

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)
)
GREGORY TODD DONLEY,) CASE NO. 03-34419 HCD
a/k/a GREGG TODD DONLEY,) CHAPTER 7
)
DEBTOR.)

Appearances:

Fred R. Hains, Esq., attorney for debtor, 125 North St. Peter Street, South Bend, Indiana 46617;

Spring Mary Zmudzinski, Esq., attorney for creditor, 400 Lincolnway East, P.O. Box 683, Mishawaka, Indiana 46546-0683; and

Joseph D. Bradley, Esq., Chapter 7 Trustee, Suite 512, 105 East Jefferson Boulevard, South Bend, Indiana 46601.

MEMORANDUM OF DECISION

At South Bend, Indiana, on June 4, 2004.

On November 10, 2003, Gregory Todd Donley (“the debtor”) filed a Motion to Avoid Judicial Lien. The holder of that judicial lien was the debtor’s former spouse, Victoria Laverne English (“English”). She filed a Response to the motion on December 2, 2003. Two months later, the court conducted a hearing and allowed the parties to file briefs on the issue. Following the briefing period, the court took the matter under advisement. For the reasons that follow, the court denies the debtor’s motion.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(K) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1)

and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rule of Bankruptcy Procedure 7052. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

On August 4, 2003, the debtor filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code. According to the bankruptcy schedules, the debtor listed as an asset the marital real estate on Hollyhock Road in South Bend, Indiana. He reported that the property has a value of \$126,000 and is encumbered with a mortgage of \$120,000 to Homeq Servicing Corporation. The debtor claimed a homestead exemption of \$6,000 pursuant to Indiana Code § 34-55-10-2(b)(1). On schedule F, he listed an unsecured nonpriority claim, in the amount of \$8,000, held by Victoria English pursuant to a property settlement agreement. On November 10, 2003, in his motion to avoid his former wife's claim, the debtor stated that English's \$8,000 claim was a judicial lien upon his real estate that impaired his claimed exemption. He moved to avoid the judicial lien on the property under 11 U.S.C. § 522(f)(1).

The underlying facts are not in dispute. Gregory Todd Donley and Victoria Laverne English were married on June 20, 1998. On March 21, 2003, their marriage was dissolved by the St. Joseph Superior Court. They had acquired real estate on Hollyhock Road during their marriage. The state court found that the fair market value of the real estate, as of the date of the decree of dissolution, was approximately \$142,000. The property was encumbered by a mortgage with a principal balance of approximately \$126,000. By the stipulated agreement of the parties, the court awarded the real estate to the debtor, "free and clear of any claim by [English]," provided that the debtor would pay to English "one-half of the parties' equity in the real estate." R. 36, Ex. 1 ("Findings of Fact and Decree of Dissolution of Marriage" of St. Joseph Superior Court) at 2. The amount of the equity was \$16,000, and thus the judgment amount awarded to English was \$8,000. The state court ordered the debtor to pay English that amount and to refinance the existing mortgage in order to pay English her

share of the equity. The court ordered English to execute a quitclaim deed, conveying her interest in the real estate to the debtor, and to execute and file with the court a release of judgment after the debtor had paid the judgment. Instead of complying with the state court's orders, the debtor filed bankruptcy.

In his Motion to Avoid Judicial Lien, the debtor asserted that the judgment awarded to English is a judicial lien upon his residential real property that the debtor wants to avoid pursuant to § 522(f)(1) because it impairs the residential exemption to which he is entitled. In her "Response by Victoria Laverne English to Debtor's Motion to Avoid Judicial Lien," English objected to the debtor's request. She stated that she had initiated an adversary proceeding asking the court to find the lien nondischargeable and that the parties had filed a stipulation agreeing that the debt was nondischargeable. *See* Adv. Proc. 03-3133. English asked that the debtor's motion be denied and that the lien remain on the real estate.

On December 10, 2003, the court approved the parties' stipulation. It declared the state court judgment in favor of English, in the amount of \$8,000, nondischargeable in the debtor's bankruptcy. It also dismissed the adversary proceeding.

