Bankruptcy Issues for the Family Law Attorney

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Table of Contents

Introduction

It will be assumed for purposes of this discussion that the vast majority of divorcing couples, in which one or both of them file for bankruptcy before or after the divorce is final, will have primarily consumer debts, and their choice will be to file either a petition for liquidation under Chapter 7 or a petition for reorganization under Chapter 13 of the Bankruptcy Code. Generally, a petition under Chapter 7 results in the liquidation (sale) of all the debtor's non-exempt property, and the discharge of most or all of the debtor's obligations. A petition under Chapter 13 results in a plan that is filed and confirmed by the court under which the debtor makes payments to a trustee for distribution to his creditors over a three or five year period. When the plan is completed, most debts that have not been paid are discharged, and the debtor is allowed to keep most of her property, such as houses, cars, and personal property items.

Note that the Bankruptcy Code was substantially amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Most of the changes rendered by BAPCPA are applicable to consumer bankruptcies, and a number of them affect the intersection of divorce and bankruptcy.

Issue 1: Bankruptcy Planning: In processing the dissolution, I think my client might be eligible for a bankruptcy . . .

1.1 Can I talk to my client about the potential for filing bankruptcy without violating any ethical or bankruptcy court rules?

Answer: Generally yes, you can help your client plan for bankruptcy – just do not cross the line into fraudulent transfer.

Under BAPCPA any lawyer discussing bankruptcy (providing "bankruptcy assistance") with his or her client may become a "debt relief agency" subject to various restrictions and disclosures. This provision is constructed to make it illegal to recommend that someone incur debt in anticipation of a bankruptcy case, and, as it is written, it may apply when the client is either the debtor or creditor. 11 U.S.C. §526(a)(4) (2005). See also 11 U.S.C. §101(3); §101(4A); §101(12A). "Bankruptcy assistance" is defined as service provided with the "purpose of providing information, advice, counsel . . ." with respect to any bankruptcy case. *Id*. at §101(4A). Once the attorney is a "debt relief agency," various disclosures must be given, documents must be provided to the client, and various restrictions apply to all advertising.

In 2010, the US Supreme Court reversed the Eighth Circuit panel that found the provision unconstitutional and, instead, held that the statute was meant to be narrowly construed. The narrow construction limited the application to advice that was an *abuse* of bankruptcy because the decision ". . . to incur more debt [was] because the debtor is filing for bankruptcy, rather than for a valid purpose."

In an attempt to give more meaning to the distinction, Justice Sotomayor refers to a history of bankruptcy reform attacking loading up on debt that would be discharged in bankruptcy as fraudulent and therefore excepted from discharge in bankruptcy. Justice Sotomayor states:

> *"Thus advice to refinance a mortgage or purchase a reliable car prior to filing because doing so will reduce the debtor's interest rates or improve his ability to repay is not prohibited, as the promise of enhanced financial prospects, rather than the anticipated filing, is the impelling cause. Advice to incur additional debt to buy groceries, pay medical bills, or make other purchases "reasonably necessary for the support or maintenance of the debtor of a dependent of the debtor," § 523(a)(2)(C)(ii)(II), is similarly permissible." Milavetz, Gallop & Milavetz, P.A. v. U.S.*, 130 S. Ct. 1324, 176 L. Ed. 2d 79, 63 Collier Bankr. Cas. 2d (MB) 910, Bankr. L. Rep. (CCH) P 81703 (2010) (footnote 6).

The family law attorney must, therefore, balance what may be appropriate legal advice with the restrictions set forth in the debt relief agency provisions. To avoid violating these provisions, the attorney must either avoid providing the client with any advice regarding bankruptcy, or make sure that any advice that is given does not advise the client to incur more debt in contemplation of a bankruptcy filing if such action could be considered abuse of the bankruptcy discharge.

1.2 Under what circumstances do I encourage my client to file bankruptcy now, before the divorce is final? Under what circumstances would it benefit my client to wait until after the divorce is processed to start a bankruptcy proceeding? Does the timing really matter?

If both Husband and Wife are contemplating bankruptcy (their joint situation is upside down), there are potential benefits and potential detriments to either option – whether filing a bankruptcy before a divorce is finalized or waiting for the divorce to be completed before filing the bankruptcy proceeding. Family law attorneys and their clients are well-served by considering the potential ramifications of either decision before filing or finalizing either the bankruptcy or the divorce case, and action taken in both preferably includes cooperation between spouses and cooperation between the family law and bankruptcy counsel.

Remember that married, heterosexual debtors can file a joint bankruptcy. All other debtors will be filing as separate individuals. A married debtor can also file separately and the other spouse is not required to file.

When considering the timing of a bankruptcy as it relates to the divorce proceeding, there is no universal answer; however, be sure to consider:

1.2.1 Only obligations that exist as of the <u>date of filing</u> bankruptcy are dischargeable. The divorce may create new obligations, such as an obligation to hold the other spouse harmless.

Example:

Husband is being plagued by credit card collection calls and a looming foreclosure and wants relief through bankruptcy. He expects his separation from Wife to transition to an actual divorce in the foreseeable future, but he does not want to wait to get relief from the pressure his creditors are applying. He files a Chapter 7 petition.

After the bankruptcy is filed, Wife files for divorce and the case proceeds on a contested basis. Husband's bankruptcy discharge is granted while the divorce is pending. No assets are collected, and Husband's personal liability for debt both in his name and jointly in his and Wife's names is discharged. 11 U.S.C. §524(a) and §727(b).

Wife's personal liability for debt in her name and jointly with Husband is *not addressed in Husband's bankruptcy.* The divorce court orders Husband to pay the creditors and hold Wife harmless from one-half of the marital debt and one-half of the parties' joint mortgage debt.

