New Jersey Lawyer Magazine

June 2005 / No. 234

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Matrimonial Issues in Bankruptcy

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Bankruptcy cases requiring the application of matrimonial law or concepts have generated extensive litigation regarding a number of issues, including the following: 1) the determination of property of the bankruptcy estate; 2) the effect of the automatic stay on matrimonial litigation; 3) sale of marital property in bankruptcy; 4) treatment of alimony, support, and maintenance claims; and 5) treatment of property settlement claims. This article briefly examines each of these issues.

Determination of Property of the Estate

The timing of a divorce judgment determines a spouse's rights in property in a bankruptcy case. New Jersey law imposes a constructive trust upon property to be transferred pursuant to a divorce judgment. Therefore, if a debtor files a bankruptcy petition *subsequent* to entry of a divorce judgment compelling transfer of property to the non-debtor spouse, and prior to the actual transfer of property, the debtor holds the property in constructive trust for the non-debtor spouse, and the property is, under Bankruptcy Code Section 541(d), excluded from the bankruptcy estate.[1] Any such constructive trust prevails over a bankruptcy trustee's avoidance powers,[2] and survives a bankruptcy discharge.[3] Further, if the parties have already previously litigated issues relating to equitable and legal ownership of marital property, the claim preclusion, issue preclusion, and/or Rooker-Feldman doctrines may bar the relitigation of such issues.[4]

In contrast, a trustee's avoidance powers prevail over a non-debtor spouse's interest in property if the debtor files the petition *prior* to entry of a divorce judgment. In such a situation, no constructive trust arises.[5] Instead, any equitable interest of the non-debtor spouse in property, equitable distribution, or support gives rise to a monetary claim.[6]

Courts disagree on whether such a claim constitutes a pre-petition or post-petition claim. In the *Lawrence* case, the court held that the non-debtor spouse held an allowed, pre-petition claim under Bankruptcy Code Section 502(b).[7] In the *Berlingeri* case, in comparison, the court held that under New Jersey law the non-debtor spouse's claim did not arise until after the post-petition entry of divorce judgment; therefore, the court found, the spouse possessed a post-petition claim non-dischargeable under Bankruptcy Code Section 727(b).[8]

Assuming the property at issue constitutes property of the bankruptcy estate, a debtor is entitled to exempt certain property from the estate. Yet, exempt property is subject to the payment of alimony, support, or maintenance,[9] and under New Jersey law a "qualifying trust," including an IRA, is not exempt from claims for child support or spousal support, or of an alternate payee under a qualified domestic relations order (QDRO).[10] Meanwhile, a debtor's right to *receive* alimony, support, or maintenance payments necessary for the support of the debtor and any dependants is exempt from creditors.[11]

Effect of the Automatic Stay

The filing of a bankruptcy petition stays the determination of the interests of a debtor in property of the estate, such as equitable distribution of a debtor's interest in marital assets, any exercise of control over such property, and the assertion of any monetary claims against property of the estate.[12] The filing of a Chapter 13 petition also effects, with certain exceptions, an automatic stay against any effort to collect a consumer debt from a non-debtor spouse liable on the debt.[13]

Exceptions to the general automatic stay rule exist. First, the automatic stay does not apply to non-economic aspects of a divorce case, such as the dissolution of the marriage and child custody issues.[14] Second, the automatic stay does not preclude collection of equitable distribution of non-estate property, such as property excluded from the estate, including an ERISA-qualified pension or IRA, exempt property, the debtor's post-petition earnings under Bankruptcy Code Section 541(a)(6), property abandoned by the trustee, or debtor surplus under Bankruptcy Code Section 726(a)(6).[15] Third, the automatic stay does not apply to equitable distribution of property titled in the name of the non-debtor spouse.[16] Fourth, the automatic stay does not apply to the commencement or continuation of a criminal action or proceeding against the debtor.[17]

Courts have found that, pursuant to this section, the auto-

matic stay does not apply to a proceeding to hold a debtor spouse in criminal contempt.[18] The stay may apply, however, if the primary purpose of the proceeding is collection of support.[19] Moreover, the automatic stay may apply to a proceeding to hold a debtor spouse in civil contempt for failure to make support payments. Many courts view such a proceeding as a device to collect money from the debtor.[20]

