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From the Bankruptcy Courts: The Bankruptcy Court's Role in Determining Nondischargeability of Obligations Owed to a Former Spouse

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THE BANKRUPTCY COURT'S ROLE IN DETERMINING NONDISCHARGEABILITY OF OBLIGATIONS OWED TO A FORMER SPOUSE

The policy in favor of giving the honest debtor a fresh start in bankruptcy is subordinate to the more compelling interests of the debtor's family members in continuing to receive financial support. This ranking of priorities is manifested by an exception to discharge that applies to any debt owed to a spouse, former spouse, or child of the debtor, for alimony, maintenance, or support in connection with a separation agreement, divorce decree or other court order, or property settlement agreement.[1]

The exception for alimony, maintenance, and support obligations does not apply if the obligation is assigned to another entity by the debtor's family member or former spouse.[2] However, as a result of a 1981 amendment to the Code, obligations of this nature remain nondischargeable if they are assigned to the state pursuant to Section 402(a)(26) of the Social Security Act as a condition for eligibility for support payments from the Federal Aid to Families with Dependent Children Fund.[3]

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[1] 11 U.S.C. § 523(a)(5). This is the only type of debt that may not be discharged in a chapter 13 debt adjustment case. See 11 U.S.C. § 1328. This exception was expanded in 1984 to apply to court orders other than divorce decrees. 1984 Amendments § 454(b). In cases that were commenced prior to October 8, 1984, a debt for child support that did not arise from a separation agreement, divorce decree, or property agreement is dischargeable. See *In re* Bruner, 43 Bankr. 143 (E.D. Mo. 1984).

[2] 11 U.S.C. § 523(a)(5)(A); see *In re* Brunhoff, 4 Bankr. 381, 382 (S.D. Fla. 1980) (holding that the debtor's past-due alimony obligations became dischargeable after the death of his ex-wife). "The debt has been assigned to another entity, the ex-wife's personal representative, by operation of law and is not, therefore, nondischargeable under the provisions of the Code." See also *In re* Fields; 23 Bankr. 134 (D. Colo. 1982) (child support arrears became dischargeable when the debtor's wife filed liquidation petition, thus effectuating assignment of child support claim to the trustee of her bankruptcy estate.

[3] Pub. L. No. 97-35, 95 Stat. 863 (Omnibus Budget Reconciliation Act of 1981, § 2334); see *In re* Stovall, 721 F.2d. 1133 (6th

This provision was amended further in 1984 to include as nondischargeable any obligation of this nature that had been assigned to the federal, state, or local government.[4] Moreover, courts have held that a debtor's obligations in the nature of alimony, maintenance, or support are nondischargeable if owed to a third party when there has not been assignment of the debt by the spouse. For example, the court in *In re French*[5] held that the debtor's obligation imposed by a state court order to pay legal fees directly to his former spouse's attorney in connection with a divorce proceeding was a nondischargeable support obligation even though it was payable to someone other than his ex-wife.[6]

Nondischargeable Alimony Obligations vs. Dischargeable Property Settlement Obligations

The Bankruptcy Code makes it clear that the mere labeling of an obligation as one for alimony, maintenance, or support will not, in and of itself, render it nondischargeable. This often leads to litigation concerning the fine distinction between nondischargeable alimony obligations and dischargeable property settlement obligations, an issue that has been puzzling the courts for many years. Legislative history relating to the Code indicates that federal bankruptcy law will govern the determination of whether a debt is in the nature of alimony, mainte-

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Cir. 1983) (holding that an assignment to the state of child support obligations pursuant to an Illinois state statute rendered the debt nondischargeable because the state statute was consistent with § 402 § 2334); see *In re* Stovall, 721 F.2d. 1133 (6th U.S.C. § 602(a)(26)). Several courts have held that its application is prospective and affects only those bankruptcy cases commenced on or after August 13, 1981. These courts have held that in cases commenced under the Bankruptcy Code prior to August 13, 1981, all obligations to pay support that have been assigned to the state as a prerequisite for receiving public assistance are dischargeable. See *In re* Flamini, 19 Bankr. 303 (Bankr. E.D. Mich. 1982); Heldt v. State, 17 Bankr. 519 (Bankr. D.S.D. 1982). But see *In re* Reynolds, 726 F.2d 1420 (9th Cir. 1984) (holding that the 1981 amendment is applicable to cases that were pending at the time of enactment).

[4] See 11 U.S.C. § 523(a)(5), *as amended by* 1984 Amendments § 454 (applicable in cases filed on or after October 8, 1984).

[5] 9 Bankr. 464 (Bankr. S.D. Cal. 1981).

[6] See also, e.g., *In re* Williams, 703 F.2d 1055 (8th Cir. 1983); *In re* Calhoun, 715 F.2d 1103 (6th Cir. 1983); *In re* Spong, 661 F.2d (2d Cir. 1981); *In re* Knabe, 8 Bankr. 53 (S.D. Ind. 1980); *In re* Bell, 5 Bankr. 653, 655 (W.D. Okla. 1980) ("attorney fee dischargeability . . . must rise or fall with the primary debt"); cf. *In re* Lewis, 39 Bankr. 842 (W.D.N.Y. 1984) (court would limit nondischargeability of debts payable to third parties to attorney fees only); *In re* Delillo, 5 Bankr. 692 (D. Mass. 1980); see also *In re* Wolfe, 26 Bankr. 731 (Kan. 1982) (debtor's obligation on an auto loan, incurred when he purchased a car as a gift for his former spouse, was in the nature of child support and was nondischargeable despite absence of a hold harmless agreement). See 124 Cong. Rec. H11096 (daily ed. Sept. 28, 1978).

nance, or support.[7] This is a departure from the previous practice of resorting to state law on this issue.[8] The Court of Appeals for the Fourth Circuit has stated that "the proper test of whether the payments are alimony lies in proof of whether it was the intention of the parties that the payments be for support rather than as a property settlement."[9] In an attempt to establish more concrete guidelines for distinguishing between alimony, maintenance, and support, and obligations in the nature of a property settlement, the bankruptcy court in *In re Nelson*[10] listed eleven factors usually taken into consideration when determining the true intentions of the parties or the state divorce court:

1. Whether the obligations of payment terminate on the death of either spouse or on remarriage of the spouse benefitted by the payments;
2. Whether the obligation terminates when the dependent children reach maturity age or are otherwise emancipated;
3. Whether the payments are to be made directly to the spouse;
4. The relative earnings of the parties;
5. Evidence that the spouse relinquished rights in property in return for the payment of the obligations;
6. The length of the parties' marriage and the number of dependent children;
7. The document itself and any inferences that can be drawn from placement of specific provisions within the document;
8. Whether the debt was incurred for the immediate living expenses of the spouse;
9. Whether the payments were intended for the economic safety of the dependent(s);
10. Whether the obligation is enforceable by contempt; and
11. Whether the payments are payable in installments over a substantial period of time.

It is common for a separation agreement or divorce decree to incorporate the husband's promise to hold the wife harmless from debts incurred during the marriage. Again, bankruptcy courts may be required to determine whether such obligations are actually in the nature of nondischargeable alimony, maintenance,

[7] See H.R. Rep. No. 595, 95th Cong., 1st Sess. 364 (1977); see also *In re* Williams, 703 F.2d 1055, 1056 (8th Cir. 1983) (court of appeals wrote that whether a debt is a support obligation or property settlement "is a question of federal bankruptcy law, not state law"); *In re* French, 9 Bankr. 464-468 (S.D. Cal. 1981) (the court noted that this issue "is strictly a matter of federal law").

[8] See, e.g., *In re* Wailer, 494 F.2d 447 (6th Cir. 1974), in which the federal court looked to Ohio law to determine whether a particular obligation was one to pay alimony.

[9] Melichar v. Ost, 661 F.2d 300, 303 (4th Cir. 1981), *cert. denied*, 102 S. Ct. 1974 (1982); see also Shaver v. Shaver, 736 F.2d 1314 (9th Cir. 1984); *In re* Eisenberg, 13 Bankr. 1001 (E.D.N.Y. 1982).

[10] 16 Bankr. 658 (M.D. Tenn. 1981), *rev'd in part on other grounds*, 20 Bankr. 1008.

or support. The Court of Appeals for the Seventh Circuit has suggested four factors that might assist bankruptcy courts in discerning the true intention of the parties or the divorce court with respect to a husband's promise to hold a wife harmless from debts incurred during the marriage: (1) whether the settlement agreement includes provision for payments to the ex-spouse; (2) whether there is any indication that the hold-harmless provision was intended to balance the relative incomes of the parties; (3) whether the hold-harmless clause is in the midst of provisions allocating property; and (4) whether the hold-harmless provision describes the character and method of payment.[11]

In re Calhoun: A Landmark Decision

In a 1983 landmark decision that has significantly altered the bankruptcy court's role involving domestic relations issues in the Sixth Circuit, the court of appeals in *In re Calhoun*[12] held that a factual finding that the debtor's assumption of joint debts in a separation agreement incorporated into a divorce decree was *intended* by the parties to be in the nature of alimony, support, or maintenance does not resolve the dischargeability question, but merely begins the judicial analysis. "If the bankruptcy court finds, as a threshold matter, that assumption of the debts was intended as support it must next inquire whether such assumption has the *effect* of providing the support *necessary* to ensure that the daily needs of the former spouse and any children of the marriage *are satisfied.*"[13] If the debtor's obligation to assume joint debts is not necessary to provide daily necessities, such as food, housing, and transportation, the inquiry ends and the debtor's obligation to hold the former spouse harmless is discharged. If the debtor's obligation was intended to be in the nature of support and has the effect of providing necessary support, the bankruptcy court must then determine whether the amount of support represented by the assumption is "not so excessive that it is manifestly unreasonable under traditional concepts of support."[14] Justifying this inquiry as an application of the "fresh start" concept underlying federal bankruptcy law, the court of appeals emphasized that the inquiry is "limited to whether the amount agreed to is manifestly unreasonable in view of the earning power and financial status of the debtor

[11] *In re* Woods, 561 F.2d 27, 30 (7th Cir. 1977). In a subsequent case, the court of appeals indicated that "the *Woods* factors, however, are not exhaustive." *In re* Coil, 680 F.2d 1170, 1172 (7th Cir. 1982).

[12] 715 F.2d 1103 (6th Cir. 1983).

[13] *Id.* at 1109.

[14] *Id.* at 1110.

spouse."[15] If the debt assumption is excessive, the bankruptcy court should set a reasonable limit of nondischargeability of that obligation.

The Problems That Remain

The *Calhoun* decision raises several troublesome questions. First, will its holding be extended to other forms of support other than the debtor's agreement to assume joint debts? Several bankruptcy courts have extended its reasoning to all forms of alimony, maintenance, and support.[16] Second, although the court in *Calhoun* stated that the bankruptcy court does not sit as a "super divorce court," it remains to be seen whether the Supreme Court or courts in other circuits will tolerate such an extensive intrusion by bankruptcy courts into issues concerning the reasonableness of support provisions.[17] As one bankruptcy court noted, "the *Calhoun* rule is an elegant formulation, probably destined for citation as a seminal work in the new federal common law of domestic relations, but is fraught with forebodings for bankruptcy judges and divorce practitioners."[18] The same court also observed that the *Calhoun* decision "signals a significant involvement of bankruptcy courts in domestic relations, matters heretofore thought to fall within the sole province of the state courts."[19]

[15] *Id.* The court indicated that the debtor's present and foreseeable ability to pay, at the time the debts were assumed, is the focus of the inquiry. The amount exceeding this ability should not be characterized as support. However, if the circumstances of the debtor have changed since the time the debts were assumed, the court may consider the current ability to pay. *Id.* at 1110 n.11.

[16] See *In re* Helm, 48 Bankr. 215 (W.D. Ky. 1985); *In re* Elder, 48 Bankr. 414 (W.D. Ky. 1985).

[17] Cf. Caswell v. Lang, 757 F.2d 608 (4th Cir. 1985) (holding that a chapter 13 plan may not include provisions affecting past due child support obligations). "The state court's determination respecting the rights of the parties in these areas of state concern should not be disturbed by federal bankruptcy courts." *Id.* at 611.

[18] *In re* Helm, 48 Bankr. 215, 216 (W.D. Ky. 1985).

[19] *Id.* at 225.