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Community Property and the Banruptcy Reform Act of 1978 Selected Articles on the Bankruptcy Reform Act of 1978.

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COMMUNITY PROPERTY AND THE BANKRUPTCY REFORM ACT OF 1978*

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Within the last decade, seven of the eight community property states have extensively revised their marital and domestic relations laws to provide spouses with joint or equal management and control of their community property.[1] While these new laws are undoubt-

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1. *See generally* ARIZ. REV. STAT. ANN. §§ 25-211 to -215 (1976); CAL. CIV. CODE §§ 5100-5132 (West Supp. 1979); IDAHO CODE § 32-912 (Supp. 1978); NEV. REV. STAT. §§ 123.010 to .250 (1979); N.M. STAT. ANN. §§ 40-3-6 to -17 (1978); TEX. FAM. CODE ANN. §§ 5.01-.02, 5.21-.25, 5.61-.62 (Vernon 1975); WASH. REV. CODE ANN. § 26.16.030 (1961 & Supp. 1978). Only

edly socially desirable, and perhaps even constitutionally mandated,[2] their enactment gave rise to a number of serious problems under the prior Bankruptcy Act concerning the proper administration of a bankruptcy estate involving community property.[3] In response to these problems,[4] Congress has enacted specific provisions in the Bankruptcy Reform Act of 1978[5] in an attempt, when possible, to harmonize creditors' remedies under state community property laws with the new federal statute.[6] This article will serve as an introduction to the community property provisions of the new Bankruptcy Code by suggesting the proper statutory interpretation for each provision, examining the administration of a debtor's bankruptcy estate involving community property, and recommending amendments to correct certain inequities found in the new Code.

Parts I and II of this article discuss the initiation of a bankruptcy case in a community property state and describe the property of the debtor and the debtor's spouse that will comprise the bankruptcy

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Louisiana adheres to the system of sole management of the community property by the husband. *See* LA. CIV. CODE ANN. art. 2398 (West Supp. 1979).

2. For a listing of articles discussing the constitutionality of community property laws, see Reppy, *Retroactivity of the 1975 California Community Property Reforms*, 48 S. CALIF. L. REV. 977, 979 n.2 (1975). One of the motivations for reforming the community property law in California was the legislature's concern that the old law was subject to constitutional attack. *See id.* at 980 n.5.

3. *See generally* Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1610-70 (1975) (by Alan Pedlar).

The Bankruptcy Reform Act of 1978 was enacted by Congress on November 6, 1978 in the form of Public Law 95-598. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (to be codified as 11 U.S.C., and in scattered other titles). This Act culminates the legislative process initiated in 1970 when Congress established the Commission on the Bankruptcy Laws of the United States. *See* Klein, *The Bankruptcy Reform Act of 1978*, 53 AM. BANKR. L.J. 1, 3 (1979) (synopsis of legislative history, enactment, and transition). The Bankruptcy Reform Act of 1978 repeals the Bankruptcy Act of 1898, *as amended by* the Chandler Act of 1938, and with a few exceptions, the substantive provisions became effective October 1, 1979. *See id.* at 3. *See generally* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, sec. 401-411, 92 Stat. 2682-88 (to be codified as 11 U.S.C., and scattered other titles).

In the text of this article, "Bankruptcy Reform Act," "Reform Act," "Bankruptcy Code" and "Code" will be used interchangeably in references to the Bankruptcy Reform Act of 1978. Similarly, textual references to the Bankruptcy Act of 1898 *as amended by* the Chandler Act of 1938 will include "Bankruptcy Act," "Repealed Act," "Former Act," and "Act." Citation form for references to the Act will be: Bankruptcy Act § ___ (repealed 1978, previously codified as ___ U.S.C. § ___).

4. *See generally* HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY LAW REVISION, H.R. REP. No. 595, 95th Cong., 1st Sess. 176-77, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6136-38.

5. 11 U.S.C.A. §§ 101-151326 (West Supp. 1979).

6. H.R. REP. No. 595, 95th Cong., 1st Sess. 176-77, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6136-38.

estate. Part III describes the categories of creditors who will be entitled to be paid from property of the debtor's bankruptcy estate and discusses the complex scheme for distribution of the assets of a bankruptcy estate which is comprised, in whole or in part, of community property. A suggested interpretation for the distribution scheme is set forth, and several amendments to the Code are proposed which would eliminate certain questionable distribution provisions and avoid, in the vast majority of the cases, the cumbersome administrative problems presented by section 726(c) of the Bankruptcy Code.[7] Part IV describes the unique concept of a partial discharge obtained by a debtor's non-bankrupt spouse under the Bankruptcy Code and discusses the legislative history and policy considerations which gave rise to this result. Part V comments briefly on the avoiding powers of a trustee under the Bankruptcy Code as those powers are affected by reference to state community property laws. Finally, Part VI of this article makes a series of suggestions to the Advisory Committee on Bankruptcy Rules concerning the need for rules of bankruptcy procedure specifically applicable to community property states.

Before beginning a study of the interrelationship of community property and the new Bankruptcy Code, one must master certain of the definitions provided in Bankruptcy Code section 101. Under the new Bankruptcy Code, there is no longer any person who is a "bankrupt."[8] Pursuant to Code section 101(12), a "debtor" is defined as a "person or municipality concerning which a case under this title has been commenced."[9] Those entities who hold a right to payment as against the debtor are said to have a "claim,"[10] and the debtor's liability on a claim is termed a "debt."[11] Unlike a claim, a "community claim" is a debt owed by the debtor *or the debtor's spouse,* which under state law could have been satisfied from community property that would have passed to the debtor's bankruptcy estate, whether or not such property existed at the commencement of the case.[12] Thus, three criteria must be met before an obligation

7. 11 U.S.C.A. § 726(c) (West Supp. 1979).

8. Under the repealed Bankruptcy Act a "bankrupt" was defined as "a person against whom an involuntary petition or an application to revoke a discharge has been filed, or who has filed a voluntary petition, or who has been adjudged a bankrupt." Bankruptcy Act § 1(4) (repealed 1978, previously codified as 11 U.S.C. § 1(4)).

9. 11 U.S.C.A. § 101(12) (West Supp. 1979).

10. *Id.* § 101(4).

11. *Id.* § 101(11).

12. *Id.* § 101(6).

has the status of a community claim: (1) it must be a debt owed by one of the spouses; (2) it must be satisfiable from community property under applicable state law; and (3) the community property from which the debt could be satisfied under state law must be included within the assets which would pass to the debtor's bankruptcy estate, whether or not such assets exist at the commencement of the case. Finally, a "creditor" is defined as an entity holding a pre-petition claim against the debtor or a pre-petition "community claim."[13] Therefore, under the Bankruptcy Code, the term "creditor" includes entities to whom the debtor owes no debt, but who may execute on the debtor's property to satisfy a claim against the debtor's spouse.

I. INITIATION OF THE BANKRUPTCY CASE

A. *Voluntary Petitions*

Under the new Code a debtor initiates a bankruptcy case by filing a voluntary petition with the bankruptcy court.[14] The voluntary commencement of a case "constitutes an order for relief."[15] Even though the filing of a bankruptcy petition by one spouse immediately terminates the other spouse's right to equal or joint management and control of the community property,[16] the debtor clearly need not have the permission of his or her spouse to file a bankruptcy case.[17]

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13. *Id.* § 101(9). The definition also includes certain post-bankruptcy claims arising under section 502(f), 502(g), 502(h), or 502(i) of the Bankruptcy Code.

14. 11 U.S.C.A. § 301 (West Supp. 1979).

15. *Id.* The order for relief in a case commenced under chapter 7 of the Bankruptcy Code (Liquidation) is the equivalent to an adjudication under the former Bankruptcy Act. *See* S. REP. No. 989, 95th Cong., 2d Sess. 31, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5817; H.R. REP. No. 595, 95th Cong., 1st Sess. 321, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6277.

16. *See* 11 U.S.C.A. § 541(a)(2)(A) (West Supp. 1979). An entity in control of property of the estate shall deliver the property to the trustee. *Id.* § 542(a). The term "entity" includes any person. *Id.* § 101(14). Additionally, section 549 of the Code empowers the trustee to void postpetition transfers of property of the estate. Pursuant to section 541(a)(2) of the Code, most community property of the spouses is property of the estate. *See id.* § 541(a)(2).

17. Section 301 of the Code empowers the "debtor" to commence a voluntary bankruptcy case. The requisites for being a debtor, defined in section 109, do not include permission of the debtor's spouse. Further, the community property states lack the power to require the spouse's permission because the federal bankruptcy laws override conflicting state laws. *See, e.g.*, Elliott v. Bumb, 356 F.2d 749, 755 (9th Cir. 1966), *cert. denied*, 385 U.S. 829 (1966); Massaschusetts v. Bartlett, 266 F. Supp. 390, 392-93 (D. Mass. 1967), *aff'd*, 384 F.2d 819 (1st Cir. 1967), *cert. denied*, 390 U.S. 1003 (1968); *In re* Ann Arbor Brewing Co., 110 F. Supp.

The new Bankruptcy Code also provides that spouses may initiate a joint case by filing a single petition under the chapter in which the debtors seek relief.[18] Filing this petition constitutes the order for relief for both spouses.[19] After the joint case is initiated, the bankruptcy court will determine the extent to which the debtors' estates are to be consolidated, if consolidation is appropriate.[20]

111, 113-14 (E.D. Mich. 1951). *See generally* U.S. CONST. art. I, § 8, cl. 4 (empowering Congress to establish bankruptcy laws); U.S. CONST. art. VI, cl. 2 (supremacy clause); Lake, *Conflict: The Bankruptcy Act v. State Statutes,* 10 LOY. L.A. L. REV. 753 (1977). Under the former Bankruptcy Act, the bankrupt needed only to owe debts of any size to file a voluntary petition in bankruptcy, and absent a showing of fraud, the motive of the bankrupt was immaterial. *See* Bankruptcy Act §§ 4a, 59a (repealed 1978, previously codified as 11 U.S.C. §§ 22(a), 95(a)); 1 COLLIER ON BANKRUPTCY ¶ 4.03, at 578-81 (14th ed. 1976). There is no equivalent to section 59a of the Bankruptcy Act, previously codified as 11 U.S.C. § 95(a), in the Bankruptcy Code.

It is unlikely that a debtor would invoke a chapter 7 liquidation case under the Bankruptcy Code for the purpose of defeating the other spouse's right to manage and control the community property because the debtor would also lose control over his property. A more serious problem is presented, however, when the debtor files a petition under chapter 11 or chapter 13 of the Code. Under sections 1107(a) and 1303 the debtor in possession or debtor, respectively, retains the power to manage and control the bankruptcy estate. In these cases the bankruptcy court should carefully protect the interest of the nondebtor spouse in community property by requiring "notice and a hearing" to the nondebtor spouse prior to disposition of community property. *See* 11 U.S.C.A. § 102(1) (West Supp. 1979). In situations involving no legitimate creditor interest, when the sole purpose of the case is to defeat the nondebtor spouse's right to manage and control the property, the bankruptcy court has the power to abstain. *See* 11 U.S.C.A. § 305 (West Supp. 1979).

Frequently, a bankruptcy case is commenced by one spouse during the pendency of a dissolution or divorce proceeding. The bankruptcy petition terminates the jurisdiction of the divorce or dissolution court over, at least, the non-exempt assets of the spouses until all creditors are paid in full. The jurisdiction of the bankruptcy court is exclusive because the initiation of divorce or dissolution proceedings does not terminate either spouse's management and control over community property by placing the community property in *custodia legis* of the divorce court. *See, e.g., In re* Cummings, 84 F. Supp. 65, 69 (S.D. Cal. 1949); Lord v. Hough, 43 Cal. 581, 585 (1872); Chance v. Kobsted, 66 Cal. App. 434, 437, 226 P. 632, 633 (Dist. Ct. App. 1924).

