GONE BROKE: ISSUES IN BANKRUPTCY

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GONE BROKE: ISSUES IN BANKRUPTCY

I. INTRODUCTION

A. Scope of Paper

This paper is designed to discuss certain advance issues of bankruptcy law that may impact family law representations. It presumes a working familiarity with the Bankruptcy Code.

B. Sources and Acknowledgments

For a more basic discussion of bankruptcy issues impacting family law practitioner, readers may want to review other papers on the intersection of family law and bankruptcy: *Dealing with Debt: Bankruptcy and Beyond*, written by Diana S. Friedman, Joseph A. Friedman and Ashley L. Amos, presented at "Family Law on the Front Lines" in March 2003; *The Bankruptcy Reform Act of 2005: Why Do They Call it BARF*?, written by Joseph A. Friedman, Diana S. Friedman and Andrew J. Anderson, presented at 2006 "Family Law on the Front Lines" in June, 2006. This paper is an update of my 2010 Advanced Family Law Course paper, Financial Crisis: Selected Issues in Bankruptcy.

II. DISCHARGE AND DISCHARGEABILITY

A. Domestic Support Obligation

In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).

The Bankruptcy Code as amended by BAPCPA, now uses a specific term "domestic support obligation," which is defined as:

> [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 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 a court of record; or
> iii) a determination made in accordance with applicable non-bankruptcy 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 debt.

11 U.S.C. § 101(14A).

This broad definition appears to include any non-property division type of obligation that a family law client might incur during a divorce or SAPCR.

The definition of a domestic support obligation establishes that such an obligation can be made via a separation agreement, divorce decree, or property settlement agreement. Furthermore, BAPCPA's definition will also recognize child support established and/or enforced by the Office of the Attorney General or other governmental unit. 11 U.S.C. § 101(14A)(A)(ii) (2005).

The domestic support obligation also expands the Bankruptcy Code's prior definition of support obligations by addressing debts arising before or after filing and expressly permitting support claims to be asserted by governmental entities. 11 U.S.C. § 101(14A)(B).. The importance of this change is emphasized by Judge Hale's decision under prior version of 11 U.S.C. § 523(a)(5) *County of Dallas v. Baldwin*, Adversary No. 05-3591 (February 13, 2006). In *Baldwin* a juvenile court order placing a child in the custody of Child Protective Services had ordered the parents to pay placement fees of $1000.00 per month payable to the Clerk of the County Court. The County asserted the debt for unpaid placement fees was non-dischargeable support under 11 U.S.C. § 523(A)(5). The Court, however, found the debt was not a debt owed to "a spouse, former spouse, child," and therefore, the unpaid placement fees were dischargeable. One should also note the definition excludes a support claim if it is assigned to a non-governmental entity without the consent of the non-debtor's spouse, unless the assignment is voluntary and only for purposes of collection. 11 U.S. C. § 101(14A)(D). Under this definition, it is unclear whether or not a "friend of court" or private company collecting child support under court order would be a governmental entity, or considered a voluntary assignment. Therefore, it is possible that these types of

arrangements may possibly endanger the protections the Bankruptcy Code gives support obligations.

As discussed below, the most obvious use of domestic support obligation definition is to make support obligations non-dischargeable under 11 U.S.C.§ 523(a)(5).

B. A Distinction: Discharge vs. Dischargeability

The discharge sought by a debtor in a bankruptcy proceeding is generally the primary reason that an individual files a bankruptcy case. The discharge operates as an injunction that prohibits creditors from holding onto pre-petition debts and attempting to collect upon those debts at a later time. 11 U.S.C. § 524(a); *see also* 11 U.S.C. §§ 727, 1141, 1328.

Debtors who file Chapter 7 cases receive a discharge approximately 120 days after filing, absent litigation contesting the discharge. Debtors who complete Chapter 13 plans, generally receive discharges within three to five years.

In a recent case, the Court of Appeals, Eight District of Texas, El Paso, the Court of Appeals considered the failure of the appellant to raise her discharge in bankruptcy at the lower court is a suit involving the overpayment of child support obligations by the appellee. *In the Interest of P.L.H., S.R.H.* and *C.H.H.*, 324 S.W.3d 114 (Tex. App. El Paso 2010) (hereinafter "*PLH*"). In that decision, the Court held that the Appellant's failure to raise her discharge as an affirmative defense meant that the court need not address pursuant to Texas Rule of Civil Procedure 94.

In this author's opinion, the Court of Appeals in *PLH* failed to consider that a debtor's discharge is a matter of federal law not state court procedure. Section 524 of the Bankruptcy Code specifically provides that a discharge: *voids any judgment obtained at any time . . . whether or not discharge of such debt is waived.* 11 U.S.C. § 524(a)(1). A discharge under 11 U.S.C. § 524(a)(2) operates as an injunction against any action to collect, recover or offset any discharged debt as a personal liability of the debtor. *See* e.g. *In re Ellett*, 254 F.3d 1135, 1148 (9th Cir. 2001). *Lone Star Security & Video, Inc. v. Gurrola (In re Gurrola)*, 328 B.R. 158 (9th Cir. BAP 2005). Courts have long held that a creditor who fails to comply with an order of discharge is liable for sanctions to compensate the debtor for losses and damages sustained on account of the violation. *See In re Whitaker*, 16 B.R. 917, 923 (Bankr. M.D. Tenn. 1982). Moreover, a creditor cannot merely ignore a debtor's claim of discharge, but instead, a creditor has a duty to obey the discharge. *In re Jones*, 389 B.R. 146, 161 (Bankr. D. Mont. 2008). The debtor does not have a duty to prove the existence of the discharge injunction. *Id.* at 163.

