BANKRUPTCY: THE IMPACT ON DOMESTIC SUPPORT OBLIGATIONS AND
RELATED FAMILY LAW ISSUES

11 U.S.C Section 523 (a) (5) and 11 U.S.C. Section 523 (a) (15)

Under the Bankruptcy Code there are two types of bankruptcy’s that are predominately used by individuals Chapter 7 and Chapter 13. Chapter 7 is a vehicle whereby debtors can discharge their unsecured debt, reaffirm certain secured obligations, such as a home or car loan, and at the end of the process obtain a “fresh start”. Chapter 13 is somewhat different in that the debtors repay a portion of their unsecured debt through a Plan that can be as short as 3 years or as long as 5. At the end of the Plan any remaining unpaid portion of their unsecured debt is discharged and they also receive a “fresh start”. Later on we will discuss the advantages and disadvantages of filing a Chapter 7 v. a Chapter 13 as well as the impact the filing of each has on a non-filing spouse.

Congress when creating the Bankruptcy Code (‘Code”), mostly recently amended in 2005, intended that at the completion of the process, be it through a Chapter 7 or Chapter 13, that the unsecured obligations of the debtor would be discharged and that the debtor would receive a “fresh start”. However within the Code there are certain obligations or debts that are deemed non-dischargeable. Some of these non-dischargeable debts are in the area of domestic relations and impact domestic support obligations (“DSO”).

11 U.S.C. Section 523 (a) (5) is first of the sections of the Code that deals with the non-dischargeability of certain domestic obligations, in particular DSO’s. 523 (a) (5) reads as follows, “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-for a domestic support obligation.” To get the full impact of this section one must look to the definition section of the Code and Section 101 (14 A):

“The term domestic support obligation” means a debt that accrues before, on or after that date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable non-bankruptcy 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 the court or record; or
(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) Not assigned to a nongovernmental 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.”

While 523 (a) (5) seemed to cover most of the items that could be included in a separation agreement, divorce decree or court order Congress went one step further and enacted 11 U.S.C 523 (a) (15). 523 (a) (15) which reads as follows: “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-to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is 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 of record, or a determination made in accordance with State or territorial law by a governmental unit.”

With regard to these two exceptions to discharge there is an important distinction. As pointed out in Thomson Reuters Bankruptcy Manual 2016, Section 8:20, Pgs. 214-215, “Domestic support obligations are excepted from the discharge in both a Chapter 7 and a Chapter 13, but a martial obligation that does not come under the definition of domestic support obligation is discharged in a Chapter 13 (See In Re Nelson, 451 B.R. 918, 925, (Bankr. D. Or. 2011), In Re Kennedy, 442 B.R. 399 (Bankr. W.D. Pa. 2010), In Re Young, 425 B. R. 811 (Bankr. E.D. Tex 2010) and In Re McCollum, 415 B. R.625 (Bankr. M.D. Ga 2009). Court will consider whether the nature of the obligation was in the nature of a property settlement or one for a domestic support obligation.

While most of the litigation involving §523 (a) (5) and §523 (a) (15) arise in the Chapter 13 context there are still some issues in Chapter 7 cases. Those cases arise where it may be difficult to determine whether the obligation falls into the (a) (15) category.

In Re Bernitter, 2014 Bankr. Lexis 2567 (Bankr. D. Kansas 2014) is one of those cases. As part of their divorce proceeding Debtor and his wife entered into a separation agreement and general partnership agreement. Pursuant to the separation agreement the real estate owned by the Debtor and spouse was placed into the general partnership. Six years after the divorce Debtor executed and delivered a promissory note to his former spouse. The note represented the equitable interest of the spouse in the real estate transferred into the partnership at the time of the
divorce. The debtor made some payments on the note but eventually went into default and his former spouse filed suit and obtained a state court judgment. Debtor then filed a Chapter 7 bankruptcy and his former spouse then filed suit claiming the debt was non-dischargeable under §523 (a) (15). The Court pointed out that in order to recover under §523 (a) (15) the spouse needed to establish that the debt in question, “(1) was to a former spouse, (2) is not for (a) 5 support and (3) is incurred in connection with a separation agreement, divorce decree or other order of a court of record.” Id. at 2574. The Court found that this debt was one that fell under §523 (a) (15) in spite of the fact that the Promissory Note in question was entered into 6 years after the date of the divorce, no evidence to show that the promissory note was contemplated at the time of the divorce, that the judgment arising out of the promissory and which was the subject of the claim in the Bankruptcy Court was not entered until 15 years after the date of the divorce. The Court’s own statement was that the promissory note was a different arrangement than what the parties contemplated at the time of the divorce but that it grew out of the partnership agreement which grew out of the settlement agreement. I think this case is one that shows how far the bankruptcy court in Kansas will go to find that a debt will fall under §523 (a) 15. As pointed out in Bernitter and other Kansas bankruptcy cases, “Although most §523 (a) exceptions to discharge are strictly construed in favor of the debtor, exceptions to discharge under §523 (a) (15) are construed more liberally than other provisions of §523”. Court certainly stretched the reach of §523 (a) (15) in this case.