On February 2, 2004, the court conducted a hearing on the debtor's motion and English's objection. At the hearing, both parties relied on the Supreme Court decision *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825, 114 L.Ed.2d 337 (1991). The court granted the parties' request to file briefs on the lien avoidance issue and the applicability of *Farrey* to their respective positions. After the briefs were filed, the court took the matter under advisement.

Discussion

The issue is whether English's judicial lien on property in which the debtor claims an exemption impairs the homestead exemption¹ and is subject to avoidance by the debtor under 11 U.S.C. § 522(f)(1).

¹ The Bankruptcy Code allows a debtor to exempt certain types of property from a bankruptcy estate. *See* 11 U.S.C. § 522. Individual states chose to opt out of the federal provisions and to substitute their own set of exemptions, and Indiana was one such state. *See* § 522(b); *Citizens Nat'l Bank v. Foster*, 668 N.E.2d (continued...)

Section 522(f)(1) provides that “the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled . . . if such lien is (A) a judicial lien. . . .”² The debtor claims that his interest in the residential real estate is entitled to a homestead exemption pursuant to the Indiana exemption statute, which provides:

(b) The following property of a judgment debtor domiciled in Indiana is not subject to levy or sale on execution or any other final process from a court, for a judgment founded upon an express or implied contract or a tort claim:

(1) Real estate or personal property constituting the personal or family residence of the judgment debtor or a dependent of the judgment debtor, or estates or rights in that real estate or personal property, of not more than seven thousand five hundred dollars (\$7,500). The exemption under this subsection is individually available to joint judgment debtors concerning property held by them as tenants by the entireties.

Ind. Code § 34-55-10-2(b)(1). Under Indiana law, therefore, the debtor has a right to an exemption of \$7,500 for the family residence. He has claimed an exemption of \$6,000, and there is no challenge to his entitlement to that exemption under state law. The issue before the court is whether § 522(f)(1) permits the debtor to avoid English’s judicial lien on the real estate interest that the debtor obtained in the dissolution decree.

As both parties recognized, the circumstances in this case are quite similar to those in *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825, 114 L.Ed.2d 337 (1991). In that case, the Wisconsin state court, in its decree of dissolution, had awarded the debtor Sanderfoot the marital home and had ordered the debtor to pay his former spouse Farrey almost \$30,000 to ensure an equal division of the marital estate. To secure the award,

¹(...continued)

1236, 1238 (Ind. 1996). Indiana debtors may exempt from their bankruptcy estates only the property specified as exempt by state law under Indiana Code § 34-55-10-2. See *In re Jones*, 768 F.2d 923, 927 (7th Cir. 1985); *In re Berryhill*, 254 B.R. 242, 243 (Bankr. N.D. Ind. 2000). Their right to the exemption is determined as of the date of the bankruptcy petition. See *In re Burns*, 218 B.R. 897, 898 (Bankr. N.D. Ind. 1998).

² A lien is a “charge against or interest in property to secure payment of a debt or performance of an obligation.” 11 U.S.C. § 101(37). A judicial lien is a “lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.” § 101(36). In this case, the judgment awarded to English, the former spouse, in the decree of dissolution secured the amount of money the debtor owed to English as a result of the division of their marital assets. See *Penix v. Hicks*, 618 N.E.2d 1346, 1347 (Ind. Ct. App. 1993) (finding that a judgment entered on dissolution of marriage was a secured lien interest). The lien imposed by the court order secured a debt in the amount of \$8,000.

the decree created a lien against the homestead in that amount. Sanderfoot filed bankruptcy instead of complying with the decree. He then claimed the property as exempt and moved to avoid Farrey's lien. *See id.* at 292-94, 111 S. Ct. at 1827. The bankruptcy court denied Sanderfoot's motion; the district court reversed and the court of appeals affirmed the district court ruling. The Supreme Court reversed the appellate judgment.

