The Interaction of Domestic Relations and Bankruptcy

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There are several issues that typically arise when one of the parties in a divorce action or a separation also files a personal bankruptcy. Every domestic relations lawyer should have a sufficient knowledge of the potential bankruptcy pitfalls to properly advise and guide his or her client or, at least, to know when to consult a bankruptcy lawyer.

I. The Automatic Stay

The automatic stay of section 362 of the Bankruptcy Code, 11 U.S.C. § 101 et seq., applies as soon as a bankruptcy petition for relief is filed. (See highlighted copy of this statute below.) The word "stay" is synonymous with "injunction", and the word "automatic" means that this statutory injunction applies without the need for a judge to sign an order.

The stay prevents any creditor of the debtor from taking any action to collect or perfect its claim against the debtor or against property of the debtor's bankruptcy estate. There is no requirement of formal service or notice before a party is bound by the automatic stay. *See Job v. Calder,* 907 F.2d 953 (10th Cir. 1990).

A violation of the automatic stay may be void and may even result in sanctions. Some federal courts accept the minority position that such acts are voidable, depending on the facts of the case and whether the violation was intentional, but the Eleventh Circuit adheres to the majority position that acts in violation of the stay are void. *U.S. v. White*, 466 F.3d 1241 (11th Cir. 2006).

Section 362 states that the following family law activities are not stayed:

1. actions for establishment and modification of domestic support obligations (362(b)(2)(A)(ii));
2. actions concerning child custody or visitation (362(b)(2)(A)(iii));
3. actions for divorce (except for the division of property) (362(b)(2)(A)(iv));
4. actions regarding domestic violence (362(b)(2)(A)(v));
5. actions for collection of domestic support obligations from property that is not property of the estate(362(b)(2)(B)); and
6. withholding of income that is property of the estate for the payment of domestic support (362(b)(2)(C)).

Even if the proposed action by the non-bankrupt party is not one of the family law exceptions listed above, some bankruptcy courts have modified the automatic stay to allow a creditor to liquidate the amount of its claim or to accommodate litigation that gotten so far along that it is more practical for the other court to try the case. *See, e.g., Smith v. Tricare Rehab Sys.,* 181 B.R. 569 (Bankr. N.D.Ala. 1994) (finding cause to grant movant's motion to modify automatic stay to allow movant to complete state court case and then file proof of claim based on any judgment.)

However, if there is any doubt concerning whether a contemplated act falls under one of these exceptions to the automatic stay or other orders of the Bankruptcy Court, the best practice is to file a motion asking the Bankruptcy Court asking for modification of the stay to permit the proposed act to go forward. Section 362(b)(2)(A)(iv). *See, e,g., In re Caffey,* 384 B.R. 297 (Bankr. S.D.Ala. 2008) aff'd 384 F.App. 882 (11th Cir. 2010) (former spouse violated automatic stay by pursuing contempt proceeding without seeking relief from stay); *In re Gellington*, 363 B.R. 497 (Bankr. N.D. Tex. 2007) (income withholding by state for child support did not violate stay but was improper as violation of order confirming Chapter 13 plan that provided for support arrearage).

Family law practitioners should review carefully section 362(k), which authorizes a bankruptcy court to award a debtor actual damages, including costs and attorney's fees, for a creditor's *good faith* violation of the stay and actual damages plus "in appropriate

circumstances… punitive damages" for a creditor's *willful* violation of the stay. The bankruptcy courts take stay violations very seriously – even the Internal Revenue Service has been required to pay damages for stay violations. *Cf. In re Hunsaker* No. 16-35991 (9th Cir. 2018) (Bankruptcy court could award emotional distress damages against IRS)*; A & J Auto Sales, Inc.,* 210 B.R. 667 (Bankr. D.N.H. 1997).

II. Property of the Bankruptcy Estate

Ownership of a valuable asset of the marriage is often a key issue when a spouse or former spouse files a personal bankruptcy. The relevant section of the Bankruptcy Code, section 541(a), defines property of the bankruptcy estate as "all legal and equitable interests of the debtor in property as of the commencement of the case." There are some narrowly defined exceptions, including funds placed in programs for tuition plans and ABLE plans for children and grandchildren. It is well established that the bankruptcy court must apply applicable state law to define what constitutes the debtor's interest in certain kinds of property. *Butner v. U.S.*, 440 U.S. 48, 55 (1979).

The bankruptcy court has jurisdiction over all aspects of property of the estate, even if it has abstained so that a state court may adjudicate the rights of spouses to property. *In re Sokoloff*, 200 B.R. 300 (Bankr. E.D. Pa. 1996). Most bankruptcy courts, however, will not do so but will abstain. *In re Jacobs*, 401 B.R. 202 (Bankr. D. Md. 2008); *Matter of Levine*, 84 B.R. 22 (Bankr. S.D. N.Y. 1988); *see also In re Abrams*, 12 B.R. 300 (Bankr. D. P.R. 1981) (bankruptcy court declined to exercise jurisdiction over marital status, even though it had jurisdiction over property).

III. Discharge of Debts

Two relevant sections of the Bankruptcy Code for the survival of domestic relations claim are section 523(5) and (15). (See highlighted copy of this statute below.)

Section 523(5) excepts from discharge "domestic support obligations that are "owed and recoverable by a spouse, former spouse, or child of the debtor or such child's parent, legal guardian or responsible relative; or a governmental unit." To be excepted from discharge, the obligation must be "in the nature of alimony, maintenance or support." The Bankruptcy Code does not require the filing of an adversary proceeding complaint to determine the non-dischargeability of domestic support obligations. [For the definition of "domestic support obligation", see section 101(14)(C).]

