *Id.* at 55 ("we believe it appropriate in this case to grant Mrs. Polliard relief from the automatic stay to pursue a determination of the amount of her claim in the Court of Common pleas.").

<sup>156</sup> *Id.* at 56.

<sup>157</sup> *Id.*; see 11 U.S.C. § 363(h) (2006).

Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of the section, and the interest of any co-owner in the property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

- (1) partition in kind of such property among the estate and such co-owners is impracticable;
- (2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interest of such co-owners;
- (3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
- (4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

*Id.*

<sup>158</sup> See *Polliard*, 152 B.R. at 53 (finding marital residence worth \$56,000 after mortgage is paid, which is an asset in the bankruptcy).

V. CONSTRUCTIVE TRUSTS: THE FIRST CIRCUIT'S ANSWER IN *DAVIS V. COX*<sup>159</sup>

Some courts do not agree with the outcome of the ordinary case where a non-debtor spouse's interest in the equitable distribution of marital property only becomes a general unsecured claim in the other spouse's bankruptcy. Going against the grain, these courts have searched high and wide to find a solution which will yield a more just outcome. Critics might consider their final product somewhat of a stretch, but fans can see the genius of the scheme. What was first introduced by the Bankruptcy Court for the District of Massachusetts in 1991<sup>160</sup> was recently adopted by the First Circuit in 2004.<sup>161</sup> That solution is the imposition of a constructive trust which is said to hold the non-debtor spouse's interests in the marital property free of the bankruptcy estate and subject to attack in state court.

A. *Constructive Trusts*

To define a constructive trust is a seemingly impossible task. What constitutes a constructive trust has been the focus of debate for years.<sup>162</sup> Under a general definition, though, a constructive trust is a legal fiction. It is a trust which is imposed upon equitable grounds by a court against one who has obtained property wrongfully.<sup>163</sup> The imposition of constructive trusts is said to be a way to prevent the wrongdoer from being unjustly enriched. Originally, courts of equity used constructive trusts to remedy situations where property was wrongfully obtained through a breach of fiduciary duties.<sup>164</sup> The applicable state law gives rise to these types of trusts. Most states' laws require some type of close relationship or fiduciary duties between the parties.<sup>165</sup> Without the existence of these fiduciary

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<sup>159</sup> *Davis*, 356 F.3d at 76.

<sup>160</sup> *See In re Perry*, 131 B.R. 763, 767–68 (Bankr. D. Mass. 1991) (imposing a constructive trust which excluded non-debtor spouse's interest in the marital property from the bankruptcy estate).

<sup>161</sup> *See Cox*, 356 F.3d at 84 (finding debtor spouse held non-debtor spouse's interest in an IRA account which was considered marital property in a constructive trust that did not enter the bankruptcy estate).

<sup>162</sup> *See generally* Robert J. Keach, *The Continued Unsettled State of Constructive Trusts in Bankruptcy: Of Butner, Federal Interests and the Need for Uniformity*, 103 COM. L.J. 411, 417 (1998) (considering constructive trusts to be difficult to define and stating more than one view exists of exactly what a constructive trust is).

<sup>163</sup> BLACK'S LAW DICTIONARY 1547 (8th ed. 1990) (noting "despite its name, [a constructive trust] is not a trust at all" rather defining constructive trust to be "an equitable remedy that a court imposes against one who has obtained property by wrongdoing").

<sup>164</sup> *See McKey v. Paradise*, 299 U.S. 119, 122–23 (1936) (showing numerous circumstances exist where equity courts should fasten constructive trust upon property which was obtained by breach of fiduciary duties); *cf. In re Ames Dep't Stores, Inc.*, No. 02-6271, 2004 U.S. Dist. LEXIS 17575, at \*15 (S.D.N.Y. Sept. 1, 2004) (finding court cannot impose constructive trust where no fiduciary duty existed and no unjust enrichment took place); *In re Penn-Dixie Steel Corp.*, 6 B.R. 817, 825 (Bankr. S.D.N.Y. 1980) (refusing to impose constructive trust where only wrongdoing was failure to pay debt).