Notably from the prospective of a family lawyer who may encounter this issue in the future, the *Jones* court, in sanctioning the creditor and its counsel for violation of the debtor's discharge stated:

> A person who has consulted with an attorney "can be charged with constructive knowledge of the law's requirements." The [creditor] voluntarily selected [the lawyer] as its attorney of record, and it cannot now avoid the consequences of its acts or omissions of its freely-selected attorney. It is simply no excuse for [the lawyer] to claim his is not a "bankruptcy attorney."

In re Jones, 389 B.R. at 161.

Accordingly, if properly presented to the bankruptcy court, the *PLH* appellee and his counsel are at risk of having the judgment declared void and having monetary sanctions entered against them notwithstanding their victory on appeal. As such, the author can only advise the reader who is commencing a suit against a discharged debtor for amounts due to analyze the discharge issue in advance rather than rely on pleading waivers.

C. Non-Dischargeability of "Other Obligations" Awarded In A Divorce Decree

Although a debtor may obtain a discharge in bankruptcy, certain types of debts may be non-dischargeable. Of particular relevance to family law practitioner is the non-dischargeability of Domestic Support Obligations ("SDSO") and other obligations created under a divorce decree or agreement incident to divorce.

In the past, certain debts awarded in a divorce proceeding, other than alimony, maintenance or support obligations were non-dischargeable in Chapter 7, 11 and 12 cases unless: (a) the debtor lacked the ability to pay such debt from future income; or (b) the discharge of such debt will result in a benefit to the debtor that outweighs the detrimental consequences to the spouse, former spouse or child of the debtor. 11 U.S.C. § 523(15) (2004). As one can imagine, there was much litigation under the prior law, along with complicated schemes for switching burdens of proof. These legal issues have all been eliminated by BAPCPA.

The new language of section 523(a)(15), instituted by BAPCPA again specifically refers to obligations arising under divorce decrees, separation agreements, other orders of a court of record, or a determination made in accordance with state or territorial law that are not domestic support obligations. However, the Act has deleted the former requirement that the Court consider whether the debtor lacked an ability to pay, or the harm caused to the spouse creditor caused by granting a discharge. With this balancing test removed, and the bar to discharge domestic support obligations under

section 523(a)(5), a debtor filing under Chapters 7, 11 and 12, cannot discharge any obligations arising from orders or agreements entered into during divorce or SAPCR proceedings. *See, e.g.* 11 U.S.C. § 1141(d)(2) (2005). In addition, BAPCPA modified § 523(c)(1) such that the non-debtor spouse no longer need to timely file suit in order to preserve the non-dischargeable status of such obligations. Compare 11 U.S.C. § 523(c)(1) (2004) with 523(c)(1) (2005). However, debtors in Chapter 13 cases remain able to discharge non-domestic support obligations. 11 U.S.C. § 1328(a)(2).

Nevertheless, the case *Cooper v. Cooper (In re Cooper)*, 2010 WL 1992372 (Bankr. E.D. Tenn. 2010) remains a reminder that the debt must arise under the divorce decree and that post-decree actions can transform obligations and make them dischargable. In *Cooper*, the original debt in questions was husband's obligation under a note secured by parties home. Under the decree, husband agreed to pay the obligation and the wife continued to reside in the home. Sometime after the decree was entered, husband encountered financial problems, and with wife's agreement, the original debt was refinanced and retired, and a new obligation secured by the home was created. In the husband's bankruptcy, husband's obligation to pay this new debt was declared dischargeable under Section 523(a)(15). The *Cooper* court reasoned the refinancing was a novation and the obligation under the decree that would have qualified under § 523(a)(15) had been satisfied. *Id*. *5.

An interesting question was recently presented to me: Is an award of damages for breach of fiduciary duty in a divorce decree dischargeable? In a non-family law setting, only fraud or defalcation while acting in fiduciary capacity is non-dischargeable. *See* 11 U.S.C § 523(a)(4). In this author's opinion, a literal reading of the Bankruptcy Code says such an award is not dischargeable. Section 523(a)(15) provides: that a debt to a spouse in connection with a divorce decree or a determination made in accordance with state law by a governmental unit. An award of damage for breach of fiduciary duty in a divorce decree would seem to meet this definition. While I have been unable to locate any cases on point, the courts have made clear that BAPCPA's changes to § 523(a)(15) significantly limits the discharge of non-domestic support obligations.

D. Non-Dischargeability of Domestic Support Obligations

As in the past, child support obligations remain non-dischargeable in bankruptcy. 11 U.S.C. § 523(a)(5) (2005).

