THE INTERSECTION BETWEEN FAMILY LAW AND BANKRUPTCY LAW

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I. **WHAT IS BANKRUPTCY**

Bankruptcy law is statutory federal law authorized by the United States Constitution. The current bankruptcy law was first passed in 1978. The law was significantly changed in 1984, 1986, 1994 and 2005. The basics of the law, despite these changes, have remained constant. Bankruptcy, at its heart, is a set of laws designed to provide for two things:

- Equitable treatment of all creditors; and
- A fresh start for those individuals or businesses who seek its protection.

II. **BANKRUPTCY CHAPTERS**

Bankruptcy law is divided into different statutory sections called “Chapters.” Each Chapter is described below.

A. **Chapter 7-Liquidi**

Chapter 7 is what is commonly known as straight bankruptcy or liquidation. The Chapter 7 proceeding may be commenced by any person (individual, partnership, or corporation) except: (a) a railroad, (b) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, homestead association, or credit union, or (c) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such in the United States. 11 U.S.C. § 109(b).

The first time a creditor may know that its debtor is in bankruptcy is when they receive the Bankruptcy Notice in the mail. It is important for a creditor to read the bankruptcy notice from cover to cover. The notice is in small print but it contains important information such as:

- The date, time and place of the Meeting of creditors.
- The deadline to file Proofs of Claim if such a deadline has been established.
- The deadline to object to exemptions claimed by the debtor.

The primary purposes of Chapter 7 liquidation proceedings is to give individual debtors, as well as corporate debtors, an orderly method of distributing their assets to creditors in a fair and equitable manner. This is generally referred as the “equity” or “fairness” policy of the Bankruptcy Code. In addition to this equity policy, an additional purpose of a Chapter 7 is to give individual debtors a chance for a “fresh start” and an ability to begin life, in an economic sense “anew.” This policy does not apply to a corporation that is liquidating in either a Chapter 7 or liquidating through a Chapter 11 “liquidating Plan” and therefore, corporations in a Chapter 7 or in a “liquidating” Chapter 11 do not receive discharge for their debts.

In keeping with this “fresh start” policy, Congress and most states have made the policy decision that creditors should not be permitted to force liquidation of all an individual debtor’s assets.
Virtually all states protect “the clothes on the debtor’s back.” This principle of exemption of assets from the claims of creditors has created much controversy since the adoption of the Bankruptcy Reform Act of 1978.

B. **Chapter 11**

Chapter 11’s primary purpose is to allow businesses or corporations in financial distress, to continue to operate while they reorganize or restructure their debts. An individual with an exceptionally complicated financial picture can also utilize Chapter 11. The framework and functioning of a Chapter 11 is beyond the scope of these materials. The interaction of Bankruptcy law and family law is the same in a Chapter 11 case as in a Chapter 7 case except that in an individual Chapter 11, the debtor acts as his or her own Trustee.

C. **Chapter 12**

Chapter 12 is an addition to the Code specifically designed to offer relief to Family Farmers. In many of its provisions, Chapter 12 is similar to Chapter 13. Its provisions and requirements are also beyond the scope of these materials. Suffice it to say, that Congress has enacted this special provision for the debt problems of farmers. Its provisions were passed during the agricultural crisis of the 1980s but were only made permanent in 2002.

D. **Chapter 13**

Chapter 13 of the Bankruptcy Code has entitled adjustment of the debts of an individual with regular income. Its ancestor was the former Chapter XIII known as a “wage earner proceeding.”

Only individuals and sole proprietors (not corporations, partnerships and the like) are eligible to file under the protections of Chapter 13 of the Bankruptcy Code. In addition, as the title of Chapter 13 indicates, in order to successfully complete a Chapter 13 plan, the individual must have a regular source of income or otherwise be a wage earner.

Chapter 13 is utilized in situations where the debt structure of a given debtor is sufficiently low, the income is sufficiently high or the nature of the debt is such that a portion of the creditor’s debts can be paid while put on a budget as set up under a Chapter 13 Plan. If their income is high enough, debtors who file a Chapter 7 are required to convert to a case under Chapter 13, or their Chapter 7 bankruptcy will be dismissed for “abuse.” Similar to a Chapter 11 case, in some ways the Chapter 13 debtor acts as their own trustee, although there is an administrative trustee in charge of collecting money and seeing that the debtor follows through on the plan that is approved by the Bankruptcy Court.

III. **STRUCTURE AND FUNCTIONING OF BANKRUPTCY**

A. **The Estate**

The commencement of a case under any bankruptcy chapter creates an estate composed of all legal and equitable interest the debtor has in property wherever located. See 11 U.S.C. § 541(a). It includes tangible and intangible property, including causes of action, such as those for personal injuries. Importantly, the nature and extent of the debtor’s interest in specific property is
determined by reference to state law. Certain property is specifically excluded from the bankruptcy estate.

An important caveat for those spouses who file a bankruptcy and then negotiate a settlement of their marriage dissolution within 180 days of the filing of the bankruptcy. Although a court order providing for division of property of the parties during the course of either spouse’s bankruptcy is forbidden under 11 U.S.C. § 362(b)(2)(a)(iv) (see below), family courts sometimes ignore that statute. If such an order is entered, and the order grants new property to the spouse who filed bankruptcy, that new property is included in the bankruptcy estate by virtue of the “you can’t file bankruptcy to keep property you’re going to get soon” statute, 11 U.S.C. § 541(a)(5)(B). See In re Gasztold, 2011 WL 5075440 (Bankr. D. Conn.).

B. Venue

A husband and wife can file a joint bankruptcy petition or two separate petitions. 11 U.S.C. 303. Obviously, filing one petition is more cost effective. Where husbands and wives live in different states, their ability to file a joint bankruptcy petition must be carefully examined. The bankruptcy venue statute, 28 U.S.C. § 1408 states:

…a case under title 11 may be commenced in the district court for the district—

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or

(2) in which there is pending a case under title 11 concerning such person’s affiliate, general partner, or partnership.

If a married couple desires to file a joint bankruptcy petition, but they live apart (one of the spouses lives out of state) the venue provisions of 28 U.S.C. § 1408 might prevent the non-Minnesota spouse from filing a bankruptcy in Minnesota since both the husband and wife must have venue for the parties to file a joint Minnesota bankruptcy. In re Estrada, 224 B.R. 132, 136 (Bankr. S.D. Cal. 1998). However, if the largest asset of the couple is a Minnesota house, the non-party spouse might have venue in Minnesota for a bankruptcy petition under the theory that they have their “principal assets” in Minnesota.

C. The Bankruptcy Trustee

One purpose of a Chapter 7 bankruptcy is the gathering of unprotected assets (non-exempt assets) by the bankruptcy Trustee, the selling of those assets and the distribution of the proceeds to the creditors.

To assist the trustee in carrying out this purpose, the code grants to the Trustee the ability to gather together the assets of the estate, and to avoid certain transfers or liens which violate the
equity policy of the Bankruptcy Code. Thus, a Trustee is enabled with certain “avoiding powers” such as avoiding fraudulent transfers, preferential transfers and unlawful post-bankruptcy transfers. These powers are very important in connection with the assets of a bankruptcy debtor who enters bankruptcy before or during a divorce proceeding.

The avoiding powers are very powerful tools to wrest assets away from Debtors to assist the payment to the creditors. The status which §544(a) of the Bankruptcy Code confers upon the trustee in bankruptcy is that of “the ideal creditor, irreproachable and without notice, armed cap-a-pie with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings.” In re Waynesboro Motor Co., 60 F.2d 668, 669 (S.D. Miss. 1932).

1. Avoiding Unperfected Property Interests

One avoiding power of the Trustee that is sometimes involved with family law is the ability of the Trustee to avoid unperfected or unsecured property interests, including property interests that a family law court would recognize as belonging to a non-debtor spouse.

11 U.S.C. § 544:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

(b) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an
unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

2. Property of the Estate - Turnover of Retainer

The bankruptcy trustee has the authority to seek turnover of any property of the estate. 11 U.S.C. § 542. Since property of the estate consists of all property brought into the estate, this would include a retainer paid to an attorney for services rendered in any upcoming divorce action. There are three cases decided in Minnesota bankruptcy courts concerning whether the EARNED but unpaid portion of a retainer can be kept against the attack of a trustee. In re Kinderhaus Corp., 58 B.R. 94 (Bankr. D. Minn. 1984) (Judge O’Brien – yes); In re C&W Merchandising Corp. d/b/a Owatonna Lamp Comp., Minn. Bky No. 00-43588, (MN Bankr. February 6, 2002) (Judge Dreher – yes); Brick Hearth Pizza, Inc., 302 B.R. 877 (Bankr. D. Minn. 2003) (Judge Kishel – no).

3. Preferential Transfers

Under 11 U.S.C. § 547, one of the most powerful rights a bankruptcy trustee has is to seek return of any payments made to a creditor within the 90 days prior to the filing of the bankruptcy. These “preferential transfers” are subject to many defenses, such as the fact that the transfer was made in the ordinary course of business or in the ordinary course of the relationship between the debtor. The trustee, however, only has to show that the transfer was made within the applicable time period, that the debtor was insolvent at the time and that the payment was made for an antecedent debt. The defenses have to be pleaded and proved by the defendant. Unfortunately, one of the largest targets for a trustee in a divorce situation is any payment made to debtor’s divorce attorney within 90 days of the bankruptcy filing. See Christians v. Walling, Berg & Debele, P.A., In re Letourneau, Minn. Bky 08-44191, Adv. 09-4106, complaint at Dkt No. 1 (matter was settled).

4. Fraudulent Transfers

Under Bankruptcy Law, any transfer of property can be questioned by a bankruptcy trustee, who, under Section 548(a)(1)(B) of the Bankruptcy Code, has the power to seek the return of any property transferred by the debtor without reasonably equivalent value being received in return for the two years prior to the filing of the bankruptcy. A bankruptcy trustee can also “borrow” the Minnesota Fraudulent Transfers Act under 11 U.S.C. § 544(b)(1) to seek return of property
transferred for less than fair market value for *six years* prior to the filing of an action to void such transfers. Minn. Stat. § 513.44. What if one spouse stayed at home during the marriage, and then a joint bankruptcy is filed. Can a bankruptcy trustee go after all that the non-working spouse owns under the combination of Section 548 of the bankruptcy code and Minn. Stat. § 513.44?

(a) Federal law

The rules under 11 U.S.C. § 548 and Minn. Stat. 513.44 are slightly different. Any gifts given in the two years prior to the bankruptcy are going to be allowed so long as, at the time of the transfer, the debtor was solvent (so long as the transfer didn’t make the debtor insolvent). The question remains, however, whether any such transfer, even if made when solvent, falls into the other category of federal fraudulent transfer, transfers made with the “actual intent to hinder, delay or defraud” a creditor. For example, the trustee could claim that the debtor gave a gift to her spouse prior to the bankruptcy to simply maximize the couples’ exemptions with the understanding that she would be re-gifted back the property after the bankruptcy was over. The debtors’ response will likely be the completeness of the gift to the non-working spouse. Under Minnesota law, a gift must be made with donative intent whereby the transferor will have an unqualified right to keep and dispose of the gift. *Weber v. Hvass*, 626 N.W.2d 426 (Minn. App. 2001), *rev. den.* (Minn. June 27, 2001); some debtors have attempted to raise a defense that even if the transfer was made when the debtor was insolvent, such transfers were for the support of the non-working spouse and that this support was “reasonably equivalent value.” In general, such arguments have not been upheld. See *In re Bargfrede*, 117 F.3d 1078 (8th Cir. 1997) and cases therein. A slightly different argument has been more successful. Courts have sometimes allowed a pre-petition spousal transfer against a fraudulent transfer attack by bankruptcy trustees where the money was transferred to the other non-debtor spouse so that the spouse could pay ordinary, reasonable household expenses. *In re Grube*, 2011 WL 4704227 at *5 (Bankr. C.D. Ill.).

(b) State law

Under Minnesota law, if there is no question that the transfer was not to hinder, delay or defraud creditors (which also exists under Minnesota law, Minn. Stat. 513.44(a)(1)) the question of actual insolvency at the time of the gift is not part of the test for a fraudulent transfer. Instead, the focus is on whether by transferring the property the transferor intended to incur debts beyond their ability to pay as they came due, or whether the transferor believed or reasonably should have believed that the gift would cause them to incur debts that were beyond their ability to pay as they became due. Minn. Stat. § 513.44(a)(2)(ii). This is a much more subjective test and a bankruptcy trustee attempting to get back
six year worth of transfers needs to prove different things about the transfers made within two years of the bankruptcy (mere insolvency) and within six years of the beginning of the adversary action (intent to incur insolvency by the transfer).

When a party is awarded property in a divorce, can a bankruptcy trustee later question that transfer as “fraudulent?” In a recent case in the 9th Circuit, a bankruptcy debtor (ex-wife) had received $800 in property in a contested divorce case where her spouse received over $10,000 in property. The ex-wife’s bankruptcy trustee sought to void the property transfer to the husband under bankruptcy law. The award of property had been made by the family court judge where the ex-wife had failed to cooperate in discovery of her assets and the award was therefore somewhat punitive. The 9th Circuit Court of Appeals indicated that all judgments in a contested divorce case were final and, absent a showing of fraud, established “fair market value” under the circumstance of a divorce decree. Batlan v. Bledsoe, (In re Bledsoe), 569 F.3d 1106 (9th Cir. 2009); accord, Ingalls v. Erlewine (In re Erlewine), 349 F.3d 205 (5th Cir. 2003).