<sup>165</sup> *See In re Koreag, Controle et Revision S.A.*, 961 F.2d 341, 352 (2d Cir. 1992) (stating New York law requires finding of (1) confidential or fiduciary relationship; (2) an express or implied promise; (3) a transfer made in reliance on that promise; and (4) unjust enrichment).

duties between parties, a breach of those duties, and some type of fraud, actual or constructive, a court generally will not impose a constructive trust upon the property in question.<sup>166</sup> An element of uncertainty exists when trying to determine what type of wrongdoing reaches the level of necessitating a constructive trust. We know what is not enough though, because numerous courts have held that mere non-payment of a debt does not reach that level.<sup>167</sup>

How does the constructive trust theory play out in bankruptcy courts? Historically, bankruptcy courts have recognized the doctrine of constructive trust.<sup>168</sup> Bankruptcy courts generally will recognize a constructive trust if (1) parties can show that they have an equitable interest in the particular property and (2) they can trace the property back to themselves.<sup>169</sup> While these elements usually need to be shown in bankruptcy court, state property law still governs and ultimately determines whether a constructive trust may be used. Prior to 1978, the process of imposing a constructive trust in bankruptcy proceedings went fairly smoothly. But with the adoption of the Bankruptcy Reform Act of 1978 came an addition to the trustee's strong arm powers which were originally in section 70(c) of the old bankruptcy law.<sup>170</sup> Once Congress adopted section 544(a)(3)<sup>171</sup> of the new Code, much confusion amongst the bankruptcy community regarding the effect of constructive trusts began to surface.<sup>172</sup> Under section 544(a)(3), the trustee has the rights of a hypothetical bona fide purchaser of real property, trumping any unperfected interests in the property. Courts continue to fight over whether this power gives the trustee the right to reclaim the property regardless of the non-debtor spouse's interest which is said to be held in the constructive trust.

Courts have struggled to reach a definitive answer to the question of whether the trustee's strong arm powers can trump the rights of the holder of the constructive trust and bring that property into the estate.<sup>173</sup> Basically, the trustee's status as a

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<sup>166</sup> See *Penn-Dixie Steel Corp.*, 6 B.R. at 824 (generalizing definition of constructive trust and setting forth requirements for a court's finding of need for constructive trust); see also *NPF IV v. Transitional Health Servs.*, 922 F. Supp. 77, 84 (S.D. Ohio 1996) (explaining constructive trust is used by courts of equity where a breach of fiduciary duties has occurred); cf. *United States v. Paschen Contractors, Inc.*, 664 F. Supp. 298, 305–06 (N.D. Ill. 1987) (denying party's motion for constructive trust based on failure to plead existence of fiduciary duties).

<sup>167</sup> See *Penn-Dixie Steel Corp.*, 6 B.R. at 825 (holding non-payment of debt is not enough to impose constructive trust); see, e.g., *In re Cardian Mortg. Corp.*, 122 B.R. 255, 261 (Bankr. E.D. Va. 1990) (stating failure to pay debt does not give rise to constructive trust); *McKey*, 299 U.S. at 123 (indicating that failure to pay debt is not enough).

<sup>168</sup> See Ashley S. Hohimer, Note, *Constructive Trusts in Bankruptcy: Is an Equitable Interest in Property More Than Just a Claim?*, 19 BANK. DEV. J. 499, 510 (2003) (critiquing history of bankruptcy courts' treatment of constructive trust doctrine).

<sup>169</sup> *Id.* at 510–11. (citing Professor Andrew Kull's article, *Restitution in Bankruptcy: Reclamation and Constructive Trust*, 72 AM. BANK. L.J. 265, 283 (1998)).

<sup>170</sup> See *id.* at 511 (discussing Bankruptcy Act of 1898 and strong arm powers given to Trustee).

<sup>171</sup> 11 U.S.C. § 544(a)(3) (2006) (conferring powers of bona fide purchaser to Trustee).

<sup>172</sup> See Hohimer, *supra* note 168, at 512 (noting confusion that resulted from code amendment).

