Divorce & Bankruptcy

I represent Wife in a recently filed divorce. She had husband have a lot of debt. Wife just consulted with a bankruptcy attorney and was advised not file for bankruptcy. I've communicated that to Husband's divorce attorney, but it looks like he may still pursue bankruptcy.

Can I file a motion in the divorce case asking that he be prohibited from filing for bankruptcy? It seems like the divorce judge shouldn't be able to prohibit him from taking other legal action, but not sure where I'm getting that from. Is it a due process issue?

Any creative thoughts on how to deal with this? So far my best plan is to just get the issue in front of the Judge and Husband's attorney one way or another so they can strongly recommend that he not file for bankruptcy.

I do not see how you can stop a person from filing. It is a constitutional right, isn't it? What would the basis be for him be ordered not to file? Basis for her not file could be related to whose name debts are in. Can you share reason W told not to file?

Is H's BK attorney different than the divorce attorney? If so, have you spoke to divorce attorney?

I am dealing with a divorce where my client had to file BK during the case. It complicated the divorce at the time. We agreed best to stay the divorce entirely and not bifurcate. H was going to join in the BK (would have made some things easier), but decided not to.

Phil A. Taylor, Massachusetts

If they have tons of debt, they either both file during the divorce or wait to file afterwards.

Here is what happens.

Husband files bankruptcy, divorce is stayed.

His name is removed from all joint creditors and any debts solely in his name are gone (and thus no longer marital debts), wife's name remains on the joint debts and her sole debts remain. Her sole debts are still potential marital debt.

Now the divorce proceeds and the divorce court divides up the marital debt between the spouses. There is the potential that there is less debt or the potential that the debt is exactly the same. And then husband is ordered to pay some portion of the marital debt.

This is because while his responsibility to the CREDITOR is removed, his responsibility to the now EX is not yet even created until the judgment is entered and thus is a new "debt" post-bankruptcy.

Filing bankruptcy won't get a spouse out of paying their share of the marital debt unless the debt goes away completely.

Also, in some states, if you declare bankruptcy after the divorce, that allows for the division of property to be reopened and reconsidered in light of the new circumstances. Here in Ohio we have the choice of saying it does or doesn't.

The best use of bankruptcy is for the party wanting to declare bankruptcy to have most of the debt in their own name, take on the debt as part of the settlement (and potentially not have something else offset or not owe support payments to the other spouse) and then file after divorce to get rid of the debt. Unless you're in a state that can cause it to be reopened (and the judgment allows for reopening).

Erin M. Schmidt, Ohio

No judge can prohibit a person from filing BK.

It is called a voluntary petition for a reason.

You cannot twist H's arm over this, except in indirect ways perhaps.

The reason it is not recommended to file BK for both H and W now is that it can become quite complicated and costly to both parties.

Chapter 7s are the problem and this is what people with a lot of debt and an impending divorce typically file.

There are many issues that come up that will require W and H to retain BK attorneys (in addition to their family law attorneys).

Some of those issues are:

automatic stay issues (and exceptions to stay); exemption issues (depending on what assets are there to protect); of course, the 800-pound gorilla, the C7 BK trustee (two of them if each party files their own case), who can trigger another set of problems for both W and H.

I would write a nice letter to H's counsel, telling him of all these issues and also mentioning that (assuming divorce decree not issued yet) H may not avail himself of all exemptions because the divorce has not been finalized. I am not sure how it works in IL, but it is quite often it is state law that provides for what property may be protected in BK (many states have opted out of the federal exemption scheme).

In any event, under some circumstances, if the BK debtor wants to use what are called special exemption (not too many real property assets to protect), H cannot avail himself of those unless W signs a waiver that she won't use those exemptions if she files for BK (as they are still husband and wife). I would also point out to H's counsel that once H files a 7 BK, he cannot dismiss it unilaterally (like C13s, for example). H may end up getting stuck in a BK case prematurely and not be able to protect all his assets anyway.

It makes no sense to file also because H does not know yet what assets will be awarded to him by the family court yet.

These can make a quite compelling argument to H not to file for BK until divorce is finalized.

You did not ask for this, but will let you know anyway.

Here is the big issue for your client if H files BK later, after property divided by family court and divorce finalized.

Division of the property by the family court may not be exactly what the BK trustee likes and s/he may challenge that division later in something called an avoidance action (typically would be a fraudulent conveyance action under both federal and state law). I use to do this when represented trustees. It was quite effective. To protect W from such an action later, I would strongly recommend that you have the family court involved in the division of the property and that the family court make specific findings that the way it is dividing the property between W and H is not just equitable, but it is also adequate consideration as far as what W and H are each respectively giving up. A suit by the BK trustee will be later based on less than adequate consideration received by H on account something given to W. You can later use such findings of fact to assert issue preclusion against the BK trustee.