Similarly, in another case, 125 days prior to the debtor's Chapter 7 filing, the debtor transferred his interest in the marital residence to his estranged wife prior to the approval of the transfer by the family court. The transfer was later approved by the family court, and incorporated into the divorce decree. When the ex-husband filed bankruptcy, the bankruptcy trustee sought to avoid the transfer as a constructive fraudulent conveyance. In re Zerbo, 397 B.R. 642 (Bkrtcy.E.D.N.Y. 2008). The Bankruptcy judge deciding the case noted there was no evidence of fraud or collusion between the parties. The Court held that without such proof the divorce court's subsequent approval of the property division, because it was part of a regularly conducted marital dissolution proceeding, conclusively established "reasonably equivalent value" was exchanged between the parties. If the Bankruptcy judge could be convinced that such a transfer was made for the principal purpose of frustrating the husband’s creditors, the result could have been different. Other courts have looked behind the divorce court settlement and found constructive fraud; especially where the timing of the divorce and bankruptcy was suspicious as was certainly the Bankruptcy Trustee’s belief in Zerbo.

5. **Other Examples of Use of Avoiding Powers by Trustee to Obtain Assets**

Where a spouse has a lien on their former home as a result of a property division in family law court, if the spouse with a lien subsequently files bankruptcy the lien on his/her former homestead is not exempt property under federal law. Therefore, that lien becomes property of the bankruptcy estate (the Debtor can buy it back if they can reach a deal with the trustee). Further, if the ex-spouse who owns the home with the lien files bankruptcy, unless that lien is recorded/memorialized on the real estate title (this is automatic with abstract property, NOT with Torrens) then the bankruptcy trustee can avoid the lien and take an interest in the property to the extent of the value of the lien.
D. The Automatic Stay

The filing of a petition with the Bankruptcy Court instantaneously shields the debtor from most further acts by creditors to collect on debt owed as of that date. Filing automatically invokes the automatic stay under § 362(a) of the Bankruptcy Code. As a result, the debtor’s estate is preserved for all creditors. The stay protects both the debtor, who gets relief, and the creditors as a group, whose claims are protected against other creditors who could otherwise pursue their own remedies. It puts a stop to the typical creditor’s “race to the courthouse,” and replaces it in a Chapter 7 context with an “equitable distribution of all of the assets of the bankruptcy estate.” Unfortunately for a non-filing spouse, a Bankruptcy filing takes away the critical right of the family court to continue with a divorce action with regard to property division:

Subject to certain exceptions, actions stayed under 11 U.S.C. § 362(a) include:

1. Commencement or continuation of judicial or administrative proceedings.
2. Enforcement of a judgment;
3. Acts to obtain possession of property of the estate or from the estate or to exercise control over property of the estate. The Automatic Stay is not limited to judicial or legal attempts by a creditor to obtain the collateral securing an obligation.
4. Acts to create, perfect or enforce a lien against property of the estate or against the debtor, except for the filing of a Mechanic’s Lien.
5. Acts to recover a claim arising prior to the bankruptcy
6. Any set-off.

1. Marital Law Exceptions to the Automatic Stay

Subsection (b) of § 362 of the Bankruptcy Code provides significant exceptions to the Automatic Stay for some but not all actions concerning marital dissolution. Actions which are not stayed by the filing of a petition are:

(b) The filing of a [bankruptcy] petition...does not operate as a stay…

(2) under subsection (a)—

(A) of the commencement or continuation of a civil action or proceeding—

(i) for the establishment of paternity;
(ii) for the establishment or modification of an order for domestic support obligations;
(iii) concerning child custody or visitation;
(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) [Not Applicable];

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the Social Security Act;

(F) [Not Applicable]; or

(G) [Not Applicable];

2. **Lifting the Automatic Stay**

A creditor who desires to continue its collection action against the debtor can generally only do so if the debtor fails to make a payment or keep a promise made after the filing of the bankruptcy (for failing to make a payment that comes due post-petition on a car or home, for example). The debts that accrued based on the obligations arising before the filing of the bankruptcy are handled in the bankruptcy process. If the creditor can show “cause,” they can go into Bankruptcy Court and file a Motion to Lift the Automatic Stay pursuant to Section 362(d) of the Bankruptcy Code. A

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1 An object lesson in the protection by the bankruptcy court of its turf concerning the ability to determine property rights, *see In re Charlton*, 389 B.R. 97 (Bankr. N.D. Ca. 2008).

1 Husband buys a painting that the parties stipulate is legally owned by the husband.

2 The parties file for divorce.

3 Prior to the completion of the divorce, the husband files bankruptcy.

4 The wife claims a 1/2 interest in the Chagal painting in the bankruptcy case claiming she has an equitable interest in the painting.

5 The bankruptcy court awards the painting to the husband’s bankruptcy estate.

6 The family court issues orders in the divorce case that essentially try to retroactively grant a final interest in the Chagal painting to the wife.

7 The Bankruptcy court issues an order that essentially says to the family court “you must be joking” and reaffirms its prior holding.
Motion to Lift the Automatic Stay takes approximately 30 days to accomplish.

Cause may include lack of “adequate protection” of an interest in the property of the parties seeking the relief, or with respect to a stay of an act against the property, where the debtor has no equity in the property and the property is not necessary to affect reorganization. (See 11 U.S.C. § 362(d)). However, if one spouse files for bankruptcy in the middle of a divorce, the other spouse cannot lift the automatic stay to allow the divorce to proceed with regard to property division. Although it is possible for the other portions of the divorce to go forward, whether a state court judge would or could do so depends on the judge and the circumstances in the case. The spouse’s relief with regard to property division is to seek abstention (See, In re Jacobs, 2010 Bankr. LEXIS 2737 (Case No. 10-12785) (Bankr. S. Dist. Ohio 2010) – abstention doctrine invoked to allow the lifting of the automation stay to allow divorce court to consider proper division of property after debtor failed to comply with property payments to ex-spouse pursuant to a dissolution proceeding. See generally, Thomas H. Dobbs, Note, The Domestic Relations Exception is Narrowed After Ankenbrandt v. Richards, 28 WAKE FOREST L. REV. 1137, 1137-38 (1993)). If the Bankruptcy Court refuses to abstain then the state court judge must wait to divide property until after the bankruptcy is completed.

E. Discharge of Debts

1. Pre-Petition Debts Discharged

The filing of a bankruptcy petition is designed to result in a discharge of most of the debts the person filing bankruptcy (the “debtor”) lists on their bankruptcy schedules. Approximately 30 days after the bankruptcy petition and schedules are filed, a meeting (called “The First Meeting of creditors” or a “341 meeting”) is held where any creditor can attend and ask questions concerning the Plan. The Chapter 7 341 meetings are held St. Paul, Minneapolis, Mankato, Rochester, St. Cloud, Fergus Falls and Duluth.

Normally, a Chapter 7 debtor can expect to receive a “discharge” order exactly 90 days after he files bankruptcy unless the Trustee or creditor files an objection to discharge prior to that time. A discharge is a Court Order that says the debtor doesn’t have to repay their debts, but there are a number of exceptions. (See below.)

The discharge voids any judgment obtained at any time to the extent that the judgment determines the personal liability of the debtor with respect to the discharged debt. The discharge also operates as an injunction (the violation of which may be punishable by contempt) against action of any kind to collect, recover or off-set a discharged debt as a personal liability of the debtor, or to recover that debt from the property of the debtor. Accordingly, all collection efforts regarding a discharged debt are prohibited by this injunction. (See 11 U.S.C. § 524).
2. **Exceptions to Discharge**

The most important non-marital exceptions to the Discharge Order are:

(1) The debtor, with intent to hinder or defraud, has transferred or destroyed his or her property or has allowed someone else to do so. *(See 11 U.S.C. § 727(a)(2));*

(2) The debtor has destroyed, falsified or failed to keep records regarding the debtor’s financial condition or business transactions, unless such failure was justified under all of the circumstances. *(See 11 U.S.C. § 727(a)(3));*

(3) The debtor knowingly and fraudulently, in connection with his or her case, made a false oath, used a false claim, or offered to give or receive a bribe, or withheld records from an officer of the estate. *(See 11 U.S.C. § 727(a)(4));*

(4) The debtor fails to satisfactorily explain any loss of assets necessary to meet the debtor’s liabilities. *(See 11 U.S.C. § 727(a)(5));*

(5) The debtor has been granted a discharge under a Chapter 7 or Chapter 11 case which was commenced within eight years before the date of the filing of the present petition. *(See 11 U.S.C. § 727(a)(8));*

(6) The debtor has been granted a discharge under Chapter 13 within certain periods. *(See 11 U.S.C. § 727(a)(9));*

3. **Dischargeability of Family Law-Related Debts in Chapter 7 Cases**

Although the debtor may be granted a discharge, 11 U.S.C. § 523 of the Code provides that certain types of debts are non-dischargeable and remain liabilities of the debtor after the close of the case. The marital “exceptions to discharge” are found in Section 523(a)(5) and (a)(15).

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b)\(^2\) of this title does not discharge an individual debtor from any debt—

   (5) for a domestic support obligation [see definition below];

\(^2\) See Section IV.D. with regard to discharge of family law obligations in a Chapter 13.
(15) to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit;

(1) ... the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.\(^3\)

11 U.S.C. § 101(14A) defines what a “domestic support obligation” is: (a) a debt owed to or recoverable by a spouse, former spouse, or child of a debtor or such child's parent, legal guardian, or responsible relative, or a governmental unit; (b) in the nature of alimony, maintenance, or support of such spouse, former spouse or child, without regard to whether such debt is expressly so designated; (c) established under a separation agreement, divorce decree or property settlement agreement, or an order of a court of record; and (d) not assigned other than for collection purposes.

One issue with the definition of “domestic support obligation” is that if a husband is the sole obligor of a debt (credit card debt or attorneys’ fees, for example) that the wife agrees in the divorce decree to undertake to pay in the divorce, the portion of the divorce order that provides for this is not a “domestic support obligation” since the court would be ordering the husband to pay a debt that is not owed to the former spouse, but is owed to the creditor. Therefore, if the wife files bankruptcy there is an argument that her obligation to pay the creditor is discharged. However, even under pre-BAPCA law (that is, prior to various vesting dates of BAPCPA in 2005), obligations to pay the other’s spouse’s debt were found in several court cases to be “contingent debts” of the non-bankruptcy filing spouse and were dischargeable. Some Courts have continued to protect ex-...

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\(^3\) Non-pertinent portions omitted. This section is important to spouses or former spouses of bankruptcy debtors as it does not require a non-debtor spouse or ex-spouse to bring an action (which can be done in either federal court or state court) to determine a debt non-dischargeable within the time limit specified (actually just hinted at) in Section 523(c)(1). There is no time limit, except perhaps any applicable statute of limitations, which may or may not be applicable under state family law rules, to seeking to have a marital obligation declared non-dischargeable. If the bankruptcy case of the filing spouse is closed, however, it will be necessary to re-open that bankruptcy case if the non-debtor ex-spouse wants the bankruptcy court to rule on the issue.
spouses in this manner even in lieu of indemnification language. See In re Howard v. Howard, 336 S.W. 3d 433 (Ky. 2011); accord In re Georgi, 459 B.R. 716 (Bankr. E.D. WI 2011). Despite these rulings, the best approach to make sure that you don’t have to fight about the definition of “domestic support obligation” in your client’s ex-spouse’s bankruptcy is to include language that indemnifies the husband from the wife’s obligation to pay off the husband’s debts, or vice-versa. The domestic support obligation section of the Bankruptcy Code makes it clear that the order to pay the debt is also an order indemnifying the non-filing spouse from any non-payment. The indemnification is a debt owed to a former spouse and therefore the obligation to pay the debt is non-dischargeable as a “domestic support obligation.” See, Fast v. Fast, 266 N.W.2d 47 (Minn. App. 2009). Accord, In re Andrews, 434 B.R. 541 (Bankr. W. Dist. Ark. 2010) – collected cases at 550-51.

Note that if the state court acts first and completes the divorce, all child support, maintenance AND property decisions are recognized by the bankruptcy court and held to be non-dischargeable in a Chapter 7 case. Troubles remain, however, if the divorce has not yet started or is in process when one of the two parties to the divorce file bankruptcy. Chapter 13 cases also have different dischargeability rules.


One of the most important powers an ex-spouse has to go after their ex-spouse AFTER that ex-spouse has filed bankruptcy and received a discharge from their debts is a little-used and not well-understood section of the bankruptcy code, 11 U.S.C. § 522(c)(1). That section of the bankruptcy code says that all exempt property that the debtor gets to keep despite filing bankruptcy is still exempt against any debts that the debtor incurs AFTER they get discharged from bankruptcy EXCEPT for domestic support obligations (child support and spousal maintenance). This means that a spouse owned back child support or spousal maintenance (but not property awards) from a divorce can, for example, seek to sell their ex-spouses’ home out from under him or her after he or she emerges from bankruptcy, even if the amount of equity in the homestead is below the state maximum ($360,000 as of 2010). See Rupp v. Elmasri (In re Elmasri), 369 BR. 96 (Bankr E.D.N.Y. 2007) (reading § 522(c)(1), (c)(2) and (f)(1)(A) together, court allowed non-dischargeable domestic support claim to be paid from proceeds of exempt homestead).