<sup>173</sup> See Hohimer, *supra* note 168, at 512–16 (addressing different approaches and asserting Judge Queenan's as appropriate).

bona fide purchaser under section 544(a)(3)<sup>174</sup> is at the heart of the debate. If the trustee's strong arm powers can cut off the party's equitable interest in the property regardless of the fact that it is held in a constructive trust, then the property becomes property of the estate under section 541(a) anyway.<sup>175</sup> In this case, the imposition of a constructive trust does the injured party no good. However, if the court finds that the constructive trust creates a vested pre-petition right in the property, then the trustee's powers cannot cut off that vested right. Under the second scenario, the trust works well to protect the injured party. Amassed in confusion, courts appear to be split on this topic.<sup>176</sup>

Finally, regardless of the strong arm power argument, once the court reaches a decision on that issue, it must determine if the property under the constructive trust becomes property of the estate under section 541 of the Code.<sup>177</sup> It has been the general theme that if the trustee's powers were found not to cut off the constructive trust beneficiary's rights, then the property in trust would not be brought into the estate.<sup>178</sup> The idea is that property in which the debtor does not hold an equitable interest should not be used to benefit his creditors. However, a recent case in the Bankruptcy Court for the District of Massachusetts has decided that this property does become part of the estate and the beneficiary of the constructive trust becomes a claim-holder in the bankruptcy.<sup>179</sup>

## B. *Davis v. Cox: A Recent Attempt to Quell the Unfair Results of the Earlier Cases*

### 1. Facts

*Davis v. Cox* arose from the typical fact pattern. First, Laurie Davis Cox brought suit on November 4, 1998, against her husband for divorce in Maine state court.<sup>180</sup> Subsequently, on April 5, 2000, her husband, Thomas Cox filed for chapter 13 bankruptcy relief in the U.S. Bankruptcy Court for the District of Maine.<sup>181</sup> Once Mr. Davis filed for bankruptcy, the automatic stay under section 362 took effect

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<sup>174</sup> 11 U.S.C. § 544(a)(3) (2006) (giving Trustee the status of bona fide purchaser).

<sup>175</sup> See *supra* note 82 and accompanying text.

<sup>176</sup> See Hohimer, *supra* note 168, at 515–16 (citing numerous cases indicating courts are split on issue of whether Trustee's status as bona fide purchaser can cut off party's rights in property in constructive trust). Compare *In re Mill Concepts Corp.*, 123 B.R. 938, 948 (Bankr. D. Mass. 1991) (disallowing Trustee's use of strong arm powers to avoid beneficiary's equitable interest in property) with *D & F Petroleum, Inc., v. Cascade Oil Company, Inc.*, 65 B.R. 35, 42 (Bankr. D. Kan. 1986) (finding Trustee's status as bona fide purchaser under §544(a)(3) allows him to cut off beneficiary's interest in constructive trust and bring property into estate free and clear of all other claims).

<sup>177</sup> See *supra* note 82 and accompanying text.

<sup>178</sup> Hohimer, *supra* note 168, at 508–509 (recognizing bankruptcy courts' adherence to long history of using constructive trusts).

<sup>179</sup> *CRS Stream, Inc. v. Engineering Resources, Inc.*, 225 B.R. 833, 845 (Bankr. D. Mass. 1998) (disagreeing with courts who hold property held in constructive trusts does not enter bankruptcy estate).

<sup>180</sup> See *Davis v. Cox (In re Cox)*, 356 F.3d 76, 78 (1st Cir. 2004).

