

Excepting Divorce and Custody-Related Debts from Discharge in Bankruptcy

By Michael R. Pacewicz

Introduction

Perhaps one of the most frequently and zealously litigated issues in consumer bankruptcy is the nondischargeability of a divorce-related obligation to a former spouse. Often, non-debtors find themselves facing off against former spouses who have filed bankruptcy, at least partially, to escape debts stemming from divorce proceedings. These non-debtor spouses, quite naturally, tend to turn for assistance to the family law attorney who shepherded them through their divorce.

Family law and general practitioners who find themselves thrust into bankruptcy court may be shocked to discover that a seemingly explicit divorce decree or property settlement agreement does not necessarily prevent or guarantee the discharge of a divorce-related debt. This article will attempt to provide non-bankruptcy practitioners with an understanding of extant Tenth Circuit jurisprudence related to the nondischargeability of divorce-related obligations, including obligations for attorney's fees and costs.

The Bankruptcy Discharge

Section 524 of the Bankruptcy Code¹ details the effect of the bankruptcy discharge. Under this section, the discharge voids any judgment to the extent the judgment creates a personal liability for the debtor on a debt

incurred prior to the filing of the bankruptcy petition.² The discharge also acts as an injunction preventing creditors from commencing or continuing efforts to collect pre-petition debts as a personal liability of the debtor.³ Congress, however, has deemed that a debtor's personal liability for certain debts should survive bankruptcy. These debts are enumerated in § 523 of the Bankruptcy Code, which was enacted as part of the Bankruptcy Reform Act of 1984. One of the debts excepted from discharge is a debt "to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child."⁴

Early 10th Circuit Precedent

In 1986, the Tenth Circuit decided *In re Yeates*, its first case involving § 523(a)(5) since the implementation of the Bankruptcy Reform Act.⁵ In *Yeates*, the parties obtained a divorce from a Utah state court and executed an agreement wherein each party waived the right to receive alimony. In return for the reciprocal waivers, the wife agreed to assume the mortgage on the parties' home and the husband agreed to borrow \$6,000, using the home as collateral, and to pay the proceeds of the loan to the wife. After the divorce, the husband defaulted on the loan and subsequently filed for bankruptcy. The

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wife filed an adversary proceeding seeking to have the debt declared nondischargeable as a support obligation. The husband/debtor argued that the debt was part of a property settlement and was therefore dischargeable in bankruptcy. The bankruptcy court ruled for the debtor, holding that because the wife's economic position was not adversely affected by the divorce, the debtor owed her no duty of support and the debt was therefore not in the nature of alimony, maintenance or support.⁶

The wife appealed to the district court, which reversed the bankruptcy court's ruling.⁷ The district court found that the bankruptcy court had applied an incorrect legal standard when it focused on the husband's duty to provide support in determining whether the debt was in the nature of support. The district court ruled that had the bankruptcy court applied the correct standard, it would have found the debt to be in the nature of support.⁸ This time the debtor appealed.

The Tenth Circuit affirmed the decision of the district court and found the debt to be nondischargeable under § 523(a)(5). In doing so, the court set forth several principles that courts throughout the Tenth Circuit continue to apply in determining dischargeability under § 523(a)(5). Initially, the court noted that the legislative history behind § 523(a)(5) compels courts to look to bankruptcy law, rather than state law, in determining what constitutes alimony, maintenance or support. At the same time, however, the court recognized that well-developed state law principles provide guidance in making that determination. The *Yeates* court then ruled that the bankruptcy court erred in employing the "duty to support" test and set forth the test to be used in situations where divorced parties enter into a property settlement agreement: whether, at the time the agreement was made, the parties intended to create a support obligation. If so, the debtor's obligation under the agreement will not be dischargeable in bankruptcy.⁹

Determining what the parties intended when they made the agreement can, of course, present difficulty. The *Yeates* court ruled that

an unambiguous agreement that clearly reflects that the parties intended an obligation to be either support or property settlement would normally control. Where the agreement is ambiguous, however, the court must consider extrinsic evidence in determining the parties' intent. Turning to the facts of the case, the court reasoned that the non-debtor spouse's need for support is a "very important factor in determining the intent of the parties," and found that the wife's "dire financial circumstances at the time of the divorce" led to the conclusion that the debtor's loan payments were in the nature of support.¹⁰

