The Bankruptcy Code and Its Impact on Attorneys' Fees in Divorce in Arizona

BY LAWRENCE D. HIRSCH

The Bankruptcy Code has several provisions concerning divorce proceedings and awards made pursuant to a decree of dissolution. For example, child support and spousal maintenance obligations are never dischargeable (they are enforceable after the conclusion of the bankruptcy).[1] They are known in bankruptcy as Domestic Support Obligations ("DSO"). Amounts due a former spouse at the time of the filing of the Bankruptcy are treated as Priority debts.[2] In addition, any claim that a debtor makes to exempt property from the estate does not apply to a claim held by the recipient of a DSO.[3] A debtor cannot confirm a Chapter 11, 12 or 13 Plan unless all post-petition DSO payments have been made.[4] A Plan of Reorganization under Chapter 12 or 13 must provide for the payment in full of a DSO (or other Priority Debt) unless the recipient agrees otherwise.[5] As a general rule, payments to medical and mental health professionals, especially regarding the care and treatment of minor children, are considered to be a DSO and subject to the same conditions.[6]

There are other types of awards arising from a divorce that are not in the nature of support. Equalizer payments, debt assumption, transfers of property and the like are more in the nature of a division of property and not in the nature of support. Those obligations are provided for in 11 U.S.C. § 523(a)(15), and debts arising under that section are not dischargeable in either Chapter 7, Chapter 11 or Chapter 12, but they are dischargeable in Chapter 13. A debtor wishing to discharge an indemnification obligation, an equalizer payment or the "buy-out" of an asset may find such relief under Chapter 13.

Many decrees of dissolution provide for an award of attorney's fees from one spouse to another. Sometimes the award is made payable to the ex-spouse and sometimes to that spouse's attorney. Case law has held that it makes no difference if the fees are payable to the ex-spouse or to that spouse's attorney.[7] Are those fees considered to be a DSO? In that case, the same rules apply as stated above regarding discharge, priority and claims of exemption. Are they more in the nature of a property distribution or the assignment of debt? If so, perhaps the fees

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are governed by § 523(a)(15) and may be discharged in a Chapter 13.

The categorization of an award of attorney's fees arising from a dissolution of marriage is of significant relevance in Chapter 13 cases because fees that are not considered to be a DSO can and will be discharged at the successful completion of a Chapter 13 Plan. This issue has led to a great deal of litigation in Chapter 13 as debtors seek to discharge fee awards, and creditors and their counsel seek to protect those fees and see that they are paid in the plan. While the issue still has significance in Chapter 7 (priority treatment and the lack of exemption protection for such awards if they are found to be a DSO), it is far more likely to arise in Chapter 13.

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The determination of whether an obligation is a DSO or is a non-DSO is a determination that can be made by either a state court or the bankruptcy court. Jurisdiction on this matter is concurrent.[8] Each court will apply a federal standard to determine if the debt is a DSO, but each will look to state law for guidance.[9]

Arizona enacted A.R.S. § 25-324 in 1973 concerning this issue, and it has been subject to revision and addition on several occasions since. At that time, the statute provided that:

> The court from time to time, after considering the financial resources of both parties, may order a party to pay a reasonable amount to the other party for the costs and expenses of maintaining or defending any proceeding under this chapter. For the purpose of this section costs and expenses may include attorney's fees, deposition costs, and such other reasonable expenses

> as the court finds necessary to the full and proper presentation of the action, including any appeal. The court may order all such amounts paid directly to the attorney, who may enforce the order in his name with the same force and effect, and in the same manner, as if the order had been made on behalf of any party to the action.[10]

The first reported decision from the Ninth Circuit concerning this "new" statute was *In re Catlow*.[11] There, the Ninth Circuit held that fees awarded to a former spouse in a post-divorce custody matter were non-dischargeable under the Bankruptcy Act, the statute in existence at the time of the filing of the bankruptcy (it was the predecessor to the Bankruptcy Code). The Ninth Circuit also held that the result would be the same under the Bankruptcy Code. The court held that the fees were non-dischargeable because they arose out of an obligation to support. The court stated:

> The Arizona statute authorizing attorney's fees … permits a fee award upon a showing of financial necessity and requires a court to consider the respective needs and incomes of both spouses prior to making an award. Arizona courts have ruled consistently that this statutory obligation is founded upon a spouse's duty of support to his or her spouse. The courts have held that "attorney's fees are as much for the wife's support as payments made directly to her …" and a decision to grant fees "is an adjudication of her need of such support in order to litigate with her husband upon an equal basis."[12]

At that time, the financial needs of the spouse were the sole basis for an award of fees. The statute remained unchanged for a number of years. A 1996 amendment added a clause allowing the court to consider "the reasonableness of the positions each party has taken throughout the proceedings" to the grounds for an award of fees, in addition to the financial resources of the parties. In 2007, an additional provision was added to subsection A to allow the court, upon the request of a party or "another court of competent jurisdiction," to make specific findings as to whether all or part of a fee award was based upon need or upon the reasonableness of a position taken. Those findings could be made prior to or subsequent to a fee award. And the statute was amended in subsection B to further define "costs" and to add subsection C to allow for direct payment of the fee award to the attorney for the recipient spouse and to allow that attorney to separately enforce the award. (This provision had previously been part of Subparagraph A but was moved and became Subparagraph C.) Finally, in 2010, the current version of the statute was adopted, creating a new subsection B regarding sanctions (and moving the old B and C to become C and D).

