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Interaction Between Bankruptcy Law and State Law: What Illinois Judges Need to Know

Steven H. Resnicoff*

INTRODUCTION

In Illinois, bankruptcy filings continue to increase, yet the critical interaction between bankruptcy law and state law remains largely unexplored. Failure to appreciate this relationship often results in the formal nullification or vitiation of expensive, protracted state proceedings. At the same time, other matters may be needlessly suspended or delayed. Judges who recognize the connection between bankruptcy and state law can avoid roadblocks, preserve the fruits of their proceedings, further the interests of justice, and—at least partially—protect litigants from attorneys who are insufficiently experienced in bankruptcy law.1

This Article seeks to help Illinois judges2 identify how bankruptcy law affects their proceedings and suggests how they may proceed most efficiently. Part I presents a brief bankruptcy “primer” summarizing the principal kinds of bankruptcies and the concepts they entail. Part II focuses on bankruptcy’s automatic stay and the ways in which it should, and should not, impact on state courts. Part III examines the function and limits of a bankruptcy discharge and the role of state courts in determining whether debts are discharged. Part IV discusses how a bankruptcy filing alters applicable time constraints on access to state courts.

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1. Some inexperienced practitioners may even be saved from themselves.

2. For the convenience of Illinois judges, this Article cites primarily Illinois and Seventh Circuit precedents. This Article does not attempt to discuss all of the ways in which bankruptcy law affects, overrules, or interrelates with state law. Instead, the goal is to advise state court judges regarding those matters which may affect the efficiency and legal validity of proceedings in their courts. To effectively structure, negotiate, and enforce transactions, state court practitioners must master additional aspects of bankruptcy law. Nevertheless, this Article provides a substantial start for them as well. For a more complete treatment of issues raised herein, see, e.g., Robert E. Ginsberg, Bankruptcy: Text, Statute, Rules (3d ed. 1992) [hereinafter Ginsberg]; Collier on Bankruptcy (Lawrence P. King ed., 15th ed. 1992) [hereinafter Collier]; Henry J. Sommer & Margaret D. McGarity, Collier Family Law & the Bankruptcy Code (Lawrence P. King ed., 1992); American Bankruptcy Institute, Bankruptcy Issues for State Trial Court Judges 1991-1992.
Finally, Part V illustrates several special problems arising in the context of marital dissolutions.

I. BANKRUPTCY BASICS

A. Types of Bankruptcies

The Bankruptcy Code (the "Code") is divided into eight chapters. Unless otherwise specified, the provisions of Chapters 1, 3, and 5 apply to all types of bankruptcies, while Chapters 7, 9, 11, 12, and 13 are each devoted to a particular kind of bankruptcy. All bankruptcy proceedings are initiated through the filing of a bankruptcy "petition." 

The various bankruptcy proceedings have one of two basic functions: liquidation or reorganization. In a liquidation under Chapter 7, most of the property owned by the debtor at the time of the filing is sold and the proceeds are used to cover administrative costs and to pay prebankruptcy creditors. In return for surrendering prepetition property, individual debtors ordinarily receive a discharge of personal liability for prebankruptcy debt and keep assets acquired after the filing for use in their "fresh start." Essentially, an individual debtor in Chapter 7 has two "economic lives"; the filing of the bankruptcy petition ends the first life and starts the second. Usually, the reason a person voluntarily files for Chapter 7 is to obtain a bankruptcy discharge.

Chapters 9, 11, 12, and 13 involve reorganizations. The essence of a reorganization is that the debtor's assets are not liquidated. Instead, a plan is proposed which allows the debtor to restructure debts and pay creditors over time. The debtor usually receives a discharge of personal liability for any portion of prebankruptcy debts not paid under the plan.

Chapter 9 is a specialized, rarely used proceeding for municipal debtors. Chapter 12, also infrequently used, applies only to

10. See 11 U.S.C. §§ 524, 944(b), 1141(d), 1228(a), 1328(a) (1988).
“family farmers.” Family farmers are individuals or individuals and their spouses whose income derives chiefly from farming operations and whose aggregate debt does not exceed $1,500,000. Most reorganizations involve Chapters 11 and 13. Chapter 11 is frequently used by business entities, such as corporations or partnerships, or by individuals owning businesses; nevertheless, it may also be used by individual wage earners. A Chapter 11 bankruptcy, like a Chapter 7 bankruptcy, may be voluntarily or involuntarily commenced. By contrast, individual consumer reorganizations are typically filed under Chapter 13, which allows only for voluntary filing by debtors. To be eligible for Chapter 13, individuals—and their spouses if the filing is a joint one—must have regular income and owe less than $100,000 in noncontingent, liquidated, unsecured debt and less than $350,000 in noncontingent, liquidated, secured debt. Reorganization plans commonly require the debtor to make payments over a number of years.

B. Basic Concepts

The Bankruptcy Code, like codifications of other bodies of law, relies heavily on the use of special terms. Especially important is an understanding of the meanings of (1) property of the estate; (2) property of the debtor; and (3) claim. These terms are integral to

15. Section 303(a) provides for involuntary commencement of a bankruptcy proceeding only under Chapter 7 or Chapter 11. 11 U.S.C. § 303(a) (1988).
17. Plans in Chapters 12 and 13 may not require payments over more than three years without court approval “for cause,” in which case the maximum period for payment is five years. 11 U.S.C. §§ 1222(c), 1322(c) (1988). There is no explicit time restraint on Chapter 11 plans, but as in Chapters 12 and 13, the court must find that the plan is feasible. See 11 U.S.C. §§ 1129(a)(11), 1225(a)(6), 1325(a)(6) (1988).
18. Many, but not all, Code terms are defined in 11 U.S.C. § 101 (1988). Unfortunately, there are several latent “defects” in this section about which one should be forewarned. First, although the section seems to be structured alphabetically, a number of terms at the end of the section appear out of order (because they were added when the Code was amended). Second, some terms are defined as phrases rather than as individual words, and of these, some are alphabetized in accordance with the first word of the phrase, see, e.g., 11 U.S.C. § 101(30), while others are ordered according to the last word of the phrase, see, e.g., 11 U.S.C. § 101(7). Third, the subsections of 11 U.S.C. § 101 are incorrectly numbered: there are two subsections numbered (54), (55), (56), and (57) respectively.
the workings of automatic stay and discharge law, described in Parts II and III.

1. Property of the Estate Versus Property of the Debtor

In a Chapter 7 liquidation, *property of the estate*, defined by Code section 541, consists of those assets of the debtor which are liquidated and used to pay administrative costs and prepetition debts.\(^1\) This fund is effectively committed to financing obligations pertaining to the Chapter 7 debtor’s prepetition economic life. Except as necessary for administrative costs, property of the estate is not available to postfiling creditors.

Some assets, such as beneficial interests in certain trusts\(^2\) or property acquired after the bankruptcy filing,\(^3\) fall outside of the statutory definition of *property of the estate* and are *property of the debtor.*\(^4\) Some assets that are initially included in property of the estate may ultimately become property of the debtor, if the debtor uses applicable exemptions\(^5\) or if the trustee abandons burdensome or inconvenient assets.\(^6\) In contrast to property of the estate, property of the debtor, as a general rule, may be pursued only by postpetition creditors and not by prepetition creditors.\(^7\) Nonetheless, as discussed in Part V of this Article, considerable confusion arises in reorganizations about precisely what assets are property of the estate.\(^8\)

2. Claim

The Code expansively defines a *claim* to include any right to payment, even one that is not reduced to judgment, that is un-
secured, unliquidated, unmatured, contingent, and disputed.\textsuperscript{27} Similarly, a claim includes a right to equitable relief for breach of a “performance,” even if the right to such equitable relief is not reduced to judgment and is unsecured, unliquidated, unmatured, contingent and disputed.\textsuperscript{28} According to most courts, a party may have a prepetition bankruptcy “claim” even if under state law a cause of action has not yet accrued.\textsuperscript{29}

II. Bankruptcy Stays

A. The Phenomenon of Automatic Stays

The filing of any type of bankruptcy petition triggers a stay under Code section 362(a) that is applicable to virtually all efforts to collect prepetition claims against the debtor, the debtor’s property, or property of the estate.\textsuperscript{30} This means, among other things, that a state court proceeding is immediately and automatically stayed, no matter how far along it has progressed. Actions enjoined include: (1) foreclosure sales,\textsuperscript{31} (2) eviction proceedings,\textsuperscript{32} (3) suits against third parties to avoid allegedly preferential or fraudulent transfers,\textsuperscript{33} (4) actions to collect against nondebtor third

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\item \textsuperscript{27} 11 U.S.C. § 101(5)(A) (1988).
\item \textsuperscript{29} Compare Burlington N. R. R. v. Dant & Russell, Inc. (\textit{In re} Dant & Russell, Inc.), 853 F.2d 700, 709 (9th Cir. 1988) (need not have a right to payment under state law to have a bankruptcy “claim”) \textit{with} Avellino & Bienes v. M. Frenville Co. (\textit{In re} M. Frenville Co.), 744 F.2d 332, 337 (3d Cir. 1984), cert. denied, 469 U.S. 1160 (1985) (no bankruptcy “claim” unless there is right to payment under state law). See generally Kevin J. Saville, \textit{Discharging CERCLA Liability in Bankruptcy: When Does a Claim Arise?}, 76 MINN. L. REV. 327 (1991).
\item \textsuperscript{30} 11 U.S.C. § 362(a) (1988). In certain circumstances, bankruptcy courts rely on Code § 105 to enjoin state judicial proceedings. Stays issued pursuant to Code § 105 do not arise automatically, are relatively rare, and are ordinarily narrowly drawn. Consequently, they raise far fewer practical problems for state court judges than do the Code’s automatic stays.
\item \textsuperscript{31} See, e.g., \textit{In re} Bresler, 119 B.R. 400 (Bankr. E.D.N.Y. 1990) (foreclosure violates stay even though party conducting sale had no knowledge or notice of bankruptcy filing); First Fin. Sav. & Loan Ass’n v. Winkler, 29 B.R. 771, 773 (N.D. Ill. 1983) (all “proceedings” against the debtor’s estate, including foreclosure, are stayed by bankruptcy filing).
\item \textsuperscript{33} The debtor’s continuing interest in the property transferred is “property of the estate,” which is protected from creditors by the automatic stay. See, e.g., Carlton v. Baww, Inc., 751 F.2d 781 (5th Cir. 1985); American Nat’l Bank of Austin v. MortgageAmerica Corp. (\textit{In re} MortgageAmerica Corp.), 714 F.2d 1266 (5th Cir. 1983); Dana Molded Prods., Inc. v. Brodner, 58 B.R. 576, 578 (N.D. Ill. 1986).
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parties that are based on "alter ego" theories, suits for injunctive relief, (6) actions nominally against a debtor but intended to reach the proceeds of a debtor's insurance policy, (7) entry of a state court judgment, even when the judgment is in favor of the debtor, and (8) divorce actions against the debtor that are based either on grounds that could have been raised prior to the bankruptcy filing or on those grounds that involve financial obligations between the parties.