Fifth, the automatic stay does not apply to the commencement or continuation of an action or proceeding for the establishment of paternity.[21] Sixth, the automatic stay does not apply to the commencement or continuation of an action or proceeding for the establishment or modification of an order for alimony, maintenance, or support.[22] Finally, the automatic stay does not apply to the collection of alimony, maintenance, or support from property not of the estate.[23] Thus, in a Chapter 7 or 11 case, the automatic stay does not apply to proceedings to collect alimony, maintenance, or support from a debtor's post-petition earnings.[24] Because Bankruptcy Code Section 1306(a)(2) provides that a debtor's post-petition earnings constitute property of the estate, however, the automatic stay applies to those proceedings in a Chapter 13 case.[25]

Further, even assuming that the automatic stay applies, a bankruptcy court may, for a variety of reasons, grant relief from the automatic stay, or abstain from hearing a matter to which the automatic stay applies. For example, bankruptcy courts have granted relief from the automatic stay to allow enforcement of a pre-petition divorce judgment.[26] Also, some bankruptcy courts have granted relief from the automatic stay or abstained from a determination of property interests on the basis that a state court, applying principles of equitable distribution, can better determine such interests in a pending divorce proceeding.[27] Nevertheless, other bankruptcy courts have retained jurisdiction over such a determination on the basis of, among other things, the bankruptcy estate's interest in the property.[28]

Sale of Marital Property in Bankruptcy

A bankruptcy trustee may sell property jointly owned by the debtor and a non-debtor, either as tenants in common, joint tenants, or tenants by the entirety, so long as each of the following elements is satisfied: 1) partition of the property would be impracticable; 2) sale of the estate's interest in the property would realize significantly less than sale of the property free of the co-owner's interest; 3) the benefit to the estate of the sale outweighs the detriment to the co-owner; and 4) the property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.[29]

"Experience has demonstrated that [factors] (1), (2) and (4) are usually stipulated or easy to prove...."[30] "The ultimate battle...is usually over [factor] (3)...."[31] "[E]ven where a nondebtor spouse and children will suffer substantial hardship, sale will be authorized...where it is the only way funds would become available for distribution to the debtor's creditors."[32]

If the trustee attempts to sell jointly owned property, the non-debtor spouse or co-owner must be accorded the right of first refusal on the sale.[33] Moreover, if the debtor and non-debtor spouse held the property in tenancy in common, each of the owners is entitled to half of the net proceeds.[34] Insofar as one spouse paid a disproportionate share of the mortgage payments and repairs, such expenditures, in the absence of evidence indicating otherwise, are presumed to be gifts.[35] Finally, a former marital residence is no longer subject to equitable distribution after the debtor's interest in the residence has been sold in bankruptcy.[36]

Treatment of Alimony, Support, and Maintenance Claims

Courts have declined to accord administrative claim, or priority, status to alimony, maintenance, or support.[37] A court could, however, conceivably declare that a portion of the estate constitutes property of the debtor, *i.e.*, property not of the estate, for the purpose of paying a non-debtor spouse's support on an ongoing basis.[38] Moreover, under the present bankruptcy code, an allowed claim for alimony, support, or maintenance owed to a spouse, former spouse, or child of the debtor is, unless assigned to a third party, entitled to seventh priority of payment.[39] Such a claim cannot include debt that has not matured as of the petition date.[40]

In addition, under Bankruptcy Code Section 523(a)(5), a bankruptcy discharge generally does not discharge an individual debtor from any debt owed to a spouse, former spouse, or child of the debtor for alimony, support, or maintenance.[41]

Although a divorce decree or settlement establishing a debtor's obligation may have arisen in a state court proceeding, federal law governs the determination of whether the obligation is actually in the nature of alimony, maintenance, or support within the meaning of Section 523(a)(5).[42] Whether an obligation is in the nature of alimony, maintenance, or support, as distinguished from property settlement, depends on the intent of the parties at the time of settlement.[43]

In determining the parties' intent, courts examine three principal factors: 1) the language and substance of the agreement at issue; 2) the parties' financial circumstances at the time of settlement, including the non-debtor spouse's custody of minor children, employment, and income; the parties' financial circumstances at the time of bankruptcy are irrelevant; and 3) the functions served by the obligation at the

time of divorce or settlement, *i.e.,* an obligation serving to maintain daily necessities such as food, housing, transportation, education, or medical expenses is indicative of a debt intended to be in the nature of support.[44]

In examining the first factor, the court must look beyond the label attached to an obligation. A debt could be in the nature of "support" under Section 523(a)(5), even though it would not qualify as alimony or support under state law.[45] The objecting party bears the burden of proving non-dischargeability.[46]

In the majority of published decisions applying Section 523(a)(5) in this state, courts have found the debt in question non-dischargeable.[47]