Approximately one month after the *Yeates* decision was released, a different Tenth Circuit panel decided *In re Goin*,¹¹ another case involving § 523(a)(5). In *Goin*, the divorce decree required the husband to pay his ex-wife \$80,000 in \$5,000 increments until the entire sum was paid. The decree also required the husband to pay \$350 per month in child support. According to the decree, the \$80,000 represented the ex-wife's one-half interest in real estate and securities. After making three payments, the husband sought relief under chapter 7 and filed a complaint seeking to determine the dischargeability of the balance of the debt. The bankruptcy court ruled that the \$80,000 debt was in the nature of support or alimony and was therefore nondischargeable.¹²

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The bankruptcy court looked to several factors set forth by the Ninth Circuit in *Shaver v. Shaver*¹³ in reaching its decision. Those factors include: (1) whether it appears that the spouse needs support in those cases where the decree does not explicitly so provide; (2) the existence of minor children and a disparity in income; (3) whether the payments are made directly to the recipient and are paid in installments over a substantial period of time; and (4) whether the obligation terminates upon remarriage or death.¹⁴ The bankruptcy court found evidence supporting the first three of the *Shaver* factors and concluded that the parties intended the \$80,000 to be support and maintenance. The district court affirmed, and the debtor appealed to the Tenth

Circuit.¹⁵ The circuit court, applying the clearly erroneous standard of review to the bankruptcy court's findings of fact, affirmed. In doing so, the court stated that bankruptcy courts must go behind the language of the divorce decree to determine the intent of the parties and the substance of the obligation.¹⁶ Notably, the *Goin* court did not limit the consideration of extrinsic evidence to those instances in which the language of the divorce decree is ambiguous, as the *Yeates* court had done.

Reconciling *Yeates* and *Goin*

The next significant Tenth Circuit decision involving § 523(a)(5) didn't come along for another six years. In *In re Sampson*,¹⁷ the parties obtained a divorce and entered into an agreement providing that the debtor would pay a set amount to his former spouse each month for eight years. The agreement described the payments as support and specifically stated that the payments were not part of a property settlement. Several years later, the debtor filed a voluntary petition under chapter 7 of the Bankruptcy Code. His former spouse instituted an adversary proceeding seeking to except the debt from discharge. The evidence presented to the bankruptcy court indicated that the debtor's former spouse was an unemployed homemaker with no independent income and no job skills or training at the time of the divorce. The debtor presented evidence that the monthly payments were intended as part of a property settlement but were described as maintenance in the agreement so that he could deduct the payments for income tax purposes. The bankruptcy court, deeming itself bound by *Yeates*, found that the language of the agreement was clear, thus prohibiting the consideration of extrinsic evidence, and held that the debt was nondischargeable. Surprisingly, the bankruptcy court then proceeded to make additional findings, stating that it would have found that the parties intended the debt as a property division, had it been able to look behind the agreement.¹⁸

On appeal, the district court held that the bankruptcy court should have considered the extrinsic evidence in making its determination as to the dischargeability of the debt, and further held that the bankruptcy court's alternative finding that the parties intended the obligation as a property division was incorrect. Upon examining the language of the agreement and the surrounding circum-

stances, the district court found the debt nondischargeable.¹⁹

When the case reached the Tenth Circuit, the court was faced with the task of reconciling the *Yeates* and *Goin* decisions and formulating a standard for deciding when a debt is "in the nature of alimony, maintenance, or support." In *Yeates* the court had placed heavy emphasis on the parties' intent and stated that an unambiguous agreement would normally control the determination. *Goin*, on the other hand, placed an affirmative duty on the bankruptcy court to go behind the divorce decree or agreement to determine both the parties' intent and the substance of the obligation owed by the debtor, even where the language in the decree or agreement is unambiguous. The first step in this reconciliation was to jettison the notion that an unambiguous agreement could control the court's determination in favor of a less restrictive rule, also found in *Yeates*, that "[a] written agreement between the parties is *persuasive* evidence of intent."²⁰ The *Sampson* court then reiterated the two-prong test of *Goin*, refining it slightly by instructing that with respect to the first prong, it is "the shared intent of the parties at the time the obligation arose" that is critical.²¹ A party's post hoc explanation regarding his or her state of mind at the time of the agreement, even if unrefuted, would not be determinative of the intent issue.²²

Applying this standard to the facts before it, the *Sampson* court rejected the debtor's evidence because it tended to show only the debtor's state of mind at the time of the agreement rather than the parties' shared intent. In the court's view, such evidence could not overcome the "clear expression of the parties' shared intent" found in the agreement.²³ The court also found that the relative financial condition of the parties evinced a shared intent to create a support obligation. Thus, the court concluded that the bankruptcy court's alternative finding that the parties intended the obligation as a property division was in error.²⁴

