

Bankrupting Is Hard To Do: Family Law Considerations and the Filing of Bankruptcy

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The intersection of family law and bankruptcy law raises issues in the areas of support obligations, community and separate property, dischargeability, and timing, such as when to file which.

Domestic Support Obligations. Domestic support obligations (DSOs) are not discharged by filing a bankruptcy under Chapter 7. 11 U.S.C. 523(a)(5). For purposes of bankruptcy, a DSO is support owed to or recoverable by a spouse, former spouse or governmental unit that is in the nature of alimony, maintenance or support (including assistance provided by a governmental unit) of such person under the provisions of a separation agreement, divorce decree, property settlement agreement or other order of a family court.¹

Automatic Stay. The automatic stay stays family law cases only to the extent of the division of property and debts. There is an exclusion from the automatic stay under §362(b)(2) for the establishment or enforcement of DSOs. This includes the continuation of wage assignments, the continuation of administrative enforcement such as suspension of licenses (drivers, professional or recreational), reporting overdue DSOs to consumer reporting agencies, interception of tax refunds, and enforcement of medical obligations.

Community, Separate and Joint Property. Arizona is a community property state. After marriage (in the absence of a premarital agreement), the incurring of a debt by one of the spouses creates an obligation to the creditor of both (a) community debt and (b) a separate debt for the spouse who incurred the debt (except for debts for real property or upon personal guarantee). A debt incurred by both spouses binds both their community and their separate property.²

A discharge in a bankruptcy filed by both husband and wife discharges the community and separate obligations of the debtors.³ The debtors' community and separate property are subject to administration by the bankruptcy trustee.⁴

If only one spouse files the bankruptcy, the community debts and the separate obligations of the filing spouse are discharged. However, community debt incurred by the non-filing spouse is not discharged. The community property of the couple, as well as the filing spouse's separate property, is subject to administration by the trustee. In addition, the non-filing spouse's separate property is subject to the administration of the trustee in an amount equal to the community debt that the non-filing spouse incurred.

After dissolution of marriage, the community debts become joint debts of the parties.⁵ The dissolution of marriage will apportion the community debts of the parties but is not binding on the creditors. The filing of bankruptcy by one former spouse after the marriage is dissolved does not discharge the non-filing spouse of the former community debts (now joint debts).

The dissolution decree's apportioning of the community debts is usually accompanied by a hold-harmless provision: the spouse to whom a particular debt is assigned will hold the other spouse harmless for that debt. The assigned spouse is obliged to pay the particular debt, and, in the event that the debt is not paid, the other spouse can pay that debt and seek recovery of that debt from the non-paying spouse. In a Chapter 7 bankruptcy, the non-paying former spouse can discharge that obligation to pay the

¹ 11 U.S.C. section 101 (14A)

² A.R.S. section 25-215

³ 11 U.S.C. section 524(a)(3)

⁴ 11 U.S.C. section 541(a)(2)

⁵ *Community Guardian Bank v. Hamlin*, 182 Ariz. 627, 898 P.2d 1005 (App. 1995)

creditor, but he or she cannot discharge the hold-harmless provision and the potential obligation to repay the other former spouse.⁶

The filing and service of the petition for divorce (or legal separation) terminates the marital community and, possibly, the responsibility for the debts incurred by the other spouse so long as the petition for divorce ends in divorce (or legal separation).⁷

The Superior Court can take into consideration the discharge of debts in dividing community assets. Under A.R.S. § 25-318(A), the family court is to divide the marital property equitably (not necessarily equally). The Court of Appeals has sustained a family court redistributing property post-discharge in bankruptcy and upon a Rule 60 motion.⁸

Family Court Orders. A Chapter 7 bankruptcy does not discharge the obligations of a divorce decree, separation agreement or other orders of the family court. Such an obligation is dischargeable in a Chapter 13 filing. Common provisions that are ordered by the family court order that have dischargeability repercussions are hold-harmless provisions (discussed *supra*), property division orders and attorney fee awards.

FAMILY LAW AND BANKRUPTCY FILING CONSIDERATIONS

Which to File First? Among the most frequent issues at the intersection of family law and bankruptcy law is the question of which action to file first.

Consideration One. The filing and service of the petition for divorce (or legal separation) terminates the marital community and possibly the responsibility for the debts incurred by the other spouse, so long as the petition for divorce ends in divorce (or legal separation).⁹ It may be in a party's best interest to terminate the marital community prior to filing bankruptcy to prevent additional community debt being incurred after the bankruptcy filing (and rendering the obligation not subject to discharge).

Consideration Two. A Chapter 7 bankruptcy does not discharge the obligations of a divorce decree, separation agreement or other orders of the court.¹⁰ So there is merit to filing the bankruptcy prior to the entry of a family court and, thus, depriving the bankruptcy judge of the jurisdiction to divide debts. It also takes a very contentious issue off of the negotiation table.

Consideration Three. As was mentioned above, the Superior Court can take into consideration the discharge of debts in dividing community assets. The family court is to divide the marital property equitably under A.R.S. §25-318(A). The Court of Appeals has sustained a family court order redistributing property post-discharge in bankruptcy and upon a Rule 60 motion.

⁶ 11 U.S.C. section 532(a)(15)

⁷ A.R.S. §25-211(2)

⁸ *Birt v. Birt*, 208 Ariz. 546, 96 P.3d 544, 549-51 (App.2004)

⁹ A.R.S. §25-211(2)

¹⁰ 11 U.S.C. §523(a)(15)