Bankruptcy courts have faced this issue in different ways over the years since the ruling in *Catlow*. In an unpublished decision,[13] Judge Case concluded that the Ninth Circuit has found that there is a "presumption" that fees awarded in custody disputes are

considered to be in the nature of support. He cited *Catlow*, *Chang* and *Jarski*.

Such a reliance may be unfounded. As stated above, the only statutory basis for a fee award in *Catlow* was the financial need of the party. The Ninth Circuit in *Chang* (a decision made under California law) simply cited *Catlow* for the proposition that a federal court will look to state law for guidance on the issue and that fees can be awarded directly to the professional and not just to the spouse. The bankruptcy court in *Jarski* cited A.R.S. § 25-324 as it existed in 2003 (after the 1996 change referenced above) and held that it was the same statute as was analyzed in *Catlow*. Query whether the "presumption" found by Judge Case is accurate.[14]

In 2007 the Ninth Circuit Bankruptcy Appellate Panel affirmed, in an unpublished decision, a ruling by Judge Curley in *In re Ackerman*.[15] The case presented an unusual procedural setting, but the underlying issue of the dischargeability of fees was addressed. The BAP focused entirely on issues regarding financial need as a basis for a determination as to whether fees were dischargeable.

One judge concluded the Ninth Circuit found a "presumption" that fees awarded in custody disputes are considered to be in the nature of support. Such a reliance may be unfounded.

A recent unpublished ruling from the Arizona Bankruptcy Court illustrates the difficulty faced by the court in analyzing this situation. In *In re Basmajian*,[16] Judge Whinery was presented with a fee award in which the recipient spouse was found to be in greater financial need yet also had taken unreasonable positions in the divorce litigation. The debtor was assessed fees to be paid to her ex-husband, even though she was the one in greater financial need. The non-debtor spouse filed a claim as a priority creditor. Judge Whinery reviewed the state court record and concluded that the fee award was dischargeable because it was based not upon need but upon the positions taken in litigation:

> After explicitly finding that there was a disparity in financial resources between the parties in that Mr. Basmajian had more property and had the ability to earn a significant income, while the Debtor did not, the State Court found that "[a]lthough this would be a factor for an award of attorney's fees to [the Debtor], [the Debtor had] maintained unreasonable positions that unnecessarily increased the scope and expense of litigation." (Dkt. 27, Ex. A at 13. The State Court went on to state that "[e]vidence supports that both parties acted unreasonably and delayed the sale of the marital residence and caused additional attorneys' fees to address those actions." *Id*. In the exercise of its discretion, the State Court granted Mr. Basmajian's re-

quest for a portion of his attorneys' fees and costs and instructed Mr. Basmajian to submit supporting documentation. Though the fees and costs were likely awarded pursuant to A.R.S. § 25-324(A) given that the State Court exercised its discretion in awarding the fees and costs and given the State Court's explicit consideration of both the parties' financial resources and reasonableness of the parties' positions, regardless of whether the State Court awarded the fees and costs pursuant to A.R.S. § 25-324(A) or (B), it is clear that the award was not based on the parties' financial resources or any need of Mr. Basmajian. The State Court explicitly found that Mr. Basmajian had greater financial resources than the Debtor and only awarded Mr. Basmajian the attorneys' fees and costs at issue because it found that the Debtor had taken unreasonable positions during the course of the State Court litigation.

Judge Whinery focused on the state court's conclusion that the debtor spouse, although more in need, had taken unreasonable positions in litigation. She considered the fee award to be, perhaps, in the nature of a sanction under § 25-324(B)—even though the statutory grounds for the award were not present and no findings had been made by the court under that subsection. Perhaps Judge Whinery was breaking from tradition in finding that fees based not upon need but upon litigation tactics should not be found to be non-dischargeable even in the context of custody litigation.

On March 11, 2020, the Ninth Circuit Court of Appeals issued a ruling in *In re Sodergren*.[17] There, the Circuit recognized that the ruling in *Catlow* was of limited precedential value due to the change in the applicable Arizona statute as set forth above.