However, by grafting the old Bankruptcy Code section 523(a)(5) language into the definition of the domestic support obligation (as discussed above), Congress also applied an extensive body of case law under which bankruptcy courts examined the intent of the parties and/or the state court at the time when the agreement or order was entered. The purpose of the analysis was to determine if the obligations were intended to actually be support.

Generally, the analysis under the old § 523(a)(5) started with an understanding that Federal bankruptcy law, not state law determined what constituted support. *See, e.g., In re Paneras*, 195 B.R. 395, 400 (Bankr. N.D. Ill. 1996); *Bonheur v. Bonheur (In re Bonheur)*, 148 B.R. 379, 382 (Bankr. E.D.N.Y. 1992). This approach remains in the new definition of domestic support obligation. 11 U.S.C. § 101(14A) (2005). Further, the Court can determine if an obligation is "in the nature of alimony, maintenance, or support, without regard to whether such debt is expressly so designated." *Id.*

1. Child Support

Bankruptcy courts have given the term "child support" broad construction. For example, bankruptcy courts have held that a debtor's agreement to pay for four years of college for his child was in the nature of child support and non-dischargeable. *See, e.g., In re Brown*, 74 B.R. 968 (Bankr. E.D. Conn. 1987)(the debtor's obligation to pay for a child's higher education was non-dischargeable despite fact that debtor was no longer obligated to support the child under state law); *Epstein v. DeFillippi (In re DeFillippi)*, 430 B.R. 1, 4 (Bankr. D. Me.) (party declared de facto parent for grandchild, liable for guardian ad litem fees as DSO).

Thus, even in Texas, where court-ordered child support obligations usually ends when a child turns 18 and graduates from high school, a properly drafted agreement or order containing an agreement for payment of a child's higher education may preclude the debtor spouse from discharging this obligation. However, to avoid discharge, the obligation should clearly find that it benefits the child. *In re Brown*, 74 B.R. at 973.

Another advantage of having the determination under Federal law is that a valid property settlement agreement renders a contractual support obligation non-dischargeable in bankruptcy, even where the court has decreased the court-ordered support obligation. For example, in *Ruhe v. Rowland*, 706 S.W.2d 709 (Tex. App.-Dallas 1986, no writ), the husband contractually agreed to pay $750.00 per month in support. Later, the husband had his court-ordered support obligation reduced to $350.00. When the husband was sued in contract for the difference, the resulting judgment was held to be non-dischargeable. *Id.*

The fact that the bankruptcy court may look beyond the language of the decree or property settlement to determine if the obligation is, in reality, one for support of the child, does not always work in

favor of the creditor spouse. For example, *In re Rhodes*, 44 B.R. 79 (Bankr. D. N.M. 1984), the court found that lump-sum payment that denominated as child support was in reality compensation for a spouse's share of the community estate, and hence dischargeable.

Practitioners should note that the discussion above has been focused on analysis of the dischargeability of obligations created by an original divorce decree. The analysis as to the dischargeability of obligations arising under a judgment relating solely to child support, including the award of attorneys' fees, is much less complex under current case law in the Fifth Circuit. *See, e.g. In re Hudson*, 107 F.3d 355, 357 (5th Cir. 1997) (because the ultimate purpose of a proceeding on child support is to provide support for the child, attorneys' fees awarded in connection are also in the nature of child support, and thus non-dischargeable). *See also, In re Chang*, 163 F.3d 1138 (9th Cir. 1998)(expenses incurred in a child custody dispute in which the court appointed a guardian for the child were not dischargeable).

Thus, when state court awards in a modification proceeding both child support and attorneys' fees to the non-debtor spouse, the bankruptcy court has found as a matter of law the attorneys' fee award was non-dischargeable. 11 U.S.C. § 523(a)(5), *In re Fulton* (*Whipple v. Fulton)*, 236 B.R. 626 (Bankr. E.D. Tex. 1999); accord *In re Dvorak (Dvorak v. Carlson)*, 986 F.2d 940, 941(5th Cir. 1993).

2. Spousal Support Obligations

As with child support, the question of whether a debt actually constitutes alimony, maintenance or support, and is therefore non-dischargeable, has always been considered a question of federal bankruptcy law, and not state law. *In re Biggs*, 907 F.2d 503 (5th Cir. 1990); *Kessel v. Kessel (In re Kessel)*, 261 B.R. 902 (Bankr. E.D. Tex. 2001).

Bankruptcy courts frequently have found payments ordered to former spouses to be non-dischargeable support obligations, even in Texas, which until recently had no court ordered alimony. Thus, a debt or obligation awarded pursuant to a decree of divorce may be categorized as alimony, support or maintenance by the bankruptcy court if they find that the intent of the court or the agreement was for it to be support. *See, e.g., In re Davidson*, 947 F.2d 1294, 1296 (5th Cir. 1991); *In re Nunnally*, 506 F.2d 1024, 1027 (5th Cir. 1975).