Section 523(a)(5) litigation in this state has given rise to a variety of principles. For instance, in order to be non-dischargeable, the alimony, maintenance, or support need not be directly owed to a spouse.[48] Further, although "a debt owed to a third party is considered owed to the child [under Section 523(a)(5)] if it is for the child's support," "there is no evidence in either New Jersey state law or federal bankruptcy law to suggest that the term 'child of the debtor' encompasses any relationship other than a parent/child relationship."[49] Hence, child support debt owed by someone other than a parent, including a guardian, is dischargeable under Section 523(a)(5).[50]

Second, the doctrines of claim or issue preclusion may prevent the relitigation of a state court's determination regarding alimony, support, or maintenance. For instance, in *Buglione v. Berlingeri (In re Berlingeri)* the bankruptcy court held that the parties were bound, under the principle of collateral estoppel, by the language of a state court consent judgment specifically providing that the claim at issue would be non-dischargeable in a bankruptcy case. In contrast, in *Romeo v. Romeo (In re Romeo)* the court refused to accord preclusive effect to a state court judgment, merely stating in conclusory language that certain debts owed by the debtor to his non-debtor spouse were non-dischargeable.

Third, the dependent party's attorney fees incurred in a divorce proceeding are usually considered to be in the nature of support, and as a result, non-dischargeable.[51] Courts disagree, however, as to whether legal fees and costs incurred in a Section 523(a)(5) proceeding are non-dischargeable.[52]

Finally, Section 523(a)(5) does not preclude either the debtor spouse or non-debtor spouse from seeking modification of alimony in state court.[53]

Bankruptcy courts and state courts share concurrent jurisdiction over a Section 523(a)(5) determination.[54] Additionally, the Bankruptcy Code does not require that a creditor file a proof of claim relating to debts non-dischargeable under Section 523(a)(5),(55) and a non-debtor spouse may file a complaint to determine the dischargeability of such a debt at any time.[56]

Treatment of Property Settlement Claims

Under current Bankruptcy Code Section 523(a)(15), a debt incurred in a divorce or separation, or in connection with a separation agreement or divorce decree, and not in the nature of alimony, maintenance, or support, is non-dischargeable in a Chapter 7 or 11 case unless 1) the debtor does not have the ability to pay the debt, or 2) discharging the debt would result in a benefit to the debtor that outweighs the detrimental consequences to the spouse.[57] This section is intended to encompass divorce-related debts, such as debts in property settlement agreements.[58]

In assessing a debtor's ability to pay under Section 523(a)(15), courts in this state have applied a disposable income test.[59] A court should consider the income of a debtor's new spouse or live-in companion in such an assessment.[60] Meanwhile, "[t]he 'detriment test' weighs the burdens imposed on the nondebtor spouse in not receiving the sum and the benefit to the debtor spouse in not paying the sum."[61] "The debtor must ultimately demonstrate that, if the debt is discharged, the benefit to the debtor of that discharge is greater than the harm to the creditor."[62]

In *Sanabria*, the court held that the benefit to the debtor of discharging a $350,000 property settlement obligation outweighed any detriment to the non-debtor spouse where: 1) the non-dischargeable support obligations to the non-debtor spouse exceeded the debtor's income, and 2) the non-debtor spouse's income and the payment of support were sufficient to support the non-debtor spouse.[63]

A bankruptcy petition must provide reasonable notice of any intention to discharge an obligation under Section 523(a)(15).[64] Further, only a bankruptcy court currently has jurisdiction to make a Section 523(a)(15) determination,[65] and a complaint to determine the dischargeability of a debt under Section 523(a)(15) must be filed no later than 60 days after the first date set for the meeting of creditors.[66] ⚖

Endnotes

1. *In re Giberson*, 260 B.R. 78, 81-82 (Bankr. D.N.J. 2001); *In re DeLauro*, 207 B.R. 412, 415-16 (Bankr. D.N.J. 1997).
2. *DeLauro*, 207 B.R. at 416.
3. *Evans v. Evans*, 347 N.J. Super. 139, 141-43 (Ch. Div. 2001).
4. *Compare Giberson*, 260 B.R. at 82-83 *and DeLauro*, 207 B.R. at 417-18 *with Reid v. Reid*, 310 N.J. Super. 12, 20 (App. Div.), *certif. denied*, 154 N.J. 608 (1998). Issue preclusion, otherwise known as collateral estoppel, bars re-litigation of an issue identical to that in a prior action. *Parkview Assocs. P'ship v. City of Lebanon*, 225 F.3d 321, 329 n.2 (3d Cir. 2000), *cert. denied*, 535 U.S. 1055 (2002). Claim

preclusion, otherwise known as *res judicata*, prohibits re-examination not only of matters actually decided in the prior case, but also those that the parties might have, but did not, assert in that action. *Id*. The Rooker-Feldman doctrine stands for the elementary principle that a party's recourse for an adverse decision in state court is an appeal to the appropriate state appellate court, and ultimately to the Supreme Court under Section 1257, not a separate action in federal court. *Id*. at 324.