Section 523(a)(15) excepts from discharge all property division and nonsupport orders in a divorce or a separation for the benefit of a spouse, former spouse or child of the debtor. The Bankruptcy Code does not require the filing of an adversary proceeding complaint to determine the non-dischargeability of property division debts in a Chapter 7 case, but they are dischargeable in a Chapter 13 case.

STUDY CASES

Set out below are fact situations involving domestic relations issues from several bankruptcy decisions of federal courts in the Eleventh Circuit.

A. Ownership of Pension Benefits

The Fact Situation:

1. The parties' divorce decree incorporated the parties' oral agreement that the ex husband would pay the ex wife a portion of his pension payments or benefits each time he received them from his time as a sanitation employee if the City of Chicago.
2. Twelve years later, the former husband began receiving his pension benefits, but he did not pay anything to his former wife. Five years after that, the ex wife finally pursued an action to either force him to make the required payments to her or to establish that she was the co-owner of the pension.
3. The ex husband, who had moved to south Alabama, filed a Chapter 13 bankruptcy and listed his pension as his property and his former wife as an unsecured creditor.

The ex wife responded by filing a complaint in the Bankruptcy Court alleging that the parties had agreed at the time of divorce that she would "accept a portion of the pension" in lieu of alimony. She also conceded that her former husband did not owe her alimony, maintenance or support since the divorce.

4. At trial, the ex wife argued that half of the pension either vested in her or became subject to a constructive trust when the divorce decree was entered and that, consequently, there was no "debt" to be discharged in the former husband's Chapter 13 bankruptcy.
5. Bankruptcy Judge Margaret Mahoney on Mobile ruled that "from the plain language of the divorce order, the agreed pension arrangement " is a property settlement; "… no constructive trust was formed; and… under the language of the divorce order, " it can't be her property because ... it says it had to come through" the ex husband, which "clearly shows it's not self-executing and it was not in her hands." Consequently, Judge Mahoney declared the debt to be a dischargeable "property settlement debt" in the Chapter 13 case. The ex wife appealed to U.S. District Court.

Which party won the appeal of Judge Mahoney's factual and legal conclusions to Chief District Judge William Steele of Mobile? See the decision in *Steele v. Heard,* 487 B.R. 302 (S.D.Ala. 2013), attached below.

B. Payment of Ex-Spouses Attorneys' Fees

The Fact Situation:

1. The wife retained a law firm ("Law Firm") to represent her in a divorce action, and eventually the state trial court entered an order requiring the husband to pay $43,000 to the Law Firm for attorneys' fees, expert witness fees and court costs. By agreement of the parties, the state court also granted the Law Firm a charging lien in the amount of $40,284.38 against the husband's interest in any assets or proceeds that he kept or received in the divorce action.

2. Nine years later the former husband filed a Chapter 7 bankruptcy, and the Law Firm responded with a complaint asking the Bankruptcy Court to declare that the Law Firm's state court judgment against the former husband was non-dischargeable under §523(a)(5) as a "debt to a former spouse".
3. At summary judgment, the parties stipulated that the Law Firm's judgment arising from the divorce action qualified as a spousal support debt and, absent the bankruptcy, it would still be enforceable against the ex husband. The parties also stipulated that the statute of limitation had run on the Law Firm's retainer agreement with the former wife, making it unenforceable against the wife. In other words, by the time of the former husband's bankruptcy, the former wife was no longer liable to the Law Firm for attorney's fees and expenses from the divorce.
4. The Bankruptcy Court entered a summary judgment order, including a lengthy analysis of the application of § 523(a)(5) to this fact situation.

Which party's motion for summary judgment did the Court grant, and why? See the decision in *In re Gentilini*, 365 B.R. 251 (Bankr. S.D.Fla. 2007), attached below.

C. Turnover of Marital Property to Ex-Spouse

The Fact Situation:

1. The parties obtained a divorce in Pike County, Alabama. There were no children and no alimony or support issues. The trial court's order included an Exhibit A of personal property to which the former husband, Ray, was entitled and an Exhibit B of personal property to which the former wife, Edwina, was entitled "to the extent that the same are still in existence".
2. Two months later, Ray filed a Chapter 7 bankruptcy, which included his former wife as a potential creditor. She did not take any action in the bankruptcy, and Ray received a discharge.

3. Later, the parties argued about whether Ray had retained some of the personal property that the state court had awarded to Edwina, and she pursued contempt charges against him, resulting in his being jailed twice in the next three years.
4. Eventually, Ray filed a motion to reopen his bankruptcy case, which was granted, and he then filed a complaint alleging that his obligations to Edwina had been discharged and seeking injunctive relief against any further contempt proceedings in the divorce action.
5. Bankruptcy Judge William Sawyer of Montgomery held that the former wife's claim was a pre-bankruptcy claim and that she had proper notice of her forme husband's bankruptcy case. The central question was whether Edwina's claim survived the bankruptcy under § 523(a)(15), which excepts from discharge debts for division of property which arise under a divorce decree.

Which party received a judgment from the Court, and why? See the decision in *In re Ray Horn, Jr.*, Case No. 02-11347-WRS, Adv. Pro. No. 07-1146 (Bankr. M.D. Ala. 2008), attached below. (Note: There has been a change in the law pertaining to filing a discharge complaint under section 523(a)(15) since this opinion was entered, but the Court could have reached the same conclusion on other grounds stated in its opinion.)