4 One possible example: “Petitioner shall indemnify and hold respondent harmless from any obligation to make payment of any obligation listed in paragraph ___ as well as paying to respondent any reasonable attorneys’ fees and costs incurred in obtaining said indemnification.”

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5. **Filing A Proof Of Claim.**

In order to participate as a creditor in a bankruptcy, a Proof of Claim must be filed with the Bankruptcy Court. However, in most Chapter 7 cases no Proofs of Claim will be included with the notice of filing bankruptcy and the case will proceed as a “no asset” bankruptcy where no one will file a Proof of Claim because most bankruptcy petitions on their face show no funds will be available to pay creditors. If this changes, the creditors are notified, provided a copy of Proofs of Claim to file, and instructed on the time limits that apply (120 days is the non-governmental deadline for filing a proof of claim). If a non-filing soon-to-be divorced spouse is limited to a claim as an unsecured creditor in a bankruptcy court, they will generally receive nothing.

IV. **CHAPTER 13**

A. **Differences between Chapter 7 and Chapter 13**

In a Chapter 13 proceeding, an individual repays all or a percentage of his or her debts over a maximum period of five (5) years, during which time the court stays any action by a creditor to collect on a debt, such as wage garnishment, car repossession, or mortgage foreclosure. A Chapter 13 Plan is appropriate for persons who want to pay off all or part of their debts and have the financial ability to do so over an extended period of time. Under BAPCPA, those individuals who fail the “Means Test” may be forced into a Chapter 13. A discharge is obtained for any debts not paid off during the repayment period after the completion of the Plan, again, subject to certain exceptions.

B. **The Importance of the Chapter 13 Plan**

In a Chapter 13 case, the debtor files a Plan and must get the Plan approved by the Bankruptcy Court at a Confirmation Hearing. Many Chapter 13 Plans are poorly written. The provisions of a Chapter 13 Plan need to be examined to make sure that the non-filing spouse is receiving his or her due and that the Plan conforms to the Bankruptcy Code and applicable Local and National Bankruptcy Rules.

If the non-filing spouse does not participate in the process, often their rights will be waived or at least compromised. Consider the instructive but highly complicated case of *In re Burnett.*

In *In re Burnett,* 646 F.3d 575 (8th Cir. 2011) The 8th Circuit was faced a slew of unusual facts. The Bankruptcy Court confirmed a chapter 13 plan that provided for payment in full of child support but not payment of spousal maintenance (despite the fact that 11 U.S.C. § 1322 requires spousal maintenance claims to be paid in full during the course of a chapter 13 plan) where the ex-spouse did not object to the plan. The plan provided that the amount of interest on pre-petition child support could be determined, post-discharge, by the family law court! The debtor made certain payments under his plan, but not all of the child support obligations to his ex-spouse. Nevertheless, despite the admonition that a debtor not receive any discharge of their debts if their domestic support obligations remain unpaid (11 U.S.C. § 1328(a)), the debtor received a discharge of his other debts, but not the domestic support obligation (very curious). Post-
discharge, the family court made three rulings. The family court found the amount of the pre-bankruptcy child support interest and awarded a judgment for the unpaid interest. Secondly, the family court found that the debtor owed back spousal maintenance with interest. Thirdly, the family court awarded judgment for interest on the unpaid post-petition child support that the debtor had not paid during the course of the bankruptcy. The Debtor went back to the bankruptcy court and cried foul. The case went through various holdings in the Bankruptcy Court and the BAP. The 8th Circuit finally held that the order of the family court ordering pre-petition child support interest was within the court’s jurisdiction per the confirmed plan. The Court held that the family court’s award of a judgment for spousal maintenance violated 11 U.S.C. § 1327(a) which says that a confirmed plan is res judicata. The 8th Circuit’s ruling, in line with the U.S. Supreme Court’s holding in United Student Aid Funds, Inc. v. Espinosa, ___ U.S. ___, 130 S.Ct. 1367 (2010) was that 11 U.S.C. § 1327(a)’s res judicata effect trumped any portion of the plan that violated another provision of the bankruptcy code (such as not paying your past due maintenance claims in full during the course of the plan). The Court further found that the bankruptcy court had no jurisdiction over the post-confirmation judgment against the debtor for interest on post-petition child support payments that the debtor had just finished not paying during the course of his bankruptcy plan.

C. Filing of Proof of Claim in Chapter 13 Case

The Proof of Claim for a Chapter 13 Tenant/debtor is attached with the first notice a creditor receives from the Bankruptcy Court announcing the filing. The creditor must file a Proof of Claim within 120 days after the petition was filed or the proof of claim may not be honored.

D. Non-Debtor Ex-Spouse Rights in Chapter 13 Cases

In a Chapter 7, most "divorce related debts" are now non-dischargeable under Sections (523(a)(5) and (15) of the Bankruptcy Code (see section3.D.). However, in a Chapter 13, only domestic support obligations (orders for maintenance or child support) are non-dischargeable. Property awards or promises related to property awards, such as promises to pay off the joint debt of the parties, are dischargeable. The technical legal reason for this is that a discharge in Chapter 13 bankruptcies are governed by § 1328(a)(2) which lists certain subsections of 523(a)(exceptions to discharge) that are applicable in a Chapter 13. § 523(a)(5) is listed. § 523(a)(15) is not listed. Unfortunately, § 523(a) itself provides that §523(a)(15) debts are not discharged in a Chapter 13, and therefore the two statutes appear to conflict. The more specific section in § 1328(a)(2) should be given effect by the court. In re Bateman, 331 F. 3d 821, 826 (11th Cir. 2003).

Whether a particular debt is a support obligation or part of a property settlement is a question of federal bankruptcy law, not state law. A divorce decree's characterization of an award as maintenance or alimony does not bind a bankruptcy court but is however a starting point for the determination of the award's intended function. The burden of proof under § 523(a)(5) is on the

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5 The technical legal reason for this is that a discharge in Chapter 13 bankruptcies are governed by § 1328(a)(2) which lists certain subsections of 523(a)(exceptions to discharge) that are applicable in a Chapter 13. § 523(a)(5) is listed. § 523(a)(15) is not listed. Unfortunately, § 523(a) itself provides that §523(a)(15) debts are not discharged in a Chapter 13, and therefore the two statutes appear to conflict. The more specific section in § 1328(a)(2) should be given effect by the court. In re Bateman, 331 F. 3d 821, 826 (11th Cir. 2003).
party asserting that the debt is nondischargeable. *In re Phegley*, 443 B.R. 154 (8th Cir. BAP 2011), citations omitted.

Note that if the bankruptcy filing spouse promises to pay off ALL the debt, the non-debtor spouse is protected by a co-debtor stay (the creditors cannot go after the non-bankruptcy filing spouse), if not, they’re not.

One unanswered question is how a property lien awarded in a divorce will be treated in a Chapter 13 bankruptcy. Many Chapter 13 plans provide that liens on secured property are dissolved once the amount of the value of the secured debt is paid. For example, if a car is worth $5,000 and the loan on the car is $10,000 a Chapter 13 plan will often provide that once the Chapter 13 plan pays $5,000 (plus interest) on the car that the lien from the lender on the car is dissolved and the car is owned free and clear. However the lien on the car is not a judicially created lien which are treated differently.

Take this hypothetical: Husband is bound in a divorce decree to pay off joint credit cards in the amount of $50,000.00; the obligation is secured on a piece of real property the husband owns that is worth $25,000. The husband files chapter 13. In connection with a Chapter 13 plan, the husband proposes to pay 50% of his debts off in the chapter 13 plan and asks that at the end of the case that the lien on the real property he owns that is encumbered by the credit card debt be dissolved. If this was allowed, wife would be stuck with the remaining $25,000 in credit card debt and her ability to foreclose on the husband’s real property would be gone. On the other hand, if *Farrey v. Sanderfoot* (see below) is applied to forbid the dissolution of the underlying lien, the wife would be able to keep the lien on the real estate, but not foreclose upon it because the underlying debt had been discharged. The only way wife gets paid in that scenario is when the husband sells the real estate. No court that I know of has answered this question, however, I’m betting *Farrey v. Sanderfoot* would apply.

### E. **Section 1307(c) 11**

In connection with a Chapter 13 plan filed by a former spouse where a domestic support obligation is ordered, under Section 1307(c)(11), the debtor could diligently make all payments under the Chapter 13 plan and still not get his discharge if that debtor has fallen behind on payment obligations under the domestic support order. The debtor must certify to the bankruptcy court at the end of the payment plan that they are current on post-petition domestic support obligations or the court will not enter the discharge order.

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6 For those bankruptcy practitioners reviewing these materials, this example ignores the implications of the “910 car” section of BAPCPA.

7 One court, without mentioning, or apparently thinking about the application of *Farrey v. Sanderfoot* has indicated that the underlying lien (which was on non-homestead property) is stripped off under 11 U.S.C. 506 when the value of the property leaves the lien wholly unsecured (assuming later completion of the plan), even if that amount paid to the debtor is less than payment in full. *In re Rosa*, 2011 WL 6257305 (Bankr. M.D. Fla).
F. Misc. Family Law Chapter 13 Issues

What happens if a married couple files a Chapter 13, a plan is approved and then the couple separates or enters into divorce proceedings? The bankruptcy court, rather than the family law court, is the ultimate arbiter of what will happen in the already-filed bankruptcy. Every jointly filed bankruptcy case is actually two individual cases joined together (in Minnesota the two cases are “substantively consolidated” by rule upon the filing. 8) Both parties are equally responsible for payment of the joint Chapter 13 plan. The bankruptcy system doesn't know or care who makes the payments or where the payments come from on an on-going basis in a jointly filed case. In case of separation or divorce, assuming some sort of agreement between the parties (or even some sort of order from the family court) concerning who has to make what portion of the Chapter 13 payments, a failure of either party to make their portion of the payment can be the cause of the joint Chapter 13 plan to fail for both parties. The only way to prevent a separated or divorced couple from having the other party keep from having "their" chapter 13 plan to fail is to apply to the bankruptcy court to separate the two bankruptcy estates and either have each individual file their own chapter 13 plan or convert their case to a chapter 7 case. In the case of an application for separation of the two bankruptcy estates, both parties would have to have separate bankruptcy counsel different than the counsel who filed the original action (actually, there are some bankruptcy lawyers who would continue to try to represent both parties but I believe that would be malpractice).

V. BANKRUPTCY FILINGS AND FAMILY LAW DECREES

A. Exemptions

When someone files a chapter 7 bankruptcy, that debtor does not have to turn over all of their property to their bankruptcy trustee. In order to provide that bankruptcy debtor with a fresh start, laws in all 50 states and the federal bankruptcy law itself provides that a certain amount of property does not have to be turned over to pay the debts of creditors. This pile of property that a debtor can keep is called “exempt property.” The pile of property that has to be turned over to the trustee, that is not covered by any legal exemption, is called “non-exempt” property. In Minnesota, as opposed to many other states, when someone files bankruptcy they can choose to use either Minnesota exemptions or federal exemptions. There are several differences between the Minnesota exemptions and the federal exemptions. For people who file bankruptcy who are owed money from a divorce decree, there are three principal issues, back due child support, back due property settlements and back due maintenance awards. Note that the assets being talked about here are sums of money owed to the Chapter 7 bankruptcy debtor as of the date of filing. The money that comes due after filing bankruptcy generally is not attacked by the bankruptcy trustee, however it is not absolutely safe for reasons that are beyond the scope of this outline.

1. Treatment of Child Support Payments Owed to the debtor in Bankruptcy

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8 See Section VI. C. 2. for more information on substantive consolidation.
Under both Minnesota law and federal exemptions available under the bankruptcy code, child support is protected in varying degrees as exempt property.

Minn. Stat. § 550.37 subd. 15 provides an exemption for all unpaid child support due to the bankrupt debtor.

11 U.S.C. § 522(d)(10)(D) provides an exemption for past due child support “in an amount reasonably necessary for the support of the debtor.” If the debtor chooses federal exemptions and is owed a large amount of past-due child support, the Chapter 7 bankruptcy trustee could argue that some of that amount is in excess of the amount necessary for the support of the debtor and seek to have a portion of the past-due amount paid into the debtor’s bankruptcy estate.

2. Treatment of Property Settlements Owed to the Debtor in Bankruptcy

If a debtor in bankruptcy is owed money by their ex-spouse on a property settlement, there is no exemption for such an award under either federal law or Minnesota law. The exempting of this property would have to be done under other available bankruptcy exemptions. There is no Minnesota exemption that covers a property settlement granted in a divorce, however, federal exemptions provide for a “wild card” exemption for certain amounts of personal property. 11 U.S.C. § 522(d)(5). The Wild Card exemption ranges from a minimum of $1,075 and a maximum of $11,200, based upon how much equity is in the debtor’s homestead (the more equity, the less “Wild Card” exemption is available).