The statutory stay is automatic and self-executing. The stay is effective without any order or action by the bankruptcy court and applies to all "entities," whether or not they are aware that a bankruptcy petition has been filed. To any type of debtor in Chapters 9, 11, 12 or 13 or to an individual debtor in Chapter 7, this stay remains in place until either the case is closed or dismissed, or a discharge is granted or denied. In Chapters 12 and 13, a stay also automatically bars actions against persons who, although not themselves bankruptcy debtors, are liable with a debtor for a consumer debt. These Chapter 12 and 13 stays are

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34. The debtor's cause of action against such third parties is considered "property of the estate," and the automatic stay prevents a creditor from interfering with it. See, e.g., Koch Refining v. Farmers Union Cent. Exch. Inc., 831 F.2d 1339 (7th Cir. 1987), cert. denied, 485 U.S. 906 (1988) (the bankruptcy trustee, not a creditor, had standing to bring an action against the debtor corporation's shareholders). But see Ashland Oil Co. v. Arnett, 875 F.2d 1271, 1280 (7th Cir. 1989) (when it suffered a sufficiently distinct injury, creditor had standing).


38. The Code § 362(a) stay applies to "the commencement or continuation . . . of a judicial . . . action . . . against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case." 11 U.S.C. § 362(a)(1) (1988). As a result, if a divorce action against the debtor is based on grounds arising prior to the bankruptcy filing, the stay seems to apply even if the divorce does not involve financial issues. See also Henry J. Sommer, The Impact of Bankruptcy on Family Law Cases, C728 ALI-ABA 71 (1992) [hereinafter Sommer]. But see In re Ford, 78 B.R. 729, 734 (Bankr. E.D. Pa. 1987) (stay does not apply to divorce proceeding devoid of economic considerations).

39. The word entity includes a "person, estate, trust, governmental unit, and United States trustee." 11 U.S.C. § 101(15) (1988). According to some authorities, the automatic stay operates not only upon parties to a proceeding but also directly upon the state or federal court in which the proceeding is being conducted. See, e.g., Maritime Elec. Corp. v. United Jersey Bank, 959 F.2d 1194, 1206 (3d Cir. 1991).


42. 11 U.S.C. §§ 1201, 1301 (1988). Chapter 9 also contains a stay provision in addition to the stay provided by § 362 but, because the Chapter 9 stay rarely arises in state courts, its implications will not be discussed. 11 U.S.C. § 922 (1988).
referred to in this Article as *co-obligor stays*. A co-obligor stay terminates if the debtor's bankruptcy case is closed, dismissed, or in some instances, converted to a Chapter 7 or a Chapter 11 proceeding.\(^{43}\)

### B. Problems Posed by the Automatic Stays

The Code section 362 stays and the co-obligor stays interfere with state court actions in three principal scenarios: (1) in cases in which the stays legally enjoin further state court proceedings and the state court complies with the stay; (2) in cases in which the stays legally enjoin state court action but the action proceeds in violation of the stay; and (3) in cases in which state courts, misunderstanding the legal effect of the stays, needlessly suspend or dismiss state actions. As discussed below, such interference often undermines the efficiency and efficacy of state court proceedings, as well as the pursuit of justice. State court judges can minimize such adverse results by refining their appreciation of the scope of the stays, by learning the various ways to obtain relief—possibly even retroactively—from the stays, and by making appropriate inquiries of, and even suggestions to, counsel appearing before them.

1. Legal Interruption of State Court Proceedings

In some cases, state courts recognize that a stay applies and correctly refuse to allow the proceeding to continue. In many instances, however, it would be desirable to allow state proceedings to continue. Assume, for instance, that a state court has conducted a complicated and extensive trial with numerous expert and nonexpert witnesses. Shortly before a verdict is reached, the defendant files bankruptcy, and the trial is stayed. The rights asserted in the lawsuit must be adjudicated so that any appropriate payments can be made to the plaintiff in the defendant’s bankruptcy proceeding. Because of the stay, however, the litigation may have to be repeated from scratch in a bankruptcy forum. The time, effort, and expense invested by the court and the parties in the state proceeding may simply be wasted.\(^{44}\) Resultant delay can be especially prejudicial to a creditor whose collateral is rapidly depreciating in

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43. The Chapter 13 co-obligor stay terminates if the Chapter 13 proceeding is converted to either a Chapter 7 or a Chapter 11 case. 11 U.S.C. § 1301(a)(2) (1988). Although the Chapter 12 co-obligor stay terminates if the proceeding is converted to a Chapter 7 case, there is no provision for termination upon conversion to a Chapter 11 case. 11 U.S.C. § 1201(a)(2) (1988). The Code provides no apparent reason for this distinction.

44. Additionally, the parties will have disclosed their evidence, tactics, and strategies.
value. Moreover, to the extent the matters at issue involve questions of state law—and especially if they concern topics traditionally reserved to the states, such as family law—Illinois courts could resolve them more efficiently and expertly than could bankruptcy courts.

Consider another example. The automatic stay does not apply to actions brought by the debtor; it applies only to actions against the debtor. This can be problematic. For example, assume that before the bankruptcy filing, the debtor filed suit against a creditor, and the creditor has claims against the debtor which, under state law, must be asserted as mandatory counterclaims. Fairness and efficiency suggest that the creditor should be allowed to file such counterclaims, but the stay forbids the creditor from doing so.

Fortunately, there are three possible ways around the automatic stay. A creditor may ask the bankruptcy court for (1) "relief" from the stay, (2) bankruptcy-court abstention from the underlying litigation, and/or (3) dismissal of the bankruptcy proceeding.


46. Upon the filing of the bankruptcy petition, most of the debtor's causes of action, however, will become "property of the estate." Consequently, only those charged with supervising such property, either the bankruptcy "trustee" or the "debtor-in-possession," will be authorized to proceed with the action. 11 U.S.C. §§ 701-704, 1104-1107, 1203, 1303 (1988). The automatic stay prevents the debtor from personally bringing or continuing such actions. Thus, the action may be continued despite the automatic stay, albeit not by the debtor.

47. Code § 362(a) refers to actions brought or taken against the debtor, the debtor's property, and property of the estate. It does not refer to actions brought by the debtor. 11 U.S.C. § 362(a) (1988). Consequently, if a debtor, prior to filing, has instituted a state action against a nondebtor defendant and if the debtor fails to prosecute such action after the debtor's filing, the court may dismiss the lawsuit with prejudice under applicable state law for failure to prosecute. See, e.g., Merchants & Farmers Bank of Dumas v. Hill, 122 B.R. 539 (E.D. Ark. 1990) (dismissing debtor's counterclaim for failure to prosecute); Scarborough v. Duke, 532 So.2d 361 (La. Ct. App. 1988) (dismissing debtor's action for failure to prosecute); Emerson v. A. E. Hotels, Inc., 403 A.2d 1192 (Me. 1979) (dismissing tenant-debtor's action against landlord for want of prosecution); cf. Martin-Trigona v. Champion Fed. Sav. & Loan Ass'n, 892 F.2d 575 (7th Cir. 1989) (stay did not apply to suit brought by the debtor or to action by creditor to dismiss such suit).

48. In re Pro Football Weekly, Inc., 60 B.R. 824 (N.D. Ill. 1986) (stay forbids the filing of compulsory counterclaims, but the stay can be modified to allow a party to assert its counterclaims).

49. 11 U.S.C. § 362(d) (1988) (providing "relief" by terminating, annulling, modifying, or conditioning stay).


First, a "party in interest,"52 such as a creditor, may move53 the bankruptcy court54 for partial or total relief55 from the stay. Relief may be granted from the Code section 362(a) stay for "cause."56 In the situations discussed above, relief is often granted.57 Similarly, a creditor may also receive relief from the stay to execute, foreclose, or sell specific collateral if it proves that (1) the debtor has no equity in the property and (2) the property is not reasonably necessary for the debtor's effective reorganization.58 Relief from a co-obligor stay is allowed if (1) between the debtor and the co-obligor, the co-obligor received the consideration for the creditor's claim, (2) the plan filed by the debtor does not propose to pay the claim, or (3) the creditor would otherwise be irreparably harmed.59

52. Although this term is not formally defined, case law assumes that this includes the debtor's prepetition creditors.

53. Relief from automatic stays under the Code is obtained by motion. See Bankr. Rules 4001(a), 9014.

54. Although section 362(d) refers generally to "the court," and not specifically to the bankruptcy court, there seems to be no authority suggesting that a state court could grant relief from the stay. There is no hint of concurrent jurisdiction regarding exercise of the authority provided under Code § 362(d).

55. Bankruptcy courts may attach conditions to relief from the stay. See, e.g., In re Winterland, 101 B.R. 547 (Bankr. C.D. Ill. 1988) (creditor allowed to sue debtor in state court in order to collect from debtor's insurance carrier, but relief conditioned on creditor's payment of debtor's personal attorney's fees).

