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When Money Problems and Marital Problems Collide

Equitable distribution can be asserted as a claim in bankruptcy before judgment of divorce is entered

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Money problems and marital problems often occur in tandem. It is not unusual for one or both spouses in the midst of a divorce to file for bankruptcy. When this occurs, a number of issues arise in both the matrimonial proceeding and the bankruptcy proceeding, including questions of which court has jurisdiction over the assets, whether marital obligations are affected by bankruptcy and the effect of a bankruptcy on the parties' agreements about allocation of assets and liabilities. These questions have been the subject of a number of published opinions in New Jersey Bankruptcy Courts.

Until recently, the well-established rule in this jurisdiction was that a right to equitable distribution could not be asserted as an unsecured claim in a bankruptcy case until a judgment of divorce was entered. The rejection of this rule was affirmed by the Third Circuit in the case of *In re Ruitenberg*, 745 F.3d 647 (3d Cir. 2014), which held that Candace Ruitenberg had a claim for equitable distribution against her husband Paul's bankruptcy estate even though a final judgment had not been entered in the matrimonial proceeding that was pending at the time Paul's bankruptcy petition was filed.

Before the Third Circuit decided *Ruitenberg*, the prevailing law in New Jersey was that a claim for equitable distribution was not a claim under Bankruptcy Code Section 101(5) until a judgment of divorce was entered. *In re Berlingeri*, 246 B.R. 196 (Bankr. D.N.J. 2000). *Berlingeri* relied on *Carr v. Carr*, 120 N.J. 336 (1990), which states that under N.J.S.A. 2A:34-23, "the right to equitable distribution of marital property arises upon entry of the judgment of divorce." *Berlingeri*, 246 B.R. at 199. This analysis was echoed in *In re Howell*, 311 B.R. 173 (Bankr. D.N.J. 2004), where the Bankruptcy Court relied on *Berlingeri* to find that the wife could not seek equitable distribution of marital assets when her husband filed for bankruptcy after the divorce action had been filed but before the final judgment of divorce was entered.

The *Ruitenberg* makeover of this treatment of equitable distribution claims in a bankruptcy proceeding came in the wake of the Third Circuit's decision in *Jeld-Wen v. Van Brunt (In re Grossman's Inc.)*, 607 F.3d 114 (3d Cir. 2010), which overruled *Avellino & Bienes v. M. Frenville Co. (Matter of M. Frenville Co.)*, 744 F.2d 332 (3d Cir. 1984). *Frenville* held that a claim under Bankruptcy Code Section 101(5) arises when the underlying state law cause of action accrues. The "accrual test" articulated by *Frenville* was overruled by the Third Circuit in the *Grossman's* decision and replaced with a "conduct test" to determine when a claim arises. "The *Frenville* court focused on the 'right to payment' language in §101(5) and, according to some courts, 'impos[ed] too narrow an interpretation on the term claim'... by failing to give sufficient weight to the words modifying it: 'contingent,' 'unmatured,' and 'unliquidated.'" *Grossman's*, 607 F.3d at 121. The *Grossman's* opinion further explained that the accrual test "does not account for the fact that a 'claim' can exist under the Code before a right to payment exists under state law."

The *Ruitenberg* case involved a divorce proceeding, a bankruptcy filed by Paul and an equitable distribution claim asserted by Candace. Candace later filed her own bankruptcy proceeding, and her equitable distribution claim against Paul was asserted by her Chapter 7 trustee. Paul's bankruptcy trustee objected to Candace's equitable distribution claim, relying on *Howell* and *Berlingeri*. Candace's trustee argued that since *Howell* and *Berlingeri* relied on *Frenville*, and since *Frenville* had been overruled, the conduct test established in *Grossman's* should be utilized and Candace's equitable distribution claim should be considered an allowable prepetition claim under Bankruptcy Code §101(5).

Bankruptcy Judge Raymond T. Lyons decided that in light of *Grossman's* rejection of the accrual test, Candace had an allowable unsecured claim for equitable distribution against Paul's estate under the definition of a claim set out in Bankruptcy Code §101(5). *In re Ruitenberg*, 469 B.R. 203 (Bankr. D.N.J.