While state law does not govern the determination of non-dischargeability, it may serve as a guide to determine the nature of the obligation. *Champion v. Champion (In re Champion)*, 189 B.R. 516 (Bankr. D.N.M. 1995). Thus, the mere fact that an obligation is designated as alimony does not necessarily mean that it is alimony if a decree or property settlement agreement designates payments as alimony. *Smith v. Smith (In re Smith)*, 97 B.R. 326 (Bankr. N.D. Tex. 1989). On the other hand, if the debtor spouse treats such payments as alimony for tax purposes, the debtor spouse will be estopped from seeking to discharge the obligation. *In re Davidson*, 947 F.2d 1294, 1296; *Stebbins v. Seibert (In re Stebbins)*, 2002 WL 1482728 (N.D. Tex. 2002)(debtor estopped from asserting that payments be deducted pre-petition from income taxes as alimony were not in the nature of alimony). Similarly, when the decree provides obligations are in lieu of support payments, courts have construed obligation to be in the nature of support. *In re Deberry*, 429 B.R. 532, 539 (Bankr. N. D. N.C. 2010).

Moreover, the assumption of marital debts may be in the nature of support even if a decree or agreement provides for express support elsewhere. *See Kubik v. Kubik (In re Kubik)*, 215 B.R. 595 (Bankr. D. N.D. 1997)(husband's obligation to pay obligations related to marital homestead non-dischargeable support in light of award of marital resident to non-debtor spouse for purposes of raising minor children), but see *Selby v. Selby (In re Selby)*, 2010 WL 6494059 (Bankr. S.D. Ohio 2010) (obligation to hold spouse harmless as to rental property debt not DSO when clear was intended as part of property division). Ultimately, the bankruptcy court will separately examine each obligation in the context of the particular facts of each case. *See, e.g. Sanders v. Lanare (In re Sanders)*, 187 B.R. 588 (Bankr. N.D. Ohio 1995).

The burden of proof rests on the non-debtor spouse to establish that the debt in question is actually in the nature of alimony, maintenance or support for the purpose of non-dischargeability. *Bell v. Bell (In re Bell)*, 189 B.R. 543 (Bankr. N.D. Ga. 1995). *See generally, Grogan v. Garner*, 111 S.Ct. 654 (1991)(creditor seeking determination that debt is non-dischargeable has the burden of proof by preponderance of the evidence). However, bankruptcy courts have differed on how § 523(a)(5) will be construed. *See In re Champion*, 189 B.R. at 520 (support under § 523 construed broadly) compare with *In re Bell*, 189 B.R. at 547 (section 523 construed narrowly).

Bankruptcy courts, under the guidance of the various courts of appeals, have developed a non-exhaustive list of evidentiary factors to assist them in determining whether an obligation is truly in the nature of alimony, maintenance or support:

a. the parties' disparity in earning capacity;
b. the relative business opportunities of the parties;
c. the physical condition of the parties;
d. the educational background of the parties;
e. the probable future financial needs of the parties;

f. the benefits each party would have received had the marriage continued.

See, e.g. In re Kessel, 261 B.R. at 908; *In re Billingsley*, 93 B.R. 476 (Bankr. N.D. Tex. 1987); *In re Benich v. Benich (In re Benich)*, 811 F.2d 943 (5th Cir. 1987); *In re Nunnally*, 506 F.2d 1024 (5th Cir. 1975). In the case of a contested divorce, the bankruptcy court will examine the intent of the family law court as well as the evidence adduced in support of the decree. *In re Champion*, 189 B.R. at 518 (interpreting Texas decree). To determine the "true" nature of payments, courts have examined whether payments to provide alimony continue when the recipient dies or remarries and whether the obligation is to be paid in installments. *In re Ingram*, 5 B.R. 232 (Bankr. N.D. Ga. 1980). If the obligation continues regardless of remarriage or death, courts often find that the debt is dischargeable. *See In re Kaufman*, 115 B.R. 435 (Bankr. E.D.N.Y. 1990). Furthermore, at least one court has noted that if the property settlement awards virtually all the property to one spouse, and also provides for periodic payments to that spouse, such payment must be in the nature of support. *In re Smith*, 97 B.R. at 329.

One important issue which has arisen in connection with the issue of whether obligations to the non-debtor spouse under a divorce decree or property settlement are actually in the nature of support has been the award of attorneys' fees to the non-debtor spouse. Several bankruptcy courts have considered whether attorneys' fees pursuant to a divorce decree awarded directly to the non-debtor spouse's law firm are in fact entitled to discharge because such a debt is not a debt owing to "a spouse, former spouse, or child of the debtor," as required by the express language of § 523(a)(5). The Fifth Circuit held in *Joseph v. J. Huey O'Toole, P.C. (In re Joseph)*, 16 F.3d 86 (5th Cir. 1994), that a debtor's obligation to pay his wife's attorneys' fees was a non-dischargeable debt so long as it was in the nature of alimony, maintenance or support. Accordingly, *In re Miller*, 55 F.3d 1487 (10th Cir.), cert. denied, 516 U.S. 916 (1995) (applying plain language of statute would elevate form over substance). However, other courts have not been as kind to counsel. *See Hartley v. Townsend (In re Townsend)*, 177 B.R. 902, 904 (Bankr. E.D. Mo. 1995) (court awards of attorneys' fees directly to the attorney, and not to the "spouse, former spouse or child" are dischargeable debts); *Newmark v. Newmark (In re Newmark)*, 177 B.R. 286 (Bankr. E.D. Mo. 1995) (same); *see also County of LaCrosse v. Stevens*, 436 B.R. 107 (Bankr. W.D. Wis. 2010) (reimbursement of ad litem fees non-dischargeable DSO, fees were in best interest of child). Accordingly, counsel should be aware that the award of attorneys' fees directly to her law firm may create an issue regarding dischargeability in a subsequent bankruptcy filing. *See Liberty Acquisitions, LLC v. Cordova (In re Cordova)*, 439 B.R. 756, 760-61 (Bankr. D. Colo. 2010) (fees assigned by court appointed child and family investigator to collection agency, dischargeable because of assignment). Moreover, fees owed to a lawyer by its client are not domestic support obligations and are dichargeable. *Fein v. Young (In re Young)*, 425 B.R. 811, 818 (Bankr. E. D. Tex. 2010).