3. Treatment of Maintenance Awards Owed to the Debtor in Bankruptcy

Federal Exemptions: Under Federal law, the amount of past-due alimony that can be exempted is the same as for child support, that is, 11 U.S.C. § 522(d)(10)(D) provides an exemption for past due alimony/maintenance “in an amount reasonably necessary for the support of the debtor.”

Minnesota Exemptions: Finding the laws that provide an exemption for maintenance/alimony under Minnesota law is hard work. Start with Minn. Stat. § 550.37, Subd. 13. “Earnings.” [The following property is exempt from collection for debts]. “All earnings not subject to garnishment by the provisions of section 571.922.” In 1998 the garnishment laws changed and under Minn. Stat. § 571.921 Subd. 3, the definition of “earnings” was amended to include maintenance awards as further defined in Minn. Stat. § 518.003, subd. 3a. [“Maintenance” means an award made in a dissolution or legal separation proceeding of payments from the future income or earnings of one spouse for the support and maintenance of the other.”] In putting all of these statutes together, maintenance awards are “earnings” which are protected from garnishment up to 75%. This exemption follows any maintenance award into any bank account but only for 20 days. There is a case decided in 1989, before the law was changed that said that maintenance awards are garnishable in full. Last v. Last, 438 N.W.2d 122 (Minn. App. 1989). Last is no longer good law in light of the 1999 statuary change in the definition of “earnings”.

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VI. PROPERTY RIGHTS IN BANKRUPTCY OF A NON-BANKRUPT SPOUSE

A. Use of State Property Law in Bankruptcy-in General

In general, bankruptcy law looks to the applicable state law to decide property rights. *Butner v. United States*, 440 U.S. 48, 55 (1979). What that means is dependent on the question that is asked.

B. Liability of a Spouse for the Other’s Debts under Minnesota Law

In Minnesota, until 1897, by statute, husbands were responsible for their wife’s torts and for most of the 20th century a married man was responsible for all the “necessaries of life” contracted by their wife. This statute was changed in 1980 to make both spouses liable for each other’s necessaries of life and later reformed to only have them be responsible for each other’s medical expenses (Minn.Stat. § 519.05.) This fascinating codification of the common law and the changes to the statute over the years to take into account the increasing awareness of women’s equal right to personhood has never been challenged in Minnesota that I know of for the basic constitutional principal that one person can’t contract away another person’s rights merely because of their relationship. In *North Ottawa Community Hospital v Barbara Kieft*, 457 Mich. 394, 578 N.W.2d 267 (1998), the Michigan Supreme Court abrogated the common-law doctrine of necessaries and held that neither a husband nor a wife is liable, absent express agreement, for necessaries supplied to the other. The Michigan Court of Appeals had previously held in *Borgess Medical Center v Smith*, 149 Mich App 796 (1986), and *Bronson Methodist Hospital v LaRoy*, 171 Mich App 729 (1988), that a spouse, solely by virtue of being married, was liable to third parties for necessaries of the other, including medical expenses. The Michigan Supreme Court overruled those cases, reasoning that a wife's liability for her husband's expenses was barred by the Married Woman's Property Act (an old law that provided women can contract for the right to own property), that the Act was constitutional, and that it would violate equal protection to hold husbands liable for such expenses of their wives and not hold wives liable for such expenses of their husbands. The Court determined that the common-law necessaries doctrine violates equal protection principles and that the appropriate remedy for this unconstitutionality is to abrogate the doctrine in its entirety, thus holding that neither husband nor wife is liable, absent express agreement, for necessaries supplied to the other.

Despite the fact that Minn. Stat. § 519.05 might be unconstitutional, if one spouse files an individual bankruptcy, they should list the unpaid medical bills of their spouse that they may be liable for under that statute.

C. Ownership of Property Prior to the Start of a Divorce

The ownership of property is an endlessly fascinating subject. There is a lot of scholarship on theoretical models of ownership of property in a functioning marriage\(^9\) and how the law should

\(^9\) By “functioning” I mean a marriage where no divorce or separation action has been started.
treat property purchased by both spouses during the course of a marriage, but there isn’t any agreement by either state courts or bankruptcy courts on all of this scholarship. The truth is, in the vast majority of cases, in a functioning marriage, until someone outside the marriage asks the question, no one really can say who owns the family dog or the swing set or the lawn mower. One suspects that this is one of the reasons why such a marriage is deemed to be functioning.

Spouses can buy goods individually and have the world recognize that that item is owned by them. Goods with titles are great examples of this. A married couple can buy a car and title it in one or the other spouse’s name. That spouse can sell that car without the other spouse’s permission.

Further, a married couple, even a couple with only one income, can agree between themselves that all the money earned goes into a common pot, accessible by either spouse and that they both own the earnings. Conversely, where one of the spouses is the only spouse who works outside the home, that spouse can deposit their paycheck in an account that their spouse has no access to, nor are they legally required to share those funds with the spouse. If the non-earning spouse doesn’t like the way the earning spouse is handling their finances, the only LEGAL recourse is divorce.

Finally, even if funds are not shared between a married couple, that couple can agree that when they spend their money that the things that they buy are owned jointly with their spouse or belong to the family. The list of such goods is endless but might include furniture, pets, household items and food. The act of purchasing goods that others may share in the ownership of changes the ownership of the goods from sole ownership to joint ownership. One scholar has dubbed this process “transmutation.”

For many years, under Minnesota case law, if an individual put their earnings into a joint checking account, the law would presume that they intended to “transmute” the ownership of those funds jointly to any joint fund holder. Park Enterprises v. Trach, 233 Minn. 467, 47 N.W.2d 194 (1951). However, the Minnesota Supreme Court, in a surprising decision, changed that presumption and found that no such presumption occurs. Enright v. Lehmann, 735 N.W.2d 326 (Minn. 2007). In Enright, the husband owed a debt, but the only funds deposited in the couple’s joint checking account were earned by Mrs. Enright. A creditor of the husband garnished the couple’s joint account. In disallowing the garnishment, the Supreme Court found that a creditor trying to garnish a joint bank account must prove that the funds that they are garnishing belong to the garnishee. 735 N.W. 2d at 334-335. See also, Smith v. State, 389 N.W. 2d 543 (1986) explaining this presumption is in keeping with the Minnesota Multi-Party Accounts Act, Minn. Stat Section 528.04(a) (1984).

There are other examples of this presumption in state law. For example, under the laws of Minnesota and presumably most if not all states, a wife cannot be held accountable for the debts of her husband and vice-versa. Cf., Kipp v. Sweno, supra.

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State law therefore seems to emphasize the economic contribution of an individual in determining who owns that property. Anyone seeking to overcome the presumption between two married persons that whoever earned the money owns that money and the goods purchased by those funds has the burden to prove that those funds or goods were meant to be owned by the other individual or the family as a whole. As mentioned, this is a very messy area and not very well understood.

D. Interpretation of State Property Laws by Bankruptcy Courts

1. Joint Bankruptcy Filings

So what is a bankruptcy court do with this mess of individual rights, transmuted property and joint ownership when a married couple files bankruptcy? In order to further analyze the rights of married individuals in bankruptcy court, it is important to understand the concept of the "bankruptcy estate." Under state law, each individual person has their own assets, whether owned individually, or in some form of joint or common ownership with other people. Because each individual is a separate legal entity, each person can make their own decision to file bankruptcy. Married couples do not have to file bankruptcy together. If a married couple does file bankruptcy together they can file one bankruptcy petition under 11 U.S.C. § 302. The chief advantage of this is the ability of the couple to pay one filing fee and one legal fee. In addition, in Minnesota, for most purposes, a married couple's separate bankruptcy estates are joined together in a process called "consolidation" or "substantive consolidation."

2. Substantive Consolidation

Substantive consolidation essentially merges together the assets of both couples and allows the bankruptcy court to pay the creditors of both couples on a pro rata basis, unless the court orders otherwise. This means that in a jointly filed bankruptcy, if the husband has all of the assets and very few debts, and the wife has most of the debts and no assets, the husband’s debts will be paid off in the same proportion as the wife’s debts, even though if the husband did not file bankruptcy the husband’s creditors would be paid in full and the wife’s creditors would have received nothing.

3. The Confusing Issue of Who Owns What in Bankruptcy Court

11 See Section III.A.

12 (a) A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual’s spouse. The commencement of a joint case under a chapter of this title constitutes an order for relief under such chapter. (b) After the commencement of a joint case, the court shall determine the extent, if any, to which the debtors’ estates shall be consolidated. 11 U.S. C. § 302, Minnesota Bankruptcy Local.

13 RULE 1015-1. JOINT ADMINISTRATION/CONSOLIDATION Unless ordered otherwise, the estates of the debtors in a joint case filed under §302 of the Code are consolidated for all purposes and shall be jointly administered.
Minnesota law clearly provides that a spouse at some point during a divorce gains in interest interest in all marital property. Minn. Stat. § 518.003 Subd. 3b.

**Marital property; exceptions.** "Marital property" means property, real or personal, including vested public or private pension plan benefits or rights, acquired by the parties, or either of them, to a dissolution, legal separation, or annulment proceeding at any time during the existence of the marriage relation between them, or at any time during which the parties were living together as husband and wife under a purported marriage relationship which is annulled in an annulment proceeding, but prior to the date of valuation under section 518.58, subdivision 1. All property acquired by either spouse subsequent to the marriage and before the valuation date is presumed to be marital property regardless of whether title is held individually or by the spouses in a form of co-ownership such as joint tenancy, tenancy in common, tenancy by the entirety, or community property. Each spouse shall be deemed to have a common ownership in marital property that vests not later than the time of the entry of the decree in a proceeding for dissolution or annulment. The extent of the vested interest shall be determined and made final by the court pursuant to section 518. If a title interest in real property is held individually by only one spouse, the interest in the real property of the non-titled spouse is not subject to claims of creditors or judgment or tax liens until the time of entry of the decree awarding an interest to the non-titled spouse. The presumption of marital property is overcome by a showing that the property is nonmarital property.

However, this law does not apply to determine who owns what in a bankruptcy case unless a dissolution of marriage proceeding has already begun prior to the time of the bankruptcy (and perhaps not even then, see *In re Johnson*, below).

Bankruptcy courts have been far from consistent in ruling on the issue of who owns what and who gets to keep what in a bankruptcy. Consider the case of *In re Carlson*. Where no divorce had been started, a couple filed a joint bankruptcy where the husband was the sole contributor of income. Shortly prior to filing the bankruptcy the couple had received a tax refund on their joint tax return. The couple deposited the refund check in their joint checking account and declared bankruptcy. The couple asserted on their bankruptcy schedules that they each owned 1/2 of the tax return. This was important because if the return belonged to each spouse 50/50, they would be able to keep all of it by “exempting” all of the tax return. The bankruptcy trustee objected to the wife’s exemption and argued that the entire tax refund belonged to the husband as only his withholding led to the refund. The debtor’s attorney argued that Minnesota divorce law provides that the non-earning spouse held a equitable interest in her husband’s property. The bankruptcy judge and the 8th Circuit Bankruptcy Appellate Panel (a panel of three bankruptcy judges from different states in the same federal circuit acting as an intermediate appeals court between the bankruptcy court and the Circuit Court of Appeals) ruled that the marital dissolution “marital property” theory of equitable ownership is not a concept recognized in bankruptcy court and that therefore the whole tax return belonged to the husband. *In re Carlson* (*Carlson v. Moratzka*), 394 B.R. 491 (8th Cir. BAP 2008). The result of *Carlson* was that 1/2 of the tax refund was deemed to be non-exempt and the funds were used to pay the couple’s creditors. The Minnesota Supreme Court agrees that the concept of jointly owned “marital property” is not a concept that can be

The *Carlson* case did not cite but followed the holding of case of *In re Johnson,* 210 B.R. 153 (Minn. Bankr. 1997), where Minnesota Bankruptcy Judge Robert Kressel found the same thing, that the marital property concept of “equitable ownership” does not have a place in bankruptcy court unless the parties are actually in the middle of a divorce before one of them files for bankruptcy. Judge Kressel pointed out (but the BAP in *Carlson* did not) that actual ownership of items titled in an individual’s name could be overcome by proof of common ownership (the converse of the issue in Carlson where the ownership of the tax refund was in both spouse’s names). It is uncertain how a spouse (or a bankruptcy trustee) could prove that the filing spouse shared an ownership interest in the non-filing spouses’ property. A California appellate court, in deciding whether an ex-spouse still had a community interest in an automobile looked at circumstantial evidence such as the conduct of the parties towards each other over a long period of time to determine that the parties had intended to transfer the automobile’s ownership to separate property, despite the fact that the title of the property was in both parties’ names. *Durker v. Zimmerman,* 229 Cal.App.2d 203, 206, 40 Cal.Rptr. 227, 229 (Cal. App. 1964).