56. 11 U.S.C. § 362(d) (1988). When there is adequate protection, courts frequently balance the equities in determining whether cause exists for relief from the stay. See, e.g., Holtkamp v. Littlefield (In re Holtkamp), 669 F.2d 505 (7th Cir. 1982) (creditor must show that lifting the stay will harm neither debtor nor other creditors); In re Parkinson, 102 B.R. 141 (Bankr. C.D. Ill. 1988) (no cause exists if lifting the stay will allow creditor to obtain advantage over other creditors); In re Chirillo, 84 B.R. 120, 123 (Bankr. N.D. Ill. 1988) (cause exists if the stay harms the creditor and if granting relief will not unjustly harm the debtor or other creditors).

57. See, e.g., IBM v. Fernstrom Storage & Van Co. (In re Fernstrom Storage & Van Co.), 938 F.2d 731 (7th Cir. 1991) (relief granted to allow determination of debtor's liability in order to collect from insurance carrier); In re Holtkamp, 669 F.2d 505 (7th Cir. 1982) (where notice of bankruptcy filing was provided by debtor's attorney on eve of trial, relief granted to proceed and liquidate creditor's claim in district court); In re Moralez, 128 B.R. 526 (Bankr. E.D. Mich. 1991) (because of state court's expertise and interest, relief granted to allow spouse to file state court action to determine whether Chapter 7 debtor's divorce obligation was in the nature of nondischargeable alimony); In re Parkinson, 102 B.R. 141 (Bankr. C.D. Ill. 1988) (creditor granted relief to prosecute action so long as creditor agreed not to enforce judgment against debtor personally until court decided whether debt was dischargeable); In re Winterland, 101 B.R. 547 (Bankr. C.D. Ill. 1988) (relief from stay granted to allow FDIC to continue action against savings and loan director where judgment to be enforced was against insurance company); In re Pro Football Weekly, Inc., 60 B.R. 824 (N.D. Ill. 1986) (relief from stay granted to allow the filing in state court of compulsory counterclaim against debtor-plaintiff).


When a creditor moves for relief from a Code section 362(a) stay, the stay automatically terminates for the movant unless "after notice and a hearing," the court specifically orders the stay continued pending conclusion of, or as a result of, a final hearing. If the court orders a final hearing, the hearing must begin no later than thirty days after the conclusion of the preliminary hearing. If the stay lapses because the court fails to order a continuation, an additional stay should be "reimposed" only through the affirmative action of the court pursuant to Code section 105, provided that the debtor satisfies traditional criteria for injunctive relief. When a creditor files a request for relief from a co-obligor stay, the stay automatically terminates twenty days later unless within that time the co-obligor files and serves upon the creditor a written objection.

Second, the automatic stay is inapplicable if the bankruptcy court abstains from hearing the subject matter of the state proceeding. Although the scope of mandatory abstention is narrow, bankruptcy courts have substantial discretion to abstain in the interest of justice or comity. For example, bankruptcy courts often exercise such discretion to allow state courts to determine family law matters.

Third, in appropriate cases, the nondebtor may be able to move in bankruptcy court for dismissal of the debtor's case. There are a

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60. According to the Code's rules of construction, the phrase after notice and a hearing does not always mean that an actual hearing must have occurred. 11 U.S.C. § 102(1) (1988). Generally, if no party requests a hearing, or if expedience requires the court to act without first conducting a hearing, then a hearing need not be conducted. 11 U.S.C. § 102(1)(B) (1988).
62. Id.
63. Wedgewood Inv. Fund, Ltd. v. Wedgewood Realty Group, Ltd. (In re Wedgewood Realty Group, Ltd.), 878 F.2d 693, 697-701 (3rd Cir. 1989) (requiring debtor to demonstrate (1) the substantial likelihood of success on the merits, (2) debtor faces irreparable harm, (3) harm to the movant outweighs harm to the nonmovant, and (4) injunctive relief would not violate public interest).
64. 11 U.S.C. §§ 1201(d), 1301(d) (1988).
65. 28 U.S.C. § 1334 (1988). When a state lawsuit is automatically removed to the bankruptcy court, another method of avoiding the effect of the stay is to convince the bankruptcy court to remand the case to the state court. In fact, remand seems to be a necessary technical step after the bankruptcy court has decided on substantive grounds either to grant relief from the stay or to abstain. Consequently, remand is not discussed in the text as an independent alternative.
67. See, e.g., In re French, 139 B.R. 476, 482 (Bankr. D.S.D. 1992) (stating that remand of divorce proceeding to state court was appropriate in order "to allow the state court to use its expertise in resolving such matters").
variety of statutory bases for dismissal. One which is often alleged, and which applies to all types of proceedings, is the debtor's lack of good faith. Finding a lack of good faith requires consideration of a variety of facts and circumstances. Courts have found bad faith when a debtor's sole purpose for a bankruptcy filing was to delay or complicate state court proceedings, avoid or frustrate a state court contempt order, or forestall an inevitable foreclosure. State courts, however, do not have jurisdiction to collaterally attack the stay or the bankruptcy filing because of bad faith.

Nonbankruptcy attorneys are often unaware of these ways around the automatic stay. By inquiring whether counsel has requested relief from the stay, asked the bankruptcy court to abstain, or sought dismissal, state judges may inspire counsel to take action, which, if successful, could preserve the value of the state proceedings to date and the fairness and efficiency of future proceedings.

2. State Actions Violating the Stay

A second problematic scenario arises when a state court conducts a proceeding that violates the stay. In Illinois, as in many

69. See Michigan Nat'l Bank v. Charfoos (In re Charfoos), 979 F.2d 390 (6th Cir. 1992) (bad faith is grounds for dismissing Chapter 11 petition); Elmwood Dev. Co. v. General Elec. Pension Trust (In re Elmwood Dev. Co.), 964 F.2d 508 (5th Cir. 1992) (in determining whether a lack of good faith warranting dismissal exists, a variety of factors must be considered); Industrial Ins. Servs. v. Zick (In re Zick), 931 F.2d 1124 (6th Cir. 1991) (bad faith constitutes "cause" for dismissal of Chapter 7 case under Code § 707(a)).
70. Hardin v. Caldwell (In re Caldwell), 851 F.2d 852, 859 (6th Cir. 1988) (cites 11 factors, acknowledging that no list is exhaustive).
73. Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir. 1984) (finding bad faith where debtor filed Chapter 11 petition on eve of foreclosure sale).
74. Gonzales v. Parks, 830 F.2d 1033 (9th Cir. 1987) (holding that state court was without jurisdiction to hear claim that filing of bankruptcy petition constituted abuse of process).
75. In some instances, including family law proceedings, it is unclear whether the relatively vague "cause" requirement of Code § 362(d)(1) would be met. Assuming that the bankruptcy judges are interested in sending the matter to the state courts, it may be more practical to at least cite abstention as an alternative remedy. As to marital proceedings, the issues of comity necessary to warrant abstention should be satisfied.
other jurisdictions, these proceedings are usually treated as void\textsuperscript{76} and represent a needless waste of judicial and private resources. In addition, under the Code, the creditor responsible for the proceeding faces the possibility of sanctions, including punitive damages.\textsuperscript{77}

\textsuperscript{76} See Garcia v. Phoenix Bond & Indem. Co. (\textit{In re Garcia}), 109 B.R. 335, 338 (N.D. Ill. 1989) (county collectors' postpetition sale of debtor's realty for prepetition taxes); Richard v. City of Chicago, 80 B.R. 451, 453 (N.D. Ill. 1987) (postpetition tax sale); Pettibone Corp. v. Baker (\textit{In re Pettibone}), 110 B.R. 848 (Bankr. N.D. Ill.) (state court personal injury suits), aff'd, 119 B.R. 603 (N.D. Ill. 1990), \textit{vacated on other grounds sub nom.} Pettibone Corp. v. Easley, 935 F.2d 120 (7th Cir. 1991). Although the Seventh Circuit has not reached this issue, see \textit{generally Pettibone}, 935 F.2d 120, most circuits that have taken a position have held state proceedings that violate the stay void. See Maritime Elec. Co. v. United Jersey Bank, 959 F.2d 1194 (3d Cir. 1992) (prepetition conversion action deemed void); Schwartz v. United States (\textit{In re Schwartz}), 954 F.2d 569, 571-72 (9th Cir. 1992) (stating that "the great weight of authority" holds violations of automatic stay void, not voidable; thus, postpetition tax assessment declared void); Ellis v. Consolidated Diesel Elec. Corp., 894 F.2d 371, 372-73 (10th Cir. 1990) (district court "lacked power" to enter summary judgment in products liability action in violation of stay); Smith v. First Am. Bank, N.A. (\textit{In re Smith}), 876 F.2d 524, 526 (6th Cir. 1989) (postpetition repossession and sale of debtor's car by bank was void); 48th St. Steakhouse, Inc. v. Rockefeller Group, Inc. (\textit{In re 48th St. Steakhouse, Inc.}), 835 F.2d 427, 431 (2d Cir. 1987), cert. denied, 485 U.S. 1035 (1988) (landlord's postpetition termination notice violated stay and was void); Borg-Warner Acceptance Corp. v. Hall, 685 F.2d 1306, 1308 (11th Cir. 1982) (any postpetition attempt to exercise self-help or repossession by creditor would be void); see also Kommanditselskab Supertrans v. O.C.C. Shipping, Inc., 79 B.R. 534, 540 (S.D.N.Y. 1987) (if stay applies, "district court's power to adjudicate the case is suspended"); \textit{In re Advent Corp.}, 24 B.R. 612, 614 (Bankr. 1st Cir. 1982) (postpetition termination of general term bond was void); United States v. Coleman Am. Cos. (\textit{In re Coleman Am. Cos.}), 26 B.R. 825, 831 (Bankr. D. Kan. 1983) (postpetition IRS tax assessments held void); Miller v. Savings Bank (\textit{In re Miller}), 10 B.R. 778, 780 (Bankr. D. Md. 1981) (postpetition repossession of car by bank was void), aff'd, 22 B.R. 479 (D. Md. 1982). \textbf{But see} Picco v. Global Marine Drilling Co., 900 F.2d 846, 850 (5th Cir. 1990) (district court's dismissal of suit violated stay and was voidable, not void); \textit{In re Oliver}, 38 B.R. 245, 248 (Bankr. D. Minn. 1984) (voidable, not void). Although these cases all involved the Code § 362(a) stay, there seems to be no reason to expect a different result under the co-obligor stays.