<sup>181</sup> See *id.*

preventing the state court from proceeding with the divorce.<sup>182</sup> However, upon Ms. Davis's motion, the bankruptcy court lifted the stay to allow the state divorce to continue.<sup>183</sup> Eventually, the state court reached a final judgment allowing the divorce and dividing the marital property pursuant to Maine's equitable distribution statute.<sup>184</sup> In that decision, the state court awarded most of the husband's Advest Individual Retirement Account ("IRA") to Ms. Davis.<sup>185</sup> The state court also directed that money, which was being held in escrow, be used to pay the couple's taxes and other joint debts.<sup>186</sup>

When Ms. Davis requested permission from the bankruptcy court to allow her to execute the judgment on division of the marital property, the court refused, holding that the IRA which was in Cox's name became part of the bankruptcy estate under section 541.<sup>187</sup> Following an existing line of cases, the court found that the IRA became property of the estate and the wife held a general unsecured claim for the amount she was awarded by the state court in her husband's bankruptcy.<sup>188</sup> As to the money in the escrow account, the bankruptcy court allowed the disbursement of those funds pursuant to the state court order because they were found to be under a state court lien which attached before the husband filed his bankruptcy petition.<sup>189</sup> Both Ms. Davis and Mr. Cox appealed the orders of the bankruptcy court, bringing the case all the way to the First Circuit Court of Appeals.<sup>190</sup>

In reviewing the lower court opinions, the court of appeals found that Maine state law issues an injunction at the commencement of a divorce proceeding which prevents either spouse from, "transferring, encumbering, concealing, selling, or otherwise disposing of property of either or both of the parties, except in the usual course of business or for the necessities of life."<sup>191</sup> At that point, Ms. Davis filed a *lis pendens* with the county, giving notice of the divorce relative to any real estate transaction and sent a letter to Advest, the administrator of the IRA, giving notice of the state court injunction.<sup>192</sup> Sometime after the injunction was implemented, Mr. Cox was found to have withdrawn funds from both the escrow accounts and the

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<sup>182</sup> See *id.* at 80; see also *supra* note 1 and accompanying text (among other things citing to automatic stay provision in Bankruptcy Code).

<sup>183</sup> See *id.* at 80.

<sup>184</sup> See *id.*

<sup>185</sup> See *id.*

<sup>186</sup> See *id.* at 81.

<sup>187</sup> See *id.* at 81–82; see also *supra* note 83 and accompanying text (citing to distribution of estate's property provision in Bankruptcy Code).

<sup>188</sup> See *Cox*, 356 F.3d at 82.

<sup>189</sup> See *id.* The Court of Appeals found the escrow account to be held by the court in *custodia legis*, or in custody of the court. Because of this, Ms. Davis's rights were considered vested before the filing of the bankruptcy petition, keeping the funds out of the bankruptcy estate. *Id.*

<sup>190</sup> See *id.*

<sup>191</sup> *Id.* at 79; see ME. STAT. ANN. tit. 19–A, §903(1)(B)(1) (2000) ("each party is enjoined from transferring, encumbering, concealing, selling or otherwise disposing of the property of either or both of the parties, except in the usual course of business or for the necessities of life . . .").

<sup>192</sup> See *Cox*, 356 F.3d at 79.

IRA.<sup>193</sup> The value of the IRA at the commencement of the divorce was \$65,000, but when the court entered the divorce decree, its value had skyrocketed to approximately \$90,000.<sup>194</sup> When dividing up the marital property, the state court awarded \$65,250 of the IRA to Ms. Davis.<sup>195</sup> That award is the subject of much of the dispute between parties and courts in this matter. To make matters worse, both parties stipulated that under Maine law, the entire Advest IRA is exempt from the bankruptcy proceedings. Even if the court found it to become property of the estate, neither Ms. Davis nor other creditors could touch it because the retirement account is exempt under section 522 of the Code. At the end of the bankruptcy case, the account would continue to be the sole property of Mr. Davis because of this exemption.

## 2. Holding

Judge Campbell, writing for the court, showed signs that the court struggled when they came to a fork in the road. A majority of courts, with the exclusion of two bankruptcy courts, has decided this issue by way of the unfair outcome. Yet, a very slight minority of courts has imposed a constructive trust or lien on the marital property, keeping the non-debtor spouse's interests out of the bankruptcy estate.<sup>196</sup> Here, as the court noted, this Advest IRA was exempt from bankruptcy under Maine law, so if the court agreed with the majority of courts, Mr. Cox would be allowed an end run around the law, avoiding both Ms. Davis and all other creditors with respect to this property. Conceivably trying to reach a fair outcome, the court decided to follow the minority here, and boldly stated that under the theory of constructive trust, Mr. Cox held the IRA in a constructive trust for Ms. Davis.<sup>197</sup> It was under this theory that the court stated it should be kept it out of the estate under section 541(d).<sup>198</sup>