2012). Although Judge Lyons had previously held in *Howell* that an equitable distribution claim did not arise until a final judgment of divorce was entered, in *Ruitenber* he concluded that the Third Circuit's *Grossman's* decision compelled the conclusion that a claim for equitable distribution in a matrimonial case is an allowed claim against the bankruptcy estate even if final judgment of divorce was not entered. In what the Third Circuit called a "well-reasoned decision," Judge Lyons not only considered the *Grossman's* case, he also looked to *In re Kane*, 628 F.3d 631 (3d Cir. 2010), where the Third Circuit held that the debtor, Mrs. Kane, was required to disclose in her bankruptcy case that she had an interest in a claim for equitable distribution in a matrimonial case and to list that interest as an asset on her schedules. Judge Lyons reasoned that if an interest in equitable distribution is an asset that should be disclosed by a debtor, it should also be allowed as a claim in the bankruptcy case.

Paul's trustee filed an appeal of the Bankruptcy Court decision, and the district court certified the case for direct appeal to the Third Circuit. The Third Circuit affirmed the Bankruptcy Court's decision, looking to the language of the Bankruptcy Code §101(5), which defines "claim" and held, "[e]ven if no final judgment of divorce existed for Candace and Paul when he entered bankruptcy, her interest was, at the least, unliquidated and contingent on a final decree apportioning marital property, perhaps unmaturred and likely disputed. But, no matter, it literally is a 'claim' under §101(5)." *Ruitenber*, 745 F. 3d at 650. The Third Circuit used the *Ruitenber* decision to reiterate the rationale for its holding in *Grossman's* and to explain the intended scope of the application of that case. "Although our court's formulation of the test in *Grossman's* was tailored to claims rooted in a common-law tort action, when we overruled *Frenville* we spoke more broadly of the problems with the accrual test. As mentioned above, *Grossman's* points out that Congress sought to adopt the '*broadest possible definition*' of the term 'claim' in §101(5), and we recognized that *Frenville* 'impose[d] too narrow an interpretation of a 'claim' under the Bankruptcy Code.'" Id. at 651.

The Third Circuit also referred to its decision in *In re Kane*, 628 F. 3d 631 (3d Cir. 2010), to support the conclusion that a claim for equitable distribution can exist in a bankruptcy case before a final judgment of divorce has been entered. The Third Circuit found that the conclusions of the *Kane* and *Ruitenber* decisions result in "a symmetry under the Code that is sensible: a debtor who has already begun divorce proceedings must disclose any expected share of his or her marital property as an asset of the estate under §541, and, conversely, a nondebtor spouse may file a prepetition claim against the estate based on his or her expected equitable share of the marital property even if no final judgment of divorce existed at the time of the bankruptcy filing." *Ruitenber*, 745 F. 3d at 651.

Paul's trustee argued that *Grossman's* should be read narrowly to apply only to tort claims and should not be extended to apply to matrimonial cases. He urged the court to distinguish *Kane* because that case considered whether there was an "interest" in marital property rather than a "right." The Third Circuit rejected this distinction since the two cases arose from two distinct sections of the Bankruptcy Code. The court also rejected the contention that the *Ruitenber* holding conflicts with New Jersey law and cited New

Jersey matrimonial cases that recognized that certain equities arise as to the marital estate once a divorce action is commenced.

There remains uncharted territory in cases that involve bankruptcy, divorce and equitable distribution. One unresolved question is whether a nondebtor spouse is confined to asserting an unsecured claim for equitable distribution or if that spouse has an equitable interest in the marital assets that can be enforced directly against the asset. Under New Jersey law, a spouse has a right to equitable distribution of most assets acquired during the marriage or with marital funds regardless of who holds legal title to the asset. Can this interest be asserted against the trustee in a bankruptcy case?

Both the bankruptcy court and the family court have original jurisdiction over the assets owned by a debtor spouse. In the *Ruitenber* case, Candace filed a proof of claim for her equitable distribution share and did not assert an equitable interest in property titled only to Paul which had been a marital asset. It seems that the next logical step is that if a matrimonial case is pending, the spouse has a right to claim an interest in the asset regardless of who holds legal title. This interest could be found to be superior to the trustee's rights, especially if upon filing a divorce complaint, a lis pendens is filed as to all marital property not titled in the name of the spouse asserting equitable distribution rights.

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