**UNITED STATES BANKRUPTCY COURT**
**CENTRAL DISTRICT OF CALIFORNIA**
**LOS ANGELES DIVISION**

| | |
|---|---|
| In re:<br>Sandra Lisa Sandoval,<br><br>Debtor(s) | Case No.: 2:17-bk-10379-NB<br>Chapter: 13<br><br>**ORDER DENYING MOTION TO SETTLE PROPERTY DIVISION CLAIM FOR $-0-**<br><br>Hearing Dates:<br>Dates: January 23, 2020<br>February 27, 2020<br>April 30, 2020<br>Time: 8:30 a.m.<br>Place: Courtroom 1545<br>255 E. Temple Street<br>Los Angeles, CA 90012 |

Debtor and her former husband (the "Ex") propose a property division under which the bankruptcy estate would receive $-0-, the Ex would receive $70,000.00 for his identical property interest, and title to the property would be transferred to Debtor's family. This order disapproves that collusive property division.

This order is designated for publication because it illustrates one of two methods used by the undersigned of safeguarding against such collusion. One method is for the Bankruptcy Court to resolve all disputes regarding property; but that is not always possible or practical.

The second method was used in this case. When the Ex sought relief from the automatic stay to litigate property issues in the State Court, this Bankruptcy Court modified the stay such that any property division would be treated as a proposed settlement, subject to approval or disapproval after notice and a hearing in this bankruptcy case. *See* 11 U.S.C. § 362(a)); Rule 9019 (Fed. R. Bankr. P.). This order explains this approach in more detail, and disapproves the proposed settlement.

**1. Background**

Many years before this bankruptcy case was commenced, Debtor's parents owned the house that is the subject of this dispute. But they could not afford to keep the house, so Debtor and her Ex purchased the house by paying a down payment and taking title as joint tenants. Debtor's parents continued living in the house.

Debtor asserts that the down payment was a gift to her parents; her parents paid the mortgage payments and other expenses; she and her Ex only held bare legal title; and her parents held all the beneficial interest in the house. Debtor's Ex disagrees: he alleges that the down payment was not a gift; that Debtor's parents were paying rent, not the mortgage; and that he and Debtor own both the legal and equitable interests in the house. He filed a $250,000.00 claim in this bankruptcy case based on his asserted interest in the house.

Both Debtor and her Ex appear to assert plausible positions. If Debtor is correct that her parents held the equitable interest in the house then any equity in the house probably is not reachable by Debtor's creditors (unless they could establish an avoidable transfer that is not time-barred, which seems doubtful). *See* 11 U.S.C. § 541(d) ("Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest … becomes property of the [bankruptcy] estate … only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.").

On the other hand, the law generally favors the Ex's position that he and Debtor have not only bare legal title but also equitable ownership. *See* Cal. Evid. Code § 662

("The owner of the legal title to property is presumed to be the owner of the full beneficial title. This presumption may be rebutted only by clear and convincing proof.").

If legal and equitable title are held by Debtor and her Ex then any equity in the house would be at least partially available to pay Debtor's creditors. In fact, the bankruptcy estate might well have precedence over any interest the Ex might assert.[1]

This all boils down to two main points. First, if the dispute between Debtor and her Ex were litigated to a final judgment then the bankruptcy estate potentially could recover anything between 0% and 100% of any equity in the house. Second, the bankruptcy estate typically would have at least as great an interest in the house as the Ex, if not a superior interest. So, if his claim to the house is worth $70,000.00, there is no reason in the record before this Bankruptcy Court why the bankruptcy estate would have any lesser claim.

---

[1] Even though record title is in the form of a joint tenancy, the house might be deemed community property, and in that event creditors typically would have to be paid in full before any distribution to the Ex (or Debtor). Alternatively, even if a joint tenancy applies, Debtor's bankruptcy estate typically would have a one-half interest in the house, so half of any equity would be available to pay creditors.

These issues potentially are complex, and need not be resolved for purposes of this order. *See* Cal. Fam. Code § 760 ("Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in this state is community property."); Cal. Fam. Code § 852(a) ("A transmutation of real or personal property is not valid unless made in writing by an express declaration that is made, joined in, consented to, or accepted by the spouse whose interest in the property is adversely affected."); Cal. Fam. Code § 2581 ("For the purpose of division of property on dissolution of marriage or legal separation of the parties, property acquired by the parties during marriage in joint form, including property held in tenancy in common, joint tenancy, or tenancy by the entirety, or as community property, is presumed to be community property. This presumption is a presumption affecting the burden of proof and may be rebutted by either of the following: (a) A clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate property and not community property, (b) Proof that the parties have made a written agreement that the property is separate property.") (emphasis added); *Marriage of Valli,* 58 Cal. 4th 1396, 1400-06 (2014) ("Property that a spouse acquired during the marriage is community property unless it is (1) traceable to a separate property source, (2) acquired by gift or bequest, or (3) earned or accumulated while the spouses are living separate and apart" and "[a]ssuming for the sake of argument that the title presumption may sometimes apply, it does not apply when it conflicts with the transmutation statutes.") (citation omitted) (partially abrogating *In re Summers,* 332 F.3d 1240, 1244-45 (9th Cir. 2003) (property held in joint tenancy treated as such, notwithstanding community property laws)). *Cf. In re Brace,* 908 F.3d 531 (9th Cir. 2018) (certifying to Cal. Supreme Court whether, when there is no divorce and Cal. Fam. Code 2581 does not apply, joint tenancy deed can satisfy transmutation requirements) (case submitted and pending, Supreme Court Case No. S252473, last checked 5/27/20 on https://appellatecases.courtinfo.ca.gov). *See also* 11 U.S.C. § 541(a)(2) (community property); § 726(c) (distribution of community property); § 1325(a)(4) (distributions in chapter 13 must be no less than under chapter 7).