There are specific fees and costs that fall under the purview §523 (a) (5) other than those associated with the direct payment of alimony, support or maintenance. In Re Miller, 55 F. 3d 1487, (D. Kansas 1995) a Kansas divorce action that on appeal was decided by the 10th Circuit Court of Appeals. The issue was whether guardian ad litem fees and psychologist fees incurred during the divorce and child custody proceedings could be discharged. The court in this case found that payments to a guardian litem for the Debtor’s child as well as the psychologist hired to evaluate the family, directly related to the child’s support and thus the debts were nondischargeable. Court made this finding in spite of the fact that the debts at issue were not owed to spouse, former spouse, or child and that the monies were to be paid to the guardian ad litem and psychologist directly. While the Appellate Court did not rely on the language in the divorce decree in making its ruling it should be noted that the state court judgment specifically provided that the judgments granted to the guardian ad litem and psychologist were in the nature of support and were not dischargeable in bankruptcy. While Miller was decided prior to changes made to the in Code in 2005 the language relating to support in the 1993 version of §523 (a) (5) is very similar to the definition contained in the revised Code. See no reason to believe that if this issue were to arise today the decision would be the same. While it is a case decided on other issues the Kansas Bankruptcy Court in In Re Waller, 525 B.R. 473 (Bankr. Kansas 2014) stated that “in the context of 11 U.S.C. §523 (a) (5) the label attached by the divorce court is entitled to great weight“. Id at 477.
As noted previously debts owed pursuant to 11 U.S.C. §523 (a) (15) are discharged in a Chapter 13 case pursuant 11 U.S.C. §1328 (a). That leads to many instances when the Bankruptcy Court has to decide whether a debt falls under §523 (a) (5) or § 523 (a) (15). Two cases, In Re Rivet, 2014 Bankr. Lexus 2069 (Bankr. D. Kansas 2014) and In Okrepka, 553 B.R. 327 (Bankr. D. Kansas 2015) illustrates how the Courts can apply the same statues and come to different results.

In Rivet, a Chapter 13 case, the question before the Court was whether the divorce’s courts order obligating the debtor to the pay the debt that was secured by his former spouses home was a non-dischargeable DSO under §523 (a) (5) that would have to be paid in full during the course of his Chapter 13 Plan or a property settlement obligation under §523 (a) (15) making it an unsecured debt that could be discharged at the end of his Chapter 13 Plan. The Court when making its determination as to whether an obligation is support or property division used the analysis set forth in Re Goin, 808 F2d., 1391 (10th Cir. 1987) to determine whether the non-debtor spouse needed the payment as support at the time of the divorce decree, the court cited these four factors, “(a) the presence of minor children in the home and of an imbalance of income between the spouses at the time of the divorce; (b) whether the agreement fails to provide explicitly for support and the under the circumstances the spouse needs support; (c) whether the obligation was payable to the spouse directly and in installments over time; (d) whether the obligation terminated upon the spouse’s death or remarriage. Id at 1392-1393. The Court found that two of the four factors did not appear in this case (the Debtor was not making the payments to the spouse, making them directly to the lender and termination of support was not tied to the spouses death or remarriage). In spite of only two factors being present the Bankruptcy Court found the obligation to be one for support therefore nondischargeable. In this case it appears that factor (a) the presence of children in the home overrode all else. The Court more or less stated so “in general allocation of a debt secured by a lien on the home of non-debtor and dependent children is likely to be for support”, In Re Rivet, Id at 2073. The Court also found that the fact that the debtor was solely responsible for the debt to weigh in favor finding the obligation as support even though that was not one of the Goin factors. Also because the Court found that this debt was for support it was a first priority claim under §507 (a) (1) and §1322 (a) (2) that must be paid in full during the course of the Debtors Chapter 13 Plan. All claims found to fall within §523 (a) (5) are entitled to first priority in Chapter 13 and must be paid in full during the course of the Chapter 13 proceeding.