Husband has, in effect, wasted his bankruptcy. The pre-divorce bankruptcy he filed did not and cannot discharge his liability to his now former wife. Only obligations that exist as of the date of filing bankruptcy are dischargeable. The obligations to hold Wife harmless did not exist at the time Husband's bankruptcy was filed; bankruptcy discharges debt that exists at the time of filing of the petition. *Id*.

Had Husband waited to file his bankruptcy until after entry of the dissolution judgment, he could have chosen to file either a Chapter 7 bankruptcy or a Chapter 13 bankruptcy. In a Chapter 7 case filed after entry of the dissolution judgment, any obligation to hold Wife harmless *could not have been discharged*. 11 U.S.C. §523(a)(15). In a Chapter 13 case, the obligations to hold Wife harmless from those credit card and mortgage accounts ordered in the divorce *would have been discharged* unless it was considered a domestic support order.11 U.S.C. §1328(a)(2). (See discussion below regarding Chapter 7 vs. Chapter 13).

1.2.2 Filing bankruptcy prior to finalizing the divorce may cause the client to lose use of non-exempt assets to the bankruptcy court that could have been used to assist in paying expenses during the dissolution proceeding.

Property of the bankruptcy estate that is subject to liquidation under 11 U.S.C. §541 includes all interests of the debtor and the debtor's spouse held jointly with the debtor as of the commencement of the case that is:

1. Under the sole, equal or joint management and control of the debtor, or
2. 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.

This means that the family law attorney must take steps to protect her client's jointly held property from liquidation where either her client or her client's spouse is eligible for Chapter 7 bankruptcy. For example:

Wife consults with a family law attorney and immediately files a divorce petition. She then engages bankruptcy counsel for an immediate filing of a Chapter 7 bankruptcy petition. In the course of the proceeding, both bankruptcy and divorce counsel discover that Husband, during the marriage, surreptitiously had saved in excess of $25,000, held in stocks and bonds. Wife's interest in this asset must be listed in the schedule of assets in her bankruptcy proceeding. The Chapter 7 trustee can (and will) demand turnover of one-half of the funds. 11 U.S.C. §541(a). Had Wife waited to file her bankruptcy case until after resolution of the divorce, she may have had the opportunity to use the non-exempt funds for her immediate needs, including paying attorney fees for the divorce and

bankruptcy. If the bankruptcy case is filed when there are savings, the trustee will demand turnover for the benefit of unsecured creditors. However, if the parties cooperate prior to filing bankruptcy, they could agree to use cash resources to pay both divorce and bankruptcy attorneys, and not leave those savings to their creditors.

1.2.3 Timing of the filing (and the terms of the dissolution judgment) could raise or lower household income for purposes of passing the means test.

Husband and Wife, after consulting with their separate family law attorneys, together consult with bankruptcy counsel. Husband earns $10,000 per month. Wife historically has been a stay-at-home mother of their two children, ages 10 and 12. Under the "means test,"[1] if they file together, they would be forced into a Chapter 13 filing because their income is too high. If they file separately prior to divorce, Wife would qualify for a Chapter 7 discharge, but Husband would be forced into a Chapter 13 case with a large payment plan. However, if they work together and in their dissolution judgment negotiate a combined child support and spousal support of $3,500 per month for the next seven years, Wife still qualifies for a Chapter 7 filing, and Husband's income is reduced to a point that he now also qualifies for a Chapter 7 discharge. The family as a unit saves both assets and future income that can be used for the children.

1.2.4 Pre-dissolution joint ownership of property might allow higher combined property exemptions which may be advantageous in some situations, while in others the post-dissolution division of property allows a more favorable application of the exemptions.

Husband and Wife both anticipate filing for divorce and filing for bankruptcy. They have $100,000 of equity in their home. If they file bankruptcy jointly, they can together claim a $50,000 homestead exemption. If they divorce, and as a part of the divorce are awarded the home as tenants in common without a right of survivorship, if they file individual bankruptcies thereafter Husband and Wife may each be able to claim a homestead exemption of $40,000 rather than the combined exemption of $50,000. Keep in mind, however, that to claim a homestead exemption the property must be the abode of the debtor in accordance with Oregon law.

1.2.5 Other logistical things every family law attorney should know about bankruptcy filings:

- Once spouses are divorced they can no longer file a joint bankruptcy petition with his or her former spouse.

- If a married couple enters a Chapter 13 bankruptcy (payment plan over a period of years) and wants to be divorced before completion of their plan, you have three

[1]The most significant provision of the 2005 Act is the so-called "means test" calculation, by which the debtor's average gross income for the six months prior to filing, less allowable expenses, is considered "disposable income." If monthly disposable income, paid over sixty months, is $6,000 or 25 percent of unsecured debt (whichever is greater), the debtor's Chapter 7 case is subject to dismissal or being converted to Chapter 13. 11 U.S.C. § 707(b). Also, disposable income is a factor in determining the amount of plan payments in a Chapter 13 case. 11 U.S.C. § 1325(b).

options:

1. The spouse can dismiss the Chapter 13 bankruptcy;

2. The spouse can move to segregate the soon-to-be former Husband and Wife and determine whether each qualifies for bankruptcy in their own right (this may give one party the option of segregating to a Chapter 7);

3. The spouse can wait to finalize the divorce due to the financial considerations associated with the joint Chapter 13 bankruptcy; or

4. The spouses can divorce but continue to keep the Chapter 13 plan in place. This option is available because the bankruptcy deals only with debts that existed at the timing of filing. In such a case the family law attorney should, however, make clear in the divorce judgment which party is ordered to make payments according to the Chapter 13 plan. Also, both parties should be aware that the bankruptcy court will not defer to a dissolution judgment provision requiring a husband or wife to make payment in accordance with the Chapter 13 plan – the bankruptcy will be dismissed if payment is not made, regardless of who the divorce orders to pay it or which party's fault it is that payment has not been made.