\textsuperscript{77} If a party knowingly and willfully violates the stay, the party may be sanctioned for contempt. In addition, Code § 362(b) states, "[a]n individual injured by any willful violation . . . shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(h) (1988). To recover such damages, the challenging party need not prove that there was specific intent to violate the stay; it is enough to show that the offending party was aware of the bankruptcy proceeding. Goichman v. Bloom (\textit{In re Bloom}), 875 F.2d 224, 227 (9th Cir. 1989). However, courts have disagreed on whether this private cause of action is available to corporate debtors. \textbf{Compare} First RepublicBank Corp. v. NCNB Texas Nat'l Bank (\textit{In re First RepublicBank Corp.}), 113 B.R. 277 (Bankr. N.D. Texas 1989) (the word \textit{individual} must be literally construed; corporate debtor not entitled to damages) \textbf{with} Budget Serv. Co. v. Better Homes Inc., 804 F.2d 289 (4th Cir. 1986) (corporate debtor could collect damages); Whittaker v. Philadelphia Elec. Co., 92 B.R. 110 (E.D. Pa. 1988) (same), aff'd, 882 F.2d 791 (3d Cir. 1989); Mallard Pond Partners v. Commercial Bank & Trust (\textit{In re Mallard Pond Partners}), 113 B.R. 420, 422-23 (Bankr. W.D. Tenn. 1990) (same).
Furthermore, the creditor may even unwittingly lose its right to prosecute its underlying cause of action.

In *Pettibone Corp. v. Easley*, several plaintiffs violated the stay by filing personal injury actions against a Chapter 11 debtor. The Chapter 11 plan indicated that the claims represented by such actions would survive the bankruptcy. Confirmation of the plan terminated the automatic stay. Although the applicable state statutes of limitations had expired before confirmation, the Code extended the creditors’ right to file a complaint until thirty days after termination of the stay. Nevertheless, the creditors did not dismiss and refile their actions, but merely continued them. After the thirty-day period expired, the debtor applied to the bankruptcy court for a ruling that the original filing of the lawsuits was void and that any further action by the creditors was barred by the statute of limitations. Assuming that actions in violation of the stay are void, the debtor’s position was at least arguably correct.

The type of problem presented in *Pettibone* has two possible “solutions.” The first solution is preventive; the second, curative. The automatic stay does not apply to all conceivable proceedings or parties; a number of exceptions and restrictions exist. To minimize the likelihood of allowing an action that violates the stay, state judges should learn these limits and should ask counsel questions designed to reveal whether a stay applies. The judge should at least ask each counsel if his or her client is a debtor in bankruptcy or if any alleged co-obligor in the disputed obligation is a debtor in bankruptcy. Judges should obtain specific answers on the record from the parties as well. If the answers to these questions are in the negative, the judge can fairly confidently assume that no automatic stay applies. The judge should instruct counsel,

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78. 935 F.2d 120 (7th Cir. 1991).
79. *Id.* at 121.
80. *Id.* at 122 (citing 11 U.S.C. § 362(c) (1988)).
82. *Pettibone*, 935 F.2d at 122. The bankruptcy court declared the filings void, but lifted the stay retroactively to a point in time prior to the filings of the tort claims and the confirmation, thus making the filings timely. *Id.* The district court affirmed. *Id.* (citing *Pettibone Corp. v. Baker* 119 B.R. 603 (N.D. Ill. 1990)). Stating that the bankruptcy court lacked jurisdiction to decide the statute of limitations defenses, the Seventh Circuit, however, refused to decide the issue and remanded the case with instructions to dismiss the debtor’s adversary complaint. *Id.* at 124.
83. See, e.g., 11 U.S.C. § 362(b) (1988) (criminal actions, alimony collection, and governmental regulatory actions, among others, are not stayed by the Code).
in the presence of their clients, that if the answers to either question changes at any time during the proceeding, the court must be notified at once.

If the answer to either of the questions is in the affirmative, the judge should ask counsel to produce a certified copy of the bankruptcy petition. Upon reviewing the petition, the judge should ascertain the nature of the bankruptcy proceeding and the nature of the claims asserted in the state action. On the basis of the answers given, the judge can determine whether or not a stay applies. In this way, the judge can prevent the continuation of state court proceedings that violate a stay.

Assuming that a particular proceeding has violated a stay, it may be possible to cure the violation in either of two ways. First, a creditor may seek relief from the stay under Code section 362(d), which permits a court to terminate, annul, modify, or condition a stay. Some courts have ruled that in appropriate instances a stay may be annulled, and if so, a state proceeding that would otherwise have been void may be cured. It is essential that a creditor seeking such relief specifically ask for annulment of the stay.

Although in Pettibone the bankruptcy court granted such relief to the creditors, the Court of Appeals for the Seventh Circuit refused to rule whether the annulment would successfully overcome the debtor's statute of limitations defense. The court left this issue to the appropriate state courts. Indeed, in Pettibone, the retroactive relief was granted after the case and the stay had been terminated. The court acknowledged that there might be difficulty in retroactively annulling a stay that had already been

84. It is probably easier for counsel to the party in bankruptcy to produce such a copy. Nonetheless, the stay applies automatically, even before the trial judge is convinced a filing has been made. Arguably, the stay may technically enjoin the court from demanding any action of the debtor—or the debtor's agent—including production of a certified copy of the bankruptcy petition. In practice, it is unlikely that debtor's counsel will raise this objection. In any event, the opposing party could probably obtain the copy without undue inconvenience.


87. Pettibone, 935 F.2d at 124.

88. Id.

89. Id. at 121, 123-24.
terminated.\textsuperscript{90}

Alternatively, in appropriate circumstances, a creditor may ask a court to equitably estop the debtor from asserting that a state proceeding was void. In a few cases involving egregious facts, courts have granted such relief.\textsuperscript{91} Consequently, in cases in which a proceeding has violated the stay, a state judge should inquire whether creditor's counsel has sought annulment of the stay or equitable estoppel of the debtor. In this way, the judge can cure the violation of the stay and maintain the integrity of the state proceeding.

3. Erroneous Suspension or Dismissal of State Proceedings

State courts, erroneously believing that a stay applies, may refuse to allow an action to proceed. Such an act could prejudice the parties. Evidence may be difficult to preserve, opportunity costs may be irrevocably lost, and collectability of debts may be jeopardized. Therefore, it is essential that state judges understand when stays do not apply. As a practical matter, to determine if an exception applies, judges should familiarize themselves with at least the basic exceptions\textsuperscript{92} and should closely question counsel in those cases involving a bankruptcy filing.

The provisions establishing the stays do not purport to bar all actions by creditors. For example, aside from those instances to which the co-obligor stays in Chapters 12 and 13 apply,\textsuperscript{93} creditors are free to sue a debtor's co-obligor.\textsuperscript{94} The co-obligor stays do not

\textsuperscript{90} See id. at 121 (stating that it was "troubled by the idea that a judge can 'modify' something that has expired," and acknowledging that "[e]ven legal fictions have their limits").

\textsuperscript{91} See, e.g., Matthews v. Rosene, 739 F.2d 249 (7th Cir. 1984) (where debtor, while in bankruptcy, had fully participated in litigation leading to a 33-month-old judgment without ever raising the stay as a defense, the equitable doctrine of laches barred the debtor from arguing that the state judgment was void); Job v. Calder (In re Calder), 907 F.2d 953 (10th Cir. 1990) (holding that equity prevented debtor from claiming protection of stay after state court judgment was entered, when debtor had actively litigated the state court action).

\textsuperscript{92} 11 U.S.C. § 362(b) (1988).

\textsuperscript{93} See supra notes 42-43 and accompanying text.

\textsuperscript{94} Royal Truck & Trailer, Inc. v. Armadora Maritima Salvadorena, 10 B.R. 488, 491 (N.D. Ill. 1981). Consequently, the debtor's filing will not automatically toll any statute of limitations that applies to actions against a co-obligor. Of course, if under state law the debtor is an indispensable party to the state action, it is possible that the state statute of limitations would be tolled.

Note, however, that in some instances, a bankruptcy court will use its power under Code § 105 to affirmatively enjoin proceedings against a particular co-obligor. See, e.g., Chase Manhattan Bank v. Third Eighty-Ninth Assocs. (In re Third Eighty-Ninth Assocs.), 138 B.R. 144, 148 (S.D.N.Y. 1992) (action against one guarantor stayed because
apply to commercial debts or to cases in which a co-obligor in-
curred its debt in the ordinary course of its business. 95 Similarly,
postpetition creditors are not ordinarily stayed from pursuing the
debtor or the property of the debtor; 96 nor are creditors prevented
from prosecuting actions against entities in which the debtor
merely owns an interest. 97

Code section 362(b) provides a list of explicit exceptions to the
automatic stay. 98 Those which most commonly involve state
courts include: (1) government actions to enforce both its criminal
laws and its police powers (but not to enforce a money judgment
even if obtained pursuant to such police powers), and to foreclose
on property pursuant to or affected by particular federal statutes;
(2) actions to collect alimony or support from property of the
debtor; and (3) proceedings to evict the debtor from nonresidential
property in cases in which a lease has expired either before or dur-
ing the bankruptcy proceeding. 99

If a creditor proves to the state court that he or she filed a mo-
tion for relief from the Code section 362(a) stay and represents
that the bankruptcy court did not order continuance of the stay within
thirty days, the state judge should ask debtor's counsel for proof
that an order for continuance was issued. In the absence of such
proof, the state judge may assume that the stay automatically ter-
minated. 100 Similarly, if the creditor proves that he or she filed a
request for relief from the co-obligor stay and represents that the
co-obligor failed to file a written objection within twenty days, the
state judge should ask co-obligor's counsel for proof that a written
objection was filed in a timely manner. If there is no proof, the
state court may assume that the co-obligor stay terminated.

under the circumstances such action would burden the debtor's estate; action not stayed
for two other guarantors).

