Bankruptcy Column

Bankruptcy versus Divorce: The War of the Roses in Two Parts Column 5

Divorce can take an enormous amount of time, energy, money, sweat and tears to finalize. Even collaborative divorces can require significant resources. After a divorce is finalized, can one of the spouses file bankruptcy, and undo any of the financial aspects of the divorce? The answer is yes. Bankruptcy can lead to Divorce: Part Two. Before delving into how that happens in bankruptcy, we should note that the filing of a bankruptcy during the pendency of a divorce may implicate the automatic stay and put a hold on the matrimonial action. The law here is quite specific {11 U.S.C. § 362(b)(2)(A)}. A divorce action itself is not stayed to the extent the action is seeking simply the divorce itself. For equitable distribution issues, the automatic stay is in place, at least to the extent of actually transferring title to assets. There is no stay for matters of paternity, custody, visitation, support, maintenance, or domestic violence. In those situations, no motion is needed in bankruptcy court to allow such proceedings to continue. If the automatic stay is in place for equitable distribution, an order lifting the automatic stay in bankruptcy court can usually be obtained quickly, and with minimal costs. While the automatic stay does not stop proceedings to establish support, enforcement proceedings may be subject to the stay, so a motion to lift the stay is recommended for collection actions while the bankruptcy case is open.

Whether a bankruptcy filing can affect a hard-won divorce is a complicated matter. There are several issues that can arise, including preferential payments to the creditors of one spouse; a spouse receiving assets that exceed the bankruptcy exemptions should that spouse seek bankruptcy protection; or assets being transferred in the absence of a decree confirming the transfer. However, the most common (and most anguishing) issue can be summed up as follows: can the financial obligations imposed upon a spouse pursuant to divorce be discharged in a subsequent bankruptcy filing by that spouse? Debts arising in a divorce generally fall into one of two categories: (1) domestic support obligations, and (2) debts deemed to be property divisions incurred in the course of a divorce or separation **other than domestic support obligations**. Domestic support obligations are defined in 11 U.S.C. § 101(14A) as debts "owed to or recoverable by a spouse, former spouse, or child...., legal guardian, or responsible relative, or governmental unit, (and) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit)..... without regard to whether such debt is expressly so designated..." **Non**-domestic support obligations are defined in 11 U.S.C. § 523(a)

(15) as being those that are "incurred… in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record or, a determination made in accordance with State...law by a governmental unit." How a particular financial obligation is ultimately defined will determine whether the spouse filing bankruptcy can eliminate the obligation. The issue is one of federal law guided by reference to state law. Cummings v. Cummings, 244 F.3d 1263 (11th Cir. 2001).

In a chapter 7 bankruptcy filing, neither category of debt is discharged. In fact, the spouse or former spouse of someone filing a chapter 7 bankruptcy need not take any action in the bankruptcy court to protect the obligations obtained in the divorce. The issue only arises in a chapter 13 bankruptcy. In chapter 13, domestic support obligations (ie., support and maintenance) are nondischargeable, and in fact are treated as a priority debt that must be paid in full. However, if the debt is determined to be in the other category, it may be discharged like all other dischargeable debts, such as ordinary credit card debt. In such a situation, the filing spouse may only have to pay pennies on the dollar on obligations that were just agreed to in a divorce.

Let's look at what kinds of debts we are talking about, and look at some cases trying to determine whether the debt is a domestic support obligation, or whether it is in the other category. A very common example is the indemnity provision in a separation agreement. Typically the agreement would say something like this: "Hey babe, I take full responsibility for that joint MasterCard that we ran up, so don't you worry about it." Such a clause in and of itself would not be a domestic support obligation, and this obligation to indemnify the former spouse would be discharged under chapter 13, which obviously then leaves the former spouse having to repay MasterCard.

Litigation arises when the language falls between the pure support provisions and the pure indemnity provisions. The decision is for the bankruptcy judge, and it turns upon the intent of the parties as interpreted by the bankruptcy court, and not on the labels placed on the obligation in the divorce documents. In the case of the Berube v. Berube, 533 B.R. 352 (Bankr. D. Me. 2015) the parties' agreement stated as follows:

*6. **Debts.** In light of the disproportionate earnings and earning capacities of the parties (even taking into consideration the award of general spousal support made hereafter) and the award of the aforementioned marital residence and its equity to* [Mr. Berube]*, [Mr. Berube] shall be responsible for payment of any **joint** obligations that remain unpaid. Those joint obligations shall include the Camden National Bank (Card Member Services) credit card, Best Buy, Wells Fargo credit card and Northeast FCU credit card.*

The two parent loans for the parties' children's education, which loans were taken out in Plaintiff's name, shall also be [Mr. Berube]*'s sole responsibility to repay*

[…]
Each party will hold the other harmless from any debt for which he or she is responsible pursuant to this Divorce Judgment. In the event of the bankruptcy filing by either party, the responsibility for debts allocated hereby shall be considered in the nature of a domestic support obligation.