3. Dischargeability - Drafting With Discharge In Mind

When drafting agreements and orders to be used in marital litigation there are five major concepts that need to be respected to avoid a possible future discharge. In the authors' opinions, the practitioners will not find success by placing simple declarations of non-dischargeability in documents. Instead, divorce orders and agreements will provide the greatest protection only if there are references to the existence and importance of the factors related to non-dischargeability under section 523(a)(5) (set forth above). Second, when possible, divorce documentation should include a statement of intent as to whether an obligation is to provide for spousal and/or child support. *See Devant v. Baily (In re Bailey)*, 2010 WL 4622455 *3-4 (Bankr. N. D. W. Va. 2010) (award of equity in marital home, property division not DSO, decree has separate provisions for child support and alimony and no statement court intended as support – discharged in Chapter 13).

Third, when possible, payment obligations should run to a spouse rather than to a third party creditor as the definition of domestic support obligation continues to exclude assigned obligations. 11 U.S.C. § 101(14A); *see In re Townsend*, 177 B.R. at 904. In the case of third party debt, the decree or agreement incident to divorce should require the spouse charged with paying the marital obligation to indemnify and hold the other spouse harmless for payments made to the third-party creditor as part of the support obligation. *Cf. Stegall v. Stegall (In re Stegall)*, 188 B.R. 597, 598 (Bankr. W.D. Mo. 1995)(no debt to former spouse exists as to marital debt as decree lacked hold harmless or indemnification provisions; therefore, discharge exception of § 523(a)(15) not applicable); *Salyers v. Richardson (In re Richardson)*, 212 B.R. 842 (Bankr. E.D. Ky. 1997).

Fourth, when possible, terminate payments upon death or remarriage, as courts are more likely to find such payments in the nature of support.

Fifth, care should be taken to clearly delineate property division and support concepts in the documentation. *See Pagels v. Pagels*, 2011 WL 577337 *3 (Bankr. E. D. Va. 2011) (agreement blending support and property without clear labels, not well drafted for purposes of sorting out insolvency issues).

Conversely, counsel representing the payor spouse will want to document when obligations are intended to be a property settlement. While these obligations may not be dischargeable except in a Chapter 13 proceeding, but the property settlement obligations will not be enforceable against exempt property. 11 U.S.C. § 522(c)(1) (2005).

E. Discharge and Chapter 13 and Espinosa

The Chapter 13 bankruptcy is commonly referred to as the "payment plan bankruptcy". This proceeding generally allows for the discharge of both secured and unsecured debts after the debtor has made regular payments under an approved plan for 3 to 5 years. BAPCPA changed several aspects of Chapter 13 proceedings impacting family law obligations. The Supreme Court's ruling in *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (2010) (*Espinosa*) makes it clear that diligence is still necessary to protect the non-debtor spouse in Chapter 13 cases.

1. Support Payments Protected In Chapter 13

Under the Reform Act, domestic support creditors are protected from delays in receiving post-filing support payments by several mechanisms, as follows:

a) Chapter 13 proceedings may be dismissed or converted if the debtor fails to make any domestic support payments that are due after the filing of the bankruptcy. 11 U.S.C. § 1307(a)(11). Therefore, it is imperative that the family law attorney, protecting the rights of the creditor spouse, pay particular attention to the payments made by the debtor during the pendency of the bankruptcy.

b) During the confirmation hearing, the debtor must present evidence that he is current on all post petition domestic support payments. 11 U.S.C. § 1325(a)(8). Obviously, if you are representing a domestic support creditor who has not been paid, it is important to appear at the confirmation hearing and let the court know about the debtor's failure to keep current on a post petition basis.

2. Interest On Non-Dischargeable Claims

Under a Chapter 13 bankruptcy, the payment plan must provide for the payment of interest on non-dischargeable claims, provided that the debtor has sufficient disposable income to pay all other unsecured claims in full. 11 U.S.C. § 1322(b)(10). Since domestic support obligations are non-dischargeable, they are eligible for this treatment. Accordingly, review of the plan by the domestic support creditor is critical to determine if they can earn interest on past due support.

3. Debtor's Payments

Generally, the debtor must start making plan payments no later than thirty days from the filing of the petition. 11 U.S.C. § 1326(a)(1).

This rule reduces the amount of lag time between the start of the plan payments.