In the *Johnson* case, Judge Kressel declared in dicta (and cited other Minnesota authority for the proposition) that Marital property interests “vest” at the time of the beginning of the divorce action pursuant to Minn. Stat. §518.54, subd. 5 (now Minn. Stat. §518.003, subd. 3A), 210 B.R. at 155. However, the statute states the following concerning the establishment of a marital interest “Each spouse shall be deemed to have a common ownership in marital property that vests not later than the time of the entry of the decree in a proceeding for dissolution or annulment. The extent of the vested interest shall be determined and made final by the court pursuant to section 518.18 [which describes the process of entering an order for property settlement, among other things].” The open question is whether Judge Kressel’s dicta in *Johnson* is correct, that a marital interest vests upon the beginning of the divorce or not until the final decree. The determination of that question will decide what property rights are maintained by the non-bankruptcy filing spouse where her soon to be ex-spouse files bankruptcy after the divorce starts.

However, under 11 U.S.C. § 544, even if the wife beats the husband to a bankruptcy filing by her divorce action first, and is found by the mere filing to have an inchoate interest in the assets of his or her spouse, the bankruptcy trustee is a judgment lien creditor de jure and even then, unless the divorce is completed prior to the bankruptcy filing, the bankruptcy trustee for the spouse that files bankruptcy will get ahead of any inchoate rights of the non-filing spouse by virtue of having a constructive “judgment lien” on the property subject to the possible inchoate ownership rights of the non-filing spouse. So, all of the angst in the *Carlson* case that the marital interest did not apply in bankruptcy may not be an issue since the trustee can bring that interest into the bankruptcy estate of the filing spouse.

Further confusing the matter is that in some cases title controls who is the owner pursuant to state law. That is, there are limits to arguing that ownership of personal property should be independent of whose name is on the title to the property. In Minnesota, two bankruptcy judges have ruled in non-reported opinions that a non-filing spouse cannot argue that a car titled in her
husband’s name belongs to her, even if the evidence is that she paid for the car out of her own money and she drives it all the time. Under the Minnesota Motor Vehicle Act the name on the title is presumptive of ownership. *Kanuit v. US Dep’t of Treasury*, Adv. 07-5031 (*In re Lien*), September 11, 2009 (Kressel), citing *American National General Insurance Company v. Solum*, 641 N.W. 2d 891 (Minn. 2002) and *Auto Owners Insurance Company v. Forstrom*, 684 N.W. 2d 494 (Minn. 2004).

4. **Interest of a Minnesota Spouse in Homestead Property**

   *(a) Kipp v. Sweno*

There is disagreement and confusion related to what a non-debtor spouse’s interest in real estate is when a spouse files for bankruptcy. In the case of *Kipp v. Sweno*, 683 N.W.2d 259 (Minn. 2004) a husband’s creditors sought to enforce a judgment by levying on the home of the judgment debtor, where the equity in the home exceeded the then $200,000 limit allowed under Minnesota law. The District Court in Washington County ruled that the homestead exemption precluded the forced sale of the debtor’s property and denied the creditor’s request for independent appraisal. On appeal, however, this decision was reversed and the Court of Appeals entered a judgment of foreclosure against the debtor, authorizing a sheriff’s sale of the property. The debtor appealed arguing “that his homestead, which is held in joint tenancy with his spouse, cannot be unilaterally severed and sold by a judgment creditor of appellant.” *Id.* at 262.

The Minnesota Supreme Court reversed. In concluding that husband’s creditors should not be allowed to sever joint tenancy and foreclose on the debtor’s homestead the Court held:

> We have previously noted the general proposition that a person’s “right to occupy [his or her] home is inviolable, irrespective of the meagerness or abundance of [his or her] wealth”…Furthermore, where consideration was given by a joint tenant, a unilateral severance of the joint tenancy “would not be effective to deprive the passive joint tenant of the rights so created”…Due to appellant’s spouse’s consideration upon creating the joint tenancy, combined with an unavoidable loss of her property rights in the event of a severance and sale, it does not seem reasonable to allow a unilateral action of a judgment creditor that would deprive appellant’s spouse of her passive joint tenant rights.

*Id.* at 267.

This holding has significant ramification in debtor-creditor relations law in Minnesota because now a non-debtor and debtor spouse holding property in joint tenancy will effectively be able to keep their homestead despite the legitimate claims of debtor spouse’s creditors, no matter how much equity is held in the property, at least so long as they do not file bankruptcy. Consider the twist on this fact situation where there has been a divorce and the judgment debtor has only a lien for his portion of the equity. The Minnesota Court of Appeals has ruled that a judgment creditor can execute on the
judgment debtor’s interest in the home, but that they cannot go further to force the ex-
spouse to sell the home until an event set forth in the divorce decree comes to pass. 
Granse & Assoc., Inc. v. Kimm, 529 N.W.2d 6, at 8 (Minn. App. 1995), rev. den. (Minn. 
April 27, 1995).

(b) Treatment of a “Kipp” Homestead in Bankruptcy

What happens to the “unity of the estate” between the spouses if the judgment-burdened 
spouse files for bankruptcy? Does the Kipp v. Sweno protection of that debtor’s spouse 
still apply in Bankruptcy?

Minn. Stat. § 500.19 provides that:

Subd. 5. Severance of estates in joint tenancy. A severance of a joint tenancy 
interest in real estate by a joint tenant shall be legally effective only if (1) the 
instrument of severance is recorded in the office of the county recorder or the 
registrar of titles in the county where the real estate is situated; or (2) the instrument 
of severance is executed by all of the joint tenants; or (3) the severance is ordered by 
a court of competent jurisdiction; or (4) a severance is effected pursuant to 
bankruptcy of a joint tenant.

If Mr. Sweno had filed an individual bankruptcy, would the bankruptcy trustee, based on 
the language of Minn. Stat. §500.19 subd. 5(4) be allowed to sell the home despite the 
protests of the non-filing Mrs. Sweno?

The answer is complicated. Subdivision 5 of Minn. Stat. § 500.19 was added to the state 
statutes in 1979 as a consequence of the passage of the 1978 Bankruptcy Code. One of 
the key changes of the 1978 Bankruptcy Code was that all property owned by the debtor 
(with a few exceptions) comes into the debtor’s bankruptcy estate at the beginning of the 
case. 11 U.S.C. §541. Unless an asset is then transferred out of the bankruptcy estate 
through the use of available exemptions, the bankruptcy trustee assigned to the case 
becomes the owner of those assets. After the Bankruptcy Code became effective the 
Minnesota legislature added Subd. 5 to § 500.19 perhaps to make sure that the 
bankruptcy trustee did not take the homestead of the debtor with a right of survivorship 

Minnesota Bankruptcy Judge Dennis O’Brien ruled that this statute means that when one 
spouse owing a home in joint tenancy files an individual bankruptcy that the joint tenancy 
is immediately severed.

“By filing bankruptcy, however, the joint tenancy in which the debtor and 
her former husband held the property was severed. As of June 27, 2002, 
the debtor and her former husband own the property as tenants in 
common. "A severance of a joint tenancy interest in real estate by a joint 
tenant shall be legally effective only if ... (4) a severance is effected 
pursuant to bankruptcy of a joint tenant."

In re Holman, 286 B.R. 882, 885 (Minn. Bankr. 1998) [citation omitted].
Does the fact of severance of the joint tenancy equate to the ability of the bankruptcy trustee to sell the house of a non-filing spouse if the house has equity of over the statutory equity limit (currently at least $360,000)? Although the courts have not decided this exact issue, the 8th Circuit has ruled that the issue of joint tenancy and homestead rights are two different issues and that mere ownership of a homestead as tenants in common does not equate to the ability of a judgment creditor to sell the homestead where the non-debtor spouses’ homestead rights would be destroyed.

“Although joint tenants are generally free to convey their interest in the joint tenancy, spouses who own homestead property – as joint tenants or as tenants in common – are prohibited from conveying their interest, except to the other spouse, without the other spouse’s consent.” [bold text emphasis added].

O’Hagen v. United States, 86 F.3d 776, 780 (8th Cir. 1996).\(^\text{14}\) O’Hagen found that a non-debtor joint-owner’s rights under the homestead statute (Minn. Stat. §507.02) essentially trumped a judgment creditor’s right to sell a homestead out from under them to satisfy the debts of the other joint holder of the homestead property. This was the holding even though the homestead statute recognizes that a joint tenancy can be split by a court order (such as the court order involved in execution on a judgment).

Conveyances by spouses; powers of attorney. If the owner is married, no conveyance of the homestead, except a mortgage for purchase money under section 507.03, a conveyance between spouses pursuant to section 500.19, subdivision 4, or a severance of a joint tenancy pursuant to section 500.19, subdivision 5, shall be valid without the signatures of both spouses. A spouse’s signature may be made by the spouse’s duly appointed attorney-in-fact. Minn. Stat. § 507.02

Kipp v. Sweno quoted O’Hagen with approval. One is left with the sense that perhaps O’Hagen and Kipp are wrongly decided and that the almost metaphysical protection provided to a non-debtor spouse’s homestead interest by the Kipp and O’Hagen courts might be reassessed by a bankruptcy court.

There is plenty of precedent to cite that goes both ways on this issue. See, Van Der Heide v. Labarge (In re VanDer Heide), 164 F.3d 1183 (8th Cir. 1999), reh. den., March 8, 1999 (Missouri law); see generally, “Interest of Spouse in Estate by Entireties as Subject to Satisfaction of His or Her Individual Debt” 75 A.L.R.2d 1172 at §§ 8(a) and 8(b). The cases all rely on nuances of state laws concerning joint ownership rights and homestead rights in property. Some cases allow a bankruptcy trustee to sell the home of a non-filing spouse and others prohibit it. Simply put, the jury is out as to how Minnesota Statutes §§ 507.02, §500.19 subd. 5(4), Judge O’Brien’s Holman decision and O’Hagen and Kipp will be synthesized in Bankruptcy Court. Until they are, an attorney faced with filing a

\(^{14}\) A Chapter 7 trustee has argued in a Minnesota bankruptcy case that O’Hagen has been overruled, sub silento, by U.S. v. Craft, 535 U.S. 274 (2002).
bankruptcy for one spouse where there is over $360,000.00 equity in the family homestead cannot be sure of what will happen to the non-filing spouse’s homestead rights in the bankruptcy.

One final comment on an already tangled issue: Section 522(b)(3)(B) of the Bankruptcy Code provides that if the debtor chooses to use state exemptions instead of federal exemptions, the following property is exempt:

any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law;


Under Minnesota law, per Kipp, a non-judgment debtor spouse is protected against the creditors of the judgment debtor spouse selling the homestead out from under that spouse. Is this case, the applicable nonbankruptcy law is Kipp. A bankruptcy debtor could argue that despite the fact that the bankruptcy filing severs the joint tenancy, Kipp applies to save the protection granted the “innocent” spouse under 11 U.S.C. § 522(b)(3)(B) against the Trustee selling the property to obtain homestead proceeds in excess of the current state limit. It’s worth a shot anyway. See, In re Ballard, 65 F.3d 367 (4th Cir. 1995); Matter of Paeplow, 972 F.2d 730 (7th Cir. 1992); Matter of Hunter, 970 F.3d 299 (7th Cir. 1992); In re Persky, 893 F.2d 15 (2nd Cir. 1989); See also In re Cordova, 73 F.3d 38 (4th cir. 1996).15

(c) Abandonment of Homestead

If one of the parties to a marriage files a bankruptcy in the middle of the divorce where the other spouse has moved out of the homestead before bankruptcy was filed, one question will be whether the bankruptcy filing spouse will be able to claim the entire amount of equity in the home as his/hers (subject to either the bankruptcy court or family court being able to later divide that equity equitably between the two parties) or whether the bankruptcy trustee will be entitled to keep one-half of the equity because the non-filing spouse has “abandoned” their homestead exemption rights.

Minn. Stat. §§ 510.01 and 510.04 provide that a claim of a homestead exemption can be made for the whole family, so in general, the filing spouse should be able to protect his soon-to-be-ex-spouse’s equity.

The house owned and occupied by a debtor as the debtor’s dwelling place, together with the land upon which it is situated to the amount of area and value hereinafter limited and defined, shall constitute the homestead of such debtor and the debtor's family, and be exempt from seizure or sale under legal process on account of any debt not lawfully charged thereon in writing.

15 An additional issue is whether the same argument could apply if the Debtors use federal exemptions where 11 U.S.C. § 522(3)(B) doesn’t apply or whether Bueter v. U.S. [CITE NEEDED] allows a debtor to claim those rights in any event.
except such as are incurred for work or materials furnished in the
construction, repair, or improvement of such homestead, or for services
performed by laborers or servants and as is provided in section 550. 175.

Minn. Stat. § 510.01.

If the debtor be married the homestead title may be vested in either spouse, and
the exemption shall extend to the debts of either or of both. Any interest in the
land, whether legal or equitable, shall constitute ownership, within the meaning of
this chapter, and the dwelling house so owned and occupied shall be exempt,
though situated on the land of another.

Minn. Stat. § 510.04

In addition, if the bankruptcy is filed by the soon to be ex-spouse who has moved out of the
home where they are seeking to keep their interest in the family homestead, it is allowed to claim
that the not-yet-divorced other spouse’s rights to claim a homestead protects the debtor’s share in
the homestead from attack by the trustee. See, In re (Neil S.) Johnson, 207 B.R. 878 (Minn.
Bankr. 1997). If the divorce is final prior to the filing of the bankruptcy, that protection cannot be
claimed in the bankruptcy court. In re Holman, 286 B.R. 882 (Minn. Bankr. 2002). In that
situation, debtors have tried to claim that their move out of the home and the divorce decree has
not ended their homestead rights. The claim that such a spouse had not abandoned their
homestead rights was once well received but has lately fallen on hard times. The inquiry begins
with an examination of Minn. Stat. § 510.07.

