

BANRUPTCY ISSUES FOR NON-BANKRUPTCY ATTORNEYS

Panelists:

**Honorable Judith K. Fitzgerald
Honorable Enrique S. Lamoutte
Honorable Robert A. Mark
Honorable Brian Tester**

Moderator:

Sonia Colón

AMERICAN BANKRUPTCY INSTITUTE

**February 9, 2007
San Juan, Puerto Rico**

TABLE OF CONTENTS

The Bankruptcy Abuse Prevention and Consumer
Protection Act of 2005 and its impact on the
Practice of Family Law 1

Automatic Stay 14

Executory Contracts in Bankruptcy 28

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and its Impact on the Practice of Family Law¹

INTRODUCTION

On April 20, 2005 the President signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 ("BAPCPA"). The majority of the changes became effective on October 20, 2005. BAPCPA has made substantial changes to the existing Bankruptcy Code ("the prior Code"). This article will highlight only those that affect family law.

Depending on your perspective as counsel for either a debtor or a creditor who holds a claim against the debtor, you may or may not welcome the changes. Regardless, the revisions contained in BAPCPA are clearly intended to protect recipients of support and alimony.

One of the most significant changes is a newly created Bankruptcy Code term called "Domestic Support Obligation", which is defined to encompass all debts for alimony, maintenance or support which accrue before, during or after the time the bankruptcy case is filed.

I invite you to judge for yourself whether you're a fan of BAPCPA after reviewing the most significant changes as outlined in this article. Regardless of your perspective, the bankruptcy court is now a less friendly place for debtors with support obligations. As you will see, in enacting BAPCPA, Congress has given the bankruptcy court an expanded role in the enforcement and collection of support obligations.

¹ Copyright ©2006 Matthew Bender & Co., Inc., a member of the Lexis/Nexis Group. Adapted from Hon. Sandy Karlan, New Act Enhances Protection of Support Recipients, Florida Family Law Reporter, Volume 2006, Issue No.3, March 2006, with permission of the Publisher. All rights reserved. Adapted for this program with edits by Bankruptcy Judge Robert Mark.

DOMESTIC SUPPORT POLICIES IN BAPCPA

Four basic principles guided the authors of BAPCPA in drafting the alimony/child support sections:²

1. Bankruptcy should interfere as little as possible with the establishment and collection of ongoing obligations for spousal and child support.

2. The Bankruptcy Code should provide a broad and comprehensive definition of a Domestic Support Obligation and all claims for Domestic Support Obligations should receive equal and favored treatment in the bankruptcy process.

3. The bankruptcy process should ensure the continued payment of ongoing spousal and child support and family support arrearages with minimal need for participation by support creditors in bankruptcy proceedings.

4. The bankruptcy process should allow a debtor to liquidate nondischargeable debt to the greatest extent possible within the bankruptcy case, and emerge from bankruptcy with the freshest start feasible.

In applying these principles, one author opined that BAPCPA would result in:³

1. A reduction in the need for family support creditors to appear in bankruptcy court and a related reduction in the cost and uncertainty inherent in litigating family support issues in bankruptcy court;

2. Greater consistency in law and policy between the Bankruptcy Code and the federal and child support enforcement program established by Title IV-D of the Social Security Act;

² Philip L. Strauss, Legislative Analysis of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005; Subtitle (II-)B, Priority Child Support, February 10, 2005.

³ Philip L. Strauss, Testimony before the U.S. Senate Committee on the Judiciary, February 10, 2005

http://judiciary.senate.gov/print_testimony.cfm?id=1381&wit_id+3993

3. Greater assurance that legitimate family support enforcement mechanisms will not be frustrated by the bankruptcy process; and

4. A clear recognition that all family support debts are entitled to preferential treatment in bankruptcy.

NEW DEFINITIONS

A major change under BAPCPA is the new language regarding family law obligations. It differs significantly from the limited definition under the prior Code under the exception to discharge provision for alimony and support in 11 USC §523(a)(5). A new term has been coined, "Domestic Support Obligation" or DSO, which is defined in §101(14A) of the Bankruptcy Code as follows:

(14A) The term "domestic support obligation" means 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 nonbankruptcy 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 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.