96. In re Harvey, 88 B.R. 860, 862 (Bankr. N.D. Ill. 1988) (stay does not bar credit-
or's collection efforts for postpetition debts on asset while debtor is in possession of the
asset); In re Anderson, 23 B.R. 174, 175 (Bankr. N.D. Ill. 1982) (creditor may proceed
with suit filed against the debtor after the bankruptcy proceeding).
(although the debtor owns 100% of the stock of a corporation, the stay does not bar suit
against the corporation); cf. Teachers Ins. & Annuity Ass'n of Am. v. Butler, 803 F.2d
61, 65-66 (2d Cir. 1986) (when a partnership is a debtor, the stay does not automatically
bar actions against individual partners).
99. Id.
III. BANKRUPTCY DISCHARGE

Most debtors file bankruptcy to obtain a “discharge” that eliminates their personal liability for debt and enjoins any action to collect, recover, or offset any debt as a personal liability of the debtor.\(^{101}\) Because of their conduct, some debtors are not entitled to discharge any of their debts.\(^ {102}\) Similarly, even if the debtor is generally granted a discharge, certain debts are not dischargeable.\(^ {103}\) State courts have two important roles with respect to bankruptcy discharges: (1) determining if a debt has been discharged,

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102. Code § 727, for instance, provides numerous bases for denying a discharge to Chapter 7 debtors, including: (1) fraudulent prepetition transfer, removal, destruction, mutilation or concealment of property of the debtor; (2) fraudulent postpetition transfer, removal, destruction, mutilation or concealment of property of the estate; (3) unjustified concealment, destruction, mutilation, falsification of or failure to preserve financial records; (4) knowing and fraudulent making of a false oath, presentation or use of a false claim, or withholding of financial records in or in connection with a bankruptcy case; (5) knowing and fraudulent giving, offer to give, receipt or attempt to obtain valuable consideration for acting or forbearing to act in or in connection with a bankruptcy case; (6) failure to satisfactorily explain the loss of assets or deficiency of assets to meet debts; (7) refusal to obey lawful court orders or, with certain exceptions, refusal to testify or to respond to material questions approved by the court; (8) specified debtor misconduct in connection with certain other bankruptcy proceedings; (9) receipt of a discharge in a Chapter 7 or Chapter 11 case filed within six years of the filing of the instant proceeding; (10) receipt of a discharge in a Chapter 12 or 13 case filed within six years of the filing of the instant case where creditors in the Chapter 12 or 13 case did not receive certain minimum percentages of their unsecured claims; (11) bankruptcy court approval of a written waiver of discharge that was executed by the debtor during the bankruptcy proceeding. 11 U.S.C. § 727 (1988). See generally Ginsberg, supra note 2, §§ 11.01-11.04, at 11-1 through 11-58.

103. Code § 523(a) enumerates many types of debts that are nondischargeable to individual debtors in Chapters 7, 11 and 12 and in some Chapter 13 cases. 11 U.S.C. § 523(a) (1988). Most, but not all, of the kinds of debt listed in Code § 523(a) are dischargeable in Chapter 13 if the debtor makes all of the payments required by a confirmed Chapter 13 plan. See 11 U.S.C. § 1328 (1988).

The debts specified in Code § 523(a) include (1) debts for certain taxes; (2) debts incurred by fraud; (3) debts not properly listed on required schedules filed by the debtor when respective creditors did not have adequate notice of the bankruptcy case; (4) debts for fraud or defalcation by a fiduciary; (5) debts for embezzlement or larceny; (6) debts for alimony or support for a spouse or former spouse; (7) debts for willful and malicious injury; (8) certain government fines and penalties, including criminal restitution obligations; (9) student loans; (10) debts for death or personal injury caused by the debtor's illegal operation of a motor vehicle because of intoxication from use of alcohol, a drug, or another substance; (11) debts that could have been, but were not, discharged in a prior Chapter 7 proceeding; and (12) certain debts incurred in connection with a “Federal depository institutions regulatory agency” or a depository institution. 11 U.S.C. § 523(a) (1988). See generally Ginsberg, supra note 2, §§ 11.05-11.07, at 11-58 through 11-159; Steven H. Resnicoff, Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse? Bankruptcy Dischargeability of Vicarious Debt, 42 CASE W. RES. L. REV. 147 (1992).
or is dischargeable; and (2) ruling on the character or nature of a debt. Crucial to both functions is an awareness of discharge law.

A. Determining If a Debt Has Been Discharged or Is Dischargeable and the Effect of a Discharge

The issue of whether a particular debt has been discharged usually arises in state court when a defendant in a civil action raises an alleged bankruptcy discharge as an affirmative defense. It is relatively easy to determine whether the debtor was granted a general discharge of debt by the bankruptcy court. It is more difficult to determine whether a granted discharge applied to the particular debt involved in the state court proceeding.

Creditors who want to object to the discharge of certain types of debts must do so in the bankruptcy proceeding. In many cases, however, there is no obligation to object formally during the bankruptcy case. Instead, after expiration of the automatic stay, a creditor who believes that the debt was nondischargeable may simply sue the debtor in nonbankruptcy court. In these cases, state courts have concurrent jurisdiction to determine whether the debt was dischargeable and, therefore, in fact discharged. The state court determinations are given res judicata and/or collateral estoppel effect.


105. State courts have concurrent jurisdiction over all grounds for nondischargeability under Code § 523(a) except for (a)(2), (a)(4) and (a)(6). See BANKR. RULE 4007(b) advisory committee’s note; COLLIER, supra note 2, ¶ 523.15[6]; see also Balvich v. Balvich (In re Balvich), 135 B.R. 327, 330 (Bankr. N.D. Ind. 1991) (state courts have concurrent jurisdiction over dischargeability issues under Code § 523, except for §§ 523(a)(2), (a)(4) and (a)(6)); Indiana Univ. v. Canganelli, 501 N.E.2d 299 (Ill. App. Ct. 1986) (concurrent jurisdiction under Code § 523(a)(8)); In re Littlefield, 17 B.R. 549, 551 (Bankr. D. Me. 1982) (bankruptcy court has exclusive jurisdiction under Code §§ 523(a)(2), (a)(4) and (a)(6) and concurrent jurisdiction with state courts for other exceptions to discharge under Code § 523(a)).


Collateral estoppel, however, applies to state court factual determinations, even if the
Alternatively, while a bankruptcy proceeding is ongoing and before a discharge is granted, parties may obtain relief from the automatic stay to have the state court adjudicate whether specific debts are dischargeable. For instance, although an obligation to pay maintenance or alimony to a child or former spouse is nondischargeable, obligations arising from property settlements are dischargeable.\textsuperscript{107} A state divorce decree may call for the debtor to make certain payments to the nondebtor spouse. In this case, a bankruptcy court may be especially interested in granting relief from the stay to allow the state court to determine whether, as a matter of federal bankruptcy law, the payments required by the divorce decree constitute maintenance or a property settlement.\textsuperscript{108}

Even assuming that the state court determines that a debt has been discharged, the court must properly appreciate the effect of the discharge. The discharge does not eliminate the liability of any nondebtor co-obligor. Nor does the debtor's discharge interfere with the enforceability of any security interests or liens that were

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\textsuperscript{108} Balvich v. Balvich (\textit{In re Balvich}), 135 B.R. 327, 330 (Bankr. N.D. Ind. 1991) (when divorce obligations arise out of extended state court proceedings, the interests of efficiency and economy dictate that dischargeability issue be resolved by state court); \textit{In re Moralez}, 128 B.R. 526, 528 (Bankr. E.D. Mich. 1991) (because of state court's expertise and interest, relief granted to allow spouse to file state court action to determine whether Chapter 7 debtor's divorce obligation was in the nature of nondischargeable alimony).
not avoided\textsuperscript{109} in the bankruptcy proceeding.\textsuperscript{110}

The Bankruptcy Code specifically overrules traditional contract law, under which a written promise to pay a discharged contractual debt was enforceable because the promise was supported by "moral consideration."\textsuperscript{111} Code section 524 allows a debtor to "re-affirm" his or her personal liability on a debt so that it will be unaffected by the discharge, but the debtor may do so only pursuant to the technical procedure specified in Code section 524, which requires, among other things, that any such reaffirmation be achieved through a writing submitted to the bankruptcy court and executed by the debtor before the discharge.\textsuperscript{112}

\textbf{B. Rulings Affecting Whether a Debt is Dischargeable}

Even when a dischargeability ruling is rendered by a bankruptcy court, the result may substantially depend on the adequacy of the record established in earlier state court proceedings. For example, a debt for money, property, or services incurred by fraud is generally nondischargeable in Chapters 7 and 12.\textsuperscript{113} A plaintiff in a state court action may plead and litigate the case on alternative causes of action, one sounding in contract and another in fraud, seeking the same financial judgment. If the state court specifically finds that the debtor acted fraudulently, this factual finding is entitled to collateral estoppel treatment in the bankruptcy proceeding.\textsuperscript{114} As a result, the bankruptcy court will declare the debt nondischargeable without having to retry the issue of fraud. If, instead, the state court merely renders a monetary judgment without articulating a finding regarding fraud, a bankruptcy court determination of dischargeability may consume considerable additional resources. Therefore, to preserve the value of the state court proceeding and to conserve resources, state court judges should ascertain the

\textsuperscript{109} The Code provides a variety of grounds on which particular liens may be avoided. \textit{See}, e.g., 11 U.S.C. §§ 506(d), 522(f), 544, 547, 548 and 549 (1988).

\textsuperscript{110} In describing the effect of a discharge, Code § 524(a) repeatedly refers to the "personal liability of the debtor" and states no limitations on actions against a nondebtor co-obligor or against unavoidable liens. 11 U.S.C. § 524(a) (1988). \textit{See generally GINSBERG, supra note 2, § 11.01[b], at 11-9 through 11-12; COLLIER, supra note 2, § 524.01.}

\textsuperscript{111} The former Bankruptcy Act did not interfere with the operation of Illinois contract law. Consequently, an obligation to pay discharged under the Act could be enforceable upon a new promise to pay. \textit{See} Stern v. Bradner Smith & Co., 80 N.E. 307, 310 (Ill. 1907) (holding that moral obligation was sufficient consideration for new promise).

\textsuperscript{112} 11 U.S.C. § 524(c) (1988).


