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Feature

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Marital Debt Disputes in Chapter 13: Is the Debt a DSO?

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Divorced couples come to bankruptcy courts for a determination of whether marital debts, such as mortgage payments, attorneys' fees, auto loans, credit cards, medical expenses or educational debts, are in the nature of alimony, maintenance or support. Because of the special treatment of marital debts in chapter 13, divorced couples can become adversaries in claims litigation in bankruptcy courts.

The policy that alimony is not dischargeable has been in the case law for a very long time. More than a century ago, the U.S. Supreme Court held that alimony cannot be discharged in bankruptcy.[1] The Supreme Court explained that alimony "is not founded on contract, express or implied, but on the natural and legal duty of the husband to support the wife."[2]

The exception from discharge for debts in the nature of alimony and support has a long legislative history.[3] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) created a new definition of "domestic-support obligation" (DSO) in § 101(14A), which incorporates the former version of § 523(a)(5). Courts deciding these issues post-BAPCPA rely on pre-BAPCPA cases examining whether a debt is in the nature of alimony, maintenance or support.[4]

Section 523(a)(5) states that "[a] discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt — (5) for a domestic support obligation."[5] In turn, DSO is defined in § 101(14A) and contains the following four elements:

> (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 ... or property settlement agreement;
>> (ii) an order of a court of record; or
>> (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
>
> (D) not assigned to a 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.[6]

Under § 507, allowed unsecured claims for DSOs are first-priority debts and must be paid in full in the chapter 13 plan.[7] In addition, a debtor cannot receive a chapter 13 discharge unless all

1 *Audubon v. Shufeldt*, 181 U.S. 575, 580, 21 S. Ct. 735, 45 L. Ed. 1009 (1901) (citations omitted).
2 *Id.* 181 U.S. at 579. The Supreme Court noted that "[t]he [B]ankruptcy [A]ct of 1898 provides in § 1 that a 'discharge' means 'the release of a bankrupt from all of his debts [that] are provable in bankruptcy, except such as are excepted by this act;' and includes, in § 63 ... debts 'founded upon a contract, expressed or implied.'" *Id.* at 577, citing 30 Stat. at L. 544, 563, chap. 541.
3 *See In re Mojica*, 30 B.R. 925, 928-32 (Bankr. E.D.N.Y. 1983) (traces legislative history of 11 U.S.C. § 523(a)(5)).
4 *Ashworth v. Ehrgott*, BAP CC-12-1591-TADPA, 2013 WL 6620863 at *4 (B.A.P. 9th Cir. 2013) (citing *Beckx v. Beckx*, 2009 Bankr. Lexis 4584 at *16 (9th Cir. 2009); *In re Dudding*, 10-10557, 2011 WL 1167206 at *5 (Bankr. D. Vt. 2011)).
5 11 U.S.C. § 523(a)(5).
6 11 U.S.C. § 101(14A).
7 *In re Krueger*, 457 B.R. 465, 473 (Bankr. D.S.C. 2011) (citing 11 U.S.C. § 1322(a)(2) (West 2011); *In re Johnson*, 397 B.R. 289, 295-96 (M.D.N.C. 2008)).

DSOs have been paid in full.[8] The automatic stay does not operate as a stay of the commencement or continuation of an action to establish or modify an order for a DSO.[9] Likewise, the automatic stay does not operate as a stay of the collection of DSOs from property that is not property of the bankruptcy estate.[10] For all of these reasons, a former spouse may fight to try and prove that a claim is a DSO.

A marital debt that does not meet the statutory definition of a DSO might still be excepted from discharge because of another exception to discharge in § 523. Section 523(a)(15) states that "[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 — (15) 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."

The reason for the litigation of these issues in chapter 13 is because § 1328(a) contains a list of the types of debts that are exceptions to a chapter 13 discharge. Section 1328(a) states that "the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt —

(1) provided for under section 1322(b)(5);

(2) of the kind specified in section 507(a)(8)(C) or *in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a)*."[11]

Because § 523(a)(15) debts are not listed as excepted from a chapter 13 discharge in § 1328(a), they are included in the debts that are discharged.[12]

If a chapter 13 debtor objects to a claim filed as a priority DSO, the matter becomes a contested matter governed by Federal Rule of Bankruptcy Procedure 9014. The Advisory Committee Note states that "[w]henever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter. For example, the filing of an objection to a proof of claim ... creates a dispute which is a contested matter."[13] Rule 9014 generally makes the discovery rules of the Federal Rules of Civil Procedure 26-37 applicable to contested matters.[14] When an objection to a DSO claim is filed, a contested matter is created and the parties could have a trial regarding whether a claim is a DSO.

The party asserting that a debt is a DSO has the burden of proving by a preponderance of the evidence that the obligation is in the nature of support.[15] Furthermore, exceptions to a discharge of a debt are construed strictly against a creditor and liberally in a debtor's favor.[16] However, the underlying policy of § 523(a)(5) favors enforcement of familial-support obligations over a debtor's fresh start.[17] The bankruptcy courts must balance these policies.

Most of the litigation in this area involves the second part of the DSO definition, whether the debt is in the nature of alimony, maintenance or support.[18] Bankruptcy courts look to federal law to determine whether a particular claim is in the nature of support.[19] A state court's designation or language in a marital settlement agreement stating that a debt is support or property settlement is not binding on a bankruptcy court, and a bankruptcy court can look behind such language to determine the real nature of the debt.[20] A marital debt might be a DSO, even though it cannot be a support debt under state law.[21] Even if the marital settlement agreement waives maintenance, a bankruptcy court might look to evidence of intent.[22]

In order to determine whether debt is in the nature of alimony, maintenance or support, the bankruptcy court must determine the intent of the parties or the divorce court at the time of the obligation. If the parties entered into a marital-settlement agreement, the bankruptcy court will determine whether the parties intended that the obligation be in the nature of alimony, maintenance or support.[23] If the divorce was concluded with a trial and decided by a judge, the bankruptcy court will determine whether the divorce court judge intended that a particular award be for support, and the intended purpose that the obligation was meant to serve.[24] In order to determine intent, courts look at many factors focusing on (1) the language and substance of the agreement; (2) the financial situation of the parties at the time of the agreement, including prospects for future income; and (3) the function served by the obligation at the time of the agreement.[25]

The Ninth Circuit Court of Appeals recently affirmed a bankruptcy court's determination that a marital obligation was in the nature of support.[26] The Ninth Circuit in *In re Ashworth* agreed with the trial court's application of the following factors to determine intent: (1) whether the recipient spouse actually needed spousal support at the time of the divorce; (2) if there was an imbalance in the relative income of the parties at the time of the divorce decree; (3) whether the obligation terminates upon the death or remarriage of the recipient spouse; and (4) whether the payments are made directly to the recipient spouse and paid in installments over a substantial period of time.[27] Finally, the labels given to the

8 *In re Johnson*, 397 B.R. at 296.

9 11 U.S.C. § 362(b)(2)(A)(ii).

10 11 U.S.C. § 362(b)(2)(B).

11 11 U.S.C. § 1328(a) (emphasis added).

12 *In re Pagels*, 10-07070-SCS, 2011 WL 577337 at *6 (Bankr. E.D. Va. 2011). Because of the language in § 523(a), debts under § 523(a)(15) are not discharged if a debtor receives a hardship discharge under § 1328(b).

13 *Boykin v. Marriott (In re Boykin)*, 246 B.R. 825, 827 (Bankr. E.D. Va. 2000) (quoting Fed. R. Bankr. P. 9014 Advisory Committee's Note).

14 *See In re Khachikyan*, 335 B.R. 121, 126 (B.A.P. 9th Cir. 2005) (Fed. R. Civ. P. 26-37, as incorporated by Fed. R. Bankr. P. 7026-37 and 9014(c)).

15 *Smith v. Pritchett (In re Smith)*, 586 F.3d 69, 73 (1st Cir. 2009); *Cummings v. Cummings*, 244 F.3d 1263, 1265 (11th Cir. 2001).

16 *Kolodziej v. Reines (In re Reines)*, 142 F.3d 970, 972 (7th Cir. 1998).

17 *Sampson v. Sampson (In re Sampson)*, 997 F.2d 717, 722 (10th Cir. 1993) (citing *Shaver v. Shaver*, 736 F.2d 1314, 1316 n.3 (10th Cir. 1993) (Section 523(a)(5) "departs from the general policy of absolution, or 'fresh start' in order to 'enforce an overriding public policy favoring enforcement of familial obligations'")).

18 The majority of courts find that payment of support, maintenance or alimony need not be payable directly to the spouse or one of the payees listed in the first element of the definition in order to be nondischargeable. *In re Calhoun*, 715 F.2d 1103, 1105-07 (6th Cir. 1983), and *In re Spong*, 661 F.2d 6 (2d Cir. 1981).

19 *In re Brody*, 3 F.3d 35, 39 (2d Cir. 1993); *In re Gianakas*, 917 F.2d 759, 762 (3d Cir. 1990); *Long v. Calhoun*, 715 F.2d at 1103.

20 *Cummings*, 244 F.3d at 1265.

21 *Sampson v. Sampson (In re Sampson)*, *supra* at 722; *Biggs. v. Biggs (Matter of Biggs)*, 907 F.2d 503 (5th Cir. 1990) (held that Texas divorce decree obligation was nondischargeable alimony even though state law did not allow court-ordered alimony); *In re Harrell*, 754 F.2d. 902 (11th Cir. 1985) (post-majority child support and educational expenses); *Boyle v. Donovan*, 724 F.2d 681, 683 (8th Cir. 1984) (college education found to be nondischargeable support).

22 *Reines*, 142 F.2d at 973.

23 *Id.*; *Brody*, 3 F.3d at 38; *Sampson*, 997 F.2d at 723.

24 *In re Smith*, 586 F.3d 69, 74 (1st Cir. 2009); *see also Cummings*, 244 F.3d at 1266.

25 *In re Catron*, 43 F.3d 1465 at *4 (4th Cir. 1994) (unpublished opinion); *Sampson*, 997 F.2d at 723-26; *In re Gianakas*, 917 F.2d 759, 762-63 (3d Cir. 1990); *Calhoun*, 715 F.2d at 1103 n.7; *In re Pagels*, 2011 WL 577337, at *8; *In re Krueger*, 457 B.R 465, 474-75 (Bankr. D.S.C. 2011) (also considered factor of whether there was overbearing for either party); *In re Daulton*, 139 B.R. 708-10, 711 (C.D. Ill. 1992) (20 factors focusing on language of agreement, relative income of parties, nature and function of obligation, needs of any children, length of marriage and age and health of parties).

26 *Ashworth v. Ehrgott*, BAP CC-12-1591-TADPA, 2013 WL 6620863 (B.A.P. 9th Cir. 2013).

27 *Ashworth v. Ehrgott*, *supra* at *4 (citing *Friedkin v. Sternberg*, 85 F.3d 1400 (9th Cir. 1996)).

payments by the parties might be looked at as evidence of the parties' intent.[28] The *Ashworth* court also considered the fact that the divorce judgment labeled the obligation as "support," and allowed the ex-husband to claim the payments as alimony on his tax returns and required the ex-wife to report the payments as taxable income.[29]

The cases are highly fact-specific. In *In re Krueger*, the court, after considering the substance and language of the agreement, the financial condition of the parties at the time of the agreement, the function served by the obligation, the intent of the parties at the time of the agreement, evidence of overbearing by either party and any tax benefits from the agreement, concluded that an obligation to make the mortgage payments (and the car payment) was a priority debt in the nature of support.[30]

Considering a mortgage obligation but reaching a contrary result, the court in *In re Drengacz* found that a mortgage, among other debts, was not a priority debt under § 507(a)(1).[31] The court explained that the creditor had given insufficient information for the court to conclude that the expenses were necessary for her support or the support of the couple's children. The court indicated that the result might have been different if there was evidence that she lived in the house and was forced to make the mortgage payments herself.[32]

Attorneys representing debtors and creditors should be aware of the treatment of marital debts in chapter 13. A debtor who owes a marital debt that is not a DSO might be able to file a chapter 13 and treat the debt as a general unsecured claim that is subject to a discharge. Likewise, a domestic-support creditor might file a proof of claim as a priority DSO and object to confirmation of a chapter 13 plan that seeks to treat a marital debt as a general unsecured claim.

Attorneys should review the marital-settlement agreement or divorce decree to discern whether the parties or the divorce court judge intended that the obligation be for maintenance, alimony or support, and be aware that a bankruptcy court might look beyond the labels in the document to discern whether the obligation was actually intended to be for alimony, maintenance or support. **abi**

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28 *Ashworth v. Ehrgott*, *supra* at *4; *In re Daulton*, *supra* at 708.

29 *Ashworth*, *supra* at *4.

30 *In re Krueger*, *supra*. The court noted that if the parties did not derive any tax benefit from the obligations imposed by the agreement, it suggested that the payments are in the nature of property settlements and not for maintenance or support. *Id.* at 478.

31 *In re Drengacz*, 11-B-82339, 2012 WL 5467757 (Bankr. N.D. Ill. 2012).

32 *In re Drengacz*, *supra* at *5.