

Avoiding the Discharge of Legal Fees in Bankruptcy

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It is the public policy of the United States, rooted in the Constitution itself, to permit honest debtors to reorder their affairs, make peace with their creditors and enjoy a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.¹ Bankruptcy is a means to afford an honest debtor a fresh start by discharging pre bankruptcy debts,² including, in most cases, legal fees.

It is also the public policy of the United States that a person is responsible for the support of his or her dependents. That policy is based on obvious moral and ethical considerations and on the practical realization that the government may ultimately become responsible for the support of otherwise unsupported dependents.

Congress has decided that the policy considerations involved with the support of dependents outweigh those involved with a fresh start. To that end, it enacted 11 U.S.C. § 523(a)(5)³ that

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¹ U. S. CONST. art. I, § 8; *Grogan v. Garner*, 498 U.S. 279 (1991); *In re Klein*, 42 U.S. 277 (1843).

² *Grogan v. Garner*, 498 U.S. at 286-87; *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, (1934); *Sinton v. Blaemire*, 229 B.R. 665, 667 (Bankr. D. Md. 1999).

³ (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

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(5) 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 of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

exempted support obligations from discharge in bankruptcy⁴ and 11 U.S.C. § 507 that provided that support claims in a bankruptcy must be paid before most other claims. Under certain conditions, an award of legal fees will be considered a support order. This article will address which legal fees awarded in matrimonial proceedings will be treated as support in a bankruptcy proceeding and which will not.

I. The Support of Dependents Exception to Discharge of Legal Fees

Just as all transfers of money or property from a debtor to a dependent is not support, all court ordered legal fees are not support. When legal fees are support, they become a priority debt of the bankruptcy estate and are not discharged by the bankruptcy. At first reading, it would appear that fees payable directly to an attorney for a creditor spouse come within the exception of 11 U.S.C. § 523(a)(5)(A) and would not constitute "support." Most courts have held otherwise. Fees, which otherwise qualify as support, payable to the attorney rather than the creditor/spouse, may qualify as support of a dependent and not be dischargeable.⁵

The key question is why the fees were awarded. Fees awarded to a creditor dependent, who would otherwise not be able to litigate, usually qualify as support. Fees granted either as part of a property distribution, as a sanction, pursuant to an agreement or as part of an enforcement proceeding, may not. If

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 408(a)(3) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); 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;

⁴ *In re Jones*, 9 F.3d 878 (10th Cir. 1993); *In re Frey*, 212 B.R. 728 (Bankr. N.D.N.Y. 1996); *In re Raff*, 93 B.R. 41 (Bankr. S.D.N.Y. 1988).

⁵ *In re Kline*, 65 F.3d 749 (8th Cir. 1995); *In re Peters*, 964 F.2d 166 (2nd Cir. 1992); *Silansky v. Brodsky*, Greenblatt & Renehan, 897 F.2d 743 (4th Cir. 1990); *In re Newman*, 196 B.R. 700 (Bankr. S.D.N.Y. 1996); *In re Doe*, 193 B.R. 12 (Bankr. N.D. Cal. 1996). For the minority view contra, see *In re Townsend*, 177 B.R. 902 (Bankr. E.D. Mo. 1995).

the bankruptcy court cannot rely on state court findings, it must make its own.

This analysis is complicated by the fact that most legal fee obligations are based on separation agreements or in-court stipulations of settlement. Before drafting the agreement or stipulation, the lawyers first cut up the pie. They then label the parts, usually to obtain the best tax treatment. Frequently, lawyers write to protect their clients but serve themselves less well by failing to provide for findings of fact supporting the claim that the fees were in the nature of support.⁶

The issue is further complicated because the counsel fees' order may not be necessary for the creditor's support if a property award is paid because the property settlement may make the creditor spouse self-sufficient but may become a necessary if it is not. Therefore, as with all support questions, the bankruptcy court takes a fresh look to determine what constitutes support of dependents.⁷

II. Federal Law Applies

The issue of dischargeability of a specific debt is a matter governed by federal law.⁸ However, a state court may apply federal law and determine if an obligation is support and whether it has been discharged in bankruptcy.⁹ The question is whether the state court and/or the parties intended the fee as support or as part of a property distribution.¹⁰ The bankruptcy court will review the entire financial transaction to determine what part of it

⁶ *In re Newman*, 196 B.R. 700 (Bankr. S.D.N.Y. 1996). A talented lawyer drafted findings of fact that fully protected his client, but his legal fee was discharged. He carefully enumerated facts that left no doubt that the award to his client was for the support of the debtor's dependents. As to his legal fee, he merely inserted a bald statement that he was awarded a legal fee of \$3,500. Rather than go through what would essentially be another support hearing in the bankruptcy court, he allowed his fee to be discharged.