\textsuperscript{114} \textit{See supra} note 106 and accompanying text.
Code’s dischargeability criteria and establish an appropriate record.

A clear record is important even in cases in which the doctrine of collateral estoppel does not specifically apply. For instance, under Code section 523(a)(5), a debt for alimony or for maintenance of a former spouse or child is nondischargeable, while a property settlement is dischargeable.\footnote{115} Whether an obligation constitutes alimony or a property settlement for dischargeability purposes is a matter of federal bankruptcy law.\footnote{116} When a divorce proceeding precedes the bankruptcy, the dischargeability question does not arise in the divorce court, although state courts have concurrent jurisdiction to determine this issue.\footnote{117} Nevertheless, the bankruptcy court will look to the state court record in considering a multitude of relevant factors,\footnote{118} including whether (1) the parties or the court intended the obligation to be for support; (2) at the time of the order or decree, the obligation was necessary for the recipient’s support in light of the recipient’s relative financial resources and earning power; (3) the obligation was designated in the

\begin{footnotes}
\footnote{117}{Nuellen v. Lawson, 462 N.E.2d 738, 740 (Ill. App. Ct. 1984).}
\footnote{118}{The courts identify long, nonexclusive lists of factors to be considered in determining whether a financial obligation is a nondischargeable alimony or maintenance debt or a dischargeable property settlement. See, e.g., In re Marriage of Porter, 593 N.E.2d 1138, 1142 (Ill. App. Ct. 1992) (criteria include nature of obligation, existence of children, relative earning power of spouses, and adequacy of other support); Daulton v. Daulton (In re Daulton), 139 B.R. 708, 710 (Bankr. C.D. Ill. 1992) (citing 20 factors, including any indication found in agreements, existence of children, and the parties’ understanding of provisions); In re Marriage of Lytle, 435 N.E.2d 522, 526 (Ill. App. Ct. 1982) (criteria include nature of obligation, existence of children, relative earning power of spouses, and adequacy of other support); Coffman v. Coffman (In re Coffman), 52 B.R. 667, 674-75 (1985) (citing 18 factors, including whether there was an alimony award entered by state court, whether the court intended to provide support, and the age, health, work skills and educational levels of the parties); see also Sommer, supra note 38, at 71; Diane M. Allen, Annotation, Debs for Alimony, Maintenance, and Support as Exceptions to Bankruptcy Discharge, Under § 523(a)(5) of the Bankruptcy Code of 1978 (11 USCS § 523(a)(5)), 69 A.L.R. Fed. 403 (1984); David N. Ravin & Kenneth A. Rosen, The Dischargeability in Bankruptcy of Alimony, Maintenance and Support Obligations, 60 AM. BANKR. L.J. 1, 7 (1986). This determination is especially complicated when applicable nonbankruptcy law, such as Illinois equitable distribution law, encourages the elimination of alimony as a by-product of the division of property; cf. Jenkins v. Jenkins (In re Jenkins), 94 B.R. 355, 356 (Bankr. E.D. Pa. 1988) (discussing how this problem arises under Pennsylvania law).}
\end{footnotes}
order or decree as alimony; (4) other obligations in the order or decree were designated as alimony or child support; (5) the spouse-recipient had custody of minor children; (6) the obligation was to be paid periodically or in a lump sum; (7) the obligation was subject to modification if the parties' relative earning power changed or upon other changed circumstances; (8) the obligation would terminate upon a spouse-recipient's remarriage or a child-recipient's attaining the age of majority; (9) the parties treated the obligation as support for tax purposes; (10) the obligation was expressly enforceable by contempt. 119

To ensure that in the event of bankruptcy the proper dischargeability determination is made, the state court should establish a proper record on these factors. The record should explicitly articulate and factually justify the intended function of divorce obligations. The need for these explanations may be especially acute for arguably ambiguous obligations such as "hold harmless" agreements and the assumption of debt owed to third parties. 120

IV. ACCESS TO AND BENEFITS FROM STATE COURT PROCEEDINGS

Aside from the direct effects of bankruptcy stays, the filing of a bankruptcy proceeding affects a party's access to state courts and his or her benefits from state court proceedings.

A. Access to State Courts

Access to state courts is affected by statutes of limitations, court orders, and agreements that restrict access. For example, Illinois

119. Some courts carefully examine the structure and terminology of a divorce order or decree. See, e.g., Tilley v. Jessee, 789 F.2d 1074, 1077 (4th Cir. 1986) (although true intent of the parties controls, written agreement may be examined as persuasive evidence of intent). A divorce decree that designates an award as either maintenance or property settlement, however, is far from dispositive. E.g., Williams v. Williams (In re Williams), 703 F.2d 1055, 1057 (8th Cir. 1983) (court not bound to accept the characterization of an award, contained in a divorce decree, as maintenance or property settlement).

120. See, e.g., In re Coil, 680 F.2d 1170, 1172 (7th Cir. 1982) (in determining dischargeability of debt assumption, consider nondebtor's ability to support self absent the assumption); In re Marriage of Porter, 593 N.E.2d 1138, 1142 (Ill. App. Ct. 1992) (cites numerous factors for determining whether assumption of debt to third party is support including, nature of obligation, presence of children, parties' relative earning power, adequacy of support absent debt assumption, whether obligation terminated upon nondebtor's remarriage or death, tax treatment, explicit waiver of support); In re Marriage of LaShellle, 572 N.E.2d 1190, 1194 (Ill. App. Ct. 1991) (assumption of second mortgage was nondischargeable support given nondebtor's inability to support self absent such assumption); In re Marriage of Lytle, 435 N.E.2d 522, 526 (Ill. App. Ct. 1982) ("hold harmless" agreement is nondischargeable only if in the nature of support).
law provides that if a potential plaintiff is barred by law—presumably including federal bankruptcy law—from suing a party, any Illinois statute of limitations regarding an action against the party is tolled.\footnote{121} In addition, other Illinois statutes provide additional time for certain acts when particular persons have filed bankruptcy.\footnote{122}

The Code itself does not “freeze” deadlines during the period of the bankruptcy,\footnote{123} but it provides some relief. Code section 108(c) states that if a deadline has not expired at the time of the bankruptcy filing, then a creditor may file within thirty days after notice of termination or expiration of the stays. This provision includes deadlines fixed by nonbankruptcy law, orders in nonbankruptcy proceedings, or agreements.\footnote{124}

Code section 108(b) extends deadlines regarding certain actions

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\footnote{121. See ILL. REV. STAT. ch. 110, para. 13-216 (1991).}

\footnote{122. See, e.g., ILL. REV. STAT. ch. 110, para. 12-104 (1991); ILL. REV. STAT. ch. 120, para. 444 (effective 1/1/93); ILL. REV. STAT. ch. 120, para. 2166 (1991).}

\footnote{123. See 11 U.S.C. § 108(b) (1988); Goldberg v. Tynan (In re Tynan), 773 F.2d 177, 180 (7th Cir. 1985); Moody v. Amoco Oil Co., 734 F.2d 1200, 1213 (7th Cir. 1984); Electronic Realty Assocs., Inc. v. ERA Cent. Regional Servs., Inc. (In re ERA Cent. Regional Servs., Inc.), 39 B.R. 738, 741 (Bankr. C.D. Ill. 1984).}

\footnote{124. 11 U.S.C. § 108(c) (1988). For example, if there are only 100 days remaining in the statutory period when the debtor files bankruptcy, and the bankruptcy stay is in effect for 200 days, the debtor’s right of redemption is extended until 30 days after notice of termination or expiration of the stay. The creditor is not given 100 days after such notice. See, e.g., Great Am. Ins. Co. v. Bailey (In re Cutty’s-Gurnee, Inc.), 133 B.R. 929, 932 (Bankr. N.D. Ill. 1991) (Code § 108(c) extends creditor’s right to enforce mechanic’s lien against property owner); In re Coan, 96 B.R. 828, 831 (Bankr. N.D. Ill. 1989) (Code § 108(c) extended citation lien even though Illinois law calls for automatic termination six months after date of respondent’s personal appearance in citation lien proceedings). Note, however, that this section refers only to automatic stays pursuant to 11 U.S.C. §§ 362, 922, 1201 or 1301. 11 U.S.C. § 108(c) (1988). Surprisingly, it does not explicitly apply where a stay was issued by a bankruptcy court pursuant to the court’s equitable powers under Code § 105. The following two examples illustrate how ILL. REV. STAT. ch. 110, para. 13-216, and Code § 108(c) may apply to Illinois statutes of limitations.

Example A:
Assume that John Smith has a state cause of action against Jane Doe and that Jane files bankruptcy two days before the Illinois statute of limitations expires for John’s cause of action. Under Illinois law, bankruptcy’s automatic stay, by preventing John from suing Jane, will toll the state statute of limitations; the state statute will not expire until two days after termination of the automatic stay. Because of Code § 108(c), however, John will be able to sue Jane in state court at any time within 30 days after notice of termination or expiration of the stay.

Example B:
Assume that Jane files bankruptcy 90 days, not two days, before the Illinois statute of limitations expires for John’s cause of action, and assume that the automatic stay does not terminate or expire until six months after the filing. In this case, the Illinois statute gives John more time to file suit than Code § 108(c) does. Under Code § 108(c), John will have only 30 days after notice of termination or expiration of the stay. Nevertheless,
for a debtor or a party protected by a co-obligor stay\textsuperscript{125} until the later of (1) the nonbankruptcy deadline, including any applicable suspension, or (2) sixty days after the filing of the bankruptcy petition.\textsuperscript{126} Nevertheless, while Code section 108(c) explicitly extends deadlines applicable to creditors for, among other things, the "commencing or continuing a civil action in a court other than a bankruptcy court,"\textsuperscript{127} Code section 108(b), referring to debtors and beneficiaries of co-obligor stays, does not refer to the commencement or continuation of civil actions.