In Re Okrepka 533 B.R. 327 (Bankr. Kansas 2015) provides a different look at how the Bankruptcy Courts decides whether an obligation is a DSO or a property settlement obligation. The Debtor contended that the $55,000 she was ordered to pay her ex-spouse as part of their divorce decree was a property settlement and not a domestic support obligation. As part of the divorce proceedings the Debtor was awarded the martial home. The $55,000.00 was an Equalization Payment to the ex-spouse for his portion of the equity in the residence. The Bankruptcy Court found that this was a division of property subject to §523 (a) (15). In doing so
the Court used the analysis set forth in *In Re Sampson* 997 F.2d. 717 (10th Cir. 1993), “whether the obligation is excepted from discharge under §523 (a) (5) is a dual inquiry into both the parties intent and the substance of the obligation and the crucial issue is whether the obligation imposed by the divorce court has the purpose and effect of providing support for the spouse”. *Id* at 726. In finding that the $55,000.00 was a property settlement obligation the Court found these factors persuasive, 1) “the language establishing the Equalization Payment stated that the assets and debts of the parties should be divided as follows….“ That indicates that the Equalization payments was a property division settlement not a DSO, 2) The “Equalization Payments” label in the property division section is an indication of the Divorce Court’s intent to divide the property equally, 3) there was a separate paragraph that described the maintenance portion of the Divorce Decree. The fact that the parties separated the maintaence and property settlement sections is a good indication that the Equalization was a property settlement obligation”. *Okrepka Id* at 335. This case is illustrative of how parties should draft a separation agreement and divorce decree in order to separate out items that will be dischargeable and non-dischargeable. On the other hand if you are trying to avoid obligations being discharged the separation and decree should be written to have more items characterized as support. That while it has been pointed out time and time again that the Bankruptcy Court ”is not bound by labels applied to matrimonial obligations in a state court decree.” *In Re Rivet* 2014 Bankr. Lexus 2069 (Bankr. D. Kan. 2014), there seems to be deference given to the State courts characterization of something as support or as property settlement.

One last note on *Okrepka*, that while the Debtor may have won the battle on how the debt was labeled she lost the war. Bankruptcy Court found her ex-spouse had an *in rem* judgment lien in the Martial Residence. As a result the debtor had to pay the $55,000 in full during the course of her Chapter 13 plan. So in the end same result as if they had found the debt was for support. Important to remember to always get a judgment lien in martial residence from the divorce court in order to preserve right to collect full amount should party owing the Equalization Payment file for Chapter 13 relief.

*In Re Royster*, 2015 Bank. Lexus 4001 (Bankr. Kansas 2015) deals with how attorney fees are handled when the debtor claims them as exempt in a Chapter 7 filing. In her bankruptcy filing the debtor attempted to exempt, pursuant to §522 (d) (10) (D) and (d) (11) (E) and K.S.A. 60-2312 (b), a $24,000.00 lump sum that had been granted to her in her state court divorce proceeding. The Chapter 7 Trustee objected to this exemption because he believed it fell outside the exemption for the right to receive alimony, support or maintenance under §522 (d)(10) (D). The Court found that the attorney fee award was not exempted and could be recovered by the Trustee for the benefit of the Chapter 7 estate. The overriding factors the Court relied on were that the Divorce Decree contained a meaningful maintenance award and divided the martial assets and debts. The $24,000.00 award of attorney fees was clearly not for additional alimony, maintenance or child support. Since it was not tied to one of those it stood alone and could not be exempted under the relevant statutes. Based on how the Court ruled in this case, while it may not
win the day, would have least had a chance to exempt the attorney fees award if the divorce decree had indicated it was being awarded as additional alimony or maintenance instead of standing alone.