⁷ *In re Brody*, 3 F.3d 35 (2nd Cir. 1993); *Waller v. Kriss*, 217 B.R. 147 (Bankr. S.D.N.Y. 1998); *In re Frey*, 212 B.R. 728 (Bankr. N.D.N.Y. 1996); *Mina v. Mina*, 170 Misc.2d 639 (Sup.Ct. Suffolk Cty. 1997).

⁸ *Grogan v. Garner*, 498 U.S. 279 (1991); *In re Akamine*, 217 B.R. 104 (S.D.N.Y. 1998); *Waller v. Kriss*, 217 B.R. 147; *In re Frey*, 212 B.R. 728.

⁹ *Mina v. Mina*, 170 Misc.2d 639.

¹⁰ *In re Brody*, 3 F.3d 35; *In re Frey*, 212 B.R. 728; *Mina v. Mina*, 170 Misc.2d 639.

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is in the nature of support and what part is a distribution of property.¹¹

A. *Legal Fees As Support*

When a state court awards attorneys' fees in a divorce judgment based on the parties' relative need, the debt legitimately can be characterized as support.¹² Among the factors to be considered in determining whether a debt constitutes alimony or support are the disparity in earnings between the parties at the time of the divorce or agreement and the language of the decree or agreement itself.¹³ The issue before the bankruptcy court is not whether a child or non debtor spouse requires support currently, or did at the time of the state court order or separation agreement, but, rather, whether the agreement or order intended to provide support.¹⁴ The circumstances of the parties subsequent to the entry of the state court support order are irrelevant to the bankruptcy court's analysis.¹⁵ If the state court has made factual findings, the bankruptcy court will not retry the issues of need for, or adequacy of, a support order, or whether one should be modified. It is bound by the state court's determination of those issues.¹⁶ The federal courts may determine the nature of the debt, but the state courts determine its validity and amount.¹⁷

However, the state court judgment may not declare that an obligation will be non dischargeable in a subsequent bankruptcy.¹⁸ Neither a state court ruling of law (as compared with a finding of fact) that a debt is support or that it is not dischargea-

¹¹ *In re Brody*, 3 F.3d 35; *Gibson v. Gibson*, 219 B.R. 195 (B. A. P. 6th Cir. 1998); *Moeder v. Moeder*, 220 B.R. 52 (B. A. P. 8th Cir. 1998); *Waller v. Kriss*, 217 B.R. 147; *In re Frey*, 212 B.R. 728.

¹² *In re Strickland*, 90 F.3d 444, 446-47 (11th Cir. 1996).

¹³ *In re Lanting*, 198 B.R. 817, 822 (Bankr. N.D. Ala. 1996).

¹⁴ *In re Kline*, 65 F.3d 749 (8th Cir. 1995); *In re Fitzgerald*, 9 F.3d 517 (6th Cir. 1993); *In re Frey*, 212 B.R. 728 (Bankr. N.D.N.Y. 1996); *In re Edwards*, 172 B.R. 505 (Bankr. D. Conn. 1994).

¹⁵ *Matter of Swate*, 99 F.3d 1282 (5th Cir. 1996); *In re Christison*, 201 B.R. 298 (Bankr. M.D. Fla. 1996).

¹⁶ *In re Purpura*, 170 B.R. 202 (Bankr. E.D.N.Y. 1994).

¹⁷ *In re Edwards*, 172 B.R. 505.

¹⁸ *In re Puckett*, 206 B.R. 556 (Bankr. W.D. Okla. 1997); *Frommer v. Frommer*, 104 A.D.2d 726 (4th Dept. 1984).

ble¹⁹ nor a pre bankruptcy waiver of dischargeability²⁰ are binding on the bankruptcy court.²¹

Once the debt is declared support, it will be paid before almost all other unsecured claims. It is superior even to taxes.²² Significantly, it is almost impossible to confirm a reorganization plan under chapters 11, 12 or 13 of the Bankruptcy Code without providing for the payment of support claims in full.²³

Since they survive the bankruptcy, legal fee awards qualifying as support claims can be collected from post bankruptcy income. Attorneys with non dischargeable claims sometimes try to collect their state court judgments from bankruptcy estate property. That is a mistake. Collection may only be made from non estate property and from the estate as a priority creditor in the bankruptcy court. The collection of any debt from the estate's property is barred by the automatic stay.²⁴ Past due child support not only survives the bankruptcy; it also survives the child's majority.²⁵

All legal fees, even all legal fees granted in a support proceeding, are not necessarily in the nature of support.²⁶ What then is the test? To be non dischargeable, the fees must be in the nature of support but need not be incurred litigating support.²⁷ Legal fees granted to a creditor spouse's attorney in a state court family law proceeding are not automatically non dischargeable. For example, fees awarded as part of a property distribution are dischargeable.²⁸ The creditor spouse's attorney has the burden of proving they are in the nature of support.²⁹

¹⁹ In re Sampson, 997 F.2d 717 (10th Cir. 1993).

