NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF WASHINGTON

In Re: MARY KATHRYN SANOWSKI, Debtors.	No. 98-07547-W1R MEMORANDUM DECISION RE: MOTION TO REQUIRE TRUSTEE TO DELIVER FUNDS DISTRIBUTED BY STATE COURT

On December 4, 2000, the court heard oral argument regarding William Sanowski, III's Motion to Require Trustee to Deliver Funds Distributed By State Court. The court took the matter under advisement in order to fully review the voluminous record in this case. After the hearing, Ms. Russell also filed some additional pleadings which were also reviewed. The court now enters its Memorandum Decision.

The Trustee is currently holding $77,014.64.[1] By previous Memorandum Decision dated January 27, 2000 and order of this court, the Trustee is to distribute from that amount the sum of $24,335.39 in satisfaction of a secured claim held by creditor Drury. That prior ruling concluded that sum was not property of the bankruptcy

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T. S. McGREGOR, CLERK
U. S. BANKRUPTCY COURT
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[1]Interest is accruing on at least some portion of this amount. The Trustee has withdrawn his motion to employ special counsel to recover the $10,918.44 "Hansen funds" and the court assumes the Trustee has abandoned any interest of the estate in those funds. If that assumption is incorrect, any recovery of such funds by the estate would also be distributed in accordance with this decision.

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estate as a final order had already been entered by the Grant County Superior Court awarding that sum to creditor Drury in satisfaction of its lien. This court's prior ruling has been appealed so no distribution has yet occurred.

The debtor has claimed $13,248 as exempt. The actual amount of the debtor's exemptions however, cannot be determined as the Order on Objections to Exemption Sustaining in Part and Denying in Part is on appeal. Administrative expenses as of the date of the hearing were $10,058.71. After payment of the exempt amount, the secured claim and the administrative expenses, this would leave $29,372.54 available to pay the remaining allowed claims, all of which are unsecured.

The present controversy at its most simplistic arises from the request of the debtor's former spouse, Mr. Sanowski, that the Trustee disburse to him $51,971.93 as his share of the $77,014.64 held by the Trustee in accordance with the Judgment of the Circuit Court of the State of Oregon, County of Crook, Cause No. 98-00-00055 (the "Oregon State Court"). Reducing the well crafted and thorough decision of the Oregon State Court to its most simplistic terms, it determined that Mr. Sanowski's share of the parties' community property should be $51,971.93. Obviously distribution of that amount to him would mean that the estate would not hold sufficient assets to fully satisfy the secured claim of creditor Drury and the debtor's exemptions and the administrative expenses. The debtor requests this court to order distribution to her of the full exemption claimed of $13,248. An unsecured creditor objects to the distribution to Mr. Sanowski as if such distribution occurred that unsecured creditor and all other unsecured creditors

would receive nothing. Secured creditor Drury also objects to the distribution to the extent it would affect any right of Drury to receive the $24,335.39 as previously ordered by this court.

This controversy is resolved by the application of essential bankruptcy principles. 11 U.S.C. § 541(a)(2) provides that the property of the estate consists of

> (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is
>
> > (A) under the sole, equal, or joint management and control of the debtor; or
> >
> > (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

For purposes of that statute, former spouses are included in the term "spouse". *Miller v. Walpin (In re Miller)*, 167 B.R. 202 (Bankr. C.D. Cal. 1994) and cases cited below.

One spouse may commence a bankruptcy proceeding without the consent or involvement of the other spouse. The filing of the bankruptcy petition creates an estate. That estate includes all of the community property, assuming state law places community property under the joint and equal control of both spouses, which Washington law does. WASH. REV. CODE § 26.16.030. In fact it is common for one spouse to file without the consent of the other spouse on the eve of or during a marital dissolution proceeding. The Bankruptcy Court then has the exclusive jurisdiction to administer all of the property of the estate, which includes the community property and the separate property of the bankruptcy filing spouse. The property of the estate is then administered to

pay creditors with any remaining property returned to the spouses or, in appropriate circumstances, to the state court in which the marital dissolution is pending.

In this particular situation, this Chapter 7 was commenced on December 17, 1998. Prior to that, the Washington State Court had entered a Decree of legal separation between the spouses and on December 18, 1998, without notifying the Washington court of the bankruptcy filing, the debtor requested the Washington court to enter a Dissolution of Marriage. It did so, but did not divide the community property and liabilities between the parties as that issue had been reserved for determination by the Oregon State Court. On August 18, 1999, this court entered its Amended Order Lifting Stay re State Court Proceedings to allow the Oregon State Court to divide marital assets. As stated in that order, the Oregon State Court was to divide assets and liabilities between the spouses ". . . subject to claims of creditors as determined by Bankruptcy Court" and that distribution of the 'Waldo funds' and other property of the bankruptcy estate would "remain subject to claims of creditors as provided by the Bankruptcy Code, which claims will be determined by this court."

The Oregon State Court scheduled trial in May of 2000. Its final order dividing assets and liabilities between the former spouses was entered June 1, 2000, more than 2 years after commencement of this bankruptcy.