4. Confirmation Hearing And Discharges

At the confirmation hearing, the debtor must certify that he is keeping all of his post-petition domestic support obligations current. 11 U.S.C. § 1325(a)(8). As such, the confirmation hearing is an excellent opportunity to bring non-payment of domestic support obligations to the court's attention. Therefore, the domestic support creditor will want to pay careful attention to noticed dates for plan confirmation.

Generally, the confirmation hearing for approval of the payment plan is set after the meeting of the creditors. The meeting of the creditors typically occurs between 20 and 50 days after the Chapter 13 petition is filed. 11 U.S.C. § 341 and Bankr. R. 2003(a). The confirmation hearing must be held no less than 20 days, and no more than 45 days, after the date of the creditors meeting. 11 U.S.C. § 324(b). Therefore, the soonest that a domestic support creditor should expect a confirmation hearing would be about 40 days after the filing of the Chapter 13 bankruptcy.

In order for the plan to be approved at the confirmation hearing, it must provide for the full payment of pre-petition arrearages on domestic support obligations. 11 U.S.C. § 1325(a)(8). If it does not, the domestic support creditor should object. *Id.*

Moreover, for the debtor to obtain a discharge, the debtor must certify at the end of the plan process that all payments of the domestic support obligation as required by the plan have been completed. 11 U.S.C. § 1328(a) (2005). If it does not, the domestic support obligation creditor should again object. Since discharge occurs only after the debtor completes his plan payments, domestic support obligation creditors will need to monitor the debtor's Chapter 13 proceeding from beginning to end.

5. Espinosa

A recent Supreme Court case, *Espinosa* makes clear that even though the Bankruptcy Code mandates certain procedures and treatments for claims, a creditor who does not object to plan of reorganization with non-conforming treatment may be bound by the plan treatment.

The facts in *Espinosa* were as follows: *Espinosa* owed four federally insured student loans with a principal amount of $13,250. Student loans are generally non-dischargeable absent the showing of hardship. 11 U.S.C. § 523(a)(8). A determination of hardship requires the commencement of a separate

adversary proceeding by the filing of a complaint and service of a summons. *See* Bankr. Rule 7001.

Espinosa's plan provided for the repayment of the principal amount of the loans, but stated any accrued interest would be discharged. The student loan lender did not object to the confirmation of the plan and the bankruptcy court confirmed the plan.

Subsequently, the student loan lender sought to collect the interest due, and *Espinosa* filed a motion to enforce the discharge. The bankruptcy court agreed with *Espinosa*. The District Court reversed on due process basis because the student loan lender was not served with a summons and complaint to determine dischargeability as required by the Bankruptcy Rules. The Court of Appeals reversed on the basis the student loan lender had notice of the plan and failed to object.

The Supreme Court, in a unanimous opinion, affirmed. Holding the confirmation order was a final judgment, the Supreme Court held that relief from a final judgment was limited under Federal Rule of Procedure 60(b). Although the student loan lender was denied due process under the Bankruptcy Rules of Procedure by not being served with a summons and complaint, its remedy was to object to the confirmation of the plan on that basis and appealing that ruling if it was so sustained. While one could argue that domestic support obligations are non-dischargeable without the need for a separate proceeding, practically speaking, if non-debtor spouses want to protect domestic support obligations in Chapter 13 cases as provided for in the Bankruptcy Code, they should carefully review proposed plans and raise any concerns to the bankruptcy court in the first instance.

III. THE AUTOMATIC STAY - NO LONGER A REFUGE FOR NON-PAYORS OF SUPPORT

A. Automatic Stay

Upon the filing of a bankruptcy petition, and without further notice, an automatic stay is immediately created. 11 U.S.C. § 362(a). The purpose of the automatic stay is to afford the debtor immediate protection from collection efforts upon the debtor and his property. The automatic stay generally remains in place until the case was closed, dismissed, or the debtor was discharged. 11 U.S.C. § 362(c)(2). While the automatic stay precludes collection efforts against a debtor, a creditor may seek to modify or terminate the automatic stay by filing a motion to lift the stay. 11 U.S.C. § 362(d).

Previously, the Bankruptcy Code provided limited exceptions from the stay to allow certain family law related actions to proceed. For example, support orders could be entered or modified, and collection of support from property (that was not property of the estate, *i.e.*, post-petition earning in Chapter 7 cases were all permissible). 11 U.S.C. § 362(b)(2) (2004).

In the past, many family practitioners had a difficult time getting state court judges comfortable with proceeding with any family law case without an order modifying the stay. BAPCPA has created new exceptions to the automatic stay that substantially limit the applicability and duration of the stay with regard to domestic support obligations and other family law matters. BAPCPA's explicit language should give judges greater comfort to act on many types of family law cases.

B. New Exceptions To The Automatic Stay As To Certain Family Law Matters

BAPCPA has attempted to limit the application of the automatic stay in a number of family law matters, involving domestic support obligations and custody issues. However, the family law attorney is cautioned to carefully read the code and applicable case law to determine whether the automatic stay impacts his case.

The "new and improved" section 362(b)(2) provides that the automatic stay does not apply to any of the following family law situations:

> A) of 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 a 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) of 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 a statute. 11 U.S.C. § 362(b)(2) (2005) (emphasis added).