²⁰ In re Freeman, 165 B.R. 307 (Bankr. S.D. Fla. 1994).

²¹ A bankruptcy court finding that an obligation is support, for bankruptcy purposes, is similarly not binding on a state court on other state court issues, such as the amount of a wage garnishment. See Brody v. Brody, 196 A.D.2d 308 (1st Dept. 1994).

²² See 11 U.S.C. 507.

²³ Spouse and Child Support in New York §§ 5:4, 5:5, 5:6 (West 1999).

²⁴ In re Weisberg, 218 B.R. 740 (Bankr. E.D. Pa. 1998).

²⁵ In re Ehlers, 189 B.R. 835 (Bankr. N.D. Ala. 1995).

²⁶ In re Rosen, 169 B.R. 512 (Bankr. E.D.N.Y. 1994); In re Silberfein, 138 B.R. 778 (Bankr. S.D.N.Y. 1992).

²⁷ In re Newman, 196 B.R. 700 (Bankr. S.D.N.Y. 1996); In re Schwartz, 53 B.R. 407 (S.D.N.Y. 1985).

²⁸ In re Webster, 187 B.R. 358 (Bankr. M.D. Fla. 1995).

²⁹ In re Newman, 196 B.R. 700; In re Schwartz, 53 B.R. 407.

B. *Burden Of Proof*

The Bankruptcy Code starts with a presumption that all debts are dischargeable. The party opposing a debtor's discharge has the burden of overcoming the presumption, by a preponderance of the evidence, that an honest debtor's debts will be discharged.³⁰ All objections to discharge are strictly construed against the creditor and in favor of the debtor.³¹ If the attorney for the non debtor spouse fails to affirmatively prove that an award of legal fees constitutes support, it will be discharged in the bankruptcy case.³²

C. *The Standard*

The Second Circuit Court of Appeals, in *In re Spong*³³ found that an award of legal fees could be in the nature of support.³⁴ The court reasoned that "[a]n award of attorneys' fees may be essential to a spouse's ability to sue or defend a matrimonial action and thus a necessary under law . . ." ³⁵ Although the state court action in the *Spong* case dealt with economic issues, other courts have relied on *Spong* to find fees non dischargeable in cases where support is not otherwise in issue,³⁶ such as a custodial parent's attorney in a custody suit,³⁷ a law guardian,³⁸ a court-appointed psychologist,³⁹ and a guardian ad litem.⁴⁰

³⁰ *Grogan v. Garner*, 498 U.S. 279 (1991); *In re Frey*, 212 B.R. 728 (Bankr. N.D.N.Y. 1996); *In re Rosen*, 169 B.R. 512.

³¹ *In re Hanna*, 197 B.R. 413 (Bankr. E.D.N.Y. 1996); *In re Bodenstein*, 168 B.R. 23 (Bankr. E.D.N.Y. 1994).

³² *In re Frey*, 212 B.R. 728; *In re Altchek*, 124 B.R. 944 (Bankr. S.D.N.Y. 1991).

³³ 661 F.2d 6 (2nd Cir. 1981).

³⁴ *See generally* *In re Kline*, 65 F.3d 749 (8th Cir. 1995); *Adams v. Zentz*, 963 F.2d 197 (8th Cir. 1992); *Silansky v. Brodsky, Greenblatt & Renehan*, 897 F.2d 743 (4th Cir. 1990); *Marcus, Ollman & Kommer v. Pierce*, 198 B.R. 665 (S.D.N.Y. 1996).

³⁵ *In re Spong*, 661 F.2d at 9.

³⁶ *See, e.g.*, *Matter of Joseph*, 16 F.3d 86 (5th Cir. 1994).

³⁷ *In re Jones*, 9 F.3d 878 (10th Cir. 1993).

³⁸ *In re Peters*, 964 F.2d 166 (2nd Cir. 1992); *Sinton v. Blaemire*, 229 B.R. 665, 667 (Bankr. D. Md. 1999).

³⁹ *In re Miller*, 55 F.3d 1487 (10th Cir.), *cert. denied, sub nom Miller v. Gentry*, 516 U.S. 916 (1995).