- Though the bankruptcy estate consists of property and entitlements of the debtor as of the date the bankruptcy is filed, there is one asset that can be acquired after the filing that can be brought back in to the Chapter 7 estate: inheritance to which the debtor becomes entitled to within 180 days of the bankruptcy filing. In a Chapter 13 bankruptcy, however, all assets acquired while the bankruptcy is in progress (three to five years) that is not necessary for the support of the household belongs to the bankruptcy court and the creditors.

- The trustee in bankruptcy, at the commencement of the case, has the rights and powers of the holder of a judicial lien against property of the estate. It is therefore important to file a notice of *lis pendens* on marital property that is not titled to the client. After the divorce judgment is entered, immediately perfect transfers of marital property to avoid the ex-spouse/debtor having legal title to property that was supposed to have been transferred to the client.

- The bankruptcy trustee has all of the rights and powers of the individual who is in bankruptcy but nothing more. For that reason, money a client held their divorce attorney's trust account as of the date of bankruptcy filing may be subject to capture by the trustee in bankruptcy. If the debtor had the right to come in and fire you as their attorney and get the unearned retainer back, then the bankruptcy trustee has the right to ask for it.

Issue 2: Which Marital Obligations Can a Spouse Discharge in Bankruptcy?

The Problem: A typical divorce judgment deals with various types of financial obligations, including:

1. Spousal and child support payments;
2. Unreimbursed medical expenses relating to the children;
3. Property equalization judgment between spouses;
4. One or more home mortgages;
5. Credit card balances;
6. Auto loans;
7. Student loans;
8. Tax obligations; and
9. Other miscellaneous secured and unsecured obligations.

The negotiation and litigation process involved in a divorce proceeding must be carried out with the understanding that either or both spouses might subsequently file for bankruptcy.

2.1 Bullet Point Q & A Regarding Dischargeability

1. Are spousal or child support obligations ever dischargeable?

   No. Non-dischargeable under both Chapter 7 and Chapter 13.

2. Are expenses in the nature of support, such as healthcare expenses for the children, ever dischargeable?

   Generally, no. Non-dischargeable under both Chapter 7 and Chapter 13.

3. Are property equalization judgments to spouses dischargeable?

   Never in a Chapter 7 filing. They are possibly dischargeable in a Chapter 13 (after full completion of the payment plan, part of which may be paid to the equalization judgment), and depending on whether or not any portion of the award was intended to be in the nature of support.

4. Is a court ordered obligation to pay a mortgage dischargeable?

   In a Chapter 7 the obligation is dischargeable as to the mortgage holder. It is not dischargeable as to the requirement to hold Wife harmless from the obligation.

   In a Chapter 13 it depends on whether or not the payment is in the nature of support. This is a determination that the bankruptcy court makes, and a statement in the judgment that such payment is non-

dischargeable is not binding on the bankruptcy court. Findings of fact or correspondence between the parties and their attorneys as to why it should be considered support may influence the bankruptcy determination.

5. Is a court-ordered obligation to pay off joint credit cards dischargeable?

Yes as to third party creditors. A new and separate obligation as to the spouse, to hold the spouse harmless from action by the creditors, is the issue that arises.

2.2 Exceptions to Discharge: Chapter 7 Filings vs. Chapter 13

Prior to the enactment of the BAPCPA, 11 U.S.C. §523, contained two exceptions to discharge that related to debts arising in the context of a marriage. The first exception relevant to family law was set forth at 11 U.S.C. §523(a)(15) which intended to serve as a catch-all for those debts and obligations arising from the dissolution of a marriage that did not meet the requirements of 11 U.S.C. §523(a)(15)(in the nature of support, discussed *infra*). Such obligations most frequently took the form of property division or equitable distribution, and were allowed a "conditional exempt" status subject to explicit limitations. Under the new BAPCPA, 11 U.S.C. §523(a)(15) was revised to do away with the problematic "balance of harm" analysis.

Current law automatically excepts all divorce related property division and non-support orders for the benefit of the spouse – such as hold harmless orders – from discharge in a Chapter 7 filing. 11 U.S.C. §523(a)(15).

§523(a)(15) provides that a debt is excepted from discharge if it meets these three elements:

1. The debt must be to a spouse, former spouse, or child of the debtor;
2. The debt must not be a domestic support order; and
3. The debt must have been incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court

That statute, combined with 11 U.S.C. §523(a)(5) which excepts "domestic support obligations" (discussed *infra*) from discharge in a Chapter 7 filings, effectively means that [***any* obligation owed to a former spouse is non-dischargeable under a Chapter 7 bankruptcy, whether or not the obligation is considered in the nature of support, or merely relates to property.**] This includes the fact that an equalizing money award is now non-dischargeable in a Chapter 7 bankruptcy.

The distinction between support debts and property settlement debts is still important in Chapter 13 cases, however, because §523(a)(15) does not apply to Chapter 13 filings, meaning that property settlement debts may be discharged and are not priority claims in Chapter 13 filings. 11 U.S.C. §1328(a). Dischargeable property settlements/non-domestic support obligations are treated and paid as general unsecured claims in a Chapter 13 case. In Chapter 7 cases, the distinction between a domestic support obligation and property settlements debts is usually not important because the debt is non-dischargeable as a domestic support obligation under §523(a)(5) or as a property settlement

debt under §523(a)(15).