**2. The Ex's Motion For Relief From The Automatic Stay**

In 2017 the Ex filed a motion for relief from the automatic stay so that he and Debtor could litigate property division issues in the State Court presiding over their divorce. Such motions present difficult issues for the Bankruptcy Courts. *See generally In re Rivera,* 2005 WL 6960197 (9th Cir. BAP 2005) (discussing difficult intersection of divorce and bankruptcy issues in relief from stay context).

For at least three reasons this Bankruptcy Court was persuaded to grant relief from the automatic stay, subject to the safeguards described below. First, the property issues appeared to be inextricably intertwined with the divorce issues, over which this Bankruptcy Court lacks jurisdiction. Second, there was no party in interest who appeared ready, willing, and able to represent the bankruptcy estate's interest in any litigation. Third, there was some protection for the bankruptcy estate because the Ex, acting in his own self-interest, has an incentive to press for a settlement in the divorce proceedings, and for the reasons set forth above the bankruptcy estate should be entitled to the same recovery as the Ex, absent extraordinary circumstances (*e.g.,* if the down payment came from the Ex's separate property).

To safeguard against the possibility of a collusive settlement between the Ex and Debtor, at the expense of creditors, the order modifying the stay included the following limitation:

> Any *characterization* of property (as community or separate property) and any *division* of property shall be treated for bankruptcy purposes as a proposed resolution between the debtor and the non-debtor spouse/former spouse. To assure that there is an opportunity for other parties in interest in this bankruptcy case to object to any undue prejudice that may result from such a proposed resolution, it shall be treated as a proposed compromise or settlement (even if it is embodied in a nonbankruptcy judgment) that must be the subject of adequate notice and an opportunity for a hearing under Rule 9019 (Fed. R. Bankr. P.) before final relief from the automatic stay to make any such resolution effective.
>
> In limiting relief from the automatic stay in this fashion, this Bankruptcy Court is attempting to recognize on the one hand the unique expertise and aptitude of the State Courts regarding divorce matters, and on the other hand the unique expertise and aptitude of this Bankruptcy Court regarding the rights of creditors (and other parties in interest in

> bankruptcy cases). This Bankruptcy Court cannot adjudicate divorces; and conversely the State Court might not be willing or able to address the bankruptcy issues ….
>
> … [M]arital settlement agreements can constitute fraudulent transfers as against creditors. *Mejia v. Reed*, 31 Cal. 4th 657 (2003). … This Bankruptcy Court expresses no opinion whether such general principles apply in this specific case - the point is only that in order to balance the interests of all parties in interest it appears that any resolution in State Court should be subject to an opportunity for objection in this bankruptcy case. [Order (dkt. 58), at PDF pp. 4-5 (emphasis in original)]

On December 3, 2019, the Ex filed his motion requesting approval of his proposed settlement with Debtor. This Bankruptcy Court issued an order setting a hearing on the settlement motion and tentatively denying that motion for several reasons, including:

> (3) Lack of stated grounds for approval
>
> As noted in the posted Procedures of the undersigned Bankruptcy Judge (available at www.cacb.uscourts.gov), when filing a motion for approval of a settlement, Declaration(s) should support each of the four factors in *In re A & C Properties*, 784 F.2d 1377, 1381 (9th Cir. 1986).
>
> The four *A&C* factors are:
>
> (a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises. [*Id.*]
>
> The Settlement Motion does not address any of these factors.
>
> (4) Grounds for disapproval
>
> ... The Settlement Motion does not address why Debtor's bankruptcy estate – *i.e.,* her creditors – will receive nothing on account of Debtor's record ownership of the [subject] Property. In the parlance of *A&C*, the Settlement Motion does not address the "probability of success" (the first *A&C* factor) in any claim by Debtor's estate that it would be entitled to more than nothing. ... [Order (dkt. 100), p. 2]

The above concerns were reiterated at the above-captioned hearings. But Debtor and her Ex have never offered any amendment to their proposed settlement. At the conclusion of the latest hearing the matter was taken under submission.

**3. This Bankruptcy Court will not approve a transaction that amounts to a fraud on Debtor's creditors**

It is understandable that Debtor would want to ignore her apparent ownership interest in the house, accept $0 on account of that interest, and transfer ownership of the house to her family. It is also true that Debtor offers some evidence to support her assertion that she and her Ex held only bare legal title, including the declaration of Debtor's father that he and his wife, not Debtor and her Ex, paid all home expenses and all mortgage payments since 2009, and allegedly all parties understood that the down payment was a gift. Dkt. 104, 112.