This newly defined term provides a single comprehensive definition used throughout the Bankruptcy Code in sections governing priority, discharge, exemptions and lien avoidance. Following are some additional highlights arising from this new Domestic Support Obligation term of art:

1. The expansive definition of who is now considered to be the recipient of a Domestic Support Obligation is more practical and has a more realistic application. For example the newly defined term will now include an obligation owed to a responsible relative or legal guardian. It remains to be seen how future cases will interpret who is considered to be a "responsible relative".
2. The obligation of support now includes one that accrued "before, on or after" the date of the order for relief, and will include interest that accrues on the debt under state law. Interest was not specifically included as part of a support obligation under the prior Code.
3. The obligation of support may now appear in a property settlement agreement as well as in an order of the domestic relations court, whereas in the prior Code property settlement agreements were not included at all.
4. The Domestic Support Obligation can be established pursuant to a determination by a governmental unit in accordance with applicable nonbankruptcy law such as a child support order from a department of revenue.

5. Previously the obligation could not have been assigned to third parties except under limited circumstances. Now there are specific assignees that are protected under BAPCPA.

6. Under the prior Code, the support award had to have accrued prior to the order for relief. Consequently, if a support order was signed after the filing of the bankruptcy, the debtor's obligation would not have been affected by the bankruptcy. Under BAPCPA, the debtor may not receive a discharge if a postpetition support obligation is not paid in full.

BAPCPA does incorporate language from the prior Code in defining a Domestic Support Obligation. Specifically the Domestic Support Obligation Obligations must be "in the nature of alimony, maintenance or support..." This language suggests that in the event that there is any question as to whether a debtor's obligation to pay is a Domestic Support Obligation, the courts will still look to established law such as In Re Harrell, 754 F.2d 902 (11th Cir. 1985), for the criteria to be applied in determining the exact nature of the obligation.

In re Cummings, 244 F.3d 1263 (11th Cir. 2001) would also continue to be good law for its discussion of the need for the bankruptcy court to consider the intent of the state court in determining the nature of a support award. Cases such as In re Strickland, 90 F.3d 444 (11th Cir. 1996) which define attorneys fees awarded in a domestic relations proceeding as support would continue to be applicable in applying the definition of Domestic Support Obligation.

NEW PRIORITIES

In addition to expanding the definition of a traditional support obligation, BAPCPA has also enhanced the priority of Domestic Support Obligations as compared to other general unsecured debts of the debtor. The DSO is now the first priority claim to be paid subject only to the trustee's administrative expenses. 11 U.S.C §§ 507 (a) (1) (A), (B) and (C).

How does this work as a practical matter? Provided a Chapter 7 trustee recovers unencumbered assets, the recipient of the DSO

now will receive a distribution before all other priority and nonpriority general unsecured creditors. This includes even the IRS! Unfortunately this change may be largely symbolic since the overwhelming majority of Chapter 7 debtors have no assets to distribute to unsecured creditors, even those holding priority claims.

However, BAPCPA has made it more difficult for debtors to file for relief under Chapter 7. Legislative history suggests that in enacting BAPCPA, it was the intent of Congress to require debtors to take more responsibility for their financial affairs, as well as to curb the misuse of bankruptcy laws by individuals with sufficient income to repay a portion of their debts.

The end result of this change in policy is that under BAPCPA there is a presumption of abuse for debtors with a certain level of disposable income which may preclude them from filing a Chapter 7 case. These debtors may now be filing under Chapter 13 or even Chapter 11. In both of these chapters, DSOs are well protected.

Chapter 11 and Chapter 13 will not provide an escape for the debtor. Under BAPCPA the Chapter 13 debtor's proposed plan must provide for *full* payment of *all* prebankruptcy DSOs with only two exceptions:

1. If the recipient/spouse agrees to a lower amount
2. If the recipient has assigned the benefits to a governmental entity and the debtor has committed all disposable income to the 5-year plan. Moreover, in Chapter 11 cases, an individual debtor can confirm a plan over a support creditor's objection only if the plan pays DSOs in full on the effective date of the plan.

Typically after the debtor submits his or her Chapter 13 plan, there is a period of time, sometimes weeks or even months, between the time a plan is proposed and the time the plan is actually confirmed by court order. During that window of time, debtors often fail to remain current in their postpetition support obligations. If this occurs, BAPCPA prohibits the confirmation of a debtor's proposed Chapter 13 plan if the debtor has failed to pay in full all DSO that have accrued after the debtor filed for bankruptcy. 11 USC §1325(a) (8). In addition to the confirmation requirement, the debtor's failure to pay any Domestic Support Obligations that first become payable after

the date of the filing of the petition is grounds for conversion or dismissal in both Chapter 11 and Chapter 13. 11 U.S.C. §§ 1112(b)(4)(P); 1307(c)(11). Finally, a Chapter 13 debtor cannot obtain a discharge unless the debtor has fully paid his or her prepetition and postpetition Domestic Support Obligations.

Under the prior Code, a Chapter 13 debtor had to include his or her current support obligations in the plan but the arrearages payment as ordered by the state court could be modified in the plan. This is no longer true.