5. *In re Howell*, 311 B.R. 173, 179 (Bankr. D.N.J. 2004); *Lawrence v. Lawrence (In re Lawrence),* 237 B.R. 61, 81-82 (Bankr. D.N.J. 1999); *In re Becker*, 136 B.R. 113, 115-18 (Bankr. D.N.J. 1992); *Mueller v. Youmans (In re Youmans)*, 117 B.R. 113, 121 n.3 (Bankr. D.N.J. 1990); *DiGiacomo v. DiGiacomo*, 256 N.J. Super. 404, 411-12 (App. Div. 1992).
6. *Howell*, 311 B.R. at 179; *Buglione v. Berlingeri (In re Berlingeri),* 246 B.R. 196, 199 (Bankr. D.N.J. 2000); *Lawrence*, 237 B.R. at 79.
7. *Lawrence*, 237 B.R. at 83.
8. *Berlingeri*, 246 B.R. at 199-200.
9. 11 U.S.C. § 522(c)(1); *Howell*, 311 B.R. at 175 n.2; *Becker*, 136 B.R. at 120.
10. N.J.S.A. 25:2-1(b)(2).
11. 11 U.S.C. § 522(d)(10)(D).
12. 11 U.S.C. § 362; *Becker*, 136 B.R. at 115-16.
13. 11 U.S.C. § 1301(a); *In re Haugland*, 199 B.R. 125, 127-28 (Bankr. D.N.J. 1996).
14. *Becker*, 136 B.R. at 116; *Frankel v. Frankel*, 274 N.J. Super. 585, 591 (App. Div. 1994); *DiGiacomo*, 256 N.J. Super. at 409. On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, generally applicable to bankruptcy cases filed on or after October 17, 2005. Bankruptcy Code Section 362(b)(2)(A) of the act codifies the lack of application of the automatic stay to proceedings concerning not only child custody, visitation, and marriage dissolution, but also domestic violence.
15. *Howell*, 311 B.R. at 179.
16. *Id*. at 174 n.1.
17. 11 U.S.C. § 362(b)(1).
18. *Rook v. Rook (In re Rook)*, 102 B.R. 490, 494 (Bankr. E.D. Va. 1989).
19. *Id*. at 492-93.
20. *Id*.
21. 11 U.S.C. § 362(b)(2)(A)(i).
22. 11 U.S.C. § 362(b)(2)(A)(ii); *Uslar v. Uslar*, 253 N.J. Super. 289, 296 (App. Div. 1992).
23. 11 U.S.C. § 362(b)(2)(B); *DiGiacomo*, 256 N.J. Super. at 409-13; *Leonardis v. Woodruff*, 354 N.J. Super. 135, 139 (Ch. Div. 2001). In addition, pursuant to Bankruptcy Code Section 362(b)(2)(C) of the 2005 act, the automatic stay will not apply to an action or proceeding with respect to the withholding of income that is property of the estate or the debtor for payment of a domestic support obligation.
24. *Becker*, 136 B.R. at 115-16.
25. *Id*. at 116 n.1.
26. *Giberson*, 260 B.R. at 83; *DeLauro*, 207 B.R. at 418.
27. *Berlingeri*, 246 B.R. at 198*; Kohn v. Hursa (In re Hursa),* 87 B.R. 313 (Bankr. D.N.J. 1988); *Schell v. Schell*, 212 N.J. Super. 649, 653 (Ch. Div. 1986). *See also Varela v. Varela,* 343 N.J. Super. 395, 396 (Ch. Div. 2000).
28. *Howell*, 311 B.R. at 178-80; *Lawrence*, 237 B.R. at 82-83; *Becker*, 136 B.R. at 116-19; *Youmans*, 117 B.R. at 121-22 n.8; *Fineberg v. Fineberg*, 309 N.J. Super. 205, 209-10 (App. Div. 1998).
29. 11 U.S.C. § 363(h).
30. *Youmans*, 117 B.R. at 115-16.
31. *Id*. at 121.
32. *Id.; In re Sutton*, Civ. No. 89-4704 (CSF), 1990 WL 25050, at *1-2 (D.N.J. Mar. 5, 1990). *But see Hursa*, 87 B.R. at 322; *Loeber v. Loeber (In re Loeber)*, 12 B.R. 669, 675 (Bankr. D.N.J. 1981).
33. 11 U.S.C. § 363(i).
34. *Youmans*, 117 B.R. at 118 (*citing Loeber*, 12 B.R. at 674).
35. *Id*.
36. *Colucci v. Colucci*, 251 N.J. Super. 73, 81-82 (Ch. Div. 1991); *Lee v. Lee*, 180 N.J. Super. 90, 94-95 (Ch. Div. 1981).
37. *In re Bradley*, 185 B.R. 7, 8-9, n.3 (Bankr. W.D.N.Y. 1995).
38. *Id*. at 8-10.
39. 11 U.S.C. § 507(a)(7). Pursuant to Bankruptcy Code Section 507(a)(1) of the 2005 act, a claim for domestic support obligations will, subject to exceptions, enjoy first priority of payment. In addition, pursuant to Bankruptcy Code Sections 1129(a)(14) and 1325(a)(8) of the 2005 act, a debtor, in order to confirm a plan, must remain current on his or her support obligations, and pursuant to Bankruptcy Code Sections 1112(b)(4)(P) and 1307(c)(11) of the 2005 act, failure to remain current shall constitute cause for conversion or dismissal of the case.
40. 11 U.S.C. § 502(b)(5).
41. 11 U.S.C. § 523(a)(5).
42. *Gianakas v. Gianakas (In re Gianakas),* 917 F.2d 759, 762 (3d Cir. 1990).
43. *Id*.
44. *Id*. at 762-63.
45. *Id*.
46. *Id*. at 761.
47. *Compare Gianakas*, 917 F.2d at 763-64; *MacDonald v. MacDonald (In re MacDonald),* 69 B.R. 259, 277 (Bankr. D.N.J. 1986); *Romeo v. Romeo (In re Romeo)*, 16 B.R. 531, 536 (Bankr. D.N.J. 1981); *Schorr v. Schorr*, 341 N.J. Super. 132, 138-40 (App. Div. 2001); *Winegarden v. Winegarden*, 316 N.J. Super. 52, 60-61 (App. Div. 1998) *and Loyko v. Loyko*, 200 N.J. Super. 152, 157 (App. Div.