The owner [of a homestead] may sell and convey the homestead without
subjecting it, or the proceeds of such sale for the period of one year after sale,
to any judgment or debt from which it was exempt in the owner's hands,
except that the proceeds of the sale are not exempt from a judgment or debt
for a court ordered child support or maintenance obligation in arrears. The
proceeds of an insurance claim for an exempt homestead are exempt for one
year. The owner may remove therefrom without affecting such exemption,
if the owner does not thereby abandon the same as the place of abode. If
the owner shall cease to occupy such homestead for more than six
consecutive months the owner shall be deemed to have abandoned the
same unless, within such period, the owner shall file with the county
recorder of the county in which it is situated a notice, executed,
witnessed, and acknowledged as in the case of a deed, describing the
premises and claiming the same as the owner's homestead. In no case shall
the exemption continue more than five years after such filing, unless during
some part of the term the premises shall have been occupied as the actual
dwelling place of the debtor or the debtor's family.

Minn. Stat. § 510.07 (emphasis added.)

This is a complex statute, especially in connection with the abandonment issue. The statute sets
up two scenarios whereby the holder of a homestead interest will be deemed to have abandoned
their homestead interest (thereby making any equity in the homestead available for a bankruptcy trustee to hold and sell for the creditors of the bankruptcy debtor).

1 The owner may “remove therefrom” and establish another “place of abode.” Just what does this mean? “Remove therefrom” is not defined in Black’s Law dictionary but seems to have the sense here of simply “leave.” Black’s law Dictionary (9th ed. 2009) defines “place of abode” as: “A person's residence or domicile.” Unfortunately, the concept of “residence” is different under the law than the concept of “domicile.” Residence is defined in Black’s Law Dictionary as: “The place where one actually lives, as distinguished from a domicile...Residence usually just means bodily presence as an inhabitant in a given place; domicile usually requires bodily presence plus an intention to make the place one's home. A person thus may have more than one residence at a time but only one domicile. Sometimes, though, the two terms are used synonymously.” Id. “‘Domicile’ is union of residence and intention, and residence without intention or intention without residence, is of no avail; mere change of residence, although continued for a long time, does not affect change of domicile.” Berc v. Berc, 407 N.W.2d 131 (Minn. App. 1987). If in fact the change of mere residence is enough to abandon your homestead, this will mean that anyone moving out of a home will abandon their homestead rights. There are no cases on what a Minnesota Bankruptcy Court or the Minnesota Court of Appeals or Supreme Court believe is the correct interpretation of “place of abode.”

The courts have however answered the question of whether moving away for less than six months automatically means that you’ve kept your previous homestead. There is no “safe harbor” for non-occupancy of less than six months (despite many old cases that seem to suggest this) and the court must inquire as to the actual intent of the debtor. In re Thiesse, 170 B.R. 147 (Bankr. Minn. 1994), rev’d, Reise v. Thiesse (In re Thiesse), 61 F.3d 631 (8th Cir. 1995). “Abandonment of a homestead results when the owner removes therefrom and ceases to occupy the same, with the intention of never returning, or with no intention of returning thereto to reside.” In re Hickman, 222 Minn. 161, 23 N.W.2d 593, 597 (1946) (quoting Bowers v. Norton, 173 Minn. 576, 218 N.W. 108, 109 (1928)). Accord Gordon v. Emerson-Brantingham Implement Co., 168 Minn. 336, 210 N.W. 87, 88 (1926); Clark v. Dewey, 71 Minn. 108, 73 N.W. 639, 640 (1898); Williams v. Moody, 35 Minn. 280, 28 N.W. 510, 511 (1886). This definition of abandonment requires a court to address whether the owner truly “ceased to occupy” the homestead and whether the owner had the requisite intent. See Muscala v. Wirtjes, 310 N.W.2d 696, 698 (1981).

Again, in the case of a person who is still married, even if one spouse establishes a new domicile, if the home is occupied by a relative who can claim the homestead rights of the entire family by being domiciled there, then there should be no effect on the homestead rights of the person who moved out. Minn. Stat. §§ 510.01, 510.04. Once the relationship is severed through a divorce decree however, the act of moving out and establishing a separate abode in the meantime means that you can no longer claim the old residence as your homestead.
The owner may continuously fail to occupy the premises for six months (no matter whether they have established another residence or domicile in the meantime) UNLESS they file a homestead notice in the proper form with the county recorder.

There are some odd cases concerning this issue and the statute has some gaps in it. For example, what if a divorced person moves out of the homestead, files the notice required under Minn. Stat. §510.07 for the home they just moved out of and then gets divorced. Does that mean that they can still claim that the home that they used to live in as their homestead? That seems far-fetched because the whole purpose of a “homestead” designation is to protect your home from the legitimate rights of creditors – yet there is very little discussion of this issue in connection with abandonment cases.

Consider the case of In re Joy, one of the early bankruptcy cases under the 1978 Bankruptcy Code. In re Joy, 5 B.R. 681 (Minn. Bankr. 1980). In that case, the husband was ordered out of the house at the beginning of the divorce process in December of 1977. The husband moved to another location and did not file the statutory notice to keep the marital homestead as his designated homestead. 5 B.R. at 683. The divorce was finalized in May of 1979 with the ex-wife obtaining the home and the husband obtaining a $17,000 lien. Id. The husband filed Chapter 7 bankruptcy in December of 1997 and claimed that he had a homestead interest in his now ex-wife’s home based on the fact that he had never abandoned his homestead rights in the property. In this case the trustee was seeking to step in the shoes of the husband and use the $17,000 from the homestead lien to pay the husband’s creditors. This would be the result unless the court ruled that the husband was still entitled to claim that the home he moved out of two years ago was still his “homestead.” Somewhat surprisingly, that is what Judge Dim held in In re Joy. 5 B.R. at 683. The keys to Judge Dim’s decision were the strong bias in the Minnesota Constitution and Minnesota law towards protecting homestead status and the fact that the husband had been ordered to leave the premises. Id. In Judge Dim’s opinion, this distinguished Joy from the cases that provided that a voluntary move out, even with an intention to return, only preserves your homestead rights for six months unless you file the necessary notice with the County Recorder. First National Bank of Mankato v. Wilson, 234 Minn. 160, 47 N.W.2d, 764 (1951).

The Joy case was the high water mark for bankrupt spouses seeking protection for their tenuously held homestead rights. The focus was on whether the fact of the failing to file the statutory notice destroyed Mr. Joy’s homestead exemption. There was virtually no discussion of the basic concepts that you need to “own” and “occupy” the homestead in order to claim an exemption. It was also not established whether the debtor in Joy had claimed homestead status on his taxes for his new abode, but that would have been an interesting fact to have been in the record.

There are several more cases in the Minnesota Court of Appeals and the bankruptcy courts that deal with the issues of abandonment of a homestead, one of which specifically found that In re Joy was badly decided. In re Mueller is a case that generated two reported decisions on this topic, both of which are important. In re Mueller, 210 B.R. 460 (Minn. Bankr. 1997); aff’d, 215 B.R. 1018 (8th Cir. BAP 1998). In Mueller, the wife moved from the home in February 1994. A temporary decree awarded sole possession of the home to Ms. Mueller’s spouse. The divorce was granted in January of 1996. Under the terms of the decree, Ms. Mueller obtained a $45,000
lien on the marital homestead. She then bought a new home in April of 1996. The Chapter 7 bankruptcy was filed in July of 1996. On her bankruptcy schedules, the wife claimed her new home as her homestead but tried to exempt the $45,000 by claiming that, under Joy, the $45,000 was a homestead interest entitled to exemption under Minn. Stat. § 501.07, or that the $45,000 lien was protected under the “proceeds” provision of Minn. Stat. § 510.07. Judge Kishel upheld the objection of the trustee to the claim of exemption, finding that in light of several Minnesota cases decided both before and after Joy, that Joy was wrongly decided. 210 B.R. at 465-66.

Under various precedent (the opinion is very thorough and cites several cases that are not called out in this outline) Judge Kishel pointed out that the Debtor had no remaining homestead interest in the previous home at the time of the bankruptcy filing and that the “proceeds” portion of Section 510.07 did not protect a future right to receive cash if that future right does not result in the receipt of cash by the end of the one-year statutorily protected timeframe. Id. at 466. Judge Kishel recognized that the transfer under a divorce decree met the statutory definition of “sell” or “convey,” Id., n. 15, but found that the protection of Minn. Stat. § 510.07 would only protect the debtor until a year after the transfer. Id. Judge Kishel recognized that the year-long protection of Minn. State. 510.07 had not run out as of the filing of the bankruptcy, but found that the statute had run during the course of the bankruptcy and that he would not rule that the statute protected the future interest of the Debtor where property had not been converted to cash by the end of the year.16

The Mueller case was taken up on appeal to the 8th Circuit Bankruptcy Appellate Panel. In re Mueller, 215 B.R. 1018 (8th Cir. BAP 1998). On appeal, Bankruptcy Judge William A. Hill, writing for the panel, affirmed Judge Kishel’s ruling that Joy should be overruled since the Minnesota appellate courts only allowed an exception to the filing of an intent to maintain a home as a homestead after 6 months of non-occupation under very limited circumstances. Id. at 1025. However, the BAP did not buy into Judge Kishel’s assertion that “proceeds” under Minn. Stat. § 510.07 was only cash. Rather, somewhat strangely, the BAP found that if you have proceeds from the sale of a homestead, those proceeds are only protected under Minn. Stat. § 510.07 until the homeowner abandons the homestead! Id. at 1024. Again, this strains logic. The most common use of the “proceeds” exemption of Minn. Stat. § 510.07 is where a homeowner sells their home and rents or otherwise occupies another residence until they can find another home to buy. Meanwhile, they put the proceeds of the sale of their home in the bank. By definition, selling a home, moving out and establishing another residence, results in an “abandonment” of the prior homestead. No other court has ever suggested that in this situation

16 Id. This ruling by Judge Kishel could be seen as being at odds with the rule that bankruptcy exemptions are determined as of the day of the filing of the bankruptcy by the operation 11U.S.C. § 541 and 522(d). By Judge Kishel’s logic, if a bankruptcy debtor sold his exempt homestead after filing bankruptcy, received an amount under the exemption limit for the proceeds (for example, $100,000) and kept those proceeds for a year, the bankruptcy trustee could move to have those proceeds turned over to the bankruptcy estate. To the author’s knowledge, this is not the law. Either Minn. Stat. § 510.07 proceeds provision doesn’t apply to the property created by the marital termination decree (Judge Kishel doesn’t go that far) or that property should be exemptible under Minn. Stat. 510.07 so long as the bankruptcy was filed less than a year after the divorce decree was issued.
the proceeds of the sale of the home are not protected by Section 510.07. If they are not, the statute would have no meaning.

(d) Other Issues Related to Ownership of Property—Improvement to Non-Marital Property

If one spouse owns the homestead as non-marital property, but the other spouse spends sweat equity that improves the property during the marriage, in a divorce case, the improvement to the property is deemed marital property. The spouse who is not on the title therefore gets a share of that improvement. Schmitz v. Schmitz, 309 N.W.2d 748, 750 (Minn. 1981); see generally Nardini v. Nardini, 414 N.W.2d 184, 192 (Minn. 1987). Not so in a bankruptcy case where the holder of the non-marital property file bankruptcy prior to the filing of the divorce. See In re Padilla, 2011 WL 5911243 (Bankr. D. Puerto Rico). Query what a Bankruptcy Court would or could do with that improvement if the divorce were started but not yet complete when the bankruptcy were filed. The bankruptcy trustee would likely argue that the result would be the same.

5. Marital Property—Completed Divorce Prior to Bankruptcy Filing

The majority of issues concerning the survival of marital debts from a completed bankruptcy were dealt with in 1994 when 11 U.S.C. 523(a)(15) was added to the bankruptcy code and then strengthened in 2005 to provide that nearly all marital debts in a Chapter 7 are not discharged by a spouse who files bankruptcy after a divorce decree, especially with regard to orders in state court that deal with the division of property. Despite this, there are other remaining issues concerning the interaction of various provisions of the bankruptcy code as applied to divorce decrees. The parties need to be cognizant in the changes in the bankruptcy code and judicial precedent over the years and educate judges on just what the current rules are.