ITEMS RELATED TO BANKRUPTCY FILINGS IN GENERAL

Part I

There will be times when as a family law practitioner your client will come to you with questions on the filing of Chapter 7 or 13 bankruptcy by his/her ex-spouse and how that impacts the divorce decree that may have been recently entered.

Things to know if a Chapter 7 Filed:

1) The automatic stay put in place to protect the debtor does not apply to your client. Creditors are free to pursue your client on any jointly held debt even though the debtor may have agreed in the divorce decree to be responsible for that debt.

2) If there was a marital residence and husband agreed to pay debt as part of the divorce decree and fails to do so before and after the filing of the bankruptcy, the mortgage company can pursue a lift of stay in the bankruptcy case and if successful proceed with foreclosure in state court against the residence.

3) Neither of the foregoing obligations are going to be dischargeable under either 523 (a) (5) or 523 (a) (15) so your client can pursue recovery against the debtor in either state court or bankruptcy court. See In Re Asberry, 2006 WL 2548184 (Bankr. E.D. Va. 2006).

Things to know if a Chapter 13 filed:

1) A co-debtor stay is put in place when the case in filed. 11 U.S.C. §1301 (a) Creditors may not pursue your client on a consumer debt without first obtaining relief from stay. This does not apply to any joint debt that may have been commercial in nature.

2) If there was a martial residence and Debtor was responsible for the debt and is not going to continue to pay that debt as part of his/her Chapter 13 Plan then the creditor can seek relief from stay and if successful proceed with foreclosure. Creditor also needs to get relief from the co-debtor stay before it can proceed.

3) Important to obtain copy of Debtor’s Bankruptcy schedules and Bankruptcy Plan to determine what your client’s treatment will be under the Plan. In particular this is important when the debtor’s obligation is for a DSO. Any obligation for a DSO, pursuant to §507 (a) (1), is a first priority claim and has to be paid in full during the course of the Debtor’s Plan. If the debtor has characterized the debt as one under §523 (a) (15) then the debt is unsecured, does not have to be paid in full by the end of the Plan and is
discharged. Did to make sure your clients claim is properly labeled so they receive the correct treatment under the Plan.

**Part II**

During the course of our practices we have all had clients or potential clients who want to know about Chapter 7 and Chapter 13 bankruptcies. While not exhaustive here is a list of the pros and cons of each:

**Chapter 7**

**Pros:**

1) Debtors can get rid of unsecured debt-discharge;
2) Allows debtors to retain exempt property;
3) Reaffirm secured debt real and personal property that the debtor would like to retain;
4) Fresh Start-Debt free, except for reaffirmed debt;
5) Less expensive than Chapter 13;
6) Quicker, unless complications typical case over in 90-120 days.
7) Post-petition wages and earning are exempt. (only small exception for monies received by way of a will or life insurance, see bankruptcy practitioner);
8) Small business, can lead to orderly distribution of assets, particularly useful if small LLC or Corporation going bankrupt.

**Cons:**

1) Can have dischargeability issues, preferences, fraudulent conveyances, taxes;
2) Non-exempt property can be taken by the Chapter 7 Trustee and liquidated;
3) No co-debtor-stay (important note co-debtor applies to anyone who has co-signed on an obligation not just spouse.

**Chapter 13**

**Pros:**

1) Protection of non-exempt assets;
2) Retains control over property;
3) Helps with asset retention;
4) Allows for cure of arrearages on mortgage debt;
5) Strip Down liens only pay actual value of property instead of amount owed (if more).
6) 727 (a) discharge exceptions do not apply;
7) §523 (a) (15) obligations dischargeable.
8) Super discharge §1328 (a)
Cons:

1) More expensive
2) Timely, have to be in a plan for a minimum of 3 years or could be as long as 5.
3) Post-petition wages and earnings have to be used to fund Chapter 13 Plan.
4) All disposable income has to put to funding the Plan.
5) Have to come up with a repayment plan that satisfies both the Chapter 13 Trustee and the Court.
6) Have to satisfy any pre-petition tax obligations during the course of the Chapter 13 Plan and keep all post-petition tax obligations current.