The court began its analysis by viewing Maine's equitable distribution statute.<sup>199</sup> Maine's statute sets forth three factors for the court to consider in determining

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<sup>193</sup> *See id.*

<sup>194</sup> *See id.*

<sup>195</sup> *See id.*

<sup>196</sup> *See Perry*, 131 B.R. at 767 (refusing to consider right to equitable distribution "claim" in bankruptcy); *Walston v. Walston*, 190 B.R. 66, 69–70 (E.D.N.C. 1995) (creating constructive lien in favor of non-debtor spouse).

<sup>197</sup> *See Cox*, 356 F.3d at 84 ("On the facts of this case, we conclude . . . Davis did indeed possess at bankruptcy an equitable interest in the Advest IRA . . . [under] the remedial theory of constructive trust.").

<sup>198</sup> *See id.* (holding IRA was not part of bankruptcy estate due to constructive trust theory); 11 U.S.C. § 541(d) (2006) ("Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest...becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property . . .").

<sup>199</sup> *See Cox*, 356 F.3d at 85 (revealing court's examination of Maine's statutory law, which authorized court to divide marital property as equity demanded); *see also* ME. STAT. ANN. tit. 19–A, § 953(1) (2000) (stating factors court must use in disposition of property in Maine in proceeding for divorce, legal separation, dissolution of marriage when court lacked personal jurisdiction).

equitable distribution: (1) the contribution of each spouse to the acquisition of marital property, including a contribution as homemaker, (2) the value of the property set apart to each spouse, and (3) the economic circumstances of each spouse at the time the property division will become effective.<sup>200</sup> One other concern that courts have viewed as affecting the distribution is "economic misconduct" or diminution of marital assets while the divorce is pending.<sup>201</sup> The court of appeals found that the state court made a much more in-depth look into these factors of division than the bankruptcy court. In deciding to continue on a constructive trust theory, the court of appeals stated that to disregard such a comprehensive account of the equities of the parties simply to apply strictly the Bankruptcy Code, did not make sense.<sup>202</sup> Moreover, the court seemed to dislike the idea that Mr. Cox could retain the IRA even after disregarding the injunction and illegally using the funds.

By applying the theory of constructive trust to the case, the court allowed Ms. Davis to retain her interest in the marital property notwithstanding her husband's bankruptcy. But, the court did not address a major issue. In this case, the trustee did not attempt to use his strong arm powers to cut off Ms. Davis's interest in the IRA, so the court did not address that possibility.<sup>203</sup> Since we are yet to see a court follow this opinion by imposing a constructive trust, we still do not know whether a trustee may cut off a non-debtor spouse's rights in the property held in a constructive trust with his strong arm powers. The end result here appears to be fair, something that we did not see in *Adjum*, *Perlow*, and *Polliard*. However, until new caselaw comes along, we cannot be certain how the constructive trust in domestic relations cases will affect the trustee's strong arm powers.

## VI. ANALYSIS

At first glance, we appear to be at the end of the road. A problem has been identified and a solution to that problem has been proposed and adopted by one circuit. However, *Davis v. Cox* cannot possibly be the end of the road here. While the imposition of a constructive trust was the answer in the above case, that simply was so because the trustee did not try to use his status as a bona fide purchaser or judgment lien creditor to trump the non-debtor spouse's rights and bring the property into the estate.<sup>204</sup> In addition, the First Circuit did not really address the complications that go along with applying a constructive trust theory. Generally,

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<sup>200</sup> ME. STAT. ANN. tit. 19-A, §953(1) (2000).

<sup>201</sup> See *Cox*, 356 F.3d at 84 (analyzing pattern of misconduct by husband which affected marital assets).

<sup>202</sup> *Id.* at 87 (noting disposition of marital property took into account equities between divorcing parties).