As this bankruptcy was commenced prior to entry of a final order dividing the community property, all of the community property became property of the estate. There has never been any dispute as to the community nature of the so-called 'Waldo funds',

which represent nearly all of the funds held by the Trustee,[2] and in a prior bankruptcy proceeding of this debtor, this court held they were community property. The 'Waldo funds' arose from the sale of the community real estate. As community property, they become property of the bankruptcy estate on December 17, 1998 (except the $24,335.39 as Grant County State Court had entered a final order which deprived the community of any interest and awarded the funds to creditor Drury). Post-petition termination of the marriage does not change the analysis that an undivided community property constitutes property of the bankruptcy estate when one spouse files bankruptcy. *Dumas v. Mantle (In re Mantel)*, 153 F.3d 1082 (9th Cir. 1998), *cert. denied* 526 U.S. 1068, 119 S. Ct. 1461, 143 L. Ed. 2d 547 (1999). For purposes of 11 U.S.C. § 542 (a)(2), all community property not yet divided by a state court at the time of a bankruptcy filing is property of the estate even though a dissolution of the marriage itself has occurred pre-petition. *In re Miller, supra*.

Distribution of funds from the sale of community real property was at issue in *In re McCoy*, 111 B.R. 276 (B.A.P. 9th Cir. Cal. 1990). The funds had been placed in escrow and the state court had indicated that creditors holding liens should be paid with net proceeds which would then be divided evenly between the spouses.

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[2]$2,499.66 of the funds held by the Trustee represents proceeds from settlement of a claim held by the bankruptcy estate against the third "Ford" defendants. Debtor has claimed and the court has already determined that $673.00 of that amount is exempt. Since the claim which gave rise to these funds arose long before any division of the community assets or the commencement of the bankruptcy, the court assumes these proceeds are also community property.

No order to that effect was entered. On the contrary, the state court set a trial on the issues in the case leaving open a final determination regarding division of the proceeds between the spouses. Just before trial, one of the spouses commenced bankruptcy. The escrow funds were determined to be property of the bankruptcy estate and it was the Bankruptcy Court which determined the distribution of the escrow proceeds for the benefit of those holding claims against the bankruptcy estate. Only in situations in which the state court has made a final division of the community assets between the spouses <u>prior</u> to the commencement of the bankruptcy are the assets awarded to the former spouse excluded from the bankruptcy estate of the filing spouse. *Gendreau v. Gendreau (In re Gendreau)*, 191 B.R. 798 (B.A.P. 9th Cir. Nev. 1995); *Keller v. Keller (In re Keller)*, 185 B.R. 796 (B.A.P. 9th Cir. Cal. 1995).

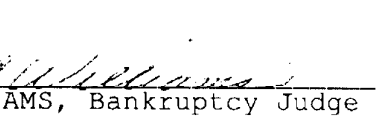
Again, a basic bankruptcy principle is that when a spouse commences a bankruptcy proceeding all community property becomes property of the estate and is to be administered under the Bankruptcy Code. Post-bankruptcy filing, a state court is determining the spouses' interest only in whatever community property remains after its administration under the Code. This is also the result in non-community property states; *In re McCulley*, 150 B.R. 358 (Bankr. M.D. Pa. 1993), post-bankruptcy petition state court distribution of property between spouses subordinate to right of trustee to liquidate the property as property of the estate; *In re Greer*, 242 B.R. 389 (Bankr. N.D. Ohio 1999), post-bankruptcy petition state court decision did not affect administration of both spouses' property as property of the estate; and *Anderson v. Conine*

(In re Robertson), 203 F.3d 855 (5th Cir. La. 2000) pre-bankruptcy petition consent judgment entered in state court which divided property between the spouses placed the property awarded to the non-filing spouse outside the estate of the bankruptcy filing spouse.

In the present situation the Bankruptcy Code requires distribution of the $77,014.64 as follows: $24,335.39 to secured creditor Drury (subject to final resolution of the pending appeal); $13,248.48 of exempt property to the debtor (subject to final resolution of the pending appeal); and $10,058.71 (or whatever sum is finally due) for administrative expenses. The balance is to be distributed by the Trustee to whatever allowed unsecured claims exist. If allowed unsecured claims do not exhaust the funds held by the Trustee, any funds remaining would ordinarily be distributed to the debtor. As to the $13,248 exempt funds and any excess funds which might remain after satisfaction of creditors, it is not the function of the court to interpret or apply the final decision of the Oregon State Court. In the discretion of the Trustee, those funds may be distributed to the registry of the Oregon State Court or may be distributed based upon further order of the Oregon State Court specifically determining the appropriate distribution of those funds between the former spouses.

The Clerk of the Court is directed to file this Order and provide copies to counsel and pro se debtor.

DATED this 10th day of January, 2001.



PATRICIA C. WILLIAMS, Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

CERTIFICATE OF SERVICE

The undersigned deputy clerk of the United States Bankruptcy Court for the Eastern District of Washington hereby certifies that a copy of the document, of which this is attached, was mailed this date to the following parties as required by the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.

Per Chambers:

Atty Stenzel
" Reeves
" Neill
Debtor

Joyce J. Peters
Deputy Clerk JOYCE J PETERS

JAN 10 2001
Date

Users/CA Forms/Certificate of Service to Parties .wpd 3/2000

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

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The undersigned deputy clerk of the United States Bankruptcy Court for the Eastern District of Washington hereby certifies that a copy of the document, of which this is attached, was mailed this date to the following parties as required by the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.

Atty Bassett
" Miller

Joyce J. Peters
Deputy Clerk JOYCE J PETERS

JAN 11 2001
Date

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