The Supreme Court began its analysis with § 522(f)(1) and the three statutory conditions that must be satisfied for lien avoidance: The debtor must be entitled to an exemption on the property; the lien must be a judicial lien; and the lien must have "attached to the debtor's interest at some point after the debtor obtained the interest." *Id.* at 296, 111 S. Ct. at 1828-29. In *Farrey*, the Supreme Court noted that the first two requirements were not at issue, and it focused on the third: "The sole question presented in this case is whether § 522(f)(1) permits Sanderfoot to avoid the fixing of Farrey's lien on the property interest that he obtained in the divorce decree." *See id.*, 500 U.S. at 295-96, 111 S. Ct. at 1828. The Court concluded:

We hold that § 522(f)(1) of the Bankruptcy Code requires a debtor to have possessed an interest to which a lien attached, before it attached, to avoid the fixing of the lien on that interest.

Id., 500 U.S. at 301, 111 S. Ct. at 1831.

To determine whether the debtor possessed the interest before the lien attached, the Court turned to state law. *See* 500 U.S. at 299, 111 S. Ct. at 1830. It found that, under the law of Wisconsin, a divorce decree extinguished the previous marital interests and created new interests. The debtor was awarded a new fee simple ownership interest in the real property, "'free and clear' of any claim 'except as expressly provided in this [decree].'" *Id.* (quoting state court judgment). The former spouse simultaneously was given the debt secured by a lien on the debtor's fee simple interest. *See id.* The Supreme Court concluded that, under Wisconsin law, the lien could not be avoided:

Sanderfoot took the interest and the lien together, as if he had purchased an already encumbered estate from a third party. Since Sanderfoot never possessed his new fee simple interest before the lien "fixed," § 522(f)(1) is not available to void the lien.

Id. at 300, 111 S. Ct. at 1830-31.

In the case before this court, the parties agreed that *Farrey* provided the proper analytical framework for determining whether § 522(f)(1) allows the judicial lien of the debtor’s former spouse to be avoided. English urged this court to follow *Farrey* because its facts are so similar to the ones now before the court. The debtor, however, insisted that *Farrey* was distinguishable from this case because it was based on Wisconsin, not Indiana, law. However, the two Indiana cases cited by the debtor did not consider changes in property interests as a result of a divorce decree.³ In her reply brief, English asserted that, under Indiana law, at the time of divorce the tenancy by the entirety is terminated and a new interest is created in the parties. The cases upon which she relied, however, did not directly support her position.⁴ The court finds that in this case, as in *Farrey*, the parties have not challenged English’s judicial lien or the debtor’s entitlement to an exemption. It turns, therefore, to the law of Indiana to determine whether the debtor possessed his property interest before English’s lien attached.

Under Indiana’s law of dissolution, the final divorce decree “converts a tenancy by the entirety into a tenancy in common with both spouses taking equal shares absent a specific contrary determination by the court.” *Mid-West Fed’l Sav. Bank v. Kerlin*, 672 N.E.2d 82, 86 n.4 (Ind. Ct. App. 1996) (citing Ind. Code § 32-4-2-2).⁵ The court adjudicating the dissolution action is required to divide all the property of the parties, whether it was owned by either spouse before the marriage or acquired by either or both spouses after the marriage. *See*

³ The debtor relied upon *Enyeart v. Kepler*, 20 N.E. 539 (Ind. 1889), which concerned an action to quiet title and recognized that a husband may convey real estate to his wife; and *Yarde v. Yarde*, 71 N.E.2d 625 (Ind. Ct. App. 1947), which involved an action for possession of real estate owned by a husband and wife, as owners by the entirety, and which set forth the rule in Indiana that there is unity of estate, possession and control. Neither case applies to the circumstances herein.