BAPCPA makes clear that a family law case dealing with child custody, visitation, or domestic violence is not subject to being stayed by a bankruptcy filing. In the context of the enforcement of domestic support obligations, and obtaining a divorce, the analysis is much more complex. To a large extent, as was the case prior to BAPCPA, whether the pursuit of support or a divorce violates the automatic stay will turn on whether the litigation involves the property of the "estate." Nevertheless, BAPCPA has at least eased

some of the burdens of bankruptcy upon domestic support obligation creditors.

C. "Estate" Defined

The filing of a bankruptcy petition automatically creates an "estate" pursuant to section 541(a). The estate includes all of the debtor's legal and equitable interests in property from the commencement of the case. 11 U.S.C. § 541(a)(1). However, this is subject to the debtor's right to exempt property from the estate pursuant to 11 U.S.C. § 522. While most property acquired by a debtor after the bankruptcy petition is filed is not property of the estate, certain "windfalls" that are acquired within 180 days are property of the estate. 11 U.S.C. § 541 (a)(5). Examples of these "windfalls" would include property obtained: (1) by bequest, devise or inheritance; (2) property from a property settlement agreement with the debtor's spouse, or of an interlocutory or final decree; or (3) benefits of a life insurance policy or death benefit plan. *Id.* In addition, property of the estate includes any interest in property that the estate acquires after commencement of the case, (*i.e.*, through a legal action such as an avoidance lawsuit). 11 U.S.C. § 541(a)(7).

Property of the estate also includes proceeds, products, offspring, rents or profits from property of the estate, but it excludes earnings from services performed by an individual debtor after commencement of the case. 11 U.S.C. § 541(a)(6). In Chapter 11, 12 and 13 cases, the debtor's post-petition earnings, and property acquired post-petition, are included as property of the estate. *See* 11 U.S.C. §§ 1115, 1207, and 1306 (2005). As was the case under the law in Chapter 7 proceedings, a debtor's post-petition earnings, and property acquired after filing, remain available to satisfy enforcement of support claims without relief from the automatic stay. 11 U.S.C. § 362(b)(2).

However, BAPCPA now makes clear that wage withholding orders are not effected by the automatic stay even if wages are part of the property of the estate. 11 U.S.C. § 362(b)(2)(C) (2005). Thus, a bankrupt can no longer use her bankruptcy filing to avoid or suspend wage withholding orders used to secure child support, no matter under which type of proceeding is filed.

D. Other Actions Not Stayed In Family Law Cases

BAPCPA has also made clear that the stay will not impact the relatively new ability under Texas law to seek the suspension of the debtor's driver's license, professional license, or recreational licenses for the failure to pay child support. TEX. FAM. CODE ANN. § 232.004 (Vernon 1999), and 11 U.S.C. § 362(b)(2)(D) (2005). Further, reporting the delinquent amount to a credit reporting agency along with the interception of tax refunds are also not effected by the Automatic Stay. 11 U.S.C. § 362(b)(2)(E-F) (2005).

BAPCPA also allows an enforcement action being brought for a medical obligation (specified under Title 4 of the Social Security Act) to proceed without regard to the Automatic Stay. 11 U.S.C. § 362(b)(2)(G) (2005).

E. Termination of Stay Upon Motion

Notwithstanding the expanded scope of exceptions to the stay, because a divorce in Texas necessarily involves division of property, and such property may be property of the estate, relief from the stay may be needed in certain family law matters. In a case filed by an individual under Chapter 7, 11, or 13, the automatic stay automatically terminates 60 days after a motion to lift the stay is filed, unless a final decision upon the case is rendered within 60 days (or the 60 day period is extended by agreement of the parties or the court for cause). 11 U.S.C. § 362(e)(2) (2005).

Generally, bankruptcy courts are willing to grant relief from the stay to allow divorces to be completed. However, the court will usually require the parties to return to the bankruptcy court for the enforcement of the decree as it impacts the bankruptcy estate and other creditors.

IV. TEXAS PROPERTY EXEMPTIONS AND BAPCPA

1. Exempt Property

Both Federal bankruptcy law and state law recognize certain property as exempt from the claims of creditors, (who do not have direct liens against the exempt property). With respect to Texas debtors, the Bankruptcy Code gives the debtor a choice between a specified list of Federal exemptions and the exemptions provided by state law. However, BAPCPA has substantially curtailed, and as it relates to domestic support obligations, entirely eliminated the right to exempt property for a bankrupt debtor.

2. Texas Exempt Property

In the past, when a debtor qualified to exempt property under Texas law, they were usually well served. The Texas Constitution provides protection of a debtor's homestead from seizure by creditors. In 1999, Texas expanded an "urban" homestead to up to ten (10) acres of land in one or more contiguous lots. The exempt property also included the improvements on such land, provided that the land and improvements were used as a home or combined home and business. TEX. PROP. CODE ANN. § 41.002 (Vernon 2000).