The court then turned to the second prong of the test: whether the obligation was in substance support. This determination hinges on what function the obligation served when the parties were divorced.²⁵ The function of the obligation, the court stated, "may be determined by considering the relative financial circumstances of the parties at the time of the

divorce."²⁶ The court concluded that where the obligation serves as the non-debtor's source of income upon divorce, it is in substance a support obligation. Based on the overwhelming disparity in the parties' financial circumstances and the non-debtor's limited employment prospects, the circuit court determined that the obligation functioned as the non-debtor's source of support at the time of divorce. Accordingly, the circuit court affirmed the district court's ruling that the debt was nondischargeable under § 523(a)(5).²⁷

The *Sampson* decision is notable in at least two respects. First, despite the court's insistence that the unambiguous language contained in a divorce decree or property settlement agreement was not controlling, the court placed a great deal of emphasis on the written agreement in question, at least with respect to determining the parties' intent. Second, and perhaps more importantly, the *Sampson* court opined that the non-debtor spouse's need for support at the time of the divorce was a very important consideration in determining both the substance of the obligation, and the parties' intent in creating the obligation. Thus, the spouse's need for support "may, in some cases, be dispositive on whether an obligation to a former spouse is nondischargeable under § 523(a)(5)."²⁸

Professional Fees and Custody Disputes

The next stage in the evolution of Tenth Circuit jurisprudence relating to § 523(a)(5) came in late 1993 with *In re Jones*.²⁹ *Jones* involved an attempt by a non-custodial parent to discharge an obligation to pay attorney's fees and costs incurred by the custodial parent in successfully defending a motion to modify custody. The bankruptcy court ruled that the debt should be discharged because it arose out of a custody proceeding, not a support action. The custodial parent, in this case the husband, appealed to the district court, which reversed, holding that "the determination of child custody is essential to the children's proper 'support' and that attorney's fees incurred in custody modification proceedings should likewise be considered as obligations of support."³⁰ The non-custodial parent appealed.

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The circuit court recognized a split among its three sister courts that had previously considered the issue. Both the Fifth³¹ and Second³² Circuits had previously held that court-ordered attorney's fees stemming from a post-divorce custody dispute were nondischargeable because they affected the welfare of the child. The Eighth Circuit, conversely, had ruled that the purpose of the custody proceeding must be examined in order to determine whether it was held in order to determine the child's best interests.³³ If it was not, then the debt was dischargeable.³⁴

The *Jones* court rejected the Eighth Circuit's approach in favor of a rule that the ultimate goal of all custody actions is the welfare of the child. Following the reasoning of the United States Bankruptcy Court for the Northern District of Oklahoma,³⁵ the court held that the term "support" for purposes of § 523(a)(5) "encompasses the issue of custody absent unusual circumstances"³⁶ Thus, the court concluded, the non-custodial parent's obligation to pay attorney's fees and costs was nondischargeable. The *Jones* court declined to elaborate, however, on what "unusual circumstances" might remove custody-related debts from the realm of support.

While *Jones* was limited in its application to debts related to attorney's fees and costs, its holding that custody actions fall within the confines of § 523(a)(5) absent unusual circumstances left open the possibility that other court-ordered obligations might be excepted from discharge. The Tenth Circuit addressed that question in *In re Miller*.³⁷ In *Miller*, a state court had appointed a guardian ad litem and a psychologist in connection with divorce and custody proceedings. Upon entering the final decree, the state court ordered the wife to pay certain sums to the guardian ad litem and the

psychologist for their fees. The wife later filed a bankruptcy petition and brought an adversary proceeding seeking a determination that the debts were dischargeable. In a decision rendered before *Jones* was decided, the bankruptcy court found that the debts were dischargeable because they were not owed to a spouse, former spouse or child of the debtor as required by § 523(a)(5). By

the time the case reached the district court on appeal, the Tenth Circuit had decided *Jones*. Finding itself bound by the *Jones* decision, the district court reversed the bankruptcy court and ruled that the fees were nondischargeable.³⁸

On appeal, the Tenth Circuit recognized that *Jones* had not addressed the question of whether an obligation to a third party could be excepted from discharge as support under § 523(a)(5). Nevertheless, the *Miller* court found *Jones* controlling and affirmed the decision of the district court. In doing so, it acknowledged the emphasis in *Jones* on the nature of the debt in question, not the identity of the payee, and rejected the notion that "support" be limited to "the bare paying of bills on the child's behalf."³⁹

After *Miller*, the analytical framework for determining exceptions to discharge under § 523(a)(5) in the Tenth Circuit was relatively well-developed. Where the issue was whether a debt constituted a property division or a support obligation, the courts would go behind the divorce decree to determine the intent of the parties and the substance of the obligation, measured from the time of the divorce. An explicit statement in the divorce decree would be persuasive, but not conclusive, evidence of the parties' intent, and the non-debtor's need for support would be an important consideration. Where the question was whether court-ordered fees and expenses were excepted from discharge, those fees and expenses, even when paid directly to third parties, were presumptively nondischargeable as support where they flowed from custody proceedings. This presumption could be overcome by a showing of "unusual circumstances."