<sup>203</sup> See *id.* at 92 (distinguishing this case from others that conclude filing of petition cut-off equitable rights of debtor spouse).

<sup>204</sup> *Id.* ("[T]rustee did not attempt to avoid Davis' interest in Advest IRA and, in fact, wholly supported the award).

the state's law must first allow for a constructive trust to be created.<sup>205</sup> Almost all states' laws require some type of close relationship and actual or constructive fraud.<sup>206</sup> Here, even if we find that there is a close enough relationship for the doctrine to be used, in many of these divorce/bankruptcy proceedings, there is no fraud in the usual sense of the word. Recognizing that not all state laws require fraud,<sup>207</sup> this element will not always create a problem for the non-debtor spouse. But, one must keep in mind that the burden of proving the elements is on the non-debtor spouse.<sup>208</sup> It is contended that in many cases, the non-debtor spouse will have great difficulty meeting this burden.

To revisit an earlier topic, a great uncertainty exists as to whether courts will find that the trustee's strong arm powers may cut off the non-debtor spouse's rights to the property which is considered to be held in the constructive trust. Section 544 gives the trustee strong arm powers which enable him to defeat claims of constructive trusts in certain cases.<sup>209</sup> In non-domestic relations bankruptcy cases, many times, the trustee's status as a bona fide purchaser under section 544(a)(3) trumps the rights of the party claiming the constructive trust.<sup>210</sup> Additionally, some bankruptcy courts have refused to allow the imposition of a constructive trust where it was not imposed by state law before the filing of the bankruptcy petition.<sup>211</sup> In any event, courts are split as to whether the strong arm powers allow the trustee to trump the rights of the party in the property held in constructive trust.<sup>212</sup> This confusion adds to the assertion that the imposition of a constructive trust does not completely solve the above dilemma.

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<sup>205</sup> See *Southmark Corp. v. Grosz*, 49 F.3d 1111, 1118 (5th Cir. 1995) (looking to Texas law, which requires actual or constructive fraud, to determine if constructive trust should be imposed); Keach, *supra* note 162, at 422 (finding bankruptcy courts will only apply constructive trusts when state law would apply them, generally requiring fraud and confidential relationship); cf. *In re Kamand Constr., Inc.*, 298 B.R. 251, 255–56 (Bankr. M.D. Pa. 2003) (reverting back to state law, which requires either fraud, duress, undue influence, mistake, abuse of confidential relationship, or other such circumstances, in order to impose constructive trust).

<sup>206</sup> See *Id.* (noting under Pennsylvania law remedy meant to restore particular funds or property to true owner).

<sup>207</sup> See generally, *Kamand Constr.*, 298 B.R. at 255–56 (showing Pennsylvania's law does not require fraud in order for constructive trust to be imposed).

<sup>208</sup> See *In re Sacred Heart Hosp. of Norristown*, 175 B.R. 543, 555 (Bankr. E.D. Pa. 1994) (stating plaintiffs bear burden of establishing constructive trust by clear, precise, and unambiguous evidence).

<sup>209</sup> Brian F. Kenney, *Constructive Trusts: A Response Sections 544(a)(1) and (2) and Interests in Personalty vs. § 544(a)(3) and Interests in Real Property*, 19–10 AM. BANKR. INST. J. 10 (2001) (explaining Trustee in bankruptcy cases can many times defeat claims of constructive trusts).

<sup>210</sup> *Id.* (noting creditors who claim constructive trusts in real property generally lose to trustees under § 544(a)(3)).

<sup>211</sup> See *id.*; see also *Omegas Group Inc. v. Wilson (In re Omegas Group Inc.)*, 16 F.3d 1443, 1454 (6th Cir. 1994) (Guy, J., concurring) ("Where state law impresses property that a debtor holds with a constructive trust in favor of another, and the trust attaches prior to the petition date, the trust beneficiary normally may recover its equitable interest in the property through bankruptcy court proceedings").

<sup>212</sup> See Hohimer, *supra* note 168, at 512–13 (describing view of Seventh and Ninth Circuit Courts of Appeal because strong-arm powers are bona fide purchaser's principal defenses against claimant's equitable interest).