Courts have held that support includes not only legal fees but, also, investigative and witness fees.⁴¹ Paternity proceedings are considered support proceedings. An attorney who receives a fee award for representing the mother or the child in a paternity proceeding in domestic relations court is a child support creditor. The fee award is non dischargeable.⁴²

The determination of whether an obligation is support is a factual one. The bankruptcy court looks first to the state court's findings. A state court's factual findings, as contrasted with a label or conclusion, that an award of legal fees was necessary for the creditor spouse's support has *res judicata* effect on the issue.⁴³ For the state court's findings to have *res judicata* effect, in making its findings, the state court must consider the creditor-spouse's ability to pay the fees and/or the effect payment would have on the creditor-spouse's financial situation.⁴⁴ Where the state court has made no factual findings, the question will be tried *de novo* in the bankruptcy court.

III. Fees for Enforcement Proceedings

The law is not settled on the question of the dischargeability of legal fees accrued enforcing an order of support. Where spouses entered into a separation agreement stating, or were subject to a divorce decree providing, that a "breaching party" or "defaulting party" was responsible for the legal fees of the party required to litigate to enforce the agreement, the fees incurred enforcing the agreement in the bankruptcy court were held to be non dischargeable support.⁴⁵ The theory is that the fees become part of the underlying support debt and is, therefore, support and

⁴⁰ In re Stacey, 164 B.R. 210 (Bankr. D.N.H. 1994); In re Staggs, 203 B.R. 712 (Bankr. W.D. Mo. 1996); In re O'Toole, 194 B.R. 629 (Bankr. E.D. Mo. 1996).

⁴¹ See, e.g., In re Smith, 207 B.R. 289 (Bankr. M.D. Fla. 1997).

⁴² Welsh v. Misener, 225 B.R. 572 (Bankr. W.D.N.Y.); Rand v. Lombardo, 224 B.R. 774 (Bankr. S.D. Cal. 1998).

⁴³ In re Strickland, 90 F.3d 444 (11th Cir. 1996); In re Rappleye, 210 B.R. 336 (Bankr. W.D. Mo. 1997); In re Clegg, 189 B.R. 818 (Bankr. N.D. Okla. 1995); In re Purpura, 170 B.R. 202 (Bankr. E.D.N.Y. 1994).

⁴⁴ In re Marquis, 203 B.R. 844 (Bankr. D. Me. 1997).

⁴⁵ Feldmann v. Feldmann, 220 B.R. 138 (Bankr. N.D. Ga. 1998); In re Sargis, 197 B.R. 681 (Bankr. D. Colo. 1996).

not dischargeable.⁴⁶ Other courts have declined to enforce or grant such fee awards because they believe the fees unreasonably interfered with the debtor's fresh start.⁴⁷ Although none of the cases so hold, perhaps the nature of the debtor's behavior may be a factor in the bankruptcy court's determination. Federal judges may be reluctant to vacate a fee award where the debtor's behavior was egregious and the award is in the nature of a sanction.

IV. The Debtor's Attorneys' Fees

Generally, the lawyer representing the debtor becomes a general unsecured creditor. The debtor's own legal fees incurred as a party to a matrimonial action are dischargeable. This is particularly disturbing to matrimonial lawyers because the automatic stay appears to limit the debtor's unpaid attorney's ability to withdraw from a state court case.⁴⁸

The debtor's legal fees are dischargeable even if they were earned obtaining support or maintenance for the debtor.⁴⁹ The issue is not if the fees were for getting support. It is whether the fees are themselves support.

V. Conclusion

The key to deciding an award of legal fees is support is usually found in the documents. In the overwhelming number of bankruptcy cases, the creditor spouse's lawyer had a substantial degree of control over the wording of the underlying settlement or separation agreement or judgment of divorce. If the fee award is in the nature of support, the agreement or judgment should enumerate why support by payment of legal fees is necessary. For example, it can recite the differences in the financial positions of the parties or the fact that the obligee does not have the resources to pay the fees while the obligor does. The recitations, however, should be factual, rather than conclusory.

A word to the wise should be sufficient.

⁴⁶ Feldmann v. Feldmann, 220 B.R. 138.

⁴⁷ In re Florez, 191 B.R. 112, 116 (Bankr. N.D. Ill. 1995).

⁴⁸ See Tremont Elec., Inc. v. Rampinelli Elec. Co., Inc., 142 Misc.2d 80 (Sup. Ct. 1988).

⁴⁹ In re Lindberg, 92 B.R. 481 (Bankr. D. Colo. 1988); In re Klein, 197 B.R. 760 (Bankr. E.D.N.Y. 1996).