As noted, if legitimate creditor interests are not served by the bankruptcy case and the debtor, because of clear solvency, does not seek a discharge, the bankruptcy court may abstain from hearing the case and return the matter to the divorce or dissolution court for appropriate administration. *See* 11 U.S.C.A. § 305(a) (West Supp. 1979); 28 U.S.C.A. § 1471(d) (West Supp. 1979). However, if legitimate creditor interest exists in the case of a solvent debtor involved in a divorce proceeding, the prudent bankruptcy court would expeditiously liquidate sufficient assets to pay creditors in full and then return the case to the dissolution court. This procedure is recommended because the divorce or dissolution court is a wholly inadequate forum for resolving creditor claims. *See In re* Marriage of Eastis, 47 Cal App. 3d 459, 463 n.2, 120 Cal. Rptr. 861, 863 n.2 (Ct. App. 1975).

18. *See* 11 U.S.C.A. § 302(a) (West Supp. 1979).

19. *See id.*

20. *Id.* § 302(b).

In cases involving community property, the extent of consolidation will depend largely upon whether either spouse possesses substantial non-exempt separate property or community property which is solely liable for the debts of one spouse. If no such separate or restricted community property exists, the estates may be fully consolidated, and the community property made available in distribution to the creditors of both spouses.[21] When one spouse owns a substantial amount of non-exempt separate or restricted community property, the estates will not be fully consolidated, for to do so would be detrimental to a particular class of creditors.[22]

Spouses may also file joint chapter 11 or 13 petitions under the Bankruptcy Code.[23] To qualify as a chapter 13 debtor, an individual must have regular income and owe noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000 on the date of the petition.[24] No provision increases this debt ceiling limitation for joint debtors. Accordingly, when the debt ceiling limitation would be exceeded by a joint petition, the filing of two separate chapter 13 cases will be appropriate.[25]

B. *Involuntary Petitions*

Filing an involuntary petition against a person under chapter 7 or 11 constitutes an alternative method for commencing a case under the Bankruptcy Code.[26] Pursuant to section 303(b) of the

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21. *See generally id.* §§ 541(a)(2), 726(c).

22. Under provisions governing the distribution of assets, separate property of a spouse is distributed solely to that spouse's creditors until they have been paid in full. Only then is the separate property of a spouse available to creditors of the other spouse. *See* 11 U.S.C.A. § 726(c)(2)(C), (D) (West Supp. 1979). The legislative history to section 302(b) provides:

> Subsection (b) requires the court to determine the extent, if any, to which the estates of the two debtors will be consolidated; that is, assets and liabilities combined in a single pool to pay creditors. Factors that will be relevant in the court's determination include the extent of jointly held property and the amount of jointly-owed debts. The section, of course, is not license to consolidate in order to avoid other provisions of the title to the detriment of either the debtors or their creditors. It is designed mainly for ease of administration.

S. REP. No. 989, 95th Cong., 2d Sess. 32, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5818; H.R. REP. No. 595, 95th Cong., 1st Sess. 321, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6278.

23. 11 U.S.C.A. §§ 109(e), 302(a) (West Supp. 1979).

24. *Id.* § 109(e).

25. No limitation is placed upon the availability of joint chapter 11 cases. *See* 11 U.S.C.A. § 302(a) (West Supp. 1979).

26. *See id.*

Code, only an entity holding a noncontingent claim against the person may institute an involuntary bankruptcy case.[27] Entities holding claims against the person's spouse should not have standing to file an involuntary petition,[28] even though these entities will have

27. 11 U.S.C.A. § 303(b)(1) (West Supp. 1979). The commencement of involuntary cases under chapter 7 or 11 is governed by section 303(b) and requires that the aggregate, unsecured claims against the debtor be at least $5,000. *Id.* An indenture trustee representing a noncontingent claimant may also institute an involuntary petition. *See id.* Under section 101(4) a "claim" means—

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
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> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

Id. § 101(4). This definition refers to *in personam* rights against the person, not *in rem* rights against the person's property.

28. An argument can be made that standing does exist because the term "claim against the debtor" includes claim against the debtor's property. *See* 11 U.S.C.A. § 102(2) (West Supp. 1979). It should be noted, however, that section 303(b) of the Code requires the petitioning creditor to have a claim against the person, not a claim against the debtor; therefore, section 102(2) should not apply. One should not be able to bootstrap standing by first filing an involuntary petition against the person and then claiming the status of a holder of a claim against the debtor. Further, section 102(2) should not be used in cases involving community property unless to do so would further the policy underlying the statute. In community property provisions throughout the Code the term "community claim" is utilized to signify a claim against a debtor's property which is not an *in personam* claim against the debtor. Section 102(2) was intended to cover non-recourse loan agreements. *See* S. REP. No. 989, 95th Cong., 2d Sess. 28, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5820; H.R. REP. No. 595, 95th Cong., 1st Sess. 315, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6279-80.

To allow creditors of one spouse to file involuntary bankruptcy petitions against the other spouse would be a disaster, particularly in light of the present section 726(c)(2)(D) windfall. *See generally* 11 U.S.C.A. § 726(c)(2)(D) (West Supp. 1979). See text accompanying notes 99-107 *infra*. If by filing an involuntary petition in bankruptcy the creditors of one spouse could reach the separate property of the other spouse, the undesired bankruptcy incentive that Professor Riesenfeld cautioned Congress about in testimony before the House Judiciary Committee would become a reality. *See Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1530 (1976).

Note that the definition of claim is broad enough to allow a creditor holding a "separate" debt owed by a person under Washington or Arizona law to institute an involuntary case. *See* W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 371-87 (2d ed. 1971) (discussing Arizona's and Washington's separate property doctrines). However, with the exception of recovered voidable transfers, no incentive or windfall is afforded to such a creditor because section 726(c)(2)(C) limits that creditor to the same non-community property of the debtor available to the creditor under state law. Washington and Arizona bankruptcy courts will encounter an interesting problem upon the filing of an involuntary petition by a "separate" creditor. These courts must determine whether a debtor owning substantial community prop-

"creditor" status in relation to the alleged debtor upon entry of the order for relief because they hold "community claims." Further, a creditor holding only a community claim, and not a claim against the debtor, should be barred from joining in the petition once it is filed.[29]

Under section 303(h)(1) of the Bankruptcy Code, when an involuntary bankruptcy case has been commenced, the order for relief shall be granted if "the debtor is generally not paying such debtor's debts as such debts become due . . . ."[30] In a community property state, the existence of creditors of the other spouse who hold community claims should have been made an influential factor in the bankruptcy court's ruling on an involuntary bankruptcy petition. However, under the present version of the statute, so long as a spouse is paying the debts contracted by that spouse, apparently no involuntary petition may be successfully prosecuted, even if the other spouse's debts are substantial enough to render both spouses hopelessly insolvent[31] on a "balance sheet" insolvency

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erty, but no separate property, and owing a separate debt that he chooses not to pay, constitutes a debtor "generally not paying such debtor's debts as such debts become due." 11 U.S.C.A. § 303(h)(1) (West Supp. 1979). *See* W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 371-87 (2d ed. 1971).

29. The Bankruptcy Reform Act, 11 U.S.C.A. § 303(c) (West Supp. 1979) provides:

> (c) After the filing of a petition under this section but before the case is dismissed or relief is ordered, a *creditor* holding an unsecured claim that is not contingent, other than a creditor filing under subsection (b) of this section, may join in the petition with the same effect as if such joining creditor were a petitioning creditor under subsection (b) of this section.

Id. (emphasis added). Technically, the phrase "holder of a claim or an indenture trustee representing such a holder" should have been carried over from section 303(b) rather than utilizing the term "creditor," which includes the holder of a community claim. *See* 11 U.S.C.A. § 101(9)(C) (West Supp. 1979). This oversight is probably nullified, however, because the holder of a community claim "may join in the petition with the same effect as if such joining creditor were a petitioning creditor." This joinder constitutes no effect whatsoever since a community creditor of the other spouse could not be a petitioning creditor. *See id.* § 303(c).

30. 11 U.S.C.A. § 303(h)(1) (West Supp. 1979).

31. Surely the existence of creditors of the other spouse affects an alleged debtor's ability to satisfy his or her debts. Nevertheless, if balance sheet insolvency truly exists, it is likely that at least one of the two spouses is "generally not paying such debtor's debts as such debts become due." If so, that spouse is susceptible to an involuntary petition. At that time, the order for relief and appointment of an interim trustee over the community property could constitute the appointment of a custodian over all or substantially all of the other spouse's property. This is sufficient for the court to grant an order for relief against the second spouse. Note, however, that a "custodian" under the Code may only refer to pre-petition liquidators such as assignees for the benefit of creditors; it may not have been intended to appy to interim trustees. H.R. REP. No. 595, 95th Cong., 1st Sess. 310, *reprinted in* [1978] U.S. CODE CONG.

analysis.[32]

II. PROPERTY OF THE ESTATE

Regardless of whether or not the bankruptcy proceeding is voluntarily or involuntarily commenced, the filing of the petition in bankruptcy creates an estate.[33] The property to be included within this estate in a community property jurisdiction will undoubtedly surprise and shock many practitioners; however, upon analysis, the estate created under the Bankruptcy Code is the only result consistent with the entry of an order of discharge for the debtor.[34]

The entry of an order of discharge for the debtor must be premised upon the fact that his or her creditors have had access to his or her non-exempt assets for the satisfaction of their claims. Under new community property laws, where both spouses have the power to manage and control the community assets, the creditors of either spouse have access to at least those community assets under the management and control of their debtor.[35] Accordingly, all non-exempt community property available to the debtor's creditors must pass to the bankruptcy estate to be distributed to creditors before a discharge can be granted. Therefore, as was the law under the prior Bankruptcy Act,[36] a petition in bankruptcy by one spouse

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& AD. NEWS 5963, 6267. Yet, with respect to the nondebtor spouse, the interim trustee is a pre-petition liquidator. *See* 11 U.S.C.A. § 303(h)(1)-(2) (West Supp. 1979). Furthermore, after the petition is filed against one spouse and the community property passes to an interim trustee, it is likely that, unless the nondebtor spouse has substantial separate property, he or she will no longer be able to generally pay his or her debts as they become due and would, therefore, be susceptible to an involuntary petition. *See id.* Similarly, it appears that whenever one spouse has filed a voluntary petition, the other spouse becomes susceptible to an involuntary petition under either section 303(h)(1) or 303(h)(2).

32. *See* 11 U.S.C.A. § 101(26)(A) (West Supp. 1979) (setting forth "balance sheet" insolvency test).

33. *Id.* § 541(a).

34. *See* Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1636-43 (1975).

35. For example, the preamble to California's amendments to its community property laws provides: "The Legislature further finds and declares that (1) the liability of community property for the debts of the spouses has been coextensive with the right to manage and control community property and should remain so . . . ." Preamble to Ch. 1206, § 1, 1974 CAL. STATS. 2609 *quoted following* CAL. CIV. CODE § 5116 (West Supp. 1979). *See generally* ARIZ. REV. STAT. ANN. § 25-214B (1976); CAL. CIV. CODE § 5116 (West Supp. 1979); NEV. REV. STAT. § 123.050 (1977); N.M. STAT. ANN. §§ 40-3-6 to -17 (1978); TEX. FAM. CODE ANN. § 5.61 (Vernon 1975); WASH. REV. CODE ANN. §§ 26.16.190 to .200 (Supp. 1978); Young, *Joint Management and Control of Community Property in Idaho: A Prognosis*, 11 IDAHO L. REV. 1, 8 (1974); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1621-24, 1649-59 (1975).

36. *See, e.g.*, Hannah v. Swift, 61 F.2d 307, 310 (9th Cir. 1932); Wikes v. Smith, 465 F.2d 1142, 1147 (9th Cir. 1972); Martoff v. Elliott, 326 F.2d 204, 206-07 (9th Cir. 1963); Foster

transfers, at the very least, all community property under that spouse's management and control to the bankruptcy estate.