Example:

Husband owes Wife a $100,000 equalizing property judgment. The judgment *cannot* be discharged if Husband files a Chapter 7 bankruptcy. If Husband files a Chapter 13 bankruptcy, the obligation can be discharged after completion of the debtor's payment plan, which may require periodic payments toward this obligation, but has no requirement that the debt be paid in full. Discharge is also dependent upon whether any portion of the award can be considered a domestic support obligation.

2.3 Exceptions to Discharge: Domestic Support Obligations, Debts in the Nature of Support

Exceptions to discharge are governed by 11 U.S.C. §523 which sets out an enumerated list of specific debts excepted from discharge. The exceptions to discharge provided for in this section are applicable to discharges brought under Chapter 7 *and* Chapter 13 bankruptcy filings.

2.3.1 Domestic Support Orders: History

Prior to the enactment of the BAPCPA, the former11 U.S.C. §523's second exception to discharge in family law cases was found at 11 U.S.C. §523(a)(5), and excepted from discharge any debt:

> *to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child in connection with a separation agreement, divorce decree, or other order of a court * * * but not to the extent that –*
>
> *a. such debt is assigned to another entity * * *, or*
> *b. such debt includes a liability designated as alimony, maintenance or support, unless such liability is actually in the nature of alimony, maintenance ,or support.*

This former exception to discharge also contained substantial limitations. By definition the exception only applied to a creditor who was as spouse, former spouse or child of the debtor. Legal guardians and relatives who had undertaken custodial responsibility for the debtor's children could not rely on this exception. Even a creditor who was a biological parent of the debtor's child (e.g., mother of a child born out of wedlock) could not utilize the statute's protections.

2.3.2 Domestic Support Obligations: Current Law

BAPCPA has addressed the limitations in the former 11 U.S.C. §523(a)(5) by replacing the "debts actually in the nature of alimony maintenance or support" language with "domestic support obligation." If a debt is a domestic support obligation, the debt **will not be discharged** if the debtor files a bankruptcy case **under any chapter**. 11 U.S.C. §523©.

A domestic support obligation is defined at 11 U.S.C. §101(14A) (2007) as:

> *The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is--*
>
> *(A) owed to or recoverable by--*
>
> *(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or*
>
> *(ii) a governmental unit;*
>
> *(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;*
>
> *(C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of-*
>
> *(i) a separation agreement, divorce decree, or property settlement agreement;*
>
> *(ii) an order of a court of record; or*
>
> *(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and*
>
> *(D) not assigned to a non-governmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.*

2.3.3 Domestic Support Obligations: Payment Under a Chapter 13 Plan

In a Chapter 13 case, a debtor is required to propose a bankruptcy plan that both cures a non-dischargeable domestic support obligation arrearage and keeps up with current payment on non-dischargeable domestic support obligations that accrue over the course of the Chapter 13 plan. As a common example, this means that the debtor must pay:

1. Any child and spousal support arrearage that existed at the time of filing in full over the course of the payment plan; and

2. Any ongoing child or spousal support order that accrues during the bankruptcy according to its terms (not late).

In most cases the plan provides an amount that is to be paid monthly toward satisfaction of the arrearage and the full current support obligation. This works provided the payment on the arrearage is enough to fully satisfy the arrearage within the term of the plan. The debtor cannot obtain a discharge unless the debtor certifies that all amounts due on the spousal and child support obligations – both pre-petition arrearages and payments that became due during the time the bankruptcy plan was in place – have been paid. 11 U.S.C. §1325(a)(8), 1328(a), 1328(g).

Debtors who have a support arrearage (or an arrearage in any other non-dischargeable domestic support obligation) are therefore, able to "buy" time through filing a Chapter 13 plan. As family law

attorneys it is important to note that the domestic support obligation arrearage (support arrearage) is a priority debt under §507(a)(1) and must be paid in full pursuant to §1222(a)(2) and 1322(a)(2) "unless the creditor consents to a different treatment." "Consent" may be construed from a failure to object to confirmation. *In re LaForgia*, 241 B.R. 351 (Bankr. M.D. Pa. 1999).

Example:

Husband owes a spousal support arrearage. He files for Chapter 13 bankruptcy. Husband must make timely payment on each month's support payment over the course of the three year payment plan, and must pay the arrearage in full. His bankruptcy will be dismissed if Husband fails in either of these regards. Though Husband has to pay the full amount of the obligation to Wife, the benefit to Husband is that he is protected from garnishment by Wife (e.g., Wife taking his bank account balance) or by the state support collection service over the life of his bankruptcy plan.

2.3.4 Domestic Support Obligations: Determining Whether a Debt "In the Nature of Support;" Drafting Strategies if Chapter 13 is on the Horizon

During the negotiation process, when issues of support are regularly resolved in a comprehensive agreement – and often through trade offs on other non-support related issues – the divorce attorney must consider the possibility that an obligation to pay a money award as equitable distribution, or an obligation to assume a martial debt, may be subject to discharge. Maintenance and child support payments and arrears are exempt from property of the estate, if court-ordered. Payments reflecting property distribution, however, may be dischargeable under a Chapter 13 filing. For that reason, the distinction between support and non-support is critical in drafting the divorce judgment.