⁴ The Indiana cases cited by English concerned whether a tenancy by the entirety is terminated by murdering the spouse (*Estate of Grund v. Grund*, 648 N.E.2d 1182 (Ind. Ct. App. 1995)), by murdering the spouse and committing suicide (*National City Bank of Evansville v. Bledsoe*, 144 N.E.2d 710 (Ind. 1957)), or by setting fire to the marital home (*Fuston v. National Mut. Ins. Co.*, 440 N.E.2d 751 (Ind. Ct. App. 1982)).

⁵ Indiana Code § 32-4-2-2 was repealed by P.L. 2-2002 § 128 and was replaced by Indiana Code § 32-17-3-2, which provides:

Estate by the entireties — Effect of divorce. — If a husband and wife are divorced while a contract [in which they purchased real estate] is in effect, the husband and wife own the interest in the contract and the equity created by the contract in equal shares.

Ind. Code § 31-15-7-4. There is a statutory presumption that an equal division of marital property, including the real estate acquired before or after marriage, is just and reasonable.⁶ See Ind. Code § 31-15-7-5; *Fobar v. Vonderahe*, 771 N.E.2d 57, 60 (Ind. 2002); *Trost-Steffen v. Steffen*, 772 N.E.2d 500, 505-07 (Ind. Ct. App. 2002); *Chase v. Chase*, 690 N.E.2d 753, 756 (Ind. Ct. App. 1998).

The parties in this case do not challenge this presumption. The Decree of Dissolution of Marriage ordered by the St. Joseph Superior Court reflects the intention of the parties to make a fair and equitable division of the marital property and joint indebtedness. See R. 36, Ex. 1. By agreement of the parties, the debtor was awarded the real estate, free and clear of any claim by English, and English was awarded an \$8,000 judicial lien, her half-interest in the equity of the real estate. However, the court declared the debtor responsible for the mortgage and ordered him to hold his former spouse harmless in connection with the mortgage. Before the debtor carried out his obligations under the decree, he (like the debtor Sanderfoot) filed bankruptcy. The specific question now is whether the debtor possessed an interest to which the lien fixed *before* it fixed.

Two bankruptcy courts in Indiana already have considered facts similar to those herein and have resolved that question based on the facts before them. Each court found that the debtor before it did not possess an interest in the property *before* the fixing of the ex-spouse's lien. Their determinations have guided this court's consideration of the facts before it.

In *In re Haynes*, 157 B.R. 646 (Bankr. S.D. Ind. 1992), Bankruptcy Judge Richard W. Vandivier presented a thorough, thoughtful analysis of *Farrey v. Sanderfoot* and of relevant Indiana law to determine whether a judgment lien attached to the pre-existing interest of the debtor. Under Indiana law, the court stated,

⁶ The court notes that Wisconsin's property division statute, W.S.A. § 767.255, which was under the scrutiny of the Supreme Court in *Farrey*, 500 U.S. at 293, 111 S. Ct. at 1827, is similar to Indiana's statute. In pertinent part, the Wisconsin provision states: "The court shall presume that all property not described in sub. (2)(a) is to be divided equally between the parties, but may alter this distribution without regard to marital misconduct after considering all of the [listed criteria]." W.S.A. § 767.255 (3). The pertinent portion of the Indiana statute states: "The court shall presume that an equal division of the marital property between the parties is just and reasonable. However, this presumption may be rebutted by a party who presents relevant evidence, including [listed] factors, that an equal division would not be just and reasonable." Ind. Code § 31-15-7-5.

in a dissolution proceeding the property of both spouses is included in the marital property “pot” and is divided equally “in a just and reasonable manner” unless a party challenges that method of allocation. *Id.* at 649-50 (citing Ind. Code § 31-1-11.5-11(b), (c)).⁷ The bankruptcy court found that the state court created that presumptively equal division by awarding to the debtor the real property and to the debtor’s former spouse a lien on that property that would secure the amount the debtor should pay her to effect a just and reasonable property division. *See In re Haynes*, 157 B.R. at 650. The state court treated the real property as marital property subject to division even though the debtor, both before and during the marriage, held the property in his name alone. As the bankruptcy court explained, “under Indiana law that interest became part of the ‘marital pot’ and the Debtor could not exit the marriage without the divorce court’s administering his interest in the Property as part of its duty to divide the marital property.” *Id.* The court then found that, to the extent the debtor’s former spouse acquired a lien against the real property pursuant to the dissolution decree, that lien was not avoidable under § 522(f)(1). *See id.*