In *Sodergren*, the superior court awarded attorney's fees in favor of an ex-husband but made no finding that the fee award was based upon the financial conditions of the parties. The ex-wife had argued to the court that she lacked financial resources. Subsequent to an award of fees, Ms. Sodergren filed for relief under Chapter 13. The bankruptcy court ruled that the fee award was not a DSO and that ruling was affirmed by both the district court and the Court of Appeals. The Ninth Circuit ruled that an award of fees, in order to be a DSO, must be based upon financial need.

The ruling raises a number of questions: What was the reason for the additional language in § 25-324 allowing the court to allocate fees between need and litigation tactics? Why does the court have the ability to make such a determination prior to or subsequent to a fee award? What is the other "court of competent jurisdiction" that can request such a finding? Is this the "path" chosen by the Arizona Legislature to let the superior court tell another court or the litigants why an award was made after the fact? If fees awarded in a divorce under § 25-324(A) in a custody matter are presumed to be a DSO what is the reason for allocation?

These issues and others remain to be sorted out in subsequent litigation and legislation.[18] It seems to the author that courts in the Ninth Circuit have failed to account for the changes in § 25-324 since *Catlow*. What logic is there in determining that an award of fees based upon anything other than financial need is in the nature of support? Why are fees awarded based upon an unreasonable position in litigation non-dischargeable only in the context of domestic relations litigation—but are dischargeable in all other matters? AZ AT

endnotes

1. *See* 11 U.S.C. § 523(a)(5) and §101(14A).
2. *See id.* §507 (a)(1) (ahead of all other debts and expenses other than the expenses of a Bankruptcy Trustee).
3. *Id.* § 522(c)(1).
4. *See id.* §§ 1129(a)(14), 1225(a)(7) and 1325(a)(8).
5. *See id.* §§ 1222(a)(2) and 1322(a)(2).
6. *See In re Chang*, 163 F.3d 1138 (9th Cir. 1998).
7. *See In re Jarski*, 301 B.R. 342, 347 (Bankr. D. Ariz. 2003).
8. *See Birt v. Birt*, 96 P.3d 544 (Ariz. Ct. App. 2004); in re Siragusa 27 F.3d 406 (9th Cir. 1994).
9. *Chang*, 163 F.3d at 1138.
10. Ariz. Rev. Stat. Ann. § 25-324 (1976).
11. 663 F.2d 960 (9th Cir. 1981).
12. *Id.* at 962-63 (internal citations omitted).
13. *In re Bradshaw*, 2007 WL 22460619 (unpublished decision).
14. *See also* Judge Collins' unpublished decision in *In re Hurst*, 2019 WL 2251828 (Bankr. D. Ariz. 2019), in which he makes the same assumption.
15. 2007 WL 7540954.
16. 2019 WL 404196 (Bankr. D. Ariz. 2019).
17. 802 Fed. Appx. 277 (9th Cir. 2020).
18. A DSO is an order of support that is based upon a settlement agreement, decree or an order of a court of record. It can arise from litigation separate and apart from the divorce itself. First, note that A.R.S. § 25-324(A) states that the statute only applies to a proceeding "under this chapter or chapter 4, article 1 of this title." Thus, the statute is limited to proceedings for the annulment of marriage, the dissolution of marriage, child support, and legal decision-making, parenting time, and third-party visitation proceedings. Second § 25-324 is but one of several statutes in Title 25 that authorize an award of attorney fees. For example, § 25-809(G) authorizes an award of attorney fees in a paternity proceeding. That statute is very similar to § 25-324. However, it is not identical. It allows the court to consider the financial resources of the parties and the position taken in litigation. It also allows for the direct payment of fees to counsel. It does not contain the sanctions provision. Section 25-414(c) authorizes the court to order a parent who violates a parenting time order to pay the attorney fees of the nonviolating parent in connection with an action to enforce parenting time. It is a "prevailing party" provision and is not based upon financial need. Sections 25-1245(B)(11) and -2353(B), (C) authorize the court to award fees in an action brought under the Uniform Interstate Family Support Act. Again, this is a "prevailing party" provision. Section 25-1062 authorizes an award of attorney fees in connection with a proceeding brought under the Uniform Child Custody Jurisdiction & Enforcement Act to the prevailing party. Section allows the court to award attorney fees (and expert fees) in a legal decision-making or parenting time case if the court finds a financial disparity between the parties. That statute does *not* mention the reasonableness of the positions taken by the parties. Also, note that Section 25-503(M) states that judgments for support and associated costs are attorney fees that are exempt from renewal and are enforceable until paid in full. Other statutes to consider: §§ 25-321, 25-403.06, 25-408(J), 25-411(G), 25-503(E), 25-504, 25-505.01, 25-513(C), and 13-3602(P) (attorney fees awards in connection with orders of protection proceedings).