The biggest problem with the constructive trust theory to be used in these domestic relations bankruptcy cases is that the imposition of the trust may be viewed as adverse to the traditional goals of bankruptcy. Judge Aspen stated this idea best when he said, "[A] constructive trust is fundamentally at odds with the general goals of the bankruptcy code."<sup>213</sup> The goals that the court referred to were not so much dealing with the debtor's fresh start, but more so the idea of ratable distribution of the estate to the creditors.<sup>214</sup> By allowing the imposition of the constructive trust, as done in *Davis*, the court is basically allowing a judicial exception to the Code which the legislators did not intend.<sup>215</sup> Yes, the outcome appears to be fair to the non-debtor spouse, but under these circumstances, the rest of the creditors are hurt by the loss of the property to the bankruptcy estate. It is submitted that were the legislators to have wanted this result, they would have written a provision in the Code allowing for it.

If the imposition of a constructive trust is not the end-all answer to the dilemma at hand, then what is? It is submitted that the best way to make sure that spouses get their fair share of the marital property in divorce is for Congress to create a provision in the Code that gives the non-debtor spouse greater rights. As we have seen, public policy favors the non-debtor spouse in matters of alimony, child support, and custody.<sup>216</sup> One option would be for Congress and the courts to treat marital property division in similar way. Going one step further, Congress could amend the Code to consider a non-debtor spouse to have a fictional security interest in the property. This may seem like a stretch, but Congress has reached farther in the past. For example, shopping center landlords have special rights not afforded other landlords.<sup>217</sup> However, if affording non-debtor spouses special rights is asking too much, then possibly Congress could include marital property division judgments among the highest priority of unsecured claims under section 507(a)(1). Under that section, the hierarchy of priority claims recently shifted with the new amendments.<sup>218</sup> Now, domestic support obligations are at the top of the list.<sup>219</sup> Were

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<sup>213</sup> *In re Stotler & Co.*, 144 B.R. 385, 388 (N.D. Ill. 1992); *see, e.g., Omegas Group*, 16 F.3d at 1452 (stating that constructive trusts are the "anathema" to bankruptcy laws).

<sup>214</sup> *See Stotler*, 144 B.R. at 388 ("Imposition of a constructive trust clearly thwarts the policy of ratable distribution and should not be impressed cavalierly.").

<sup>215</sup> There is nothing in the priority rule itself or history of that rule that shows legislature intended for non-debtor spouse's to obtain a priority claim over the property in the debtor spouse's estate. *See* 11 U.S.C. § 507(a) (2006).

<sup>216</sup> Congress built in an exception to the automatic stay for these types of cases. Even so, the Federal Domestic Relations Exception applies to these cases, making sure that the proper court determines the outcome. Finally, non-conformity with alimony, child support, and custody judgments results in a criminal offense.

<sup>217</sup> *See* 11 U.S.C. § 365(b)(3) (2006) (stating shopping center lease includes adequate future performance allowing trustee to assume when default in executory contract or unexpired lease of debtor occurs).

<sup>218</sup> 11 U.S.C. § 507(a)(1) (2006), which provides:

Congress to include marital property division judgments there, the non-debtor spouse would have a better shot at getting his or her claim paid in full.

Another place in the Code where this problem may be rectified is in the discharge provision of section 523. In the current Code, domestic support obligations are not dischargeable.<sup>220</sup> Why not add marital property division judgments to the list? We have seen that under the above cases, a non-debtor spouse may be left empty-handed because his or her claim is ultimately discharged in the bankruptcy. In some cases, a spouse works hard for the life of the marriage, only to have everything swept from beneath his or her feet. By disallowing claims for marital property division to be discharged, Congress would be holding the debtor spouse liable for the past promises made to his or her spouse.