1985) *with Tosti v. Tosti (In re Tosti)*, 62 B.R. 131, 133-34 (Bankr. D.N.J. 1986) *and Stein v. Fellerman*, 144 N.J. Super. 444, 450-51 (App. Div. 1976).

48. *See, e.g., MacDonald*, 69 B.R. at 271-72 (*citing Romeo*, 16 B.R. 531).
49. *Ceconi v. Uriarte (In re Uriarte)*, 215 B.R. 669, 673 (Bankr. D.N.J. 1997).
50. *Id*. at 674.
51. *See, e.g., DiGiacomo*, 256 N.J. Super. at 409.
52. *Compare Lawrence*, 237 B.R. at 86-87 *and MacDonald*, 69 B.R. at 278-79 *with V.M. v. S.S. (In re S.S.),* 271 B.R. 240, 247 (Bankr. D.N.J. 2002).
53. *Gianakas*, 917 F.2d at 763; *Pellitteri v. Pellitteri*, 266 N.J. Super. 56, 64 (App. Div. 1993); *Borzillo v. Borzillo*, 259 N.J. Super. 286, 301-02 (Ch. Div. 1992); *Siegel v. Siegel*, 243 N.J. Super. 211, 214 (Ch. Div. 1990).
54. *Winegarden*, 316 N.J. Super. at 59.
55. *Id*. (*citing* 11 U.S.C. § 523(c)(1)).
56. Fed. R. Bankr. P. 4007(b).
57. 11 U.S.C. § 523(a)(15). Pursuant to Bankruptcy Code Section 523(a)(15) of the 2005 act, the non-debtor spouse will no longer need to satisfy the two-prong test under the existing code.
58. *Maldonado v. Sanabria (In re Sanabria)*, 275 B.R. 204, 207 (Bankr. D.N.J. 2002).
59. *Id*. at 208; *Halper v. Halper (In re Halper),* 213 B.R. 279, 283 (Bankr. D.N.J. 1997).
60. *Halper*, 213 B.R. at 283-84.
61. *Sanabria*, 275 B.R. at 208.
62. *Id*.
63. *Id*. at 208-09.
64. *Heselton v. Maffei*, 374 N.J. Super. 184, 193-94 (App. Div. 2005).
65. *Winegarden*, 316 N.J. Super. at 60. Pursuant to Bankruptcy Code Section 523(c)(1) of the 2005 act, bankruptcy courts will no longer possess exclusive jurisdiction.
66. Fed. R. Bankr. P. 4007(c).

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