Section 541(a) of the Bankruptcy Code provides:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located:
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> . . . .
>
> (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.[37]

Other provisions of section 541 transfer all separate property of the debtor spouse to the estate. Thus, in a state where spouses equally or jointly manage and control their community property, the only property of either spouse that does not pass to the bankruptcy estate of an individual spouse is the separate property of the nondebtor spouse and the community property subject to sole management and control of the nondebtor spouse, to the extent that such property is not liable for an allowable claim against the debtor.[38]

Application of the foregoing rules to a bankruptcy case filed by an individual spouse residing in Arizona,[39] Idaho,[40] or New

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v. Christensen, 67 S.W.2d 246, 251 (Tex. Comm'n App. 1934, holding approved); John v. Battle, 58 Tex. 591, 596 (1883). *See generally* H.R. REP. No. 595, 95th Cong., 1st Sess. 176, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6136-37; *Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1526-33 (1976); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1636-37 (1975).

37. 11 U.S.C.A. § 541(a) (West Supp. 1979).

38. *See id.* § 541(a)(2)(B). A subsequent petition in bankruptcy by or against the nondebtor spouse would pass only the remaining or newly-created community property and that spouse's separate property to his or her trustee in bankruptcy. A joint petition would pass all community property to the bankruptcy estate. With one notable exception concerning voidable transfers, there is no substantive difference between joint and separate petitions by the spouses. See text accompanying note 98, *infra*. Exempt property technically passes to the estate and is then exempted out by the debtor under section 522.

39. Under Arizona law the spouses have equal management and control of the community property, and either spouse may transfer or encumber personal property. Transactions involving real property generally require joinder of both spouses. *See* ARIZ. REV. STAT. ANN. §§ 25-214B,C (1976). No provision is made for sole management of a community property business. *See generally id.*

40. In Idaho either spouse may manage and control community property except that the

Mexico[41] will pass all community property to the bankruptcy estate, for no provisions are made under the laws of these states for the sole management and control of community assets. Therefore, perhaps unfortunately, in these states a petition in bankruptcy by one spouse will pass the other spouse's sole proprietorship community property business to the estate, in addition to any community property partnership or stock interest in a business operated by the nondebtor spouse.

In California,[42] Washington,[43] and Nevada[44] a community property business may be under the sole management and control of the business spouse. Thus, while the commencement of a bankruptcy case by or against the non-business spouse in these states would pass all non-business community assets to the estate, section 541(a)(2)(A) of the Code would not transfer the community property business to the estate.[45] The assets of a solely managed community business would pass to the bankruptcy estate of the non-business spouse under section 541(a)(2)(B), but only to the extent the business assets were "liable for an allowable claim against the debtor . . . ."[46] The extent of the liability of a solely managed community property business for the other spouse's debts is not clear from reviewing applicable statutes, and has not yet been determined by the courts of California, Washington, or Nevada; however, by analogy to limited partnership law, it has been suggested that the solely managed community property business should be liable for the

spouses must join in real property transactions. IDAHO CODE § 32-912 (Supp. 1978). No provision for sole management of a community business is made. *See* Young, *Joint Management and Control of Community Property in Idaho: A Prognosis*, 11 IDAHO L. REV. 2, 9-10 (1974).

41. In New Mexico, either spouse alone may manage and control community personal property. N.M. STAT. ANN. § 40-3-14 (1978). Community realty as well as tenancies held in common or jointly with the other spouse require joint management by the spouses. N.M. STAT. ANN. § 40-3-13 (1978). No special provision is made for a community property business. The community property business was presumptively managed by the husband under the former New Mexico statute. *See* N.M. STAT. § 57-4A-7.1(A) (Supp. 1973) (repealed 1975).

42. *See* CAL. CIV. CODE § 5125(d) (West Supp. 1978); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1628-34 (1975).

43. *See* Pixton v. Silva, 534 P.2d 135, 138-39 (Wash. Ct. App. 1975); WASH. REV. CODE ANN. § 26.16.030(6) (Supp. 1978).

44. *See* NEV. REV. STAT. § 123.230 (1977).

45. *See* 11 U.S.C.A. § 541(a)(2)(A) (West Supp. 1979).

46. *Id.* § 541(a)(2)(B).

debts of the other spouse only to the extent the business assets exceed the business debts.[47] If this is the case, section 541(a)(2)(B) will afford the bankruptcy trustee the equivalent of a charging order against the other spouse's business, but the business itself would not become an asset of the estate.[48] A bankruptcy petition by the business spouse in these states passes all community property to the estate.[49]

Texas has divided community property into three separate categories: (1) community property under the joint management and control of the spouses; (2) community property under sole management and control of the husband; and (3) community property under sole management and control of the wife.[50] Therefore, upon petition by or against one spouse in Texas, all property which is under the sole or joint management and control of the debtor passes to the bankruptcy estate.[51] Additionally, in Texas, postnuptial tort creditors of one spouse may satisfy their claims from community property under the sole management and control of the other spouse.[52] Pursuant to section 541(a)(2)(B) of the Code, community property subject to sole management of the nondebtor spouse passes to the bankruptcy estate of the debtor spouse only to the extent of allowable postnuptial tort claims against the debtor.[53] Accordingly, a total discharge of the debtor's liabilities may be granted because all assets subject to levy under state law for the satisfaction of creditor claims against the debtor will be administered in the bankruptcy case.

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47. *See* Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1628-34 (1975).

48. *See* UNIFORM LIMITED PARTNERSHIP ACT § 22; Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1628-34 (1975).

49. *Compare* 11 U.S.C.A. § 541(a)(2)(A) (West Supp. 1979) *with* CAL. CIV. CODE §§ 5125(a), 5127 (West Supp. 1978) *and* NEV. REV. STAT. § 123.230 (1978) *and* WASH. REV. CODE ANN. § 26.16.030 (Supp. 1978).

50. TEX. FAM. CODE ANN. § 5.22 (Vernon 1975); *see* Cockerham v. Cockerham, 527 S.W.2d 162, 169-70 (Tex. 1975); Evans v. Muller, 510 S.W.2d 651, 654 (Tex. Civ. App.—Austin), *rev'd on other grounds*, 516 S.W.2d 923 (Tex. 1974).

51. 11 U.S.C.A. § 541(a)(2)(A) (West Supp. 1979).

52. *See* TEX. FAM. CODE ANN. §§ 5.61(b), (d) (Vernon 1975).

53. 11 U.S.C.A. § 541(a)(2)(B) (West Supp. 1979). For a discussion of this problem under the former Bankruptcy Act see Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1655 n.258 (1975).

III. Administration and Distribution of the Estate

A necessary corollary to the general rule that a petition in bankruptcy by one spouse passes the community property to the bankruptcy estate is the rule that those creditors of the nondebtor spouse who are entitled to reach such property under state law retain access to the same property in bankruptcy.[54] Under the prior Bankruptcy Act, there was no provision specifically authorizing this type of creditor participation, although such participation was clearly mandated by equity.[55] The new Bankruptcy Code, however, explicitly authorizes participation in distribution of the estate by creditors of the nondebtor spouse.

A. *Creditors Entitled to a Distribution of Assets*

As previously noted, persons holding claims against the nondebtor spouse who, under state law, could have satisfied their claims from community property that would have passed to the bankruptcy estate of the other spouse, whether or not such property existed at the commencement of the case, are now deemed to hold "community claims."[56] These persons are also included within the

54. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 176, *reprinted in* [1978] U.S. Code Cong. & Ad. News 5963, 6136-37; *Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1527-29 (1976); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 Calif. L. Rev. 1610, 1637-44 (1975).

55. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 176, *reprinted in* [1978] U.S. Code Cong. & Ad. News 5963, 6136-37; *Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1527-29 (1976); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 Calif. L. Rev. 1610, 1637-44 (1975). Assume a spouse had $100,000 in non-exempt community property and $100,000 in liabilities. Further assume that the other spouse had $100,000 in liabilities and that neither spouse had any separate property. A liquidation under state law would yield a return of 50-cents for every dollar of claim. Surely by winning a race to the bankruptcy courthouse, one spouse should not have the community property distributed solely to his or her creditors while the creditors of the nondebtor spouse receive nothing.

56. The language "whether or not there is any such property at the time of the commencement of the case," which is found in section 101(6) of the Code, will be meaningless in almost all cases. If no community property has passed to the estate, section 726(c) does not direct that sub-estates be established. Therefore, the distribution would take place under sections 726(a) and (b), thus excluding the other spouse's creditors. The language would be important and meaningful, however, if voidable transfers retained their separate or community property nature. See text accompanying note 98, *infra*. The language will also be meaningful when chapter 13 earnings are included within assets of the estate. *See* 11 U.S.C.A. § 1306 (West Supp. 1979).

meaning of the term "creditor" under Bankruptcy Code section 101(9).[57]

In all community property states except Washington and Arizona, entities holding claims against either spouse will have the status of a creditor holding a community claim.[58] All creditors in Washington[59] and Arizona,[60] except those creditors holding "separate" debts, have the status of a holder of a community claim. Of course, the "separate" creditors of the debtor in these states will be a creditor of the estate but will not have the status of a creditor

57. *See id.* § 101(9).

58. In all community property states other than Washington and Arizona, all creditors of either spouse have access to at least some of the community property for satisfaction of their debts. *See generally* ARIZ. REV. STAT. ANN. § 25-214B (1976); CAL. CIV. CODE § 5116 (West Supp. 1979); NEV. REV. STAT. § 123.050 (1977); N.M. STAT. ANN. §§ 40-3-6 to -17 (1978); TEX. FAM. CODE ANN. § 5.61 (Vernon 1975); WASH. REV. CODE ANN. §§ 26.16.190 to .200 (Supp. 1978); Young, *Joint Management and Control of Community Property in Idaho: A Prognosis,* 11 IDAHO L. REV. 1, 8 (1974); Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy,* 63 CALIF. L. REV. 1610, 1621-24 (1975).

59. Professor Marsh describes the Washington "community debt" system as follows:

> The theory of "community debts," briefly stated, is that the community property is only liable for an obligation of the [spouse] if the [spouse] was acting as an agent of the marital community in the transaction in which the obligation was incurred or if the obligation was incurred for the benefit of the marital community.

Marsh, *"California Family Law" — A Review,* 42 CALIF. L. REV. 368, 379 (1954). Thus, in Washington there can be separate debts of a spouse which are not community debts and which may not be satisfied from community assets. These include contracts not entered into on behalf of the community, personal torts resulting from activities not benefiting the community, and prenuptial debts. *See* W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 371-87, 428-34 (2d ed. 1971).

Under the new Washington statute, prenuptial creditors may reach only separate property of the debtor and, provided the claim is reduced to judgment within three years of the marriage, the community earnings and accumulations of the debtor. WASH. REV. CODE ANN. § 26.16.200 (Supp. 1978). Other separate creditors are limited to the separate property of the debtor. Community creditors may reach all community property as well as the separate property of the contracting spouse. *See* Cross, *Equality for Spouses in Washington Community Property Law — 1972 Statutory Changes,* 48 WASH. L. REV. 527, 548-50 (1973).

60. Arizona's new community property law partially rejects the "community" and "separate" debt distinction for premarital debts thereby eliminating the "two-dollar bankruptcy." *See* Schilling v. Embree, 575 P.2d 1262, 1264 (Ariz. Ct. App. 1977); Hamada v. Valley Nat'l Bank, 555 P.2d 1121, 1124 (Ariz. Ct. App. 1976). The new provision dealing with premarital separate debts, however, was not made retroactive. Thus, premarital separate debts incurred after September 1, 1973, may be satisfied from a spouse's separate property and from the community property to the extent of that spouse's contribution to the community; premarital separate debts incurred prior to September 1, 1973, are satisfied only from a spouse's separate property. ARIZ. REV. STAT. ANN. § 25-215B (1976). All postnuptial separate creditors are limited to a spouse's separate property. *See* Schilling v. Embree, 575 P.2d 1262, 1264 (Ariz. Ct. App. 1977); Hamada v. Valley Nat'l Bank, 555 P.2d 1121, 1124 (Ariz. Ct. App. 1976).

holding a community claim. These classifications identically track the scheme of creditors' remedies under state law.

In those states such as New Mexico, where creditors of one spouse may reach only a portion of the community property, the state law marshaling restriction is abolished, and all creditors of the same class who hold community claims share pro rata in the distribution of estate property.[61] In this regard, the bankruptcy system deviates from creditors' remedies under state law; however, an attempt to recognize every variation in state law would render distribution of the estate excessively burdensome from an administrative standpoint.

B. *Distribution of Property of the Estate*

Bankruptcy Code section 726(c) contains the rules for distribution of property of an estate whenever the estate includes community property of the debtor. It provides:

> (c) Notwithstanding subsections (a) and (b) of this section, if there is property of the kind specified in section 541(A)(2) of this title, or proceeds of such property, in the estate, such property or proceeds shall be segregated from other property of the estate, and such property or proceeds and other property of the estate shall be distributed as follows:
>
> (1) Administrative expenses shall be paid either from property of the kind specified in section 541(a)(2) of this title, or from other property of the estate, as the interest of justice requires.
>
> (2) Claims other than for administrative expenses shall be paid in the order specified in subsection (a) of this section, and, with respect to claims of a kind specified in a particular paragraph of section 507 of this title or subsection (a) of this section, in the following order and manner:
>
> (A) First, community claims against the debtor or the debtor's spouse shall be paid from property of the kind

61. New Mexico distinguishes between community and separate debts by providing an elaborate marshaling scheme which, in the extreme, limits separate creditors to all of a spouse's separate property and one-half of the community property. *See* N.M. STAT. ANN. §§ 40-3-9 to -11 (1978). Similar restrictions are found under Arizona law which limits premarital separate debts to the spouse's contributive share of the community property, ARIZ. REV. STAT. ANN. § 25-215B (1976), and under California law which bars prenuptial creditors from reaching the wages of the other spouse. *See* CAL. CIV. CODE § 5120 (West Supp. 1979). These types of restrictions are abolished under the federal scheme. *See generally* Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1645, 1653 (1975).

> specified in section 541(a)(2) of this title, except to the extent that such property is solely liable for debts of the debtor.
>
> (B) Second, to the extent that community claims against the debtor are not paid under subparagraph (A) of this paragraph, such community claims shall be paid from property of the kind specified in section 541(a)(2) of this title that is solely liable for debts of the debtor.
>
> (C) Third, to the extent that all claims against the debtor including community claims against the debtor are not paid under subparagraph (A) or (B) of this paragraph such claims shall be paid from property of the estate other than property of the kind specified in section 541(a)(2) of this title.
>
> (D) Fourth, to the extent that community claims against the debtor or the debtor's spouse are not paid under subparagraph (A), (B), or (C) of this paragraph, such claims shall be paid from all remaining property of the estate.[62]

This provision will govern the distribution of property in all individual chapter 7 bankruptcy cases in the equal or joint management community property states.

As detailed in the statute, when community property is involved, the bankruptcy trustee is required to segregate separate and community property and apportion the costs of administration of the bankruptcy case between the two types of property "as the interest of justice requires." The property of the estate is then divided into four "sub-estates," and claims are paid in accordance with the normal priority scheme set forth in Bankruptcy Code section 726(a), but with specific marshaling instructions relating to the various "sub-estates" which are detailed in provisions (A) through (D) of section 726(c)(2).

Sub-estate (A) includes community property that has passed to the estate, "except to the extent that such property is solely liable for debts of the debtor." Under the present community property laws, however, there is no species of community property which is "solely liable for the debts of the debtor." In each community property state all community property is at least liable for some debts of both spouses.[63] Therefore, sub-estate (A) could be read to include

62. 11 U.S.C.A. § 726(c) (West Supp. 1979).

63. *See geneally* ARIZ. REV. STAT. ANN. § 25-214B (1976); CAL. CIV. CODE § 5116 (West Supp. 1979); NEV. REV. STAT. § 123.050 (1977); N.M. STAT. ANN. §§ 40-3-9 to -11 (1978);

all the community property in the estate; however, such an interpretation renders section 726(c)(2)(B) meaningless, and is therefore unacceptable.[64] The proper interpretation of section 726(c)(2)(A), is that it includes all community property of the estate to the extent such property is liable for the debts of both spouses. Only in those situations where community property is classified, and therefore put beyond the reach of the other spouse's creditors, will it be excluded from sub-estate (A) and placed in sub-estate (B).

The most notable example of sub-estate (B) property occurs in Texas where some community property is under the sole management and control of the debtor and is not generally liable for the debts of the nondebtor spouse.[65] If the nondebtor has a postnuptial tort creditor, however, such a creditor may reach community property under the sole management and control of the debtor, and is entitled to share in a distribution of those assets. Thus, to the extent of such a postnuptial tort claim, property under the sole management and control of the debtor is not *solely* liable for the debts of the debtor. This property, in the amount of such a claim, properly belongs in sub-estate (A) which is to include all community property "except to the extent that such property is solely liable for debts of the debtor." Therefore, the only possible interpretation of the statutory language creating sub-estates (A) and (B), which would not nullify sub-estate (B), is that sub-estate (B) is comprised of the community property under the sole management and control of the debtor in excess of the amount of the postnuptial tort claims against the debtor's spouse. The balance of such property, to the extent of postnuptial tort claims against the nondebtor, is included in sub-estate (A). Accordingly, to the extent of a claim held by a postnuptial tort creditor of the nondebtor, property is shifted from sub-estate (B) to sub-estate (A), thereby leaving the property in sub-estate (B) "solely liable for debts of the debtor" as mandated by the statute.[66] Similarly, sub-estate (A) would now contain all

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TEX. FAM. CODE ANN. § 5.61 (Vernon 1975); WASH. REV. CODE ANN. §§ 26.16.190 to .200 (Supp. 1978); Young, *Joint Management and Control of Community Property in Idaho: A Prognosis*, 11 IDAHO L. REV. 1, 8 (1974); Comment, *The Implications of New Community Property Laws for Creditors' Remedies and Bankruptcy*, 63 CALIF. L. REV. 1610, 1621-24 (1975).

64. It is a general rule of statutory construction that one provision of a statute should not be construed to render another provision of the statute meaningless. *See, e.g.*, Shinn v. Heath, 535 S.W.2d 57, 62 (Ark. 1976); City of Hayward v. United Pub. Employees, Local 390, 126 Cal. Rptr. 710, 713 (Ct. App. 1976); Tidwell v. Collins, 522 S.W.2d 674, 676 (Tenn. 1975).

65. *See* TEX. FAM. CODE ANN. §§ 5.61(b), (d) (Vernon 1975).

66. This result is complimentary to the result achieved under Bankruptcy Code section

community property of the estate except that certain community property "solely liable for debts of the debtor" that comprises sub-estate (B).

A similar situation may arise in California, Washington, and Nevada, whose statutes provide for sole management and control of a community property business.[67] If sole management and control restricts the access of the other spouse's creditors to the business property, the business of the debtor would comprise sub-estate (B), except to the extent and amount that the business is liable for claims of the creditors of the debtor's spouse, which dollar amount would be shifted to sub-estate (A) under section 726(c)(2)(A), (B).

Sub-estate (C) includes all property of the estate other than community property. This encompasses such assets as the debtor's separate property, post-bankruptcy inheritances within 180 days of the petition, voidable transfers recovered by the trustee, and all other property identified in Bankruptcy Code section 541(a). All claims against the debtor will be paid from this property, but creditors of the debtor's spouse do not participate in the distribution of this fund. All undistributed property is included in sub-estate (D), and all creditors of either spouse who hold community claims are paid pro rata from this estate.

When a joint case has been filed by the spouses[68] or the two spouses have each commenced individual cases, section 726(c)(2) requires six sub-estates to be established. Sub-estate (A) is consolidated for both spouses; however, sub-estates (B) and (C) must be established for each spouse if property fitting their descriptions passes to the estate. Sub-estate (D), which contains only overflow assets, would be identical for each estate. Accordingly, the ability of a court to order full consolidation of the two estates will depend upon whether sub-estates (B) and (C) exist for either of the spouses.[69] To envision how section 726(c) is intended to operate,

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541(a)(2)(B) when, under Texas law, the community property under the sole management and control of the nondebtor spouse passes to the bankruptcy estate to the extent of allowable postnuptial tort claims against the debtor. *Compare* 11 U.S.C.A. § 541(a)(2)(B) (West Supp. 1979) *with* TEX. FAM. CODE ANN. § 5.61(d) (Vernon 1975).

67. *See* CAL. CIV. CODE § 5125(d) (West Supp 1979); NEV. REV. STAT. § 123.230(6) (1978); WASH. REV. CODE ANN. § 26.16.030(6) (1978).

68. *See* 11 U.S.C.A. § 302 (West Supp. 1979).

69. *See* 11 U.S.C.A. § 726(c)(2) (West Supp. 1979). Sub-estates (A) and (D) are consolidated because creditors of either spouse holding community claims are entitled to reach assets in these sub-estates in either spouse's bankruptcy case. Sub-estates (B) and (C) may not be consolidated, for they contain assets in which only the debtor's creditors may share. *See id.*

assume the following example under Texas law:

Assets		Liabilities	
1. Husband's separate property	$25,000	1. Debts of husband	
		a. Federal taxes	$10,000
2. Husband's solely managed and controlled community property	$25,000	b. General unsecured debt including a $5,000 postnuptial tort claim	$100,000
3. Jointly managed community property	$50,000	2. Debts of wife	
4. Wife's solely managed and controlled community property	$30,000	a. State taxes	$5,000
		b. General unsecured debt including a $10,000 postnuptial tort claim	$100,000
5. Wife's separate property	$10,000		

Upon a petition by the husband, the property of the estate would be as follows:

1. Husband's separate property[70]	$25,000
2. Community property under sole management and control of the husband[71]	$25,000
3. Jointly managed community property[72]	$50,000
4. Community property under the sole management and control of the wife to the extent it is liable for an allowable claim against the debtor[73]	$ 5,000

Further assume that the trustee recovers a $40,000 fraudulent transfer of community property; that the husband inherits $25,000 within 180 days after the filing of the petition; and that the costs of administration are $25,000. The established sub-estates under Bankruptcy Code section 726(c) are as follows:

70. *Id.* § 541(a)(1).

71. *Id.* § 541(a)(2)(A).

72. *Id.* § 541(a)(2)(A).

73. This amount is determined by the amount of the claims of the postnuptial tort creditors of the husband. *Id.* § 541(a)(2)(B).

Section 726(c) Sub-estates

(A)	$50,000[74]	$10,000[75]	$ 5,000[76]	= $65,000
(B)	$15,000[77]			= $15,000
(C)	$25,000[78]	$40,000[79]	$25,000[80]	= $90,000
(D)	$ -0-			= $ -0-

Section 726(c)(1) requires that the costs of administration be apportioned from property described in section 541(a)(2) or other estate property as dictated by "the interest of justice."[81] Assume that $15,000 of the $25,000 in administrative costs were incurred to recover the fraudulent conveyance. This would be attributable to sub-estate (C) which contains the assets representing the recovery.[82] For the purpose of this example, the other $10,000 will be attributed to sub-estate (A), with the following balances then existing after payment of administrative expenses:

Section 726(c) Sub-estates

(A)	(B)	(C)	(D)
$55,000	$15,000	$75,000	$ -0-

The order of priorities of section 726(a) is followed and the tax claims against the debtor and the debtor's spouse are paid.[83] In each

74. This is the community property liable for the debts of both spouses.

75. This is the "shifted sub-estate (B)" property. It is shifted because the wife's $10,000 postnuptial tort creditor can reach the solely managed and controlled community property in this amount.

76. This is the amount of the wife's solely managed community property which is liable for an allowable claim against the debtor; to wit, the claim of the husband's postnuptial tort creditor. The asset is in sub-estate (A) because it is community property not solely liable for the debts of the debtor.

77. This is the remaining solely managed community property which is solely liable for the debts of the debtor.

78. This figure represents the husband's separate property.

79. This figure represents the fraudulent conveyance recovery. *See* 11 U.S.C.A. §§ 541(a)(3), 726(c)(2)(C) (West Supp. 1979).

80. This figure represents the inherited funds. *See* 11 U.S.C.A. § 541(a)(5) (West Supp. 1979).

81. *See id.* § 726(c)(1).

82. Sub-estate (C) contains the assets recovered as a fraudulent conveyance. The "interests of justice" thus dictate that this sub-estate bear the costs of the recovery.

83. Section 726(c)(2) states that priority claims shall be paid in the order specified in section 726(a), and with respect to a particular type of priority claim in accordance with the marshaling scheme of sub-estates (A)-(D). *See* 11 U.S.C.A. § 726(c)(2) (West Supp. 1979).

case, the tax claim is a community claim, and will be paid from sub-estate (A), thereby leaving the following balances:

Section 726(c) Sub-estates

(A)	(B)	(C)	(D)
$40,000[84]	$15,000	$75,000	$ -0-

Thereafter, the creditors of the husband and wife who hold community claims are paid pro rata from sub-estate (A) leaving the creditors of the husband and the creditors of the wife each with $80,000 in debts after disbursement of sub-estate (A).[85] The sub-estate (B) property is then paid pro rata to creditors of the husband who hold community claims[86] thereby reducing their claims to $65,000. The sub-estate (C) assets are then paid to the creditors of the husband[87] leaving the following balances owing:

Husband's Debts	= $ -0-[88]
Wife's Debts	= $80,000
Sub-estates (A), (B) and (C)	= $ -0-
Sub-estates (D)	= $10,000[89]

The final $10,000 is then paid to creditor's having community claims against the wife from sub-estate (D).

Unfortunately, the above described procedure for distribution of the assets of the debtor's estate is unduly cumbersome, inequitable in certain specific instances, and wholly impractical in typical

84. The $15,000 of tax liabilities have been paid from sub-estate (A).

85. There are $200,000 of community claims against sub-estate (A). Accordingly, sub-estate (A) will pay 20% of each spouse's creditors' claims, thereby reducing each spouse's creditors' claims pro rata to $80,000. A creditor holding the same claim against both spouses, as in the case of a joint promissory note, or a spousal guaranty, will only participate one time, and this participation should be with the status of a claimant against the debtor to maximize recovery.

86. This property is "solely" liable for the husband's debts, and only entities holding community claims against the debtor may share in its distribution. 11 U.S.C.A. § 726(c)(2)(B) (West Supp. 1979).

87. Only creditors of the husband may participate in the distribution of these assets. *Id.* § 726(c)(2)(C).

88. The husband's debts have been paid in full by the disbursements from sub-estates (A), (B) and (C).

89. The surplus of sub-estate (C) flows into sub-estate (D) where it is available to creditors having community claims against the debtor's spouse. 11 U.S.C.A. § 726(c)(2)(D) (West Supp. 1979).

individual bankruptcy liquidation cases. The complex distribution scheme is sought to be justified as an attempt to track closely the rights of creditors under state law, thereby avoiding unwarranted windfalls to certain classes of creditors that might encourage petitions in bankruptcy by creditors seeking to improve their collection status.[90] While the goal of the provision is laudable, the results achieved are unsatisfactory.

C. *Critical Analysis of Section 726(c)*

1. *The Costs of Administration.* As noted above, administrative expenses are to be paid from community or other property of the estate "as the interest of justice requires."[91] While this language is vague, it is unlikely that an exact formula could be established to apportion costs between the separate and community property estates being administered. Furthermore, from a practical standpoint, the apportionment will not present a large problem for the court as many costs will be directly attributable to sales or litigation recoveries giving rise to proceeds in a particular sub-estate. The legislative history indicates that the court should approve any reasonable allocation proposal.[92]

It must be recognized, however, that under section 726(c)(1) the trustee in bankruptcy has been called upon to propose to the court a division of costs among sub-estates which have different beneficiaries, thereby raising a conflict of interest between the sub-estates. No fiduciary should be called upon to choose between conflicting sets of beneficiaries without the protection of a court order. Therefore, to protect the trustee, section 726(c)(1) should begin with the language "After notice and a hearing" to require the trustee to apply to the court for an order establishing the allocation of the adminis-

90. *See generally Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 2d Sess. 1530 (1976).

91. 11 U.S.C.A. § 726(c)(1) (West Supp. 1979).

92. The legislative history provides:

> The distribution is as follows: First, administrative expenses are to be paid, as the court determines on any reasonable equitable basis, from both kinds of property. The court will divide administrative expenses according to such factors as the amount of each kind of property in the estate, the cost of preservation and liquidation of each kind of property, and whether any particular administrative expenses are attributable to one kind of property or the other.

S. REP. No. 989, 95th Cong., 2d Sess. 97, 98, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5883; H.R. REP. No. 595, 95th Cong., 1st Sess. 383-84, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6339.

trative expenses. Alternatively, the new Bankruptcy Rules could provide for an opportunity for a hearing and a court order.

2. *Determination of Separate and Community Property.* The distribution provisions of section 726(c) require the trustee to segregate separate and community property before applying the marshaling rules of sub-estates (A)-(D). Unfortunately, there appears to be no provision establishing the procedure for determining the separate or community property nature of an asset. Obviously, the substance of that determination would be one of state law;[93] however, procedurally creditors of both the debtor and nondebtor spouse should have a right to be heard on this issue which could radically affect their distribution rights.

It is unnecessary, nor is there space in this brief treatment of the subject matter, to detail the vast body of law which relates to the characterization of property as separate or community. For decades, litigants have argued over the classification of property acquired before marriage, after separation, by gift, legacy or devise, and the rents, issues, and profits arising therefrom. These matters are further complicated when property acquired before marriage on credit is paid for during marriage, or when services rendered by a spouse to his separate property business give rise to charges in favor of the community. Further, issues such as transmutation of property, commingling, and tracing make this area of the law extremely fact-oriented.[94] Suffice it to say that "separate" and "community" property do not pass to the estate with labels attached which indicate their status; yet, without provision for notice and hearing, the bankruptcy trustee is directed to segregate the community property from other property of the estate and establish no less than four sub-estates of property, each of which has differing beneficiaries.

There is a practical approach to simplify and streamline section 726(c). Empirical data and practical experience indicate that the vast majority of individual consumer bankruptcies are no-asset cases.[95] Of the small percentage of cases that will involve a distribution of assets to general creditors, the assets in nearly all of these

93. *See generally* Countryman, *The Use of State Law In Bankruptcy Cases*, 47 N.Y.U. L. REV. 407 (Part I), 631 (Part II) (1972).

94. *See generally* W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 114-194 (2d ed. 1971).

95. Approximately 25% of the straight bankruptcy cases filed eventually distribute assets to unsecured creditors. *See* D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 92-93 (1971).

cases will be comprised of only community property. Therefore, rather than placing the onus upon the trustee in bankruptcy to determine the classification of property and to administer the four sub-estates, Congress should have enacted an additional provision declaring that all property of a bankruptcy estate in a community property state is to be disbursed to holders of community claims and claims against the debtor unless the debtor, or another party in interest, institutes a proceeding to have the property classified and administered under section 726(c)(2)(A)-(D). Under such a provision, unless a true economic reason existed for segregation of the property of the estate, the property would be administered as a single estate. Additionally, if a party in interest initiated a proceeding to classify the property of the estate and establish the sub-estates, then the costs of administration could be apportioned in the same proceeding as required by section 726(c)(1).

3. *Reclassification of Voidable Transfers.* As previously noted, the major justification for the sub-estate scheme is an attempt to track closely state law creditors' rights. Sub-estates (A), (B), and (C), with one glaring oversight, accomplish the intended result. All creditors able to satisfy their claims against the property comprising sub-estate (A) under state law participate in the distribution of sub-estate (A) assets under bankruptcy law. Under sub-estate (B), certain community property is reserved for creditors of the debtor who would have exclusive access to this property under state law. An indefensible inequity exists, however, in sub-estate (C), for the assets of this sub-estate are available *only* to creditors of the debtor.[96] This would be equitable if the sub-estate included only separate property of the debtor; however, this sub-estate contains all other property of the estate, including voidable transfers recovered under sections 543, 550, 533, and 723 of the Code.[97]

Little justification, if any, exists for placing recovered voidable transfers in sub-estate (C), thereby excluding the creditors of the nondebtor spouse. If the debtor gives away his community property Rolls Royce one day before bankruptcy, why should this act place the asset beyond the reach of the other spouse's creditors? Clearly, it should not, for the transfer was also a fraudulent conveyance under state law against the nondebtor's creditors. The better rule would require that all property retain its community or separate

96. *See* 11 U.S.C.A. § 726(c)(2)(C) (West Supp. 1979).
97. *See id.* § 541(a).

property character, even though conveyed in a voidable transfer or acquired by the debtor within 180 days after filing of the petition. Upon receipt or recovery, the asset would be placed in the appropriate sub-estate, thereby eliminating inherent unfairness in the distribution scheme and furthering the goal of tracking creditors' rights under state law.[98]

4. *Abolishment of Sub-Estate (D).* The attempt to follow the state priority system is frustrated by sub-estate (D), which creates such an unfair result that the provision should be repealed. To understand the unfairness, one must analyze potential claims against sub-estate (D) and the potential assets which it might contain. This sub-estate contains all property of the estate not disbursed from sub-estate (A), (B), or (C). However, for sub-estate (D) to include the excess property from sub-estate (A), all community claims against the debtor and nondebtor spouse must have been paid in full. Under sub-estate (D), only community claims against the debtor or debtor's spouse may be paid. Thus, by definition, insofar as general unsecured creditors are concerned, no surplus from sub-estate (A) will ever flow into sub-estate (D) because all general unsecured creditor claims against the sub-estate (A) assets will have been paid in full. Accordingly, any surplus in sub-estate (A) will be returned to the debtor.

For property of sub-estate (B) to overflow into sub-estate (D) for payment of general unsecured creditors, all community debts of the debtor would necessarily be paid in full. Yet, even though this sub-estate (B) property is "solely liable for the debts of the debtor," its surplus overflows into sub-estate (D). The only remaining claims against property within sub-estate (D) would be unsatisfied community claims against the debtor's spouse. Thus, although the sub-estate (B) property could not be reached under state law by the creditors of the debtor's spouse, it would become available to them in bankruptcy, thereby creating a windfall and bankruptcy incentive for these creditors of the nondebtor.

Before property of sub-estate (C) can overflow into sub-estate (D) to pay general unsecured claims, all claims against the debtor would necessarily be paid in full. Thus, sub-estate (C) property that flows

98. The inclusion of voidable transfers in sub-estate (C) is particularly unfair when one spouse's bankruptcy predates the bankruptcy of the other. There is clearly no reason why the availability of a recovered preference or fraudulent conveyance to a spouse's creditors should depend upon the order in which the two cases were commenced. Obviously, the better rule would be to have the recovery retain its pre-transfer character.

into sub-estate (D) becomes available to creditors of the nondebtor spouse, who can then satisfy their debts from the debtor's separate property. Except in very limited circumstances, no state allows the creditors of one spouse to reach the separate property of the other spouse.[99] Nonetheless, sub-estate (D) as prescribed by the Bankruptcy Code creates this windfall for creditors of the debtor's spouse.

The only arguable justification for this windfall is found in the discharge provisions of the new Code. As will be discussed in Part IV of this article, if a debtor receives a discharge, and the nondebtor spouse would have received a discharge in a companion hypothetical case, then creditors holding community claims against either spouse on the date of the filing of the bankruptcy petition by the debtor are forever barred from reaching after-acquired community property of the type included in the debtor's bankruptcy estate. The rationale for this provision is to protect the fresh start of the debtor,[100] and arguably sub-estate (D) is intended to compensate the nondebtor's creditors for the entry of the partial discharge in favor of the nondebtor's spouse. The unfairness, however, of appropriating one spouse's separate property for the payment of the other spouse's debts mandates change.

First, the nondebtor's creditors have already had access to all assets available to them under state law.[101] Thus the effect of sub-estate (D) is to render the debtor personally liable for the nondebtor spouse's debts.[102] Second, sub-estate (D) applies whether or not the

99. For example, in California creditors who provide the necessities of life to one spouse may reach the separate property of the nondebtor spouse. *See* CAL. CIV. CODE § 5121 (West Supp. 1979).

100. *See Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 2d Sess. 1531-33 (1976).

101. Typically, a creditor of one spouse is limited to that spouse's separate property and to the community property for the satisfaction of his claim. *See, e.g.*, CAL. CIV. CODE §§ 5116, 5121 (West Supp. 1979); TEX. FAM. CODE ANN. § 5.61 (a),(c) (Vernon 1975). Only in instances where a creditor has supplied a necessity of life to one spouse is the separate property of the other spouse held liable for the debt. *See* CAL. CIV. CODE § 5121 (West Supp. 1979).

102. Note that Congress chose to frustrate the debtor's fresh start when the debtor's spouse has been or would be denied a discharge. Thus, it is only when a nondebtor spouse could get a discharge but for some reason balks at filing a bankruptcy case that the partial discharge arises. Practical experience indicates that cases in which one spouse refuses to file a bankruptcy case for emotional reasons are rare. In the future, it is likely that the need for the non-business spouse to join with the business spouse in bankruptcy will diminish because of the restrictions now placed on seeking the personal guarantees of non-business spouses. *See* Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691f (1976). As between requiring a spouse to submit to the burdens of bankruptcy before enjoining the benefits of

discharge is actually granted in favor of the debtor or the debtor's spouse.[103] Thus, when a debtor's spouse is denied a discharge, that spouse's creditors may reach all after-acquired community property, yet still have access to the debtor's separate property. This result frustrates the debtor's fresh start. Third, sub-estate (D) applies even when both spouses have filed petitions in bankruptcy and no partial discharge is sought. If one spouse's bankruptcy estate becomes solvent by virtue of an inheritance or an insurance benefit arising within 180 days after the petition is filed, there is no justification to deny that spouse those funds to make a fresh start when a partial discharge has not been sought. Finally, sub-estate (D) exists only when the debtor has paid all his creditors in full. When a debtor has been able to accomplish that result, he or she has earned a fresh start and should not then be called upon to pay the debts of the nondebtor spouse from his or her separate property. A better result would be to allow the debtor to apply his or her excess assets toward a new economic beginning, and limit the nondebtor's creditors to the same remedies accorded to them under state law.[104]

The unfairness of section 726(c)(2)(D) is perhaps best illustrated with a priority claim. Priority claims are paid in the order specified by section 726(a) in accordance with the marshaling rules of sections 726(c)(2)(A)-(D).[105] Assume there exists a large tax or wage priority claim against the nondebtor spouse. In most community property states, this claim would be a community claim. This priority claim against the debtor's spouse would first be paid from sub-estate (A), then to the extent remaining unpaid, from sub-estate (D).[106] At the

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a discharge, and appropriating one spouse's separate property to pay the other's debts, Congress seems to have misread the balance of justice, if sub-estate (D) is the trade off for the partial discharge.

103. The distribution provisions of 11 U.S.C. § 726(c)(2) operate independently from the provisions related to a debtor's discharge. If the only purpose of sub-estate (D) is to compensate creditors of the nondebtor spouse for entry of the partial discharge, then when a partial discharge is not granted, no rationale supports sub-estate (D).

104. With a little thought, it is not difficult to continue the parade of horrors. Consider the chapter 11 debtor who staves off foreclosure on a parcel of separate real property and refinances the property for sufficient cash to pay all his creditors in full. Aren't his spouse's creditors going to oppose continually the debtor's plan of reorganization in hopes of adjudication so that they will also share in distribution of the proceeds from the sale of the property?

105. 11 U.S.C.A. § 726(c)(2) (West Supp. 1979).

106. Creditors of the other spouses may not participate in the distribution of the assets of sub-estates (B) and (C) under sections 726(c)(2)(B) and (C), but when a priority claim is involved the assets of sub-estates (B) and (C) flow into sub-estate (D) because the assets of sub-estates (B) and (C) represent "all remaining property of the estate" once the priority claim consumes sub-estate (A).

time these priority claims are being paid, sub-estate (D) contains all other property of the estate, including the separate property of the debtor and community property "solely liable for debts of the debtor." Nevertheless, all these assets would be appropriated to pay the nondebtor's priority tax or wage claims; a result that could never be reached under state law. Under this construction of the statute, creditors of the debtor, who alone should be entitled to share in the debtor's separate property, would lose this property to a creditor of the nondebtor spouse who has no rights in the property under state law. Yet in the foregoing example the only creditors discharged in full are the debtor's creditors who received no distribution of assets in the proceeding! [107]

On balance, the provision creating sub-estate (D) should be repealed. In the event of its repeal, any surplus remaining in a sub-estate should be returned to the debtor. With this adjustment section 726(c) would more closely parallel state law distribution schemes.

5. *Proposed Revisions of Section 726.* The following revisions of section 726 are suggested to remedy each of the problems previously noted:

> § 726(c). Notwithstanding subsections (a) and (b) of this section, if there is community property[108] in the estate, then on timely request of a party in interest[109] and after notice and a hearing,[110] the trustee shall[111] segregate such community property from other property of the estate and distribute such community property and the other property of the estate as follows:

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107. The creditors of the nondebtor may still reach the nondebtor's separate property and community property which was not of the type that passed to the debtor's bankruptcy estate.

108. As defined in proposed section 726(e).

109. A party in interest includes the debtor, the debtor's spouse, or a creditor of the debtor as defined in Bankruptcy Code section 101(9). It does not include the trustee.

110. *See* 11 U.S.C.A. § 102(1) (West Supp. 1979). Notice of the request to segregate community property and the proposed classification of the property of the estate should be given to all creditors. The proposed classification should include an allocation of administrative expenses pursuant to section 726(c)(1) of the Code. If an objection to the proposed classification is interposed, then the court should hold a hearing to determine the separate or community nature of the property. If no objection to the classification is received within the time limit set by the court, the court should enter its order classifying the property and administrative expenses as requested.

111. The court has no discretion regarding whether or not to classify the property following a request to segregate the community property. The only issue to be determined by the court is the separate or community nature of the property.

(1) Administrative expenses shall be paid either from community property, or from other property of the estate, as the interest of justice requires.
(2) Claims other than for administrative expenses shall be paid in the order specified in sub-section (a) of this section, and, with respect to the claims of the kind specified in a particular paragraph of section 507(a) of this title or subsection (a) of this section, in the following order and manner:

(A) First, community claims against the debtor shall be paid from community property that is solely liable for the debts of the debtor.[112]

(B) Second, to the extent that community claims against the debtor are not paid under subparagraph (A) of this paragraph, such claims and any other claims against the debtor shall be paid from property of the estate other than community property.

(C) Third, to the extent that community claims against the debtor are not paid under subparagraph

112. The proposed amendment rearranges the existing Bankruptcy Code § 726(c) sub-estates. Proposed sub-estate (A) corresponds to existing sub-estate (B). Proposed sub-estate (B) corresponds to existing sub-estate (C). Proposed sub-estate (C) corresponds to existing sub-estate (A). Sub-estate (D) is eliminated. The rearrangement of the sub-estates is due to marshaling considerations. As the sub-estates presently exist, the creditors of the debtor are favored over the nondebtor's creditors because under the existing scheme, their claims share pro rata in the sub-estate (A) community property at their full value on an equal basis with the claims against the nondebtor. The unpaid and reduced balance of the claims against the debtor then divide the remaining sub-estate (B) and (C) property pro rata. Under the proposed scheme, the community property which is solely liable for the debts of the debtor is first distributed to creditor's holding community claims against the debtor thereby reducing those creditor's claims. Next, the creditors holding community claims against the debtor join with other entities holding claims against the debtor to divide the debtor's separate property. The claims of the entities holding community claims against the debtor are thus again reduced by a distribution of the separate property sub-estate of the debtor. Finally, entities holding community claims against the debtor (in their now reduced amounts) and entities holding community claims against the nondebtor, divide the community property which is not solely liable for the debts of the debtor.

The nondebtor's community creditors are favored by this distribution scheme because their claims compete for pro rata distribution with community claims against the debtor which have now been reduced by prior sub-estate distributions. This result partially compensates the nondebtor's creditors for the entry of the partial discharge and for the elimination of sub-estate (D). The result is also consistent with equitable marshaling doctrine which requires a creditor to look first to those sources of payment which are beyond the reach of other creditors before looking to a common fund. *See* CAL. CIV. CODE § 3433 (West 1975). The distribution scheme should not be interpreted to bar the debtor's creditors from requesting that the nondebtor's creditors marshal their claims against property of the nondebtor which did not pass to the bankruptcy estate.

(A) or (B) of this paragraph, such claims and community claims against the debtor's spouse shall be paid from community property except to the extent that such property is solely liable for the debts of the debtor.[113]

(D) Fourth, any property of the estate not otherwise distributed under this paragraph shall be paid to the debtor.[114]

§ 726(d). If there is community property in the estate and if a party in interest does not request segregation under subsection (c) of this section, then administrative expenses, claims

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113. It will be instructive to re-work the hypothetical presented in the text following note 69. Under the proposed amendment the sub-estates are as follows:

(A)	(B)	(C)
$15,000	$50,000	$105,000

Proposed (A) was formerly sub-estate (B) and is unchanged. Proposed (B) was formerly sub-estate (C) and is reduced because the recovered fraudulent conveyance which was community property has now been included in proposed sub-estate (C) pursuant to proposed section 726(e)(2)(A). Proposed (C) was formerly sub-estate (A) and is increased by the amount of the recovered fraudulent conveyance.

In terms of distribution the administrative expenses of $25,000 are now totally attributable to proposed sub-estate (C) because it contains the fraudulent conveyance recovery. The tax claim of the husband ($10,000) is paid from sub-estate (A) because proposed section 726(c)(2) provides that one follows the marshaling schedule for priority claims. The tax claim of the wife ($5,000) is paid from sub-estate (C) because that is the first estate available to the wife's creditors. The funds then available for distribution to general unsecured creditors are as follows:

(A)	(B)	(C)
$5,000	$50,000	$75,000

Sub-estates (A) and (B) are paid to the husband's creditors, thereby reducing their claims pro rata to $45,000. Sub-estate (C) is then paid pro rata to the creditors of the husband and wife yielding a dividend of $\frac{\$75,000}{\$145,000} = 51.7\%$. Accordingly, an additional $23,275.86 is paid to the husband's creditors with the wife's creditors receiving the remaining $51,724.14. Thus, the wife's general creditors receive a 51.7% payment on their claims while the husband's general creditors receive a 78.3% dividend on their claims $\left(\frac{\$5,000 + \$50,000 + \$23,275.86}{\$100,000} = 78.3\%\right)$.

Under the existing statute, if one merely collects the erroneous classification of voidable transfers, the distribution would result in the husband's creditors receiving a 97.5% dividend with the wife's creditors receiving a 32.5% dividend. The proposed amendment, by applying marshaling doctrine, increases the dividend to the wife's creditors.

114. This provision prevents the sub-estate (D) windfall and completes the tracking of state law creditors' rights.

against the debtor, and community claims against the debtor and the debtor's spouse shall be paid in accordance with subsections (a) and (b) of this section from all property of the estate.[115]

§ 726(e). In subsections (c) and (d) of this section, "community property" means—

(1) property of the kind specified in section 541(a)(2) of this title;

(2) interest in property of a kind specified in—

(A) section 541(a)(3) or 541(a)(4) of this title, if such interest is property or proceeds of property of a kind specified in paragraph (1) of this subsection;[116] or

(B) section 541(a)(5) of this title, if such interest is property of a kind specified in paragraph (1) of this subsection at the time the debtor acquires or becomes entitled to acquire such interest; and

(3) proceeds of property of a kind specified in paragraph (1) or (2) of this subsection.

This proposed language would greatly streamline the vast majority of community property bankruptcy cases. When no application for segregation of property is made under section 726(c), all property of the estate would be disbursed in accordance with the priorities of section 726(a), then to all parties holding claims against the debtor and those parties holding community claims against the debtor's spouse. In those cases involving substantial separate property or community property under the sole management and control of the debtor, a party in interest could move to establish the section 726(c) sub-estates. This would exclude the nondebtor's creditors from

115. This provision will govern in the vast majority of cases involving community property. It technically creates a windfall for "separate" creditors of the debtor who are granted access to the community property of the debtor, and a windfall for creditors of the nondebtor spouse who are granted access to the debtor's separate property. Administratively, however, the provision is quite streamlined, and section 726(c) sub-estates would always be available to any party seeking to segregate the estates.

For example, if the debtor wished certain of his or her separate property to be distributed to his or her creditors alone, and not to creditors of the nondebtor spouse, the debtor could institute a proceeding to have the sub-estates established. Such a situation could arise when one of the debtor's debts is nondischargeable or where a solvent case exists due to the debtor's separate property. Absent an application by a party in interest, all property which is property of the estate under section 541 would be administered together and would be included in the one distribution of assets from the estate.

116. This provision remedies the inequities regarding voidable transfer and after-acquired property existing in the present law under sub-estate (C).

sharing in assets which would not be available to them under state law. In the application to segregate the property, the applicant should be required to propose a classification of the property and detail the administrative expense allocations. These requirements would relieve the trustee of this responsibility while presenting the matter to the court in an adversary context.

Under the proposed revision, once the estates have been established, voidable transfers and other property of the estate would retain their separate or community property nature, thereby avoiding the present windfall to entities holding claims against the debtor. Finally, sub-estate (D) would be eliminated with the surplus of each sub-estate returning to the debtor in accordance with state law. The true benefit of the proposed amendment is the avoidance of the administrative headaches under section 726(c) since in the vast majority of cases no application to segregate will be filed. The property of the estate would be disbursed as in normal bankruptcy cases, with the exception that creditors of the nondebtor spouse holding community claims would participate in the distribution. In virtually every case, the trustee would be called upon to administer only one estate. Yet, in that rare circumstance when substantial separate property exists in the estate and there are sufficient assets to economically justify the expense to a section 726(c) applicant, the distribution scheme of section 726(c) would be available to allow disbursement of estate property in accordance with creditors' rights under state law.

IV. Discharge of the Debtor

The most difficult problem concerning the interrelationship of community property and bankruptcy is the effect of a discharge of the debtor. A policy question arises when one spouse has been involved in a bankruptcy case and received a discharge, and the other spouse is liable on a community claim but has not filed a bankruptcy petition, or both spouses have filed bankruptcy petitions, and one spouse has been denied a discharge. Should after-acquired community property of the spouses be liable for payment of pre-bankruptcy creditor claims of the nondischarged spouse under circumstances where these creditors have already participated in the distribution of assets in a bankruptcy proceeding in which the debts of one spouse were discharged?

Those who would answer "no" to the foregoing question legitimately point out that all creditors have already had "one bite" at the community property apple. To allow further access to community property would only nullify the debtor's fresh start by allow-

ing a creditor of the nondischarged spouse to begin levying execution against post-bankruptcy community property acquisitions immediately following bankruptcy.[117]

Those who would respond "yes" to the policy question state that the Bankruptcy Code was intended only to discharge debts of those persons submitting to the burdens imposed upon debtors by the Code.[118] It was not intended to discharge debts of third parties. Even more clearly, a debtor who has been denied a discharge should not be able to hide behind the discharge of his or her spouse. Further, discharging the creditors of the nondebtor spouse could only give rise to an undesirable partial discharge, since these creditors would not be discharged as against the separate property of the nondebtor spouse.[119]

Two different fact situations can be distinguished for purposes of this debate.[120] In those situations in which one spouse has filed a bankruptcy petition and the other spouse refuses to file bankruptcy for emotional or other personal reasons unrelated to creditor problems,[121] it would be unfortunate to deny the debtor spouse the benefit of his or her discharge and fresh start by allowing creditors to circumvent the discharge by suing and levying in their capacity as creditors of the nondebtor spouse. On the other hand, when both spouses have filed a bankruptcy case and one of the spouses has committed an act barring that spouse's discharge, or a spouse refrains from filing a bankruptcy petition because a discharge would be denied, it would again be unfortunate to allow the nondischarged

117. *See Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 2d Sess. 1531-33 (1976). Texas courts have previously allowed creditors of a nondischarged spouse to reach after-acquired community property following discharge of the other spouse. *See* Durian v. Curl, 155 Tex. 377, 381-83, 286 S.W.2d 929, 932-33 (1956); Flores v. Bailey, 341 S.W.2d 473, 475 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.); Cullum v. Lowe, 9 S.W.2d 70, 71-72 (Tex. Civ. App.—Amarillo 1928, no writ).

118. *See* Comment, *The Implications of the New Community Property Laws for Creditors' Remedies and Bankruptcy,* 63 CALIF. L. REV. 1610, 1648-49 (1975).

119. *See Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 2d Sess. 1531-33 (1976).

120. This issue was thoroughly debated by the National Bankruptcy Conference, which on a closely divided vote opted to oppose granting a partial discharge against the creditors of the nondebtor spouse. In hearings held before the House Judiciary Committee, Professor Riesenfeld strongly advocated the alternative position. *See id.* at 1530-33.

121. It is rare, but not unknown, for the social stigma of bankruptcy to enter into the decision of whether or not to file a bankruptcy case. Most often it is the non-business spouse who has guaranteed a business debt who is reluctant to face reality and the necessity of filing a bankruptcy case.

spouse to hide behind the other spouse's discharge to protect after-acquired community property. If that were the law, the Devil himself could effectively receive a discharge in bankruptcy if he were married to Snow White, for her discharge would protect all after-acquired community property as part of her fresh start.

There is no totally satisfactory answer to this dilemma. However, in a legislative compromise, Congress has set forth one solution to the problem in Bankruptcy Code section 524(a)(3)-(b). When analyzed, the overriding theme of these new Code provisions is that "The economic sins of either spouse shall be forever visited upon the community property."[122] In short, Congress has chosen to grant fresh-start protection[123] for after-acquired community property when both spouses are innocent of any wrongdoing, although one spouse chooses not to file a bankruptcy case. In the other situation, when a wrongdoer seeks to hide behind his or her spouse's discharge, a partial discharge for the nondebtor is denied, and after-acquired community property remains liable for the debts of the nondischarged spouse, thereby frustrating the innocent spouse's fresh start.

In statutory terms, Bankruptcy Code sections 524(a)(1)-(2) provide the standard discharge language by voiding judgments to the extent such judgments are a determination of the personal liability of the debtor, and enjoining the commencement or continuation of an action, the employment of process, or any other act to collect a debt as a personal liability of the debtor.[124] The special community property provision to protect after-acquired community property of the discharged spouse from the other spouse's creditors is contained in section 524(a)(3) of the Bankruptcy Code. This section provides that a discharge —

> operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title [community property of the

122. This quotation is attributable to Richard Levin, majority counsel to the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary of the House of Representatives and one of the primary draftsman of the new Code.

123. A fundemental purpose of bankruptcy legislation is to provide the debtor with a new start in life free from the burdens of preexisting debts. *See, e.g.*, Lines v. Frederick, 400 U.S. 18, 19 (1970); Segal v. Rochelle, 382 U.S. 375, 379-80 (1966); Local Loan Co. v. Hunt, 292 U.S. 234, 244-45 (1934).

124. *See* 11 U.S.C.A. § 524(a)(1)-(2) (West Supp. 1979).

> estate] that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523 or 1328(c)(1) of this title, or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.[125]

Thus, in community property states if one spouse has commenced a bankruptcy case in which no claim is nondischargeable and excepted from the debtor's discharge pursuant to section 523 of the Code, and the debtor's spouse would not have had a claim excepted from his or her discharge in a hypothetical case commenced on the same day as the debtor's case, then creditors of either spouse holding community claims on the date of bankruptcy are thereafter barred from asserting such claims against after-acquired community property that would have been included in the bankruptcy estate whether or not such property existed on the date of bankruptcy.[126] Following the entry of the debtor's discharge under circumstances where no claim is determined to be nondischargeable, collection of a debt by a creditor of the nondebtor spouse will be limited to the nondebtor spouse's separate property and any community property not included in the bankruptcy estate.[127] In other words, after-acquired community property will be free from prebankruptcy creditor claims against either spouse even under those circumstances in which only one spouse has filed a bankruptcy case, provided that neither spouse has committed an act creating a nondischargeable debt or barring a discharge. When the debtor has incurred a nondischargeable debt, or the debtor's spouse would have had a debt declared nondischargeable in a hypothetical case commenced on the same day as that of the debtor, the nondischargeable debt of either spouse will survive against after-acquired community property.[128]

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125. *Id.* § 524(a)(3).

126. *See id.* § 523.

127. Section 524(a)(3) is not as refined as it might have been. With respect to section 541(a)(2)(A) property, the section is clearly correct. With respect to property under the sole management and control of the nondebtor spouse, the debtor's creditors should not be barred unless all of this type of property passed to the estate, for the nondebtor's creditors have not had full access to all of this property for the satisfaction of their claims.

128. *See id.* § 523.

A similar result is reached with respect to discharge of claims.[129] Section 524(b) provides:

> (b) Subsection (a)(3) of this section does not apply if—
> (1)(A) the debtor's spouse is a debtor in a case under this title, or a bankrupt or a debtor in a case under the Bankruptcy Act, commenced within six years of the date of the filing of the petition in the case concerning the debtor; and
> (B) the court does not grant the debtor's spouse a discharge in such case concerning the debtor's spouse; or
> (2)(A) the court would not grant the debtor's spouse a discharge in a case under chapter 7 of this title concerning such spouse commenced on the date of the filing of the petition in the case concerning the debtor; and
> (B) a determination that the court would not so grant such discharge is made by the bankruptcy court within the time and in the manner provided for a determination under section 727 of this title of whether a debtor is granted a discharge.[130]

Thus, to the extent that the nondebtor spouse has been previously denied a discharge or has committed acts which would bar a discharge in a hypothetical case concerning the nondebtor spouse commenced on the same day as the debtor's case, the debts of that spouse will survive against the after-acquired community property.[131] Pursuant to section 524(b) of the Bankruptcy Code, the objections to the hypothetical discharge of the nondebtor spouse must be filed within the same time limits as objections to the debtor's discharge.[132] Thus, for the first time, the bankruptcy court

129. The draftsmen of the Code apparently did not consider the plight of the debtor who moves after bankruptcy to a community property state. In such cases courts should implement the policy of the community property discharge and dischargeability provisions of the new Code. If a creditor of the nondebtor participated in the debtor's bankruptcy in his dual capacity as a creditor of the debtor, he should be barred from reaching after-acquired community property unless he can show his debt would have been exempted from the hypothetical discharge of the nondebtor or that the nondebtor could not have gotten a discharge in bankruptcy. If the creditor of the nondebtor did not participate in the bankruptcy, he should not be barred from reaching after-acquired community property.

130. 11 U.S.C.A. § 524(b) (West Supp. 1979).

131. Spouses may not effectively obtain a discharge every three years by alternating bankruptcy cases on a three-year cycle because, under Code section 524(b)(2)(A), the nondebtor spouse cannot receive a discharge in his or her hypothetical case because of the six-year waiting period between discharges under section 727(a)(8). Accordingly, section 524(b) provides that section 524(a)(3) does not apply; therefore, the nondebtor's creditors would have continued access to the community property.

132. This time is to be established by the new Bankruptcy Rules.

will be called upon to determine the hypothetical discharge of a nondebtor or to rule upon the hypothetical nondischargeability of one or more of the nondebtor's debts.

Obviously, because of the time deadlines involved, and the potential for a nondebtor to hide behind his or her spouse's discharge, any notice of the bankruptcy case sent to creditors must list conspicuously the names of the debtor and the debtor's spouse and advise creditors of the necessity for discharge and dischargeability action against the nondebtor if cause exists for such action. Even in these enlightened times, wives have not caught up with husbands in their propensity to defraud their creditors or commit other acts which would bar a discharge. Therefore, from a creditor's standpoint, a petition in bankruptcy by a wife alone should be regarded as a "red flag" danger signal, for it may indicate that a husband is attempting to sneak a "community property" discharge by creditors.[133] Additionally, creditors should not ignore notice of a bankruptcy case if they determine the debtor owes them no money, for now creditors of the nondebtor holding community claims must also receive notice of a spouse's bankruptcy proceeding so that they may participate in the distribution of assets of the debtor's estate. Conversely, from a debtor's standpoint, all creditors of both spouses should be scheduled in order to bar creditors of the nondebtor spouse from reaching after-acquired community property. Otherwise, the claim would be exempted under section 523(a)(3) from a hypothetical discharge and therefore not barred by section 524(a)(3).