A homestead is considered "urban" if located within a municipality and able to receive certain services, set forth in the statute, such as police, electricity, and/or sewer services. Homesteads that do not qualify as "urban" are classified as "rural". Rural homesteads are up to two-hundred (200) acres, along

with all improvements thereon, if it is used by a family as their home. A single adult is entitled to one-hundred acres (100) for the purpose of his or her home. It is interesting to note that no distinction is made between a family and an individual is made for the urban homestead classification. Furthermore, pursuant to Article 16 § 50 of the Texas Constitution, the homestead is exempt from: . . . the payment of all debts except for the purchase money thereof, or a part of such purchase money, the taxes due thereon, or for work and material used in constructing improvements thereon, and in this last case only when the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sole and conveyance of the homestead. TEX. CONST. art. 16 § 50. While Texas law does not focus on the value of the homestead, BAPCPA artificially creates limits on Texas law by having monetary caps in some circumstances.

First, in order to even have the option of using the Texas' homestead election, a Texas citizen must have resided in the state for 730 days prior to the filing for bankruptcy. 11 U.S.C. § 522(b)(3) (2005). If the debtor cannot meet the domiciliary requirements, the debtor will be forced to use his prior state or Federal exemptions. *Id.*

BAPCPA then limits the Texas homestead exemption by only allowing the debtor to hold as exempt no more than $125,000.00, of the debtor's interest in a homestead acquired within the 1,215 days (approximately 3 1/3 years) prior to filing for bankruptcy relief. 11 U.S.C. § 522(p) (2005). However, this limitation does not apply to the residence of a family farmer, or to equity transferred from a prior residence in the same state acquired prior to the 1,215-day period. 11 U.S.C. § 522(p)(2)(A) (2005). Notably, the cap applies to interest "acquired" during the 1,215 day period and as such, increased equity resulting from payments made during 1,215 period does not subject to cap under § 522(p). *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005).

BAPCPA imposes a hard cap on state exemptions for certain "bad debtors." In no event, may the debtor exempt more that $125,000.00, under a state homestead exemption if the debtor has been convicted of a felony, or owes on a debt arising from a violation of the Federal Securities Exchange Act, or money is owed from an intentional or reckless tort involving bodily injury and/or death, or a RICO violation. 11 U.S.C. § 522(q) (2005). However, the hard cap with regard to felons does not apply to the extent that the interest is reasonably necessary for the support of the debtor and/or the debtor's dependents. 11 U.S.C. § 522(q)(2) (2005).

Finally, Federal law also reduces the state homestead exception by the amount of the value of the exemption that is attributable to any property disposed of by the debtor during the preceding ten years. However, the debtor must have had the intent to hinder, delay or defraud a creditor, and the property disposed of was not exempt at the time of the disposition. 11 U.S.C. § 522 (o) (2005).

While the changes to Texas homestead laws are meaningful to all Texas residents, family law lawyers will be even more surprised at how Congress eliminated all protections of Texas exempt property law as to domestic support obligations. In doing so, Congress reversed the panel decision in *In re Davis*, 170 F.3d 475 (5th Cir. 1997).

3. Exempt Property And Domestic Support Obligations

BAPCPA reverses the Fifth Circuit's *en banc* ruling in the *Davis* case. *In re Davis*, 170 F.3d 475 (5th Cir. 1997). In the *Davis* case, the non-debtor, ex-wife, sought an order in bankruptcy court requiring the debtor spouse to execute a deed conveying his homestead to her. This would enable her to enforce the parties' consent order regarding the debtor's obligation for non-dischargeable alimony, maintenance, and child support under section 523(a)(5). The bankruptcy court held that the ex-wife could not levy on the homestead, which the debtor had exempted under state law, and the district court affirmed that decision.

Initially, the Fifth Circuit first ruled that the lower courts were wrong citing the (former) 11 U.S.C. § 522(c) of the Bankruptcy Code, which stated that exempt property may be levied upon for the collection of support obligations. *In re Davis*, 105 F.3d 1017 (5th Circ. 1997). However, upon rehearing *en banc*, the Fifth Circuit affirmed the decisions of the lower courts, holding that Section 522(c) of the Bankruptcy Code did not preempt the debtor's state-law rights. *In re Davis*, 170 F.3d 475 (5th Cir. 1997). Thus, according to the *en banc* ruling, the debtor was allowed to exempt his residence valued at $500,000.00, despite the creditor spouse's claim for over $250,000.00, child support and maintenance.

Under BAPCPA, Section 522(c)(1) of the Bankruptcy Code has been modified to make clear that notwithstanding other laws to the contrary, a debtor's exempt property will be subject to liability for domestic support obligations. 11 U.S.C. § 522(c)(1).

As to a result of this change, bankruptcy now becomes a super-charged collection tool for creditors holding domestic support obligations. When this power is coupled with the ability of the creditor spouse to argue certain obligations were intended to be support, (as has been done in discharge litigation under the old section 523(a)(5) and which is discussed in more detail below), it is easy to foresee involuntary bankruptcy petitions by alimony and child support creditors in bankruptcy court in the future.

V. CONCLUSION

The interaction of bankruptcy, creditor rights and family law is a complex and difficult subject. This paper has attempted to highlight some significant issues and the changes BAPCPA has made to the Bankruptcy Code and how those changes will impact the family law practitioner. Given the fact that many of the changes have not yet faced judicial scrutiny, practitioners would be wise to keep a close eye on the case law for future developments.