The court ignored the label of Domestic Support Obligation and found that the agreement to pay the debts was part of the division of marital property. Therefore, the husband's obligation was discharged upon completion of his chapter 13 plan.

The case of In re Thomas (Court of Appeals, 6th Cir. 1/8/15, unpublished decision) the parties agreed to be equally responsible for payment of a second mortgage. This was the second divorce for the same couple (credit for trying the marriage a second time). In a significant change from the first divorce, the parties agreed to jointly pay the second mortgage, and the husband's child support obligations were reduced. Also, in the second divorce, the sale proceeds from the sale of the house were to go to the wife. The husband filed a chapter 13 bankruptcy seeking to discharge his obligation to pay the second mortgage arguing that it was not a domestic support obligation. The bankruptcy court looked at the totality of the circumstances and found that the intention was to create a support obligation. The Bankruptcy Appellate Panel and then the Circuit Court upheld the bankruptcy court. The decisions noted that the mortgage payments helped keep the children in their home, and that the expected sale proceeds were to go to the ex-wife. Of importance to the decision was the change in the support arrangement from divorce one to divorce two. Support was reduced, and the obligation to pay the second mortgage was changed to a joint obligation, whereas in the prior divorce it had been the sole obligation of the wife.

In re Edinger, 518 B.R. 859 (Bankr. E.D.N.C. 2014), found that the obligation to pay attorney fees to the other spouse was deemed a nondischargeable obligation in the nature of support. The decision was based in part on the conduct of the obligated spouse, including involving the children in her cause, and creating a financial hardship for the other spouse and his children. The court concluded that the attorney fee award was clearly intended to provide financial support for the benefit of the children.

A thorough review of factors to be considered in determining whether a debt is in the nature of support, or whether it is in the nature of property division, is set forth in the case of In re McCollum , 415 B.R. 625(Bankr. M.D.G.A. 2009). The factors include: (1) the language of the divorce agreement; (2) the relative financial positions of the parties at the time of the agreement; (3) the amount of property division; (4) whether the obligation terminates on the death or remarriage of the beneficiary;

(5) the number and frequency of payments; (6) whether the agreement includes a waiver of support rights; (7) whether the obligation can be modified or enforced in state court; and (8) whether the obligation is treated as support for tax purposes. This list is not exclusive. The intent of the parties is the controlling factor.

So, what can a divorce practitioner do? To the extent all property distributions can be accomplished simultaneously with satisfying all debts, or where the decree provides no obligation for either spouse to pay the other's debts and provides for no future transfer of assets, a subsequent bankruptcy should not impact the divorce. In a situation where it is impractical to pay off all the debts and simultaneously transfer ("distribute") property due to limited financial resources or other practical problems, then for the spouse who will be waiting for payment (or property) after the divorce, the agreement should be drafted to the extent possible to demonstrate a bona fide intent to have all such obligations fall within the category of support or maintenance. Such client should be aware, however, that a subsequent bankruptcy filing under chapter 13 by the other spouse could undo provisions of the divorce decree. The "injured" spouse would have to commence an action in bankruptcy court to fight against the discharge of the financial obligations. Such litigation in bankruptcy court is difficult, expensive, and uncertain.

If the circumstances are right, sometimes a joint bankruptcy prior to the divorce is helpful to eliminate as much debt as possible to assist in minimizing the divorce issues. A joint bankruptcy filing would only require minimal civility between the spouses in order to have the case filed and completed. Often a joint bankruptcy in the midst of a divorce can allow both parties to qualify for Chapter 7 because of the income test related to household size.

While I am sure that most attorneys who practice matrimonial law want nothing to do with bankruptcy, the lawyers handling bankruptcy want even less to deal with divorce. So, we should all strive to end the divorce at Part One.

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Debtors' Prison

I am often asked by clients, "Can I go to jail?" The reassuring answer is, "Absolutely not. There are no more debtor's prisons." But, for someone who is dishonest in their petition, jail is an option. Here is this column's teaching moment showing what not to do when seeking relief under the bankruptcy laws.

This month's hapless debtor is Ms. Young of Vermont. She knew that bankruptcy could stay

foreclosure and eviction proceedings involving the house in which she was living. Ms. Young did not own the house, but it was previously owned by her daughter. Ms. Young further knew that her own bankruptcy filing would not stay the foreclosure, but if her daughter filed, perhaps a stay would work. That was all well and fine except that her daughter did not file. Instead, Ms. Young forged her daughter's signature on the bankruptcy petition without her daughter's knowledge. Her action led to a criminal conviction, one year probation, and a really lousy family Thanksgiving dinner.