Practically speaking, family lawyers should think very carefully before advising their client, the obligor/payor, to file bankruptcy to avoid a judicial support obligation or one made by agreement. These changes should also be a caution to any obligor who thinks that the agreement they make can later be discharged if their lifestyle or finances change or believes that the bankruptcy court will be a safe haven.

THE AUTOMATIC STAY AND PROCEEDINGS FOR INITIAL ACTIONS, MODIFICATION OR ENFORCEMENT

BAPCPA has expanded the scope of domestic relation matters which are not subject to the automatic stay in 11 USC § 362. Under §362(b)(2), the following actions are not stayed:

1. establishment or modification of a domestic support obligation.
2. establishment of paternity
3. an action concerning child custody or visitation
4. an action for the dissolution of marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate
5. an action regarding domestic violence.

BAPCPA continues to exclude from the automatic stay the collection of DSOs from property that is not property of the estate. This provision was in the prior code. However, BAPCPA also specifically excludes, for the first time, the enforcement of or continuation of an Income Deduction Order pursuant to a judicial order, administrative order or statute. In other words the deductions

from salaries through an income deduction order continue even after the filing of a bankruptcy in any chapter.

Also unaffected by the automatic stay is the collection/enforcement procedures used by the child support enforcement division under Florida law and the Social Security Act including the withholding or suspension of driver's licenses or professional licenses, the reporting of overdue support obligations to credit agencies as well as the interception of tax refunds. 11 USC 362(b) (2) (D-G)

These changes are significant in enforcing support awards. Under the prior law the recipient or the state had to apply to the bankruptcy court for stay relief which was time consuming and expensive.

One enforcement limitation in the prior Code remains unchanged. DSO creditors still cannot attempt to collect against "property of the estate" which is still exclusively determined by the bankruptcy court. For example, attempting to seize a prepetition non-exempt bank account of a debtor in chapter 7 would require stay relief. By contrast, the continued collection of child support through an Income Deduction Order is specifically excepted from the automatic stay and, as discussed earlier, under Chapters 11 and 13, the debtor cannot have a plan confirmed unless all DSOs are paid in full.

As under the prior law, the DSO creditor can still proceed to enforce DSOs against exempt property of the debtor. 11 USC§ 522 (c). Such exempt property might include an IRA or 401(K). This right has been expanded by BAPCPA with the addition of language in §522(c) allowing DSO creditors to proceed against exempt property even if that property would be exempt from support claims under state law.

In the case of a pending dissolution of marriage action in which the parties have substantial marital or non marital property to divide, the family court cannot proceed to divide such property without stay relief from the bankruptcy court. As a practical matter, the bankruptcy court may grant such relief and allow the state court to determine the

equitable distribution but may limit the court from actually allowing or authorizing a distribution of that property.

DISCHARGEABILITY OF DOMESTIC SUPPORT OBLIGATIONS AND JURISDICTION

Some of the most significant family law changes in BAPCPA, changes that should eliminate substantial post judgment litigation consistent with the intention of the drafters, are the changes to the exception from discharge provisions in sections 523(a)(5) and 523(a)(15).

Section 523 (a) (5):

Prior to BAPCPA, §523(a)(5) excepted from discharge debts to a spouse, former spouse, or child of the debtor for alimony, maintenance or support provided that the debt was "actually in the nature of alimony, maintenance or support." Bankruptcy courts and state courts had concurrent jurisdiction to determine dischargeability under this section.

BAPCPA amended §523(a)(5) which now simply states that "domestic support obligations" are excepted from discharge. As discussed earlier, the definition of DSOs is broader than "alimony, maintenance or support" used in old §523(a)(5). For example, debts voluntarily assigned to a nongovernmental entity for purposes of collection are now included in DSOs and are therefore excepted from discharge under §523(a)(5).

Under both the old and new §523(a)(5), the obligation must be in the "nature" of support, an issue that was frequently litigated and an issue which has been the subject of several commentaries by the author of this article. Future litigation over this issue should be significantly reduced because of the significant changes in §523(a)(15) discussed below.

Section 523 (a) (15)

The pre-BAPCPA exception from discharge provision in §523(a)(15) was a terrifying provision of the prior Code for family

litigators and for recipients of a support obligation as well as a potential malpractice trap for practitioners. This provision was intended to provide for the nondischargeability of property divisions/equitable distributions under limited circumstances. However this section had numerous problems from the viewpoint of the recipient spouse and attorney.