Bankruptcy Judge Basil H. Lorch, III, also reviewed a debtor’s motion to avoid a former spouse’s lien on his real property in light of *Farrey v. Sanderfoot*. *See In re Warfield*, 157 B.R. 651 (Bankr. S.D. Ind. 1993). In that case, the divorce decree entered a judgment in favor of the former spouse that granted a lien against the debtor’s assets. The real estate at issue was purchased by the debtor and his current wife after the divorce. The court found that, because the debtor did not possess an interest in the property *before* his former spouse’s lien attached, he could not avoid a lien on the real estate under *Sanderfoot* and under Indiana’s “well established public policy which favors the equal distribution of property in divorce settings.” *Id.* at 655.

In this case, the family residence at issue was bought during the marriage. Under Indiana law, such a purchase creates an undivided estate by the entirety. *See* Ind. Code § 32-17-3-1 (“The interest of neither party is severable during the marriage.”) In a divorce, the husband and wife own the property in equal shares. *See* Ind.

⁷ Indiana Code § 31-1-11.5-11 was repealed by P.L. 1-1997, § 157. In its place, the legislature added Chapter 7, entitled “Disposition of Property and Maintenance,” to Article 15, “Family Law: Dissolution of Marriage and Legal Separation.” The pertinent provisions are found at Indiana Code § 31-15-7-4 and -5.

Code § 32-17-3-2. As the state courts have explained it, the tenancy by the entirety is converted into a tenancy in common and each spouse takes an equal share of the property. See *Mid-West Fed'l Sav. Bank*, 672 N.E.2d at 86 n.4. In this dissolution action, the debtor and English, by agreement, equally divided the marital property to accomplish a just and reasonable result. See Ind. Code § 31-15-7-5. The St. Joseph Superior Court simultaneously awarded to the debtor the marital residence (both his and his former spouse's share) and to the former spouse a judicial lien of half the equity in the residence. The state court's award to the debtor of the real estate "free and clear" of English's claim had the proviso that he must pay English her half of the equity in that property. As the Supreme Court explained in *Farrey*, the debtor "took the interest and the lien together." *Id.* at 299, 111 S. Ct. at 1830. The court finds that these marital property divisions were new interests; his interest came encumbered with her judicial lien. The divisions were the state court's method of converting the marital property of tenants by the entirety into the equally shared property of tenants in common.

The court concludes that, under Indiana law, the debtor "never possessed his new fee simple interest before the lien [held by his former spouse] 'fixed.'" *Id.* at 300, 111 S. Ct. at 1830. Section 522(f)(1) allows a debtor to avoid the *fixing* of a lien on the debtor's interest, but it "requires a debtor to have possessed an interest to which a lien attached, before the lien attached." *Id.* at 291, 111 S. Ct. at 1826. The debtor herein did not possess an interest *before* the former wife's lien attached. Therefore the debtor cannot avoid English's judicial lien on the property.

Conclusion

For the reasons stated above, the court finds that the judicial lien awarded by the St. Joseph Superior Court in favor of Victoria Laverne English and against the debtor Gregory Todd Donley, in the amount of \$8,000, secured her one-half interest in the equity of the marital real estate as part of the equal division of their marital assets. It further finds that the marital real estate was awarded simultaneously to the debtor. Pursuant to 11 U.S.C. § 522(f)(1) and *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825, 114 L.Ed.2d 337 (1991), the court

determines that the debtor did not possess that property interest before the judicial lien of English attached to it. The court concludes that English's judicial lien on the debtor's interest in the marital real estate is not avoidable under § 522(f)(1). The court therefore denies the debtor's Motion to Avoid Judicial Lien.

SO ORDERED.



HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT