Protecting Domestic Contribution Awards After Seventh Circuit *Harshaw* Ruling

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In a recent ruling, *Elizabeth Anne Harshaw v. Donald Wayne Harshaw (In re Donald Wayne Harshaw),*[2] the Seventh Circuit held that a pre-petition arbitration award to a debtor's former wife who had lived with him for 16 years after the divorce and had contributed $435,000 in value to the relationship, was a money judgment and not a property interest and therefore dischargeable in the debtor/ex-husband's bankruptcy. The reasoning of the ruling provides important practice tips for anyone seeking to protect a plaintiff's domestic contribution award from a discharge of the debts of the opposing debtor/domestic partner in his/her subsequent bankruptcy.

A. Seminal Facts

After a 25 year marriage, the debtor (Don) and his wife (Anne) obtained a divorce, but shortly thereafter they began cohabitating in Indiana without formally remarrying. During the sixteen year cohabitation period, Anne invested substantial time and resources caring for Don and various of his relatives, who either had special needs or severe health issues. When the relationship soured again, Anne, who could not avail herself of divorce law, sought relief for her services performed during the cohabitation period through various theories, including equitable claims of express or implied contract, unjust enrichment and *quantum meruit.* Eventually, they submitted their dispute to arbitration. Relying on Indiana law, which permitted recovery for an unmarried person "when the previous relationship shared many of the characteristics of a traditional marriage" (26 F. 4th at 770), the arbitrator determined that Don was liable to Anne.

As a remedy, the arbitrator awarded Anne $435,000 for the value of her services to the post-divorce relationship with Don. The arbitration order required that the judgment be paid from one of three sources: assignment of his retirement/pension benefits; a Qualified Domestic Relations Order (QDRO) to be approved and implemented by the court; or "any other manner acceptable to both parties." (*Id.,* at 772). Don unsuccessfully appealed the arbitration award, and then filed for bankruptcy. In his bankruptcy, Don predictably argued that the arbitration award was a mere money judgment subject to discharge in bankruptcy, and claimed his retirement accounts were exempt from creditor attachment under Indiana law. In opposition, Anne contended that the award was in fact an assignment to Anne of a property interest in Don's retirement accounts. Accordingly, her share of such retirement accounts was her property and not part of Don's bankruptcy estate. The bankruptcy court sided with Anne, finding that the arbitration award gave her a property interest and was not a mere

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[2] 26 F. 4th 768 (7th Cir. 2022).

money judgment. Finally, in Don's bankruptcy, Anne did not file a proof of claim nor object to Don's exemption for his retirement accounts (*In re Harshaw,* 2021 WL 406174 (N.D. Ill. 2021), *2).

The District Court reversed, and the Seventh Circuit affirmed the District Court, thus overruling the bankruptcy court.

B. Holding and Reasoning of Seventh Circuit Opinion

The Circuit Court held that Anne's arbitration award was a money judgment and not a property interest, and therefore dischargeable in Don's bankruptcy case. The threshold issue for the court was whether the award itself legally fit the criteria of a "money judgment" under Indiana law. It found that Indiana courts construed orders as money judgements where, as here, the order (i) requires the payment of a sum of money, and (ii) states the specific amount due. The Court also noted that money judgements, as here, are typically accompanied by an award of post-judgment interest. (*Id.,* at 772-773). By contrast, an order creates a property interest under Indiana law, as opposed to a mere money judgment, when the following factors are present: the order (a) expressly allocates property between the parties (such as "the assets are hereby divided equally between the parties"), (b) mandates an in-kind transfer to one of the parties of specific property of the other party (such as "the [husband] shall cause [the specific dollar amount awarded to the wife] to be transferred to [the wife] from the husband's pension plan), and (c) does not contain an award of post-judgment interest associated with money judgments.

In dissecting the arbitration award provisions, the Court noted the absence of the language that would typically favor a property interest characterization. The order contained no property division language nor mandated a specific source of the payment. Moreover, by giving Don (the debtor) discretion to use one of three means of payment (i.e., the pension plan, the QDRO or "any other manner acceptable to both parties") to satisfy the award, the arbitration order evidenced an intent to merely define an amount due that could be satisfied in different ways, not mandate a transfer of property from a specific source having an established or estimated value. (*Id.,* at 773-774). The order's failure to meet even the most basic legal criteria for the creation of a property interest precluded the court from relying on other factors, such as the policy favoring the finality of arbitration awards (*Id.,* at 774-775), to construe the order as anything other than a simple money judgment.

Having concluded that the award was a money judgment, it was a short step for the Court to find that the award was dischargeable in the debtor's bankruptcy case. The arbitration award's broad language that the award "should not be dischargeable in bankruptcy, since it is specifically awarded to the plaintiff as compensation, and for her support and maintenance…", was not controlling, since dischargeability of a debt in bankruptcy is governed exclusively by federal law. (*Id.,* at 772, 775-776). Under federal law, a debt is non-dischargeable if it falls within one of the non-dischargeability categories of Section 523(a) of the Bankruptcy Code, and the Court concluded that the provision most directly on point, §523(a)(5), was not applicable. Section 523(a)(5) expressly exempts from discharge "domestic

support obligations" (DSO's), but the parties stipulated that the award did not qualify as such under the Code definition of DSO's in §101(14)(A) because Anne was a non-spouse.

C. Strategic Implications and Practice Tips Arising from *Harshaw*

The *Harshaw* decision provides a roadmap for lawyers seeking to protect domestic contribution judgments (that are otherwise not domestic support obligations protected under Section 523(a)(5) of the Code) from the risks posed by a potential bankruptcy of the opposing party. These include the following:

1. *Language of Operative Award Document*: When drafting the award (be it an agreed order, divorce decree or arbitration award), if a property allocation is intended, make that allocation explicit so it cannot be recharacterized as a dischargeable money judgment. Confirm under state law that the factors favoring a property allocation over a money judgment have been clearly satisfied. Ambiguity is not your friend in protecting your client's effort to create a property right.

2. *Primacy of Federal Law Defining Dischargeability*: Do not rely on "statements of intent" in the award or settlement agreement to confer non-dischargeability, which is governed by federal law and in particular Section 523(a).

3. *Proof of Claim*; *Challenging Exemption*: As a hedge against a possible recharacterization of the property division as a money judgment, which could then be discharged, be sure to file a protective proof of claim in the debtor's bankruptcy case.[3] Moreover, where facts and law warrant, use your standing as a creditor to challenge the debtor's exemption for potentially valuable assets that could be used to pay creditor claims, such as allegedly exempt retirement assets.

   The plaintiff/creditor in *Harshaw* did not file a proof of claim in Don's bankruptcy case; therefore, when her asserted property right to his retirement assets was rejected, she had no right to participate in any distributions that may have been made to creditors in the case from proceeds of any non-exempt assets. Moreover, she at least weakened her standing to challenge the debtor's claimed exemption for his hefty retirement accounts by making herself a non-filing creditor. While the retirement account exemptions are very strong under state law, they are not impervious. For example, to the extent a retirement account has not been maintained in accordance with applicable tax laws (such as rules for self-directed IRA's prohibiting certain transactions) , its exemption from creditors could be challenged and lost. *See, e.g.,* 735 ILCS 5/12-2006 (debtor exemption in retirement plan exists to the extent the plan "is intended in good faith to qualify as a retirement plan under applicable provisions of

[3] The proof of claim might state that it is being filed to the extent the non-debtor's property interest in the subject asset (e.g., retirement accounts) is not recognized in the bankruptcy case, or is otherwise recharacterized as a money judgment.

the Internal Revenue Code of 1986….”); *In re Bauman,* 2014 WL 816407, *15 (Bankr. N.D. Ill. 2014) (in sustaining creditor's objection to debtor's claimed exemption for retirement plan, court noted that "it is not enough that the debtor intended in good faith for the plan to qualify as a retirement plan under the [Internal Revenue Code] when the plan was established. The debtor must have had that good faith intent throughout the plan's existence…"). Thus, practitioners should never put all their eggs into the basket of an asserted property right; the property right strategy should always be matched by a protective proof of claim in the debtor's bankruptcy case.