Dischargeability actions under §523(a)(5) could be brought before either the state court or the bankruptcy court because they had concurrent jurisdiction and there was no statutory time limit to seek relief. However, proceedings under §523(a) (15) to avoid the discharge of a property settlement had to be brought by adversary proceeding in bankruptcy court and if not filed within 60 days of the meeting of creditors the complaint would be time barred. This resulted in the practitioner having to file two actions, one in both state and bankruptcy court, or having to file an action in bankruptcy court just to preserve a possible dischargeability claim.

BAPCPA greatly simplifies §523(a)(15). As amended, this section excepts property settlement debts from discharge without the need to apply the cumbersome standards in former §523(a)(15), namely (1) ability to pay; and (2) whether discharge would benefit the debtor more than excepting the debt from discharge would benefit the non-debtor spouse. Moreover, under amended §523(a)(15), as in §523(a)(5), the state courts now have concurrent jurisdiction and (a)(15) actions no longer need to be filed within 60 days after the first meeting of creditors.

The only remaining complication is that §523(a)(15) does not apply in Chapter 13. In Chapter 13 cases, property settlement debts, like other unsecured debts, will be discharged although only if the debtor makes all payments required under a Chapter 13 plan.

The net result of these changes is that in Chapter 7, 11 or 12 cases, all obligations arising out of divorce or separation agreements will be excepted from discharge. DSOs, essentially debts in the nature of alimony, maintenance or support, are excepted under 523(a)(5) and property settlement obligations are excepted under 523(a)(15). Thus, in these chapters, there should no longer be a need to litigate the "nature" of the support issue.

By contrast, in Chapter 13 cases, this issue will remain alive because only 523(a)(5) applies. Thus, dischargeability of a domestic relations debt in Chapter 13 will still depend on whether the debt is in the nature of support under federal law.

TRUSTEE'S EXPANDED ROLE

The Trustee has a new role under Chapter 7 (11 USC 704) and Chapter 13 (11 USC 1302) to assist Domestic Support Obligation recipients. BAPCPA requires that the trustee provide in substantial detail the following information to such creditor

1. written notice of the claim and that the creditor/spouse/parent/guardian has the right, in the case of a child support obligation, to use the services of the state child support enforcement agency to collect the debt,

2. written notice to the state child support enforcement agency of such claim,

3. written notice that the debtor has been granted a discharge, the debtor's last known address and employer, and the existence of other nondischargeable debts and reaffirmed debts.

This is a tremendously helpful change for the recipient of the Domestic Support Obligation. So many pro se litigants have a difficult time navigating in state courts and the bankruptcy court is even more difficult for them. Often, the bankruptcy trustee will be the person with the most knowledge about the debtor and the debtor's ability to pay and this provision will provide a great service to parties who are not receiving child support as ordered.

Some have raised the question of how aggressive a Chapter 7 trustee will be in attempting to locate assets in a liquidation proceeding if there will be no recovery for other creditors because of the priority of the domestic support obligation. This remains to be seen.

CONCLUSION

In general, the changes in BAPCPA are very favorable to recipients of Domestic Support Obligations. It is important for every practitioner to become familiar with the definition of DSO as this provides the basis for all actions related to alimony, maintenance and child support. The new provisions faithfully attempt to apply the four basic principles above and make it more difficult, if not impossible, for a debtor to discharge a debt established in a child support proceeding, paternity action, divorce or modification proceeding whether incurred through judicial order, administrative order or marital or property settlement agreement.

I believe that these changes will result in substantially less litigation on family related matters for the bankruptcy courts. Of course there will always be those who argue that the division of debts, an indemnification provision, or payments on marital obligations to a third person are not really Domestic Support Obligations. In those instances the existing case law defining what is support and what is in the nature of alimony, maintenance and support should still be informative and applicable.

All in all, it appears that the days when a debtor could try to use the Bankruptcy Court to obtain a "second bite of the apple" are over and that should be good news for families.

BIOGRAPHY

The Honorable Sandy Karlan is currently the Associate Administrative Judge in the Family Division in the 11th Judicial Circuit. She is also specially assigned to the Complex Litigation Division of the Unified Family Court in addition to her regular division. Judge Karlan has been a circuit court judge since 1995. Prior to that, she was an attorney in private practice specializing in Family Law and Bankruptcy. She is certified by The Florida Bar in Marital and Family Law. She regularly lectures on family law and bankruptcy to lawyers and judges and has taught related courses at the Advanced Judicial Studies College and the Circuit Court Conference Educational Program.

The author wishes to specially thank Barbara Phillips, Esq. for her substantial contribution to this article. Additional materials were contributed by Paul L. Orshan, Esq., and Patricia Redmond, Esq.