But there is also strong evidence to the contrary. As noted above, Debtor and her Ex hold record title; they paid (at least) the down payment; the monthly payments by Debtor's parents could be characterized as rent rather than mortgage payments; the Ex denies that the down payment was a gift and, to the contrary, he asserted a claim for $250,000.00; and the settlement agreement proposes to pay the Ex $70,000.00. True, the $70,000.00 would be funded by Debtor's brother; but Debtor has offered no reason why her bankruptcy estate's apparently identical claim to an interest in the home would be worth less than $70,000.00, let alone $0.

Outside of bankruptcy, settling a valuable claim for $-0- while Debtor was insolvent would be a constructive or actual fraud on creditors. *See, e.g., Mejia v. Reed,* 31 Cal. 4th 657. Debtor and her Ex offer no reason why the same transaction should be approved within bankruptcy. This Bankruptcy Court will not approve Debtor's collusive settlement with her Ex – at the expense of her creditors.[2]

**4. Treating the proposed property division as a settlement does not unduly impinge on the State Court's jurisdiction over the divorce**

As noted above, the State Court adjudicating the divorce might not be willing or able to address the bankruptcy issues. Specifically, it might not have jurisdiction over

[2] The Settlement Motion is also being denied for inadequate notice. The original version was not served on creditors. The amended version was served only 14 days before the hearing and did not include the mandatory notice of the deadline to object. *See* LBR 9013-1(c)(2).

those issues; Debtor's creditors might not have standing to be heard in the State Courts; and in limited respects the Bankruptcy Code may override nonbankruptcy law regarding the division and distribution of property, especially when orders in the divorce case are not final as of the date of the bankruptcy petition. *See, e.g.,* 11 U.S.C. § 101(14A) (certain claims are characterized for bankruptcy purposes independent of how they are "designated" for nonbankruptcy purposes); *Rivera*, 2005 WL 6960197, at *6-8 ("Congress has given the bankruptcy court exclusive jurisdiction to determine what is property of the estate" and other issues, and any ability of bankruptcy trustee to appear in State Court would only ameliorate, not eliminate, the potential for "collusive marital settlement or decree of dissolution that distributed marital property to [non-debtor spouse] at the expense of Debtor's creditors") (citations omitted). *See also In re Willard*, 15 B.R. 898, 900-01 (9th Cir. BAP 1981) (a "divorce court's judgment [is] valid as between the parties and … ineffective against the bankruptcy estate" when the judgment is entered after the bankruptcy petition has been filed and divides or determines the character of property of the estate), *overruled sub silentio on other grounds, In re Gruntz*, 202 F.3d 1074, 1082 (9th Cir. 2000) (judicial proceedings in violation of automatic stay are void).

There is also precedent for modifying the automatic stay so as to prevent a collusive property division. "The automatic stay is often modified to enable the state court to determine matters like … property division, provided that the estate's interests are adequately protected." *Rivera*, 2005 WL 6960197, at *9 (citations omitted). *See also In re Robbins*, 964 F.2d 342, 344 (4th Cir. 1992) (affirming decision to grant relief from automatic stay to allow property division because, among other things, "the bankruptcy court could protect the estate by retaining jurisdiction and determining the rights of creditors to any of its property once the [state court] distribution became final").

At least one other Bankruptcy Court's order has limited relief from the automatic stay by expressly requiring approval of any proposed property division. That order provided that "any distribution of property of the bankruptcy estate and any

determination of title to assets of the bankruptcy estate … shall be subject to this Court's review and approval" and "in the event that [non-debtor spouse] and the Debtor enter into a settlement agreement, any provisions of such an agreement that purports to determine the distribution of or title to property of the bankruptcy estate shall not be effective with regard to such property without this Court's review and approval." *In re Michael Rodger Brown*, 2020 WL 1237935, at *4 (Bankr. S.D.N.Y. 2020).

For all of these reasons, this Bankruptcy Court does not perceive any disrespect or undue impingement on the State Court's jurisdiction over the divorce proceedings by limiting relief from the automatic stay as set forth above. To the contrary, because this Bankruptcy Court has jurisdiction over Debtor's bankruptcy case, and has before it the evidence of Debtor's insolvency and multiple creditors, this Court is in the best position to guard against giving a judicial imprimatur to what appears on its face to be a constructive or actual fraud on Debtor's creditors.

**5. Conclusion**

For the foregoing reasons, the Settlement Motion is hereby **DENIED**.

This Court will issue a separate order directing Debtor to show cause why this case should not be converted to chapter 7, or dismissed with a bar of at least 180 days against being a debtor in bankruptcy, based on (a) her apparent attempt to effectuate a constructive or actual fraud on creditors, by settling for $-0- the bankruptcy estate's valuable claim to an interest in the house, and (b) her failure to disclose her title to the house in her bankruptcy schedules.

###

Date: May 27, 2020

Neil W. Bason
United States Bankruptcy Judge