In contrast, Code section 108(a) does extend deadlines regarding a debtor's right to commence an action. Code section 108(a) states that if such a nonbankruptcy deadline has not expired by the date the bankruptcy petition is filed, the bankruptcy trustee (or, presumably, the debtor in possession)\textsuperscript{128} is allowed to file the action until the later of (1) the nonbankruptcy deadline, including any applicable suspension thereof, or (2) two years after the filing of the bankruptcy petition.\textsuperscript{129} Nevertheless, although it extends this deadline, Code section 108(a) does not explicitly provide extra time for the debtor to act; all that it expressly states is that a trustee may file suit after the original deadline. Consequently, if a bankruptcy case is dismissed and a cause of action that had been property of the estate reverts to the debtor, the debtor may not be able to rely on Code section 108(a).

If a bankruptcy case is dismissed and an action reverts to the debtor, the debtor may be able to rely on the Illinois statute discussed above.\textsuperscript{130} When the cause of action originally became property of the estate, the action could be asserted only by parties charged with administering property of the estate, the trustee, or the "debtor-in-possession."\textsuperscript{131} Consequently, under Illinois law, a bankruptcy filing may toll any state statutes of limitations until the

\textsuperscript{125} Interestingly, 11 U.S.C. § 108 does not explicitly apply to beneficiaries, if any, of stays affirmatively issued by the bankruptcy court pursuant to Code § 105 but only to beneficiaries of the automatic stays under Code §§ 362, 922, 1201, and 1301. See 11 U.S.C. § 108(c) (1988).
\textsuperscript{130} See ILL. REV. STAT. ch. 110, para. 13-216 (1991); see also text accompanying supra note 121.
applicable cause of action reverts to the debtor.\textsuperscript{132}

B. Effect on Rights Received Through State Courts

Bankruptcy law also significantly affects the rights that persons receive through state judicial proceedings. A number of Code provisions allow a bankruptcy trustee or debtor-in-possession to avoid voluntary and involuntary transfers of interests in property.\textsuperscript{133} The likelihood of avoidance can be minimized by careful state court action. For example, under state law, a regularly conducted, non-collusive judicial foreclosure sale may be presumed to have been a transfer for reasonably equivalent value, protected from avoidance under state law as a constructively fraudulent transfer.\textsuperscript{134} Nevertheless, there is no such explicit presumption in the Code, and although cases in some circuits have applied such a presumption, the Seventh Circuit has not. Instead, the Seventh Circuit has held that whether a judicial foreclosure sale was for "reasonably equivalent value" is a fact question that must be determined in light of the totality of the circumstances.\textsuperscript{135} State courts can maximize the likelihood that the sale will survive attack under the Code as a fraudulent transfer by requiring that commercially reasonable steps be taken in connection with foreclosure sales and by documenting such steps as well as any factors that would explain a low sale price.

Similarly, a judicial lien is avoidable if it impairs a debtor's exemption.\textsuperscript{136} A judicial lien is a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."\textsuperscript{137} Even if it is created by a consent judgment, the lien is a judicial lien.\textsuperscript{138} If a lien is avoided, the creditor is often left with a dis-

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\textsuperscript{132} The Illinois statute does not provide relief to the debtor from deadlines fixed by federal statutes of limitations, orders of nonbankruptcy courts, or agreement. See ILL. REV. STAT. ch. 110, para. 13-216 (1991).

\textsuperscript{133} For example, the creation of judicial liens or transfers of property effected by judicial sales may be avoided as "preferential transfers," 11 U.S.C. § 547, as unallowed impairments of bankruptcy exemptions, 11 U.S.C. § 522(f)(1), as "fraudulent transfers," 11 U.S.C. §§ 548, 544(b), or as unauthorized postpetition transfers, 11 U.S.C. § 549. Of course, a postpetition judicial lien that arose from a violation of the automatic stay may simply be void. See 11 U.S.C. § 362 (1988).

\textsuperscript{134} See, e.g., ILL. REV. STAT. ch. 59, para. 104(b) (1991).

\textsuperscript{135} Bundles v. Baker (In re Bundles), 856 F.2d 815, 824 (7th Cir. 1988).

\textsuperscript{136} 11 U.S.C. § 522(f)(1) (1988). The only exemptions available to a debtor in Illinois are those that would be exempt from creditor collection under Illinois nonbankruptcy law. ILL. REV. STAT. ch. 110, para. 12-1201 (1991); e.g., In re Sullivan, 680 F.2d 1131, 1133 (7th Cir. 1982).


\textsuperscript{138} Commonwealth Nat'l Bank v. United States (In re Ashe), 712 F.2d 864, 868 (3d
chargeable, unsecured claim, which usually remains largely un-
paid. Therefore, in selecting which property to lien, and in
evaluating the adequacy of such liens, the parties and the court
should consider the likelihood of such avoidance.

As a practical matter, the state judge may be able to provide
some additional protection to the lienor by asking the lienee, on the
record, whether he or she has any current intention to file bank-
ruptcy in the near future. If the lienee answers in the negative but
ultimately files for bankruptcy and if it can be established that the
lienee lied to the state court, the lienee can be denied a discharge
of debt or have his or her bankruptcy case dismissed because of
bad faith.

V. SPECIAL PROBLEMS IN MARITAL DISSOLUTIONS

Several ways in which bankruptcy and state matrimonial disso-
lution proceedings interact have already been briefly discussed.
This part examines three additional matters about which there is
considerable confusion.

A. Enforcement of Support Obligations

The automatic stay generally applies to efforts to enforce sup-
port obligations. Contempt proceedings based on a debtor’s failure
to pay which allow the debtor to avoid some or all punishment by
making payment are coercive. These proceedings, referred to as
actions in civil contempt, do not fall within the Code section
362(b)(1) exception for criminal proceedings.

Cir. 1983), cert. denied, 465 U.S. 1024, reh’g denied, 466 U.S. 963 (1984); Maus v. Maus,
837 F.2d 935, 938 (10th Cir. 1988).
139. It would, of course, be difficult to prove such deceit. Dishonest debtors could
assert that although they did not originally intend to file for bankruptcy, they changed
their minds. Nevertheless, by raising the issue, a state court judge could at least alert a
lienor to the potential effect of bankruptcy law.
140. For example, if the creation of the debt was the result of the debtor’s fraud,
Code § 523(a)(2) may make the debt nondischargeable.
141. See, e.g., supra note 69.
142. See supra notes 107-08 and accompanying text.
143. See, e.g., In re Marriage of Lueck, 489 N.E.2d 443 (Ill. App. Ct. 1986) (distin-
guishing contempt sanctions for failure to pay a judgment and to compel expenditure
from contempt sanctions to uphold the dignity of the court).
Criminal contempt, which imposes a fixed penalty on the debtor for failure to obey a
court order and which does not allow the debtor to reduce the penalty by subsequent
compliance with the order, is a “criminal proceeding” excepted from the stay under Code
§ 362(b)(1). See Chicago City Bank & Trust Co. v. Drake Int’l, Inc., 570 N.E.2d 765,
1. Statutory Construction

Code section 362(b)(2) provides an exception for “the collection of alimony, maintenance, or support from property that is not property of the estate.” This exception is narrowly construed and does not allow actions to create or modify support obligations. Examples of properties that are not considered property of the estate in an individual debtor’s Chapter 7 or Chapter 11 proceeding include property that is exempted, property that is abandoned to the debtor personally, and the debtor’s postpetition “earnings from services.” Consequently, although some difficult questions may arise, a nondebtor spouse in Chapters 7 and 11 may ordinarily institute wage-deduction proceedings to collect support.

Serious confusion arises about whether a debtor’s postpetition wages are “property of the estate” in Chapters 12 and 13. Each of these chapters contains a provision stating that property of the estate includes the debtor’s earnings from services after the filing “but before the case is closed, dismissed or converted to a case under chapter 7.” On the other hand, Chapters 12 and 13 also contain provisions stating that “[e]xcept as otherwise provided in

145. Stringer v. Huet (In re Stringer), 847 F.2d 549, 552 (9th Cir. 1988) (holding that child support payments are only exempt if established by an order prior to the bankruptcy filing); Freels v. Russell (In re Freels), 79 B.R. 358, 361 (Bankr. E.D. Tenn. 1987) (refusing to allow an increase in alimony despite debtor’s bankruptcy filing which materially altered the circumstances); Amonte v. Amonte, 461 N.E.2d 826, 830 (Mass. App. Ct. 1984) (concluding that § 362(b)(2) only applies to judgments for marital support that were entered before the bankruptcy filing).
147. Note that at least one court has forced a recalcitrant debtor to use available bankruptcy exemptions to remove property from the estate in order that a nondebtor spouse could execute thereon pursuant to Code § 362(b)(2). Summerlin v. Summerlin (In re Summerlin), 26 B.R. 875, 878 (Bankr. E.D.N.C. 1983).
150. Specifically, questions often arise concerning what constitutes “earnings from services.” See, e.g., Fitzsimmons v. Walsh (In re Fitzsimmons), 725 F.2d 1208, 1211 (9th Cir. 1984) (Chapter 11 and Code § 541(a)(6) exceptions apply only to earnings for services and do not allow a creditor’s collection action against that portion of sole proprietor’s income that is attributable to capital investment, contracts with employees, etc.); Unsecured Creditors Comm. v. Prince (In re Prince), 127 B.R. 187, 193 (N.D. Ill. 1991) (Code § 541(a)(6) exception does not allow a creditor’s collection against payments received by debtor in exchange for a postpetition covenant not to compete; such payments were not payments for services); cf. Bible v. Bible (In re Bible), 110 B.R. 1002, 1006 (Bankr. S.D. Ga. 1990) (Code § 362(b)(2) does not allow civil contempt action because focus of such action is coercion on the debtor personally and not collection against particular assets that are not “property of the estate”).
the plan or the order confirming the plan, the confirmation of the plan vests all of the property of the estate in the debtor.”