Resolution of the issue of whether a particular debt may or may not be discharged under a Chapter 13 bankruptcy will often hinge upon whether or not the debt is designated as support, and is, in fact, in the form of support. A state court's designation or language in a judgment stating that a debt is support or property settlement ***is not*** binding on the bankruptcy court in determining dischargeability. The bankruptcy court can look behind such language to determine the real nature of the debt. Even if a dissolution judgment or marital settlement agreement contains language stating that there is no spousal support, or that a debt cannot be discharged in bankruptcy, a bankruptcy court will make its own determination as to the nature of the obligation. That means provisions in a judgment such as the following are **not** binding on the bankruptcy court:

> *6.6 **No Bankruptcy**. The obligation of a party to pay, defend, indemnify and hold the other party harmless from the payment of any debt described in this judgment is a support obligation under 11 U.S.C. subsection 523(5) which is not dischargeable in bankruptcy as to the other party.*

Many family law attorneys choose to include this language in their judgments knowing that it is ineffective in hopes that the provision itself might have some psychological impact on an opposing party who is unfamiliar with the law. Regardless of the reason such a provision is included, the family law attorney should make clear to her own client that nothing stated in the divorce judgment can guarantee a particular result in the bankruptcy court.

Instead, the family law attorney should take care to utilize language that specifically identifies obligations as and for support. Certainly an argument can be made that any obligation arising out of a martial settlement agreement constitutes support. A party receives financial relief when he or she is relieved of an obligation to pay a particular debt to a third party creditor that would otherwise have to be paid. However, the determination of what constitutes domestic support will fall to the bankruptcy court. The bankruptcy court looks to federal rather than state law, and the focus of the inquiry is *the intent of the parties or the divorce court at the time the obligations were created*. Therefore, the family law attorney must clearly identify the nature of the debt, describe its purpose, and provide for enforcement by the spouse. This requires thoughtful consideration and drafting centered around whether or not a particular obligation is or is not *in the nature of support*.
The Sixth Circuit opinion in *Long v. Calhoun,* 715 F2d 1103 (6 Cir. 1982), is widely cited for the factors the courts use to determine whether the obligation was intended to create a support obligation, but courts consider all relevant evidence pertaining to the ***intent of the parties***, including but not limited to:

- actual substance and language of the judgment;
- the financial situation of the parties at the time of the agreement;
- the parties' employment histories and prospects for financial support;
- whether one party received marital property;
- the function served by the obligation at the time of the agreement;
- the number and frequency of payments;
- whether it would be difficult for the former spouse and children to subsist without the payments;
- the length of the marriage; and
- whether there is any evidence of overbearing at the time of the agreement that should cause the court to question the intent of a spouse.

The bankruptcy court will analyze the respective financial situations of the parties at the time of the obligation, and the more factors that support concluding a particular obligation is in the nature of support, the more likely it is that a bankruptcy court will consider the obligation to be non-dischargeable under 11 U.S.C. §523(a)(5).

A family law attorney should help her client in advance by making clear the character of a particular obligation, and whether or not it is in the nature of support, through findings of fact in their judgment, or even by negotiating the point directly in their correspondence leading up to settlement (which can be used as evidence in the bankruptcy proceeding).

Example: To prove a credit card payment is in the nature of support, a finding of fact as to the parties' intent may not be enough; the judgment itself should demonstrate that the payment was truly support.

Sample finding: "Wife is awarded $1,500 per month in spousal support. Husband is obligated to pay not less than $800 per month toward satisfaction of the credit card debt. Wife's spousal support shall increase to $2,000 per month once the credit card debt has been satisfied."

Sample finding: "This judgment obligates Husband to pay the Visa credit card obligation directly to the creditor thereby leaving Wife sufficient funds to support herself on a monthly basis. But for Husband's assumption of this obligation and promise to pay it, Wife would be entitled to an award of cash spousal support."

Sample finding: "Wife is awarded a larger share of the martial assets in the form of an equalizing judgment because it is both parties' desire that Wife have sufficient resources at her disposal to use for investment and to assist her in being self-supporting. Both parties anticipate that Husband's payment of this judgment will allow Wife to generate income and, therefore, reduce her need for Husband to make cash spousal support payment to her. Thus, the property award is actually in lieu of a direct spousal support obligation against Husband."

Simply stating that "this award is made in lieu of spousal support" is insufficient. There must actually be information on the circumstances of the parties that will lead the bankruptcy court, under its own inquiry, to determine that a payment is actually a domestic support obligation – that it in some way assists in actually supporting the obligee or her family.

Example: At trial, the trial court awards no spousal support to Wife. Wife is awarded the home, and Husband is ordered to pay Wife's medical bills, credit cards, and all past due property taxes on the home awarded to Wife. The bankruptcy court finds that the credit card obligation is not in the nature of support, but the medical bills and property taxes are. Therefore, while all of Husband's obligations are dischargeable as to third party creditors (credit card, hospital), the obligation that Husband has to hold Wife harmless from the medical bills and property taxes is not dischargeable.

Example: The family law attorney should consider negotiating for dischargeability or non-dischargeability, or asking the domestic court to rule on dischargeability, using federal law. For example, the separation agreement could specify that in light of Wife's and Son's economic circumstances, by undertaking to pay Son's education loan (co-signed by both parents), Husband's promise is a child support obligation and, as such, is intended by the parties to be non-dischargeable in bankruptcy. The crucial issue in determining whether an obligation is a support obligation is the function intended to be served, and that should be the focus of drafting language that would survive a challenge in bankruptcy court.

Items that, under the correct circumstances, may qualify as non-dischargeable domestic support obligations under the revised bankruptcy code.