6. Farrey v. Sanderfoot

11 U.S.C. §522(f)(1) provides that a debtor “may avoid the fixing of a [judicial] lien on an interest of the debtor in property.” What happens if a divorce decree awarded the wife’s interest in the family home and real estate to the husband and ordered him to make payments to the wife to equalize their net marital assets? To secure the award, the court often grants a lien against the real property. What if the obligor spouse fails to make the payments and subsequently files for bankruptcy, listing the marital home and real estate as exempt homestead property. Can the debtor avoid the filing of the judicial lien put on his property under Section 522(f)(1)? Even before Section 523(a)(15) the Supreme Court in Farrey v. Sanderfoot said no, based on a largely technical reading of the bankruptcy Code. Farrey v. Sanderfoot, 500 U.S. 291 (1991). 17

17“Farrey's lien cannot be avoided under 11 U.S.C. §522(f)(1). The parties agree that, under state law, the divorce decree extinguished their joint tenancy, in which each had an undivided one-half interest, and created new interests in place of the old. Thus, her lien fixed not on Sanderfoot's pre-existing interest, but rather on the fee simple interest that he was awarded in the decree that simultaneously granted Farrey her lien. The result is the same even if the decree merely reordered the couple's pre-existing interests, since the lien would have fastened only to what had been Farrey's pre-existing interest, an interest that Sanderfoot would never have possessed without the lien already having fixed. To permit Sanderfoot to use the Bankruptcy Code to deprive Farrey of protection for her own pre-existing homestead interest would neither follow the statute's language nor serve its main goal.” 500 U.S. at 291-92. Accord, Hall v. Weber, 2006 WL 1073189 (Minn. Ap. 2006-Unpublished).
7. The Bankruptcy Injunction

What if, prior to the final dissolution order one spouse files bankruptcy and divests the other spouse from what that spouse thought was his or her interest in property (the scenario in the last section). Can a non-filing spouse who was stripped of his or her share of a marital asset in her spouse’s bankruptcy then seek to get “make up” assets in the on-going divorce action? What if the divorce is final and then one spouse goes bankrupt leaving the other spouse with an obligation that the bankrupt spouse was supposed to take care of? Are these two situations different?

The Bankruptcy Code provides a discharge of a debtor’s debts either under 11 U.S.C. § 727 (for Chapter 7 cases) or under 11 U.S.C. § 1328 (for Chapter 13 cases). The bankruptcy code backs up that discharge with a permanent injunction that keeps creditors from trying to collect old debts that have been discharged:

524 (a) A discharge in a case under this title—

(1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged …[pursuant to] this title, whether or not discharge of such debt is waived;

(2) 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


Therefore, what rights does a non-bankrupt debtor spouse have when their ex-spouse has discharged or reduced a right to property they thought they had coming under the soon-to-be-but-not-yet-entered divorce decree? There are no cases dealing with a family law court’s ability to address a non-bankrupt spouse’s lost property while the divorce is still proceeding. There are two Minnesota cases dealing with what a state court judge can do to amend an already decided divorce decree where the property settlement granted the wife was discharged in bankruptcy. These fact patterns are rarer today because a property settlement in a divorce action is nondischargeable in a chapter 7 (but not a chapter 13) under 11 U.S.C. § 523(a)(15) (2005). However, the following cases do illustrate the deference paid to the federal bankruptcy discharge by the Minnesota appellate courts.

18 For ways to avoid this problem, see Section III.D.

19 Section 523(a)(3) and (b) deal with community property claims and the situation where another spouse in a community property state files bankruptcy after the original debtor spouse files bankruptcy. No application in “equitable division” states like Minnesota.

The Minnesota Court of Appeals in *Coakley v. Coakley*, 400 N.W.2d 436 (1987), rev. den. 1987 held that, despite a stipulated provision in the parties’ completed dissolution action which contained agreement for reopening of the dissolution judgment if the husband petitioned for discharge of his debts in bankruptcy, the property settlement was final and not subject to modification to allow wife to recoup losses incurred through husband's bankruptcy filing in view of the fact that to do so would circumvent the federal bankruptcy discharge of the property settlement.


In *Stolp v. Stolp*, 383 N.W.2d 409 (Minn. App. 1987) the non-filing spouse was not able to get around her husband’s bankruptcy filing and the bankruptcy court’s change in her rights to property as awarded by a divorce court prior to the filing of the bankruptcy. In *Stolp* the ex-wife sought to go back into state court to get an award of maintenance as a way of getting back the property she lost in her husband’s bankruptcy. The trial court agreed, but the Court of Appeals reversed for a number of reasons, such as the primacy of the bankruptcy discharge, the failure of the parties to put language in the marital termination agreement granting continuing jurisdiction over spousal maintenance and the statute of limitations. But see, *Hopkins v. Hopkins*, 487 A.2d 500 (R.I. 1985) – opposite.

3. **Cline v. Cline**

In the past, some state courts got around a discharge in bankruptcy by ruling their previous order was not an order merely splitting property. Consider the case of *Cline v. Cline*, 259 Fed. Appx. 127, Bankr. L. Rep. (CCH)¶, 81076 (10th Cir. 2007- unpublished), **cert. den., Cline v. Cline, ______ U.S. ______, 128 S.Ct. 2504 ( U.S. 2008).** In *Cline*, the United States Supreme Court refused to grant cert. in a case where the bankruptcy court and the 10th Circuit court of appeals found that a Chapter 7 debtor's obligation to make a one-time, lump-sum $250,000 payment to his former wife, pursuant to the provisions of a marital settlement agreement incorporated into the parties' judgment of divorce, was both intended by the parties as, and was in substance, "support," even though the parties had expressly classified this debt as a "property settlement" obligation and the wife had waived her right to alimony. The machinations of *Cline v. Cline* wouldn’t be necessary under the current bankruptcy law providing that even property awards are nondischargeable (11 U.S.C. § 523(a)(15) (2005), except of course in a Chapter 13 case (see above).

4. **Fast v. Fast**

In *Fast v. Fast*, 266 N.W.2d 47 (Minn.App. 2009), the Minnesota Court of appeals held, in a very common fact situation, that a hold-harmless obligation in favor of a spouse or former spouse established in a marriage separation or dissolution proceeding, is an exception to discharge under 11 U.S.C. § 523(a)(15). In this case, the husband and wife’s debt to Wells Fargo bank to fund husband’s business was subject to an order in the divorce decree that the husband would hold the wife harmless for the business debt. The husband obtained a discharge
from the debt to Wells Fargo in a Chapter 7 bankruptcy and the wife sought to declare in state court (which is allowed) that the hold harmless obligation was not discharged, despite the fact that the underlying debt had been discharged in bankruptcy. The district court was reversed by the Court of Appeals which held that the husband’s promise made in the divorce decree to hold her harmless as to his debt to Wells Fargo was not discharged under 11 U.S.C. § 523(a)(15), even though the husband’s underlying debt to Wells Fargo was discharged. The trial court had found that Section § 523(a)(5) did not apply and did not discuss the applicability of § 523(a)(15). The Court of Appeals merely pointed out that § 523(a)(15) applied and did not discuss whether the lower court was correct in holding that Section 523(a)(5) did not apply.

The Fast opinion rates two additional comments. First, it is clear that the Fast court was not clear about the interaction between 523(a)(5) and (a)(15). The two provisions are ripe for additional controversy. For example, if a provision in a divorce decree is found not to be a “domestic support obligation” can the court simply state that § 523(a)(15) can be used to hold that the same provision is still non-dischargeable? Section 523(a)(15) provides that all divorce decree provisions not included in § 523(a)(5) are non-dischargeable. So, therefore, even if a provision of a divorce proceeding is not a protected 523(a)(5) “domestic support obligation” does § 523(a)(15) save that provision in any event? In other words, does § 523(a)(15) make section 523(a)(5) superfluous? Secondly, although the trial court in Fast found that 11 U.S.C. § 523(a)(5) did not apply in this situation, if the court viewed such an order as a form of support, § 523(a)(5) would apply, since an indemnity obligation to a former spouse is a “domestic support obligation.” See Section III.D.3.

The Fast decision is also interesting because of the status of the parties after the decision. Despite the fact that Mr. Fast is still on the hook to indemnify his wife, to the extent that he can’t or won’t, Wells Fargo is still able to pursue the former Mrs. Fast for the obligation. What is the remedy for the former Mrs. Fast when she seeks to hold Mr. Fast in contempt for failing to pay off Wells Fargo (or, more accurately, failing to pay her so that she could pay Wells Fargo)? Can Mrs. Fast turn to the judge in state court who granted the divorce for assistance through a contempt order?

Under Burghardt v. Burghardt, 474 N.W.2d 235 (Minn.App. 1991), a contempt remedy in divorce cases can only be used for maintenance and support obligations but not in order to enforce a property settlement. 474 N.W.2d at 236. Assuming that a divorce judge regarded the indemnification order in Fast to be part of the property settlement, does this mean, in a case like Fast v. Fast, the state court is powerless to enforce its previous order? Burghardt suggests that the sole remedy for the wife in Fast is obtaining a judgment against the husband for the obligation, which presumably is the amount of the debt to Wells Fargo.

In other states, courts have stretched contempt further than appellate courts in Minnesota have. See In re Howard v. Howard, 336 S.W. 3d 433 (Ky. 2011) where the Kentucky Supreme Court affirmed a contempt award (which, however imposed no sanctions) for a failure of an ex-spouse to pay the divorce-required debt on his ex-wife’s pick-up truck, which led to the repossesssion of the truck.

5. More about Contempt Power
There are many other cases involving the extent of the contempt power of Family Court judges, and this is a quagmire where different courts treat precedents differently.

The following is the wisdom of my former Partner Joani C. Moberg on this issue. Joani practices Family Law at the firm of Henschel Moberg (joani.moberg@henschelmoberg.com):

The case of *Clausen v. Clausen*, 250 Minn. 293, 84 N.W.2d 675 (1957), says that courts lack the power to order one spouse to make a payment on a note and then hold them in contempt and throw them in jail if they do. But *Clausen* fails to cite, distinguish or overrule opposite opinions in *Wenger v. Wenger*, 200 Minn. 436, 274 N.W. 517 (1937). In *Carstedt v. Grindeland*, 365 N.W.2d 347 (Minn. App. 1985), the Minnesota Court of Appeals analyzed a similar issue and stated that the contempt order didn’t work because it did not “clearly define the acts to be performed.” It would have been much easier to rule that the issue was not proper for contempt, so arguably the Minnesota Court of Appeals did not believe that *Clausen* stood for this when it ruled in *Carstedt*.

Some judges question the authority in *Burgardt v. Burgardt*, 474 N.W. 2d 235 (Minn. App. 1991) to hold that contempt cannot be used to enforce property settlements. The *Burgardt* reasoning is based on the idea that marriage decrees are contracts rather than court orders and should be analyzed under contract law. Some courts are willing to ignore *Burgardt* for the reasoning of the Minnesota Supreme Court in *Wenger*. Once the court signs a decree, it is an order of the court, not a contract. Under Minnesota law, a judge may not sign off on a stipulated decree unless it is consistent with the law and the interests of Justice. Minn. Stat. § 518.13. In *Karon v. Karon*, 435 N.W.2d 501 (Minn. 1989), the court stated that the court sits as a third party representing the citizens of Minnesota. *Id.* At 503.

*Burgardt* also suggests that the reason that contempt is not available is because the Court of Appeals searched statutes for express authorization and didn’t find any. Arguably, courts do not need the legislature to confer upon them authority to enforce their own order. There is ample authority to support the idea that the court has an inherent power to enforce its own orders through contempt. *See State v. Tatum*, 556 N.W.2d 541 at 547 (*Tatum I*). The legislature can’t define or limit the contempt power of the judicial branch. *State v. Binder*, 190 Minn. 303, 251 N.W. 2d 665 (1933).

Joani concludes: “So with all that in mind, I can tell you that multiple judges before whom I have appeared have not hesitated to allow contempt motions to go forward on property issues. I have pursued contempt on failure to pay a property settlement and failure to pay attorneys’ fees, and have not had any issue; however, *Burgardt* may not have been raised as a defense in those cases.”

**VII. Dual Representation of Spouses in a Joint Bankruptcy Where the Clients Plan to Seek a Divorce After the Completion of the Bankruptcy**

RULE 1.7 Minnesota Rules of Professional Conduct provides:
CONFLICT OF INTEREST: CURRENT CLIENTS

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law; 26

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

The notes to the section provide the following additional information:

Prohibited Representations

[14] Ordinarily, clients may consent to representation notwithstanding a conflict. However, as indicated in paragraph (b), some conflicts are nonconsentable, meaning that the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client’s consent. When the lawyer is representing more than one client, the question of consentability must be resolved as to each client.

[15] Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest. Thus, under paragraph (b)(1), representation is prohibited if under the circumstances the lawyer cannot reasonably conclude that the lawyer will be able to provide competent and diligent representation. See Rule 1.1 (competence) and Rule 1.3 (diligence).
Paragraph (b)(2) describes conflicts that are nonconsentable because the representation is prohibited by applicable law.

Paragraph (b)(3) describes conflicts that are nonconsentable because of the institutional interest in vigorous development of each client’s position when the clients are aligned directly against each other in the same litigation or other proceeding before a tribunal. Whether clients are aligned directly against each other within the meaning of this paragraph requires examination of the context of the proceeding. Although this paragraph does not preclude a lawyer’s multiple representation of adverse 29 parties to a mediation (because mediation is not a proceeding before a “tribunal” under Rule 1.0(n)), such representation may be precluded by paragraph (b)(1).

Informed Consent

Informed consent requires that each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client. See Rule 1.0(f) (informed consent). The information required depends on the nature of the conflict and the nature of the risks involved. When representation of multiple clients in a single matter is undertaken, the information must include the implications of the common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege and the advantages and risks involved. See Comments [30] and [31] (effect of common representation on confidentiality).