The arguably “best” reading of these two provisions seems to create three rules, only the third of which would permit commencement of wage-deduction proceedings to collect support:

(1) Wage-deduction proceedings are certainly stayed until confirmation of the plan.153

(2) If the plan or the order confirming it designates postpetition earnings as property of the estate, the provision is effective and wage-deduction proceedings are stayed.154

(3) If neither the plan nor the order confirming it addresses this issue, then, upon confirmation of the plan, the debtor’s earnings and all of the former property of the estate becomes the debtor’s property, subject to collection action by the nondebtor for support.155

Under this construction of the statutes, the provisions of the plan or order confirming the plan are decisive. In In re Denn,156 for example, the plan stated:

Debtor submits all future earnings or other future income to such supervision and control of the trustee as is necessary for the execution of the Amended Plan. Property of the estate shall vest in the Debtor upon dismissal, conversion or discharge under 11 U.S.C. 1307 or 1328 except as the Court for cause may order otherwise while the case is pending.157

On the basis of this provision vesting the property of the estate in the debtor only upon dismissal, conversion, or discharge—and not upon plan confirmation—the court held that the creditor’s collection actions violated the stay.158

A recent Illinois bankruptcy court decision, however, stated that even if a plan provides for the property of the estate to vest in the debtor upon plan confirmation, “future statutorily defined property of the estate under section 1306(a), as needed to fund the plan,
survives confirmation and becomes property of the estate when it comes into being, notwithstanding section 1327(b).”

According to this case, a wage-deduction proceeding does not violate the stay to the extent that the proceeding applies to earnings unnecessary to fund the plan. Unfortunately, it will often be impractical for a nondebtor spouse to ascertain whether affected wages are necessary to fund the debtor’s plan.

2. Judicial Disarray

Considerable judicial sympathy exists for persons who are owed support obligations. This sympathy manifests itself in a variety of remedies—such as disapproval of the plan or dismissal of the bankruptcy proceeding because of the debtor’s bad faith, relief from the stay, and abstention from hearing alleged violations of the stay—even in cases in which the Code section 362(b)(2) exception from the stay is found inapplicable. Some courts do not allow debtors to pay current and/or past due support obligations over time in the debtor’s Chapter 12 or 13 plans. Instead, such payments must be paid for by the debtor as current expenses and budgeted appropriately. Another approach allows support arrearage to be included in the debtor’s plan but does not permit the payment schedule to vary from that prescribed by the state court unless the recipient agrees to the change. Still another view permits reasonable alteration of the payment schedule. The various approaches indicate that there is a strong sense that relief from the stay should be granted liberally and that state courts should modify support obligations to allow support recipients to enforce such obligations; debtors should not be able to use bankruptcy as a tool

160. See id. at 500.
161. E.g., In re Warner, 115 B.R. 233, 242 (Bankr. C.D. Cal. 1989) (where Chapter 13 plan proposes to pay support arrearage too slowly, the plan is not proposed in good faith); cf. In re Lanham, 13 B.R. 45, 47 (Bankr. C.D. Ill. 1981) (debtor’s plan must propose to pay support arrearage reasonably).
162. Carver v. Carver, 954 F.2d 1573, 1580 (11th Cir.), cert. denied, 113 S. Ct. 496 (1992) (bankruptcy court should have abstained from hearing about support recipient’s violation of stay).
163. See Caswell v. Lang (In re Caswell), 757 F.2d 608, 610 (4th Cir. 1985) (child support arrearage cannot be put in plan; bankruptcy courts should avoid entanglement in domestic relations issues); In re Santa Maria, 128 B.R. 32, 37 (Bankr. N.D.N.Y. 1991) (allowing reasonable alterations in payment of support arrearage but requiring current support payments to be incorporated into Chapter 13 budget and paid currently).
in their "war" with former family members. Similarly, the Court of Appeals for the Eleventh Circuit recently stated that a bankruptcy court should have abstained from hearing the debtor's action for sanctions against a support recipient whose collection effort violated the automatic stay.

The position the Seventh Circuit will take regarding support recipients and proceedings in Chapters 12 and 13 is unknown. Nevertheless, in light of the deference of bankruptcy courts to state courts in this area, if a support creditor mistakenly files a state court action that violates the stay, the creditor's counsel should be advised of the possible availability in bankruptcy court of relief from the stay, abstention, or even dismissal of the bankruptcy proceeding.

B. Avoidance of Liens Created by the Divorce Decree

Part IV discussed the avoidance power pursuant to Code section 522(f)(1). This power may be particularly pernicious in the context of divorce when after exempt property is left in the hands of one spouse merely as a convenience to him or her, that spouse then files bankruptcy, takes the exemption, and avoids the lien. If the underlying debt was a property settlement, the debtor discharges the debt and keeps the property. Even if it is nondischargeable, the debt may be uncollectible.

In *Farrey v. Sanderfoot*, the Supreme Court invalidated an attempted use of this avoidance power. A close reading of the opinion, however, suggests that the consensus of the Court depended on one or both of two special facts. First, before the divorce, title to the property in question had been held in the names of both spouses. Second, the parties stipulated that under applicable nonbankruptcy law, the divorce decree fully extinguished the prior interests of both spouses and created two simultaneous but different new interests. Each of these factors supported a separate rationale for disallowing avoidance of the lien. It remains un-

166. MacDonald v. MacDonald (*In re MacDonald*), 755 F.2d 715, 717 (9th Cir. 1985) (granting relief from automatic stay to allow state court to modify support obligation; bankruptcy courts should avoid incursions into family law).
167. Carver v. Carver, 954 F.2d 1573, 1580 (11th Cir.), *cert. denied*, 113 S. Ct. 496 (1992) (holding that bankruptcy court should have abstained even though creditor violated the stay).
168. See *supra* notes 133-41 and accompanying text.
170. *Id.* at 1830.
171. *Id.*
172. Code § 522(f)(1) allows the avoidance of "the fixing of a lien on an interest of
clear whether Code section 522(f)(1) may be used in a case in which either of these factors is missing.\footnote{173} Thus, state divorce judges should follow the advice provided at the end of Part IV: (1) to keep Code section 522(f)(1) in mind when selecting which property to lien and in evaluating the sufficiency of the lien granted; and (2) to elicit testimony on the record from the parties about their intentions regarding a prospective bankruptcy filing.

C. Minimizing a Spouse’s Right to Equitable Distribution

Illinois law provides that upon filing for divorce, spouses have a right to equitable distribution of marital property.\footnote{174} An important issue arises, as yet unresolved in the Seventh Circuit, concerning the effect of a bankruptcy filing on this right.

When the title to marital property is held by one spouse, a good faith purchaser who buys the property from that spouse without notice of a divorce filing takes the property free and clear of any right to equitable distribution. To protect against such purchasers, the spouse who does not hold title must file a \emph{lis pendens}.\footnote{175}

Upon the filing of a bankruptcy petition, the bankruptcy trustee and/or debtor-in-possession has various avoidance powers. For example, a trustee may avoid any “transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . a bona fide purchaser of real property.”\footnote{176} If the creation of the nondebtor spouse's right to have the marital property equitably distributed is a “transfer of property or any obligation incurred by the debtor,” Code section 544(a)(3) would seem capable of rendering that interest avoidable. If the avoidance power were in fact exercised, the nondebtor spouse could possibly end up with an unsecured claim for the value of the property that would otherwise

\footnote{173} See, e.g., Sommer, \emph{supra} note 38, at 71 (stating that \emph{Sanderfoot} strongly implies that in the absence of the second factor mentioned in the text, Code § 522(f)(1) could be used).


\footnote{175} See, e.g., Duncan v. Farm Credit Bank of St. Louis, 940 F.2d 1099, 1101 (7th Cir. 1991) (a \textit{lis pendens} filing puts all prospective purchasers on notice).

have been distributed to him or her. As a matter of federal bankruptcy law, to the extent that the right to equitable distribution fulfilled a support function, this unsecured claim would be nondischargeable. A conflict of authority exists about whether section 544(a)(3) applies to a nondebtor's right to have marital property equitably distributed; there seems to be no Seventh Circuit opinion directly on point. The possibility of a finding of avoidability, however, underscores the need for the nondebtor to file a *lis pendens* as early as possible.

VI. CONCLUSION

By appreciating the interrelationships between bankruptcy law and state proceedings, Illinois judges have the opportunity to protect the integrity of their proceedings and rulings and to promote

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177. According to at least one court, the nondebtor spouse does not have a "claim," but only an ownership interest in the property; therefore, if that interest were avoided under Code § 544(a)(3), the nondebtor spouse would not be entitled to any payments in lieu thereof. *In re Perry*, 131 B.R. 763, 767 (Bankr. D. Mass. 1991). The court in *Perry* notes, however, that the nondebtor's interest usually survives a § 544(a) attack by the trustee. *Id.* at 769. Still, the *Perry* court does not discuss the possibility that, as a matter of federal bankruptcy law, part of the equitable distribution obligation might be perceived as a substitute for support and, if the equitable distribution obligation were avoided under Code § 544(a)(3), the nondebtor would have some nondischargeable claim for support.

178. See, e.g., Balvich v. Balvich (*In re Balvich*), 135 B.R. 327, 333-34 (Bankr. N.D. Ind. 1991) (even if state law does not allow for "alimony," certain financial obligations arising from divorce may be treated as such for federal bankruptcy purposes).


180. The Seventh Circuit has, however, generally ruled that § 541(d) does not limit the trustee's § 544(a)(3) avoidance power. See *Belisle v. Plunkett*, 877 F.2d 512, 516 (7th Cir.), cert. denied, 493 U.S. 893 (1989).

181. If the party who holds title files for bankruptcy before the commencement of divorce proceedings, the automatic stay might technically prevent the nondebtor from filing for divorce, even if the cause for the divorce arose postpetition. This is because the filing purports to affect the marital property which, at least prior to institution of the divorce action, seems to be wholly property of the estate. 11 U.S.C. § 541 (1988).
judicial efficiency and fairness. As to questions involving the automatic stay, fairness requires that state judges ascertain a variety of facts such as what type of bankruptcy proceeding was filed, what kind of state court proceeding was held, whether the cause of action asserted is a prepetition or postpetition claim, and whether collection is sought from property of the estate. Even if a stay applies, the court may find it appropriate to suggest that counsel follow one of several alternatives to avoid the stay. In addition, state courts may be called upon to make ultimate determinations regarding whether particular debts have been or are dischargeable. Also, by making appropriate trial court records, state courts may preserve the efficacy of their rulings, avoid unnecessary relitigation, and promote justice.