- child support payments
- spousal support payments
- payments for uninsured medical expenses
- health insurance premiums
- daycare expenses
- obligation to pay life insurance premiums

- accrued interest on an outstanding support obligations
- mortgage payments
- payments on a spouse's car
- attorney fees
- an equalizing judgment in the nature of spousal support
- obligation to pay tax liabilities

2.4 Attorney Fees. Is an obligation to pay the opposing party's attorney fees dischargeable?

Prior to the BAPCPA the question of whether or not a debtor's obligation to pay attorney fees could be dischargeable in bankruptcy hinged upon the determination of whether or not the award fell within the 11 U.S.C. §523 exception to discharge reserved for debts of "alimony, maintenance, or support." That is why wise practitioners who recover an award of attorney fees always try to include a finding of fact in the judgment like the following:

> *5. _____ percent (___ %) of the attorney fee award represents charges directly related to the establishment of a child support award.*

With revisions to §523 that incorporate a new, more inclusive definition of "domestic support obligation," and the addition of 11 U.S.C. §523 (a)(5) which further excepted all other debts arising from a divorce settlement agreement, the question of whether or not an attorney fee award is a debt in the nature of alimony, maintenance or support is not as important for a Chapter 7 proceeding. An attorney fee award is generally not dischargeable under a Chapter 7 bankruptcy because the award is either related to an award of support (and therefore non-dischargeable under §523 (a)(5)) or falls under the protection of §523(a)(15) property settlement.

Because property settlements are dischargeable under Chapter 13 filings, however, the inquiry as to what portion of the attorney fee award is attributable to spousal or child support is still relevant, as the ability to discharge will depend on whether the obligation is deemed part of a domestic support obligation.

Therefore, it is still good practice to designate the percentage of the attorney fee award that is attributable to spousal and child support issues to assist in preventing discharge under a Chapter 13 bankruptcy filing.

2.5 Hold Harmless

In a divorce, the divorcing couple or the court will have to make a determination of how post-divorce responsibility for paying debts and obligations will be allocated between the spouses. In some cases your client may be personally liable for each debt and obligation. In other cases only one party may be personally liable to the creditor for a particular debt, but the court, or the agreement of the parties, requires that the other non-liable spouse is to be responsible for paying it post-divorce. Or it may be that both spouses are jointly personally liable for a debt, but only one spouse is ordered or agrees to pay it post-divorce.

When a spouse is ordered to pay marital obligations post-divorce, either because the court entered such an order after a trial or because the spouse agreed to pay such obligations in an agreed order,

the rights of the creditors to whom such obligations are owed are not affected in any way. This means that personal liability of a spouse for an obligation cannot be affected by an order of a divorce court assigning responsibility for payment of that obligation post-divorce. If a spouse is personally liable for an obligation before the divorce, he will continue to be personally liable for it after the divorce, even if the divorce court orders the other spouse to pay it. Likewise, the court's order cannot create personal liability of a spouse to a creditor where none previously existed. If the court orders a spouse to pay an obligation post-divorce with respect to which such spouse is not personally liable, such spouse will continue after the divorce to have no personal liability to the creditor to whom such debt is owed, notwithstanding the court's order.

In any of these cases there is substantial risk after the divorce that the spouse who is responsible to pay the various debts and obligations will fail to do so. In most cases, the spouse who is responsible for paying debts and obligations post-divorce will also be ordered, or will stipulate in the judgment, to hold the other spouse harmless from his failure to pay those obligations, and to indemnify the other spouse to the extent she incurs damages as a result of such failure.

Therefore, family law attorneys include standard judgment language such as:

> *Husband shall pay according to the creditor's repayment terms, defend, indemnify and hold Wife harmless from any debt in his name alone not otherwise specifically described herein.*

Does this provision protect clients? What is the impact of such a provision in bankruptcy?

In the context of a bankruptcy proceeding, a hold harmless provision in a divorce judgment is treated as any other debt held by any other creditor. The existence of a hold harmless provision *does not* mean that the spouse filing for bankruptcy cannot discharge his or her obligation as to the creditor. Rather, the hold harmless provision itself is an obligation between the spouses, separate from the obligation to the original creditor, but still subject to a determination as to whether or not it should be discharged in a Chapter 7 or Chapter 13 bankruptcy. As stated previously, the majority of obligations to former spouses are non-dischargeable under a Chapter 7 or Chapter 13 filing under either the domestic support obligation exception (§523(a)(5)), or the property settlement exception under §523(a)(15). Under a Chapter 13 filing, however, as the property settlement exception does not apply, to determine whether or not a requirement that the debtor hold a former spouse harmless is excepted from discharge requires a determination as to whether or not the provision satisfies the criteria to be considered a domestic support obligation. *In re Calhoun*, 715 F.2d 1103, 1106 (6th Circ 1983); *In re Burckhalter,* 389 B.R. 185 (Bankr. D. Colo. 2008); *In re Forgette*, 379 B. R. 623 (Bankr. W.D. Va. 2007).

As with other obligations, a bankruptcy court will look behind the labels in order to determine the intent of the dissolution court and the parties in ordering the payment. A hold harmless obligation to pay a mortgage may or may not be considered to be a domestic support obligation, depending on the language of the judgment and the circumstances of the parties at the time of the obligation. See *In re Blad*, Bankr. D. Kan. Aug. 22, 2008)(Bankruptcy Court in a Chapter 13 case found that a hold harmless obligation to pay a mortgage in a divorce decree was not in the nature of maintenance or support but was in the nature of property division and, therefore, was not entitled to priority and may be discharged at the completion of payments under the plan); See also *In re Johnson*, 397 B. R. 289,

298 (Bankr. M.D.N.C. 2008)(Bankruptcy Court held that hold harmless obligation in a divorce decree that required debtor to pay mortgage on residence was in the nature of alimony, maintenance or support and was non-dischargeable under §523(a)(5)).

Regardless of the terms of the judgment and a determination by the bankruptcy court that a hold harmless provision is non-dischargeable, practically speaking, enforceability of an order to pay an obligation or a hold-harmless agreement is problematic. A judicial action will have to be brought against the responsible spouse by the other spouse, and a judgment will have to be entered against the responsible spouse. This will, of course, involve incurring attorney's fees and other costs, and the judgment may very well be uncollectible, depending on the responsible spouse's financial situation and the availability of assets to satisfy the judgment.