Under some circumstances it may be impossible to make the disclosure necessary to obtain consent. For example, when the lawyer represents different clients in related matters and one of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision, the lawyer cannot properly ask the latter to consent. In some cases the alternative to common representation can be that each party may have to obtain separate representation with the possibility of incurring additional costs. These costs, along with the benefits of securing separate representation, are factors that may be considered by the affected client in determining whether common representation is in the client’s interests.

Just as a family law attorney would not represent two divorcing parties in a divorce action, it is unwise for a bankruptcy attorney to represent both spouses in a joint bankruptcy action if those parties later plan on filing a divorce. It is theoretically possible, if the attorney provides the proper informed consent, to obtain a waiver of the conflict and represent both parties. However, the informed consent might consist of providing the parties with a copy of all of the information in these materials with a request that the prospective clients read and understand all the possible conflicts with their spouse under the bankruptcy laws. Especially problematic are those couples with significant assets, or whose assets are held by one spouse where the majority of the debts are held by the other spouse, or where maintenance or child support will be awarded and there is
equity in the marital homestead or in retirement funds, etc., etc. While it is surprisingly common for attorneys to represent two later-to-be divorced spouses, the practice is fraught with possible problems such as a later malpractice action or a motion in the bankruptcy court to disgorge all fees paid to the attorney for the representation. See In re Vann, 136 B.R. 863 (D. Colo. 1992), aff’d, 986 F.2d 1431 (10th Cir. 1993); In re ECW, Inc., 138 B.R. 276 (Bankr. W.D. Okla. 1992); cf. In re Interwest Business Equipment, Inc., 23 F.3d 311 (10th Cir. 1994), (three interrelated corporate debtors could not employ same counsel even with waiver); In re Hot Tin Roof, Inc., 205 B.R. 1000 (1st Cir. BAP 1997) (disgorgement of attorney fees for failure to adequately disclose relationship of lawyer to insiders of debtor); In re Nat’l Dist. Warehouse Co., Inc., 148 B.R. 558 (Bankr. E.D. Ark. 1992) (lawyer disqualified from representing debtor in part for actual conflict of interest between client and prior representation of company he owned).

VIII. WHEN SHOULD I FILE? PROS AND CONS OF FILING BANKRUPTCY BEFORE THE DIVORCE AND VICE-VERSA

If it hasn’t been clear up to now, the objects of the two systems, divorce court and bankruptcy court, are primarily different. Family law courts deal with the property of the two parties, the custody of the children and the on-going financial obligations to each other, if any, after the divorce. Family law courts have only limited ability to effectively deal with the divorcing parties’ obligations to creditors. Bankruptcy courts and the Bankruptcy Code exist primarily to deal with just that issue.

A. Advantages of Filing Bankruptcy Prior to the Filing of the Divorce (Some Benefits Exist No Matter When the Bankruptcy Is Filed).

In general, but far from always, a bankruptcy filing before the divorce simplifies the financial issues between the parties that will usually have the effect of simplifying the divorce. Even if this is true, this simplification is not always to everyone’s advantage (see section B, below). Conversely, a bankruptcy filing by one party after the divorce is finalized will sometimes (but not always) upset agreements made during the divorce proceedings. Even more complicated issues arise for those parties going through a divorce when one of the parties files bankruptcy during the course of the divorce.

1. The Automatic Stay.

As described earlier in these materials, under 11 U.S.C. § 362, a filing of a bankruptcy stops all collection actions being taken or considered against the debtor. A benefit of a Chapter 13 (but not a Chapter 7) is that if one spouse files bankruptcy and proposes a payment plan to pay all of the unsecured creditors, all consumer debtors are likewise stayed from going after the spouse who also owes the debt. Filing bankruptcy prior to a divorce gives the parties a chance to temporarily gain breathing space to try to deal with their debts in an orderly fashion.

2. Discharge of Indebtedness.

An obvious advantage of a pre-divorce bankruptcy. Less debt to fight about in the divorce, easier to divide property.
3. Lien Avoidance

A bankruptcy court can avoid certain types of liens on personal property (non-possessory, non-purchase money liens) This in turn avoids having liens travel with personal property transferred in the divorce.

4. Reaffirmation of Debt/Redemption of Liens

11 U.S.C. § 524(c) deals with reaffirmation of debt. 11 U.S.C. § 722 concerns redemption of debt. Reaffirming a debt prior to the start of the divorce allows both parties to budget for the payment of the car (most common) loan, which may have fallen behind prior to the bankruptcy. Without a bankruptcy, depending on the length of the delinquency, a car lender might simply repossess the car A reaffirmation agreement, if allowed by the bankruptcy court, allows the debtor to reach a plan to keep current on payments on the loan and deal with the missed payments in some fashion, usually by adding the arrearages to the end of the loan term, thereby extending the car loan.

Redemption of an asset that has more debt than value is allowed in bankruptcy. For example, if a car has been used as a continuing source of loans to the point where the value of the car is now below the loan amount, a debtor can redeem the car from the loan company by paying the value of the car, in cash, during the bankruptcy. This practice again lowers the debt of the parties during the divorce and takes the looming possibility of repossession of a car or other item of personal property out of the equation.

5. Avoidance of Later Turnover of Non-Exempt Property Interest

Frequently parties exit divorce where one spouse owns a home outright with the other party maintaining only a lien on the home. If the lienor party files for bankruptcy after the divorce is final, the lien interest is likely non-exempt property which the bankruptcy trustee will become the owner of and sell for the benefit of the lienor party’s creditors (see section VI. D. 4. (c)).

6. Chapter 13 – Repayment of Long Term Debt/Lien Stripping of Underwater Mortgages

If a home mortgage is in arrears, filing a Chapter 7 will not solve the problem of a potential foreclosure on a homestead. Further, in a Chapter 7, even if a second, or third or fourth mortgage is completely underwater, the lien remains on the homestead after the Chapter 7 is completed. A Chapter 13 debtor (if the debtor is eligible) can many times restructure mortgage arrearages by way of a Chapter 13 plan over 1, 2 or even three years. Similar to a Chapter 7 case, a Chapter 13 debtor owning a homestead secured by a mortgage where the mortgage is partially secured cannot strip that mortgage under the terms of a Chapter 13 plan. 11 U.S.C. § 1322(b)(2). However, the Eighth Circuit Bankruptcy Appellate Panel has recently allowed lien stripping in a Chapter 13 on a second mortgage where the second mortgage was fully unsecured. In re Fisette, 455 B.R. 177, (B.A.P. 8th Cir. 2011) (applying Minnesota law). While a joint Chapter 13 plan for divorced spouses is difficult to administer, it is still possible so long as the parties cooperate in making the payments. Filing a Chapter 13 to save a house prior to a divorce that would otherwise be foreclosed upon protects the equity in the home for both parties.
7. Chapter 13 - Payment of Taxes

Payment of past-due taxes can be managed in Chapter 13 so that the parties have this issue handled before filing for divorce. Even if all other debts are wiped out by filing a Chapter 7 bankruptcy, taxes are usually not discharged and a Chapter 13 that follows a Chapter 7 discharge (known as a “Chapter 20”) will allow the non-dischargeable taxes to be paid over five years. Also, although taxes and interest on those taxes are not dischargeable, penalties are, and they can often be written down (along with the parties’ other unsecured debt) to pennies on the dollar.

8. Chapter 13 - Halting of Interest/Restructuring Joint Debt

By filing a Chapter 13 plan, the interest charges on unsecured debt stop (not true for secured debt or at least not for fully secured loans). To the extent the soon-to-be divorced couple cannot file a Chapter 7 bankruptcy, at least the Chapter 13 will allow the parties to pay their credit cards off without continuing accrual of interest rates that often exceed 20% per cent per year, thus allowing the parties more funds to pay separate household expenses and concentrate on property and custody issues in family court.

9. Chapter 13 - Writing Down Secured Debt

Parties with assets that are worth less than the value of the current loan (cars being the most obvious example) can sometimes use a Chapter 13 filing to write down the secured debt down to the value of the item. Thus, even if a party cannot file a Chapter 7, they can file a Chapter 13 and re-write their secured debts. This is not available for car loans which are less than 2 1/2 years old at the time of the filing of the bankruptcy (this is the so-called “910 Car” rule put into place in 2005.)

10. Non-Discharge of Future Indebtedness

If a prospective divorce client files bankruptcy, the filing of the bankruptcy will cause any future debts (such as debts owed to hard-working divorce attorneys or the retainers that they obtain after the bankruptcy is filed) not to be caught up in the discharge. However, clients who are unwilling to pay can usually find ways to avoid it without filing for bankruptcy. Keep in mind also that even a debtor who receives a discharge in a chapter 7 case can re-file a Chapter 13 later on. Obviously, it is malpractice to recommend a course of action to a client that is on balance bad for them but protects the lawyer’s interests.

B. Disadvantages of Filing Bankruptcy Prior to the Filing of the Divorce

1. Destruction of Credit

If the parties will need credit to finance a property split or for any other purpose (such as to buy a separate home or to rent a new apartment) filing bankruptcy will hurt the bankruptcy debtor’s credit rating for a long time and make it difficult or impossible to obtain needed credit to start a new financial life. This may be of little importance if the credit rating of the parties is already poor.
2. **Liquidation of Assets**

If one party to a divorce owns property that is not exempt, the filing of a bankruptcy will force the liquidation of that property to pay the creditors of that party. One example might be the party’s interest in a business that a bankruptcy trustee might try to liquidate to pay debts. In that case, the party might wish to avoid bankruptcy altogether to attempt to earn his way out of the debt through increased profits from the business or increased value in the property in the future.

3. **Loss of Exemptions by Owing Spouse**

If a spouse goes through bankruptcy and then winds up owing child support or spousal maintenance to their ex-spouse as a result of a divorce decree, the owning spouse loses his/her ability to claim that any of their property is exempt from future collection actions. *(See section III. E. 4.). This in reality is a reason why never to file bankruptcy if you think you might wind up owing child support or spousal maintenance since a bankruptcy wipes away the protection of those exemptions forever, even if the spousal maintenance or child support arrearages arise after the bankruptcy is final (see definition of “Domestic Support Obligation” in 11 U.S.C. § 101(14A)).

4. **Fraudulent Transfer Recapture**

If a soon to be ex-spouse has just taken a large chunk of the party’s joint savings out of a bank account, a bankruptcy filing at least within the next year (and potentially for the next 6 years) will allow a bankruptcy trustee to go after those funds, but the filing spouse won’t get to keep the money, they’ll go to pay the creditors. In this case, assuming that the sum taken is large, it would be important to allow the family court deal with the issue and distribute funds to the parties prior to filing bankruptcy *(see section III. C. 4.).

5. **Loss of Excess Homestead Exemption Under Kipp v. Sweno**

If equity in the marital homestead exceeds that current exemption limit under Minn. Stat. § 510.01 et. seq., and if most or all of the debt is in one of the spouse’s name, *Kipp v. Sweno* protects the non-obligor spouse’s excess exemption against collection. This goes away upon the filing of the bankruptcy. In addition, even outside of bankruptcy this protection only lasts as long as the house is in both party’s name. One option is to split the equity in the divorce, have the spouse that moved out buy their own home with that equity and thereby establish two legal homesteads, both of which are protected from collection and only file bankruptcy after this is accomplished. *(see section VI. D. 4.).

6. **Job Concerns**

Although it is unlawful for an employer to fire an employee merely because they have filed bankruptcy, 11 U.S.C. § 525, proving that a termination was based solely on a bankruptcy is difficult. Also, if the employee is in a business that handles money or that employee handles money for their employe or the employee owes the employer money that is now being
discharged in a bankruptcy, the employee may be able to terminate the employee and not violate the non-discrimination clause in the bankruptcy code.

7. Non-Marital Assets and Unbalanced Liabilities

As set forth above, a joint bankruptcy filing will allow a bankruptcy court to use both parties’ assets to pay the other parties’ debts without regard to whose assets are paying what debt. If a wife has all of the assets, including non-marital property that she will keep in a divorce, filing a joint bankruptcy will use her assets to pay her husband’s debts.

8. Familial Debt

A kind of catch-all reason for not filing bankruptcy is the embarrassment of filing and the unwillingness to saddle family or friends who have co-signed for debt with the repayment of that debt, especially if those family members are going to be needed after the divorce to help support a divorcing party. One counterargument is that after a bankruptcy discharge is obtained, the law does not forbid a discharged debt from being repaid. This “I’ll win the lottery and pay everyone back” is a rare but not unprecedented occurrence.
APPENDIX 1 – FORM FOR NOTICE OF APPEARANCE

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

IN RE: __________________________
DEBTOR

Bankruptcy File No. __-______________

NOTICE OF APPEARANCE OF

TO THE UNITED STATES BANKRUPTCY COURT, AND ALL OTHER PARTIES IN INTEREST:

Please take notice that the undersigned party in interest hereby appears in this matter and requests that they receive service of all motions and pleadings.

NAME OF CREDITOR

Date: _________________ By: ____________________________

Its Officer
Phone:__________________
The notice on the previous page should be filed electronically in the ECF system. Call the Minneapolis Clerk’s office at 612 664-5200, the St. Paul Clerk’s office (651)848-1000 or check the filing rules at www.mnb.uscourts.gov.