Lowther's Unusual Circumstances

Yet the question remained what unusual circumstances would put custody-related fees and expenses beyond the reach of § 523(a)(5). The *Jones* court provided no examples of such circumstances and the question was not presented in *Miller*. It was left to the Bankruptcy Appellate Panel, some eight years after *Jones* was decided, to begin molding a definition of the term "unusual circumstances."

In *In re Lowther*,⁴⁰ the parties had engaged in protracted divorce proceedings and a hard-fought custody dispute. The mother eventually retained custody of the couple's child, but

not until after the state court ordered liberal visitation and admonished the mother for alienating the child from its father. Although the father was obligated to pay child support, the state court ordered the mother to pay the father \$9,000 in attorney's fees and \$303.05 in costs after finding she was 60 percent at fault for the alienation. The mother subsequently filed for relief under chapter 7 of the Bankruptcy Code, and the father filed an adversary proceeding seeking to have the fees and costs excepted from discharge.⁴¹

At trial, the mother testified that she received food stamps and a small income from a home day care business, in addition to child support payments. The mother also testified that her expenses exceeded her income and that she could not pay the attorney fee award. The father testified that the custody dispute was caused largely by the mother and that he had incurred significant fees fighting for custody of the child. The mother argued that the case fell within the unusual circumstances exception because she was the custodial parent, while *Jones* involved a non-custodial parent attempting to discharge fees. The bankruptcy court found that the custodial or noncustodial status of the debtor was not an issue under *Jones*. The bankruptcy court further found that there was no basis for application of the unusual circumstances exception and ruled that the debt was not dischargeable.⁴²

On appeal, the mother again argued that *Jones* was premised on the fact that the non-custodial parent was the debtor. She also argued that the award of fees in *Jones* was directly related to the child's support and welfare, while the fee award in her case undermined her ability to support her child. The BAP concluded that a debtor's status as the custodial parent, standing alone, was not an unusual circumstance excluding a debt from the definition of support under § 523(a)(5). The BAP then recognized that *Jones*, by deeming all custody related fees as support, prevented it from going behind the fee award to determine its nature and purpose, as it would in a non-custody case. Precluded from examining the state court's reason for awarding the fees, the BAP reasoned that it could still consider the effect of the award to determine whether unusual circumstances were present.⁴³ The court then held that an unusual circumstance exists where "a parent's income is so insubstantial that the obligation to pay attorney's

fees will clearly affect the parent's ability to financially support the child for a significant duration."⁴⁴

The BAP went on to describe two scenarios in which such an unusual circumstance might occur: (1) where the debtor's ability to pay child support is "severely impaired" by the obligation to pay an attorney's fee award; and (2) where a custodial parent's child support payments are cancelled out by the obligation to pay attorney's fees. Finding that the mother's ability to adequately support her child would be hampered if she were required to pay the attorney's fees, the BAP reversed the bankruptcy court and ruled the debt dischargeable.⁴⁵

Clearly, the BAP was faced with an unusual set of facts in *Lowther*. As the court acknowledged, "it is a rare occurrence when the successful party in a custody dispute must pay the non-custodial parent's attorney fees."⁴⁶ Faced with the prospect of requiring the debtor to essentially surrender her child support payments for several years, the court was left with little choice. But it may also be argued that the *Lowther* court used overly broad language in reaching its result. Rather than limiting the case to its facts, the BAP created an opening for non-custodial parents to discharge custody-related fees upon a showing that their ability to pay child support is severely impaired. If nothing else, this has the potential for fomenting additional, perhaps meritless bankruptcy litigation between former spouses.⁴⁷ The Tenth Circuit may have recognized this danger when, in affirming the BAP, it limited the case to its facts and defined the unusual circumstances exception as a narrow one.⁴⁸

Conclusion

Challenging the dischargeability of a divorce-related obligation can be a confusing and frustrating experience for attorneys with limited bankruptcy experience and for their clients. Remembering some basic principles should help alleviate some of that confusion and frustration, however.

First, both attorneys and clients should remember that the labels they attach to an obligation in a divorce decree or property settlement agreement will not control the dischargeability determination. Nor will an explicit statement in the decree or agreement stating that the debt is, or is not, dischargeable. The

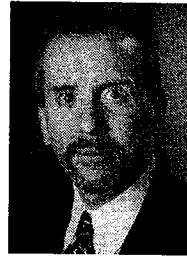
bankruptcy court must go behind the decree or agreement to ascertain what the parties intended at the time of the divorce. The bankruptcy court must also go behind the decree or agreement to determine whether the obligation is in substance support. The relative financial condition of the parties will play a significant role in this determination.