Possible solution: If spousal support was ordered, move to modify spousal support in the divorce court to ask for an increase in alimony or child support. You will need to show a change in your financial circumstances caused by the additional debt or the reality of not receiving property or money you were awarded.

Possible solution: Include an additional provision in your judgments, to the effect of:

> ***Money Judgment.*** *In addition to any other remedies available to her in law or in equity, Wife shall be entitled to a money judgment to the extent she is financially harmed by Husband's failure to pay in accordance with the creditor's payment terms, defend, indemnify and hold Wife harmless from any debt in his name alone not otherwise specifically described herein, For example, if Husband does not pay the payment to _____ credit card and Wife does so to protect her credit, Wife shall have judgment against Husband for the amount paid and for the harm she suffered to her credit.*

Possible solution: A potential creditor spouse may obtain some protection by obtaining a lien to secure the repayment of a debt. The lien should be on property held jointly, not property held only in the name of the debtor spouses. 11 U.S.C. §522(f)(1)(A) gives a debtor a right to avoid any judicial lien that impairs an exemption, subject only to the exception for domestic support obligation debt, which may not be avoided.

Possible solution: Hold harmless obligations with collateral in the hands of the obligor also should be considered. For example, a party could require execution of a deed of trust on real property, the release of which is preconditioned on payoff of hold harmless obligations. As another example, consider a conditional QDRO that divides the paying party's retirement account in "a dollar amount equal to the balance owing on the USBank Visa account ending 8397 of Husband's (Plan), if any, on July 5, 2015 [the date the account is to be paid in full].

Note that if your client anticipates filing bankruptcy, the family law attorney should avoid agreements that include hold harmless (indemnification) provisions regarding marital debt.

Issue 3: Planning for Bankruptcy in the Dissolution Judgment

3.1 The Terms of the Settlement

In anticipation of one party filing bankruptcy, it might be tempting in divorce negotiations to make a disproportionate award of property or debt to one party with the expectation that the other party will file bankruptcy. This strategy, however, is dangerous as the bankruptcy court does conduct an independent investigation as to what might be considered a fraudulent transfer.

Under 11 U.S.C. §548, the bankruptcy trustee may avoid transfers of property or obligations made or incurred by the debtor within two years prior to filing bankruptcy, if made or incurred with actual intent to hinder, delay, or defraud creditors, or, if less than fair value for the property was received, and the debtor was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result. The trustee will scrutinize settlement terms to determine whether the debtor received appropriate values for what was given to the debtor's ex-spouse. In a subsequent bankruptcy of one spouse it would be a question of fact as to whether such a settlement was voidable or not. Property divisions ordered by a trial judge after a contested hearing are not controlled by the debtors and, therefore, are not as likely to be viewed as fraudulent voidable events.

3.2 Judgment Provisions:

What is the impact of the following judgment provisions; do they work? Does the fact that these provisions may be "boilerplate" in that they are included in every judgment matter in deciding whether or not they can be enforced?

3.4.1 ***No Bankruptcy***. *The obligation of a party to pay, defend, indemnify and hold the other party harmless from the payment of any debt described in this judgment is a support obligation under 11 U.S.C. sub§ 523(5) which is not dischargeable in bankruptcy as to the other party.*

> The bankruptcy court is not bound by such a provision, but include it in your judgment for its psychological impact on the opposing party. Just make sure your client knows it is unenforceable.

3.4.2 ***Debt Forgiveness.*** *It shall be the sole responsibility of the party that this judgment directs pay a debt to report for income tax purposes any forgiveness of that debt which the creditor reports to the parties and any taxing authority as debt forgiveness for income tax purposes. The party obligated to report the debt forgiveness as income shall pay to the other party as liquidated damages any additional tax that party was forced to pay, together with attorney and accountant fees, interest and any penalties that may be incurred or assessed as a result of the obligated party's failure to comply with this provision of the judgment.*

This is an IRS issue, not a bankruptcy issue, but it should be addressed in every case where there is the potential for bankruptcy, foreclosure or debt forgiveness.

3.4.3 ***Failure to Pay A Debt***. *This judgment requires each party to pay certain debts however each party is aware that the court's order cannot modify the repayment agreement between the parties and their creditors. The court's order can only impact the obligation to pay as between the parties themselves.*

3.4.3.1 If either party fails to pay any debt or liability as set forth herein, the other party shall have the right, but not the obligation, to make any payment due provided the nonpaying party is given ten (10) days prior notice of the party's plan to make payment. If payment is made, the party who failed to pay shall be responsible for reimbursing the amount paid to the party who did make the payment together with interest computed at the same rate charged by the creditor on the obligation to which payment was made. Interest shall accrue from the time payment is made until full reimbursement is made.

3.4.3.2 A party who pays the other party's debt pursuant to this provision is hereby authorized to deduct the amount of money so paid from any payment then or thereafter due or owing the other party, ***including from any obligation to pay support.***

Be careful on including the ability to deduct money from a support obligation. If stipulated, it may be more enforceable as a contract, but if not, it may be in violation of the Oregon exemption statutes that prohibit parties from garnishing support. In addition, it is problematic if support is being collected by the Department of Justice.

3.4.4 ***Nondischargabiliy.*** *Each party's property and debt payment obligations provided for in this agreement to or on behalf of the other, either directly or by way of indemnification, are intended to be "non-support debt obligations" and, therefore, nondischargeable under 11 U.S.C. §523(a)(15) of the U.S. Bankruptcy Code.*

This is ineffective as dischargeability is ultimately determined under the bankruptcy code.