Val Loumber

State court entering an order not to file bankruptcy would be of no effect, even if you could get a judge to sign. Bankruptcy is a federal filing and would supersede.

Wife will likely need both a bankruptcy attorney and family law attorney. There are potential traps and tricks. Most commonly divorce is delayed, but state by state variance in family law means no overview is possible.

I would also check if wife's decision to file bankruptcy should be reviewed in light of husband filing. An analysis of a joint filing might also be practical.

Darrell G. Stewart, Texas

I have some comments on Erin's analysis.

Please see below.

On Wed, Sep 18, 2019 at 11:44 AM Erin Schmidt <deerhart@gmail.com> wrote:

> If they have tons of debt they either both file during the divorce or

> wait to file afterwards.

>

> Here is what happens.

>

> Husband files bankruptcy, divorce is stayed.

>

Divorce is not stayed in its entirety. Under 11 USC 362(b)(2)(iv), there is no stay "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."

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> his name are gone (and thus no longer marital debts), wife's name

> remains on the joint debts and her sole debts remain. Her sole debts

> are still potential marital debt.

>

H cannot be sought personally to satisfy any debt in existence as of the BK petition date (assuming C7 BK). 11 USC Sec. 524(a).> Now the divorce proceeds and the divorce court divides up the marital

> debt between the spouses.

There is nothing to divide because the debt (both H's marital debt and his separate debt) was administered in the BK (both H's marital debt and his separated debt). When the BK is over, unless something is specifically excepted from discharge, all of H's debt, both marital and separate is discharged. H's personal liability on such debt is gone. See exception to stay exception in Sec. 362(b)(2)(iv) above; see also 11 USC Sec. 524(a).

> There is the potential that there is less debt or the potential that

> the debt is exactly the same. And then husband is ordered to pay some

> portion of the marital debt.

>

I do not know how a family court can order H who just received a BK discharge from all debt to pay some of that debt. See 11 USC Sec. 524(a).

> This is because while his responsibility to the CREDITOR is removed,

> his responsibility to the now EX is not yet even created until the

> judgment is entered and thus is a new "debt" post bankruptcy.

Here we have to distinguish between debt to creditors and debt to spouse.

Many times, debt is divided where H is simply ordered to pay off a credit card.

The family court cannot create new debt based on old debt that is discharged. This would violate the BK federal injunction.

With respect to debt to EX, created before BK or during BK but debt arose pre-petition for purposes of the BK, in the BK that debt is recognized as nondischargeable.

11 USC Sec 523(a)(15): No discharge of individual debtor from a debt "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, or a determination made in accordance with State or territorial law by a governmental unit;"

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BK trustee can still avoid settlement as a fraudulent conveyance. BK debtor received a bunch of debt and no assets to offset debt. It is less than reasonably equivalent value.

Val Loumber

The problem with joint filing is that many divorce decrees relate back to a point in the post (e.g., separate date), which may make the couple not married as of the BK petition filing date, making them retroactively ineligible for a joint BK petition.

Val Loumber

On top of everything discussed, something to consider for your client:

Look over 11 USC Sec 523(a)(5) and (15) and try to make all debt fit within these categories.

This way, such debt is no affected by later BK by H.

Otherwise, if H is ordered in family court to just pay off some debt directly (to the creditor) and then he does not, W may be stuck with that debt, as the creditor will turn to her. She may have to file her own BK just to deal with the debt H was ordered to pay but he did not.

(It seems in IL there is no silent/phantom debt discharge. Sec. 524(a)(3) applies only to CP states.) But, if such debt is ordered owed to W and then W to pay it off, Sec

523(a)(15) makes it automatically nondischargeable (not even need to file AP).

Val Loumber

In most instances, it stays the entire divorce because the courts do not like to divorce folks and not have the assets divided.

The bankruptcy does not discharge the spouse's responsibilities under family law nor does it discharge the family laws court to determine what is/isn't martial assets/debts AND to then divide those assets/debts, as it sees fit AFTER the bankruptcy. Stop conflating being released from your responsibility to the actual creditor as being the same as what goes on in family law. So long as the debit continues to exist, it can be classified as a marital debt and the court has the power to divide it.

Family law is an equitable court, that court doesn't give a fig who's name the debt or asset is held in. It has equitable ability to make those divisions REGARDLESS of how it is titled/owned/owed.

So, while the husband isn't liable to the CREDITOR, they can still be made liable to the SPOUSE by nature of the equitable nature of the family law court.

If what you say was true, then the family law court could not divide an asset held solely in one person's name, or a debt held solely in one person's name. But they can.