Second, where the debtor spouse has been ordered by the divorce court to pay the non-debtor's attorney fees, those fees will generally be nondischargeable. If the fees relate to a custody determination, they will be nondischargeable absent a showing by the debtor that paying the fees will substantially impair his or her ability to adequately support the child, or will effectively cancel out the child support payments received by the debtor.

1. 11 U.S.C. § 101, *et seq.*
2. 11 U.S.C. § 524(a)(1).
3. 11 U.S.C. § 524(a)(2).
4. 11 U.S.C. § 523(a)(5).
5. 807 F.2d 874 (10th Cir. 1986).
6. *Id.* at 876.
7. *Yeates v. Yeates* (*In re Yeates*), 44 B.R. 575 (D. Utah 1984).
8. *Id.* at 580-81.
9. 807 F.2d at 877-79.
10. *Id.* at 878-79. Notably, the court in *Yeates* listed no other factors that courts could look to in determining whether the parties intended an obligation to serve as support or a property settlement. The outcome of *Yeates* appeared to rest entirely on the non-debtor spouse's need for support at the time of support.
11. 808 F.2d 1391 (10th Cir. 1987).
12. *Id.* at 1392.
13. 736 F.2d 1314 (9th Cir. 1984).
14. *In re Goin*, 808 F.2d at 1392-93.
15. 58 B.R. 136 (D. Kan. 1985).
16. *Id.* at 1392-93.
17. 997 F.2d 717 (10th Cir. 1993).
18. *Id.* at 719-20.
19. *Id.* at 720-21.
20. *Id.* at 723 (quoting *Yeates*, 807 F.2d at 878) (emphasis added).
21. 997 F.2d at 723.
22. *Id.*
23. *Id.*
24. *Id.* at 724-25.
25. *Id.* at 725-26 (citing *In re Gianakas*, 917 F.2d 759, 763 (3d Cir. 1990)). In an earlier decision, the Tenth Circuit had rejected the argument that the bankruptcy court should examine the non-debtor spouse's present need for support in determining the nature of the obligation. See *Sylvester v. Sylvester*, 865 F.2d 1164, 1165 (10th Cir. 1989).
26. 997 F.2d at 726.
27. *Id.*
28. *Id.* n.7.
29. 9 F.3d 878 (10th Cir. 1993).
30. *Id.* at 880.
31. *Dvorak v. Carlson* (*In re Dvorak*), 986 F.2d 940 (5th Cir. 1993).
32. *Peters v. Hennenhoefter* (*In re Peters*), 964 F.2d 166 (2d Cir. 1992).
33. *Adams v. Zentz*, 963 F.2d 197 (8th Cir. 1992).
34. *Id.* at 201.
35. *Holtz v. Poe* (*In re Poe*), 118 B.R. 809 (Bankr. N.D. Okla. 1990).
36. 9 F.3d at 881-82. It is interesting to note that *Jones* contained no discussion of whether court-ordered attorney fees stemming from divorce proceedings where custody was not an issue could constitute a support obligation. However, as far back as 1977 the Tenth Circuit had recognized that attorney fees awarded in divorce proceedings were generally treated as a form of support. See *In re Birdseye*, 548 F.2d 321, 325 (10th Cir. 1977) (Bankruptcy Act case).
37. 55 F.3d 1487 (10th Cir. 1995).
38. *Id.* at 1488-89.

39. *Id.* at 1490 (quoting *Jones*, 55 F.3d at 881).
 40. 266 B.R. 753 (10th Cir. BAP 2001).
 41. *Id.* at 755-56.
 42. *Id.* at 756. Because the parties had agreed that 90 percent of the divorce proceeding related to the custody issue, the bankruptcy court reduced the fees and costs by 10 percent.
 43. *Id.* at 758.
 44. *Id.* at 759.
 45. *Id.* at 760.
 46. *Id.* at 758.
 47. At least one non-custodial debtor, acting *pro se*, has argued that unusual circumstances should enable him to discharge a debt for attorney's fees related to custody proceedings. In an unpublished decision, the BAP affirmed the ruling of the bankruptcy court finding the debt non-dischargeable. See *In re Chapman*, 2002 WL 1926137 (10th Cir. BAP Aug. 21, 2002).
 48. *In re Lowther*, 321 F.3d 946, 949 (10th Cir. 2002).

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