While it is nice to dream, let's get back to reality. Because a huge non-debtor spouse lobby does not exist to convince Congress of the much needed changes, we must assume that the courts are going to be left on their own on this one. The large disparity between results and conflicting opinions shows that law in this area is far from settled. Be it the case where the facts fit snugly into the hole carved out by *Davis*, imposition of a constructive trust just may be the answer. But that situation is unlikely. With time, courts may march down the constructive trust road. No doubt, parties will argue based on the First Circuit's findings in *Davis*. Courts may conceive of following those arguments and determining that the rights of the non-debtor spouse are protected against attack by the trustee. It is submitted that if this is the path that the issue takes, many hard fought days will be spent by lawyers on both sides trying to convince the bankruptcy judge that the required elements of state law constructive trust doctrine are met and that the trustee is helpless against the fictional remedy afforded the non-debtor spouse.

## VII. PROPOSED AMENDMENTS TO THE CODE

It is submitted that this problem may be corrected in two different ways. One way to create a more fair result is for the states to amend their individual equitable

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(a) The following expenses and claims have priority in the following order:

(1) First:

(A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.

*Id.*

<sup>219</sup> *Id.*

<sup>220</sup> 11 U.S.C. § 523(a)(5) (2006) ("A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt for domestic support obligations").

distribution statutes to provide for the parties' rights to vest in the property at the time that they separate. States would also have to write the statutes to explain clearly that upon the separation, each party has a separate and concrete interest in the property, even though the exact value of the interests has not been determined. This procedure would be similar to the procedure in the community property states. Because the non-debtor spouse's interest would be vested before the bankruptcy filing, the non-debtor spouse's interest would presumably not become property of the estate.

While this solution may seem possible, it would bring logistical problems as each state has a different statute and parties have different rights under each different state's law. This brings us to the more practical solution. The better and more thorough solution is for Congress to address the problem through the amendment of the Bankruptcy Code itself. In order to address properly the issue, two provisions of the Code must be amended.

First, the priorities under section 507 must be changed. Under section 507(a)(1), a provision (D) should be added that would read as such:

*(D) Allowed unsecured claims for marital property to be determined under equitable distribution that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse or former spouse on the condition that funds received under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable non-bankruptcy law.*

By adding this provision into section 507(a), the non-debtor spouse's claim will get top priority along with domestic support and child support obligations. Congress has already recognized the public policy reasons for putting domestic support and alimony at the top of the list. It is submitted that the non-debtor spouse's claim for marital property should also be there. Alimony and support are very important pieces of marital law in the United States. Some spouses and children would not survive without them. The spouses' interests in the marital property should also be included along with the domestic support and alimony as those interests may be vital to the former spouses' well being in the future, giving those spouses a chance to get back on their feet.

Second, the exceptions to discharge under section 523 should also be changed to make any claim that the non-debtor spouse has to the marital property non-dischargeable in bankruptcy. A new provision, under section 523(a)(20) should read:

§ 523 Exceptions to Discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

...

*(20) owed to a spouse or former spouse for that spouse's or former spouse's interest in the marital property which was determined pursuant to a state equitable distribution statute*

As we have seen, in many of these cases, the non-debtor spouses end up with nothing because their claim is discharged at the end of the bankruptcy case. Because the debt may be discharged, the Code provides an incentive for spouses who are facing divorce suits to file bankruptcy to get back at their husbands and wives. Revenge is not a stated purpose for the bankruptcy process in the United States. By changing the Code to obviate this incentive, less chance exists that the bankruptcy process will be abused. While the debtor may still file and the trustee may still bring the property into the estate with his strong arm powers, the non-debtor spouses will be justly compensated for their interests. This would be the more fair result.

#### CONCLUSION

People get married. Some even live happily ever after. But, unfortunately, many don't. Under the current state of the law, an incentive exists for a person being sued for divorce to file bankruptcy. The incentive is far from any of the traditional purposes for which Congress enacted the Bankruptcy Code. To continue in state court absent bankruptcy means to split the property with your spouse. Yet, to file bankruptcy means to keep that property all to yourself. Which one would most rational people choose? The year is 2006 and domestic relations bankruptcy needs a facelift. The law is treating close family members like distant acquaintances. Until we implement change, those non-debtor spouses are left rummaging through the cold leftovers when they should be seated at the head of the table in front of a steaming-hot meal.

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