And if you really want to screw with someone looking at bankruptcy post-divorce, then you have the judgment read that anything and everything they are ordered to do is done as a support order and therefore it is not dischargeable in bankruptcy. This is usually done when attorney fees are ordered for one side to be paid and a way to prevent them from later discharging that order in bankruptcy

Erin M. Schmidt

Again, that will depend on the court. If H fails to pay it wife can file a motion for contempt and sanctions (of course this doesn't always work because they have no money).

And in many states even orders to pay the creditor directly can be classified as support orders and thus non-dischargeable. It is all in how you word the judgment.

Erin M. Schmidt

Whose name is on assets is just simply form over substance.

Neither family court, nor BK court are concerned about that.

If BK is first, BK estate is concerned with administering both assets and liabilities.

The BK trustee will liquidate all nonexempt marital assets to pay marital debt, as this is the debt that is owed by the Debtor and hence is debt of the estate.

The BK trustee will go after all nonexempt separate property assets as well.

By the time the divorce action is filed, there will be nothing left for family court to divide except exempt assets.

In many ways, if there is a dispute over what is a marital asset and what is a separate asset, the BK court may decide that too (assuming nothing pending in state concerning this issue).

I disagree that a family court can simply ignore the federal bankruptcy discharge injunction and impose a personal liability on the former debtor for pre-petition debts. Think of it this way. The BK discharge injunction is actually a federal court judgment. State courts are bound by such judgments. There are many ways to arrive at this conclusion: Preemption / Supremacy Clause. Every court, including the BK court, can interpret and enforce its own judgments. The BK court is also a court of equity. See 11 USC Sec. 105(a).

If you try to impose discharged debts on the debtor who received the discharge, it can lead to serious sanctions. It is contempt of court standard. Federal authority is replete on this point.

Val Loumber

Yes. Have been involved in many fights before the BK court about whether a debt can be classified as 523(a)(5) or (a)(15).

Planning and defining debts and having the family court make findings go a long way here.

Val Loumber

Erin,

One more thing.

Look over the way 523(a)(15) is worded:

"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, or a determination made in accordance with State or territorial law by a governmental unit."

To fit within this provision, you have to have first gone through the family court.

If the BK came first, how can you fit within this provision.

Debts in BK are determined as of the BK petition date. See 11 USC Sec.

502(b).

" . . . shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount . . . ."

Val Loumber

Bifurcated divorces are a thing in Illinois (or at least when I lived there they were), though they were rare.

Lesley Hoenig, Michigan

Why was she advised not to file?

Lesley Hoenig

And yet we do it all the time.

You try telling a family law judge that they do not have the power to divide the debts and assets in front of them, post discharge, in a equitable matter per state law.

Here is your problem, by claiming that the bankruptcy preempts the family law court, the family law court then CANNOT act equitably. They cannot divide whatever is left in an equitable division.

And good luck with the bankruptcy court touching most of the assets since they are, more often than not, held by both parties and thus they cannot liquidate the asset that is actually still owned by someone not party to the bankruptcy.

Bankruptcy does not eliminate or discharge the equitable power of the family law court NOR does it eliminate or discharge the FUTURE contract between the spouses.

Remember that, the contract between the spouses (which is what the division of assets and property actually are) is a FUTURE contract and thus not dischargeable because it does not exist yet.

Erin M. Schmidt

Val,

if the divorce came first you do not have to fall within that exception because the liability DID NOT EXIST prior to the bankruptcy and thus could not be discharged in the bankruptcy.

So, it goes like this

Husband and wife have CC together they both owe the creditor Husband files bankruptcy and is discharged off CC, wife still has liability to creditor

6 months after discharge husband files for divorce, 9 months after that Judgment is entered. At the time the judgment is entered, the liability to the now ex-spouse to pay part of the remaining balance on the CC is CREATED.

Bankruptcy cannot discharge FUTURE liability. Even if that future liability is debt that you personally no longer owe on. The bankruptcy makes the debt, now owned SOLELY in the other spouse's name, as a marital debt solely owned and no different in the division.

Erin M. Schmidt

Yes, usually they are done for very specific reasons (someone wants to get remarried before a baby is born, there is something holding up a huge section of the assets/debts, or it's an enormous divorce that the assets are going to take years to flesh out)

Erin M. Schmidt

The family court can divide and act equitably.

All I am saying is that it cannot resurrect debts that have been wiped out by the prior BK.

If this is actually being done, someone is asleep at the wheel.

Val Loumber

State law variance – Texas has an on-off switch for status, married or divorced. Parties are married until divorce decree is entered or judicially rendered (ordered from the bench).

Darrell G. Stewart, Texas