3.4.5 ***Debts***. *The parties are insolvent. Neither party is ordered to pay any debts. Each party is entitled to seek any relief he or she may have from joint or separate debts through bankruptcy.*

3.4.6 ***Money Judgment.*** *In addition to any other remedies available to her*

in law or in equity, Wife shall be entitled to a money judgment to the extent she is financially harmed by Husband's failure to pay in accordance with the creditor's payment terms, defend, indemnify and hold Wife harmless from any debt in his name alone not otherwise specifically described herein, For example, if Husband does not pay the payment to _____ credit card and Wife does so to protect her credit, Wife shall have judgment against Husband for the amount paid and for the harm she suffered to her credit.

Could be helpful if stipulated and if a divorce court will uphold it.

Issue 4: The Bankruptcy Automatic Stay

Exceptions to automatic stays, the injunction issued automatically upon the filing of a bankruptcy case that prohibits collection actions against the debtor, the debtor's property or the property of the estate, were expanded by the BAPCPA as they relate to family law proceedings. 11 U.S.C. §362(b)(2)(a) was amended to add several new exceptions the automatic stay. The following types of actions are no longer stayed:

(a) . . . the commencement or continuation of a civil action or proceeding –

(i) for the establishment of paternity;
(ii) for the establishment or modification of an order for domestic support obligations;
(iii) concerning child custody or visitation;
(iv) for the dissolution of marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or
(v) regarding domestic violence;

(b) . . . the collection of a domestic support obligation from property that is not property of the estate;

(c) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or statute;

(d) . . . the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law;

(e) . . . the reporting of overdue support owed by a parent to any consumer reporting agency;

(f) . . . the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the Social Security Act or under an analogous State law; or

(g) . . . The enforcement of a medical obligation as specified under title IV of the Social Security Act . . . .

Property determinations regarding the non-bankrupt spouse's interest in the debtor's retirement assets may also be exempt from the automatic stay. In *Zettwoch v. Zettwoch*, the trial court held that a non-bankrupt Wife's interest in the bankrupt Husband's retirement fund vested in her at the time of the divorce judgment was entered, and that the Husband's bankruptcy filing did not stay the court's execution of a QDRO. *Zettwoch v. Zettwoch,* 2008 WL 2447366 (June 10, 2008).

Issue 5: When Action in the Bankruptcy Court is Needed to Protect Your Dissolution Client

Bankruptcy filings have timelines, some of which are jurisdictional. If your dissolution client is served with a document from a bankruptcy court for a case involving her current or former spouse, do not wait. Get the help of a bankruptcy attorney immediately.

In a Chapter 7 filing, all obligations to a former spouse should be non-dischargeable. In a Chapter 13 filing, however, circumstances may arise where your client may need to take action to protect her interests.

The following are a few examples of circumstances under which it might be helpful or necessary to participate in a spouse or former spouse's bankruptcy:

1. The party in bankruptcy owes your client what is clearly a support obligation.

Obligations such as spousal and child support are clearly non-dischargeable in bankruptcy. Many times, either the debtor or the trustee will include these debts in the payment plan with or without any action on the part of the creditor. Regardless, it is always a good idea to make sure your client's claim is properly filed with the bankruptcy court, and to make sure it is filed timely. In the event of an untimely filing, though the obligation will not ultimately be discharged though the bankruptcy, your client as the receiver of alimony may be prohibited from taking any lawful action to collect and will have to wait for the discharge and exit from bankruptcy to initiate garnishment.

> Example: Husband owes Wife $30,000 in spousal support arrearage, but Wife fails to timely notify the bankruptcy court of this claim. Husband cannot discharge the $30,000 obligation, but Wife cannot collect until his plan is completed five years later.

2. The party in bankruptcy owes your client an obligation that could be classified as a domestic support obligation.

Obligations that are not clearly itemized as support will need to have a determination by the bankruptcy court as to whether or not the particular payment satisfies the criteria of a domestic support obligation. Only if the bankruptcy court rules that it is a domestic support obligation will the debt be protected from discharge. To raise that issue your client will have to make an appropriate claim in the bankruptcy court.

Example: Payment of past due uninsured medical expenses, payments on a mortgage and equalizing judgments all have the ability to be considered domestic support obligations. Their characterization as "in the nature of support" or "as property distribution" will govern whether or not they are paid in full, paid in part as a regular unsecured claim, or not paid at all over the course of the Chapter 13 plan.

3. The bankruptcy schedules filed by the filing party are not accurate.

If a debtor files a Chapter 13 and the ex-spouse's interests or claims are affected, the ex-spouse should carefully review the bankruptcy schedules and the Chapter 13 plan to determine whether all assets were disclosed with the appropriate value.

Strategic decisions need to be made to determine if it is in the ex-spouse's best interests to agree to a debtor's bankruptcy plan if such result will make funds available to pay current support debts.

Example: In a Chapter 7 filing your client may not agree that all assets were disclosed. You may think the bankrupting party has more assets and more available funds than they claim. Does your client want to point that out to the bankruptcy court? Or will the fact that more assets exist only mean that there is more money available to the debtor to pay your client's non-dischargeable claim at a further date?

Example: In a Chapter 13 filing where some of your client's claims are not domestic support obligations, your client is going to be paid based on the available assets the bankruptcy court determines the debtor has. It is, therefore, imperative that all assets are itemized and the values for each asset are as high as possible to get the maximum benefit for your client prior to discharge.

Example: The values and schedules created by the debtor in bankruptcy are sworn to under penalty of perjury by the debtor. Sometimes the values listed in the bankruptcy court vary considerably from the values asserted in the divorce court – it may, therefore, be useful information for your client to take advantage of.