On balance, the legislative compromise contained in the discharge provisions was unwise. Obviously Congress could not have chosen to adopt fully the fresh-start argument for the discharged spouse because husbands and wives would soon have learned that when one spouse committed acts barring discharge, or committed acts creating a nondischargeable debt, the wholly innocent spouse would need only file a bankruptcy case to effectively discharge the other spouse. This cannot be done under the present discharge and dischargeability provisions so long as creditors are aware that they must act swiftly against the debtor's spouse upon a petition by the innocent spouse.[134] However, one must still balance the interests of

133. If a creditor does not receive notice, his claim would be exempted from discharge or hypothetical discharge under Code section 523(a)(3).

134. The partial discharge is of no benefit to the nondebtor spouse if the parties do not remain married, nor was it intended to be. The intent of the partial discharge is to protect the fresh start of the debtor. If the debtor's marriage is dissolved, and the nondebtor remar-

protecting a spouse who could get a discharge but does not desire one against the administrative complexity of the partial discharge and the potential for abuse. Undoubtedly, in the early years of the Code, many undeserving nondebtors will profit from creditors' failure to understand their duty to initiate discharge proceedings against them in their spouse's bankruptcy cases. Additionally, creditors of the nondebtor spouse will continually face the contention that the property that they are attempting to levy upon is after-acquired community property, and not separate property, thereby delaying satisfaction of creditor claims and creating the potential for a lengthy trial to characterize the property prior to levy and sale. Additionally, as noted earlier, unless the statute is amended, the debtor and his or her creditors also pay a large price for this partial discharge by having the debtor's separate property appropriated to pay the nondebtor's claims under sub-estate (D). This represents an onerous expense borne by creditors in order to protect the interest of a party refusing to submit to the burdens of the Bankruptcy Code while seeking its benefits. Congress would have been better advised to limit the federal protection of the Bankruptcy Code to those who seek it.

V. The Impact of Community Property Laws on Voidable Transfers

Several provisions of the new Bankruptcy Code do not blend well with community property concepts of ownership because of the complexity of the interrelationship of community property and bankruptcy. In each case, courts should liberally interpret the Code to give effect to the purpose of the statute. For example, the community property system of ownership gives rise to several complications in the recovery of preferences and fraudulent conveyances. Bankruptcy Code section 547(b) authorizes the trustee to avoid preferential transfers of the debtor's property "(1) to or for the benefit of a *creditor;* (2) for or on account of an antecedent debt *owed by the debtor* before such a transfer was made; [and] (3) made while the debtor was *insolvent;* . . ." if certain other conditions are also satisfied.[135]

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ries, the pre-bankruptcy creditors of the nondebtor will have the same status as any other prenuptial creditors of the nondebtor and to that extent could reach community assets acquired by the nondebtor and his or her new spouse.

135. 11 U.S.C.A. § 547(b) (West Supp. 1979) (emphasis added).

As previously discussed, the term "creditor" includes an entity holding a community claim.[136] Therefore, a creditor of the nondebtor spouse receiving a transfer of community property has received the property of the debtor. However, the second requirement, that the transfer be on account of "an antecedent debt *owed by the debtor,*" may not create the proper interface with the community property system of ownership.[137] Notwithstanding the terms of the statute, a transfer of community property by one spouse to that spouse's creditor on or within 90 days before the commencement of the other spouse's bankruptcy case should be voidable if all other criteria of a preference are met.[138] This power is necessary to enable the trustee to equitably distribute the assets of the community among all creditors.[139]

Finally, the term "insolvent" is not adequately defined to include community property systems of ownership. Pursuant to Bankruptcy Code section 101(26), "insolvent" means—

> (A) with reference to an entity other than a partnership, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of —
>
> (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and
>
> (ii) property that may be exempted from property of the estate under section 522 of this title; . . .[140]

In community property states, the words "such entity's debts" should be read to mean "debts chargeable against such entity's property" to include those creditors holding community claims.[141] For example, when a debtor owns separate property valued at $25,000 and community property valued at $50,000 and owes debts

136. *See id.* § 101(9)(C).

137. *See id.* § 547(b)(2).

138. Under the former Bankruptcy Act, transfers by the non-bankrupt spouse were voidable. *See* Comment, *The Implications of the New Community Property Laws for Creditors Remedies and Bankruptcy,* 63 CALIF. L. REV. 1610, 1647 (1975). Perhaps in this case the court should invoke section 102(2) of the Code. If debt means "liability on a claim" (section 101(11)) and "claim owed by the debtor" includes "claim against property of the debtor" (section 102(2)), then spousal preferences are included in section 547(b). The deletion of the words "owed by the debtor" in 11 U.S.C. § 547(2) is the most straightforward legislative solution to this problem.

139. Presumably the spousal preference could not be set aside as a fraudulent conveyance because the cancellation of antecedent debt is fair equivalent value. *See* 11 U.S.C.A. § 548(d)(2)(A) (West Supp. 1979); UNIFORM FRAUDULENT CONVEYANCE ACT § 3.

140. 11 U.S.C.A. § 101(26) (West Supp. 1979).

141. *See id.* § 102(2).

of $70,000, the solvency of that debtor, with due regard to marshaling considerations,[142] should be dependent upon the size of the community claims held by creditors of the nondebtor spouse. Thus, if the nondebtor spouse owed $50,000 in community claims and had no separate property, the debtor should be insolvent within the meaning of section 101(26). On the other hand, if the nondebtor spouse in this example had $45,000 in separate property, the debtor should be deemed solvent because the other spouse's debts could be marshaled against that spouse's separate property. Courts should adopt a "marital" solvency test rather than a debtor solvency test to determine whether or not a preference has been made by the debtor or the debtor's spouse.

Similarly, the fraudulent conveyance provisions of the new Code[143] should be read to include transfers by the debtor or the debtor's spouse. Otherwise, the trustee would be powerless to avoid fraudulent transfers of community property made by the debtor's spouse; a result inconsistent with the intent of the statute. The situation is not as severe for creditors in this case as in the preference situation since creditors are also entitled to attack fraudulent conveyances under state law.[144] Nevertheless, to avoid competing creditor suits initiated to invalidate a transfer by a nondebtor spouse, and to insure equitable treatment for all creditors upon recovery of the fraudulent transfer, the trustee of the debtor should have the exclusive ability to avoid fraudulent transfers of community property by the debtor's spouse.

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142. Marshaling assets is an equitable doctrine requiring that a debtor's assets be applied to protect a creditor or other person having an interest in only a portion of the assets. The standard doctrine is codified in section 3433 of the California Civil Code and provides:

> Where a creditor is entitled to resort to each of several funds for the satisfaction of his claim, and another person has an interest in, or is entitled as a creditor to resort to some, but not all of them, the latter may require the former to seek satisfaction from those funds to which the latter has no such claim, so far as it can be done without impairing the right of the former to complete satisfaction, and without doing injustice to third persons.

CAL. CIV. CODE § 3433 (West 1975). In the community property context, the doctrine would require the creditors of one spouse to utilize separate property for the satisfaction of their claims to enable the creditors of the other spouse to utilize the community property for payment of their debts. This doctrine is invoked only when to do so does not prejudice other creditor's rights.

143. *See* 11 U.S.C.A. § 548 (West Supp. 1979).

144. *See* UNIFORM FRAUDULENT CONVEYANCE ACT. Typically, preferences are not voidable under state law. *See* CAL. CIV. CODE § 3432 (West 1975).

VI. Recommendations to the Rules Committee

In drafting the new Code, Congress sought to exclude virtually all mention of procedure, believing it better to allow the Supreme Court to promulgate procedural rules that could be more easily modified as needs of the new Code demanded.[145] In delegating this broad procedural rule-making authority, Congress specifically directed that the rules were not to alter the Code either in respect to procedural or substantive law.[146] The Judicial Conference has already commissioned an Advisory Committee on Bankruptcy Rules to draft new rules of bankruptcy procedure to conform with the new Bankruptcy Code.[147] In drafting the new rules, the Committee would be well-advised to recommend certain specific rules to deal with community property.

A. *Notice to Creditors*

With respect to the schedules of assets and liabilities and statement of affairs that the debtor must file,[148] it is obvious that the schedule of the debtor's liabilities in a community property state must now include the names and addresses of the creditors of the debtor's spouse. This is necessary in order to advise these creditors of their right to participate in the distribution of the assets of the estate,[149] and to bar those creditors under section 524(a)(3) of the Bankruptcy Code from reaching after-acquired community property.[150]

Additionally, because of the restrictive provisions of sections 523(c)-(d) and 524(b) upon creditor objections to discharge and requests for determinations of nondischargeability of debts of both the debtor and the debtor's spouse,[151] the name of the debtor's spouse must appear on the schedules, or perhaps even on the bankruptcy petition. It must also prominently appear on the notice of the meet-

145. H.R. Rep. No. 595, 95th Cong., 1st Sess. 292-93, *reprinted in* [1978] U.S. Code Cong. & Ad. News 5963, 6249-50.

146. *Id.* at 292-93, *reprinted in* [1978] U.S. Code Cong. & Ad. News 5963, 6249-50.

147. The Committee is an advisory committee to the Standing Committee on Rules of Practice and Procedure of the Judicial Conference of the United States. *See* 28 U.S.C. § 331 (1976).

148. 11 U.S.C.A. § 521(1) (West Supp. 1979).

149. See text accompanying notes 55-90 *supra.*

150. See text accompanying notes 117-134 *supra.*

151. *See* 11 U.S.C.A. §§ 523(c),(d), 524(b) (West Supp. 1979).

ing of creditors[152] which is sent to all creditors. This notice must also clearly advise creditors of both spouses of the time requirements of sections 523(c)-(d) and 524(a)(3)-(b) concerning both the debtor and the debtor's spouse. This notice is particularly important until creditors of the nondebtor spouse become accustomed to filing discharge and dischargeability complaints in bankruptcy cases not directly involving their debtor. Furthermore, the statement of affairs filed by the debtor should include questions inquiring into transfers made by both the debtor and the debtor's spouse.

B. *Classification of Separate and Community Property*

As previously noted, an almost impossible burden is placed on the trustee to segregate separate and community property. If the statute is not amended, the Rules Committee could significantly diminish this burden by adding an additional two-part question to the schedule of assets of the debtor in community property states. This question would request that the debtor identify any property listed in his schedules which he or she claims to be (a) separate property or (b) community property under the debtor's sole management and control. The new rules should then provide that in distributing assets to creditors, the trustee is entitled to rely upon the classification of property by the debtor unless a party in interest commences an adversary proceeding contesting the classification. Settlement of such a complaint, as well as the allocation of administrative expenses, should then be approved by the court only after "notice and a hearing."[153] While enactment of the foregoing rules would not totally eliminate the administrative problems created by section 726(c) of the Bankruptcy Code, in the vast majority of cases involving no separate property, only the section 726(c)(2)(A) sub-estate would be established. More importantly, the proposed rule resolves the trustee's inherent conflict in classifying the property of the estate.

VII. CONCLUSION

The draftsmen of the new Bankruptcy Code have done a marvelous job in selecting the appropriate property to be included in the property of the bankruptcy estate, thereby giving creditors of a debtor access to all potential assets prior to discharge. The compro-

152. *Id.* § 341.

153. 11 U.S.C.A. § 102(1) (West Supp. 1979).

mise reached with respect to the discharge of the debtor was a creative, but perhaps unnecessary, solution to a difficult problem. Only experience will indicate whether the provision will have the greatest impact in protecting the fresh start of the honest debtor whose spouse refuses to file a bankruptcy case, or the dishonest nondebtor spouse who is able to sneak his discharge past his unsuspecting creditors in the form of a bankruptcy by the innocent spouse. In the provisions for administration of the estate, Congress was somewhat overzealous in attempting to track state law rights, and may have created an administrative nightmare. Additionally, the distribution provisions, for all their complexity, do not insure an equitable distribution of the estate. Hopefully, when clarifying amendments to the new Code are introduced before Congress, the distribution provisions will be amended as suggested in this article.