Divorce Settlement Issues

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DIVORCE SETTLEMENT ISSUES

Husband and wife get divorced and husband is ordered to pay wife money pursuant to a settlement agreement. Husband's fortunes change and he is no longer in a position to pay the money due his ex-wife. His ability to alter his obligations in Bankruptcy will depend upon a number of factors. Is the obligation owed to his ex-wife a "domestic support obligation" (DSO) as that term is defined by the Bankruptcy Code or is it simply money due under a settlement agreement or divorce decree that is not a domestic support obligation? Is the husband eligible to file for relief under Chapter 13 or is he filing a Chapter 7 or Chapter 11? The answers will be significant in determining the parties' respective rights.

What is a DSO?

A "DSO'' is a domestic support obligation. It is defined in 11 U.S.C. § 101(14A) and states as follows:

> (14A) The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
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> (A) owed to or recoverable by—
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> (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian; or responsible relative; or
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> (ii) a governmental unit;
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> (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;
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> (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—

(i) a separation agreement, divorce decree, or property settlement agreement;

(ii) an order of a court of record; or

(iii) a determination made in accordance with applicable non-bankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

The classification of a debt as a DSO has significance to all parties in a Bankruptcy proceeding as its status will impact issues of dischargeability, distribution of assets and confirmability of a Chapter 11 or Chapter 13 Plan of Reorganization.

11 U.S.C. § 523(a)(5) provides that a debt is not dischargeable if it is a domestic support obligation. A debt under § (a)(5) is not dischargeable under any Chapter of the Bankruptcy Code (*see* 11 U.S.C. §§ 1141(d)(2), 1228(a)(2), 1328(a)(2)). Any reorganization plan under· Chapter 11, 12 or 13 must provide for full payment of any arrears in DSO (unless otherwise agreed upon by the Creditor) confirmation of a Plan is contingent upon a determination that all post-petition DSO payments have been made prior to Confirmation of the Plan. The failure to pay post-petition DSO obligations Is cause for the conversion or dismissal of a reorganization (*see* 11 U.S.C. §§ 1112(b)(4)(P), 1208(b)(10), 1307(c)(11)).

In addition to being non-dischargeable, a DSO is also a debt which is granted first "Priority" status under 11 U.S.C. § 507(a)(1). This means that any assets which are recoverable by the Chapter 7 Trustee need to be paid first and ahead of all other expenses, including the Administrative Expense claim of the Trustee (except for those expenses incurred by the Trustee in administering the assets which are paid out as a DSO). ln a reorganization, all DSO claims must be paid in full, unless otherwise agreed upon by the holder to the DSO claim.

The Bankruptcy Code further provides that a Debtor's claims of exemptions do not apply to a DSO. (*See* 11 U.S.C. § 522(c)(1)). What this means is not entirely clear. Can a Chapter 7 Trustee collect exempt assets from the Debtor to satisfy a DSO obligation? The language of § 507(a)(1)(C), which permits the Trustee to be paid for expenses and fees incurred in collecting a DSO for a creditor would seem to imply as much. In addition, using exempt property to pay a DSO would seem to result in additional distributions being available to other claims since the DSO would be reduced by whatever exempt property is available to pay it. Case law, however, is not clear. While recognizing that exempt property is not protected against either a tax claim or a DSO, case law does not support the conclusion that a Chapter 7 Trustee can collect exempt assets to pay those claims. *See* ln re Bozeman, 376 B.R. 813 (Bankr. W.D. Ky. 2007); In re Ruppel, 368 B.R. 42 (Bankr. D. Or. 2007); In re Quezada, 368 B.R. 44 (Bankr. S.D. Fla 2007) (the Court noted that a Chapter 7 Trustee can only sell property of the estate and exempt property ceases to be property of the estate once properly exempted). The Court in Quezada stated as follows:

> The Trustee's § 522(c)(1) and § 507(a)(1)(C) argument is colorable but not convincing. Congress did use the term assets otherwise available for payment of DSO claims in § 507(a)(1)(C) and the Home is an asset liable for and hence available for payment of DSO claims under § 522(c)(1). Still, this choice of words in § 507(a)(1)(C) is not express authority for a trustee to administer exempt property. Besides the fact that Congress could have, but did not amend § 704(a), section 507, which sets forth the priority of distributions, has to be read in conjunction with the distribution provisions in § 726 which implement the § 507 priorities. Section 726, titled Distribution of property of the estate, provides in relevant part, (a) Except as provided in § 510 of this title, property of the estate shall be distributed- (1) first, in payment of claims of the kind specified in, and in the order specified in, § 507 of this title. . . . (Emphasis added.) As the foregoing analysis shows, § 507(a)(1)(C) cannot be read as a grant of authority for a trustee to liquidate exempt assets when § 507 itself simply provides the priorities for distribution of property of the estate. Ruppel, 368 B.R. at 44, 2007 WL 108941,

at*2; Covington, 368 B.R. at 41-42, 2006 WL 2734253, at *2-*3 (also noting the absence of any § 522(c)(1) pre-BAPCPA cases authorizing a trustee to liquidate exempt property to pay nondischargeable tax claims).

Quezada at page 46.

Can the DSO recipient ask that the Bankruptcy Court order the surrender of exempt property to satisfy the claim without going through the Trustee? Can the Creditor simply go to State Court to collect the DSO from exempt assets? In In re MacGibbon, 383 B.R. 749 (Bankr. W.D. Wash. 2008), the Bankruptcy Court found that there was no violation of the Automatic Stay when a DSO recipient pursued collection efforts in the State Court from the Debtor's exempt (non-estate property) pension plan. It would seem that the DSO recipient could also seek the turnover of that property in the Bankruptcy Court, as well. *See* In re Galtieri, 172 Fed. Appx. 397, 2006 WL 358546 (3rd Cir. 2006); In re Crum, 414 B.R. 103 (Bankr. N.D. Tex. 2009).

The determination of what is and what is not a DSO can be made by either the Bankruptcy Court or the Superior Court. *See* Jordan v. Jordan, 166 Ariz. 408, 803 P.2d 129 (Ariz. App. Div. 2 1990); In re Lombardo, 224 B.R. 774 (Bankr. S.D. Cal. 1998); In re Siragusa, 27 F.3d 406 (9th Cir. 1994) and the Court will apply a federal standard, not necessarily a State Law standard in determining what is and what is not DSO. *See* In re Pierce, 95 B.R. 154 (Bankr. N.D. Cal. 1988) in which the Bankruptcy Court determined that a provision in a property settlement agreement to pay for college education for adult children was a "child support" obligation even if state law would not recognize it as such.

The Arizona Court of Appeals recognized the existence of concurrent jurisdiction in the unpublished decision of Wheeler v. Minotto, 2014 WL 2871351 (Ariz. App., June 24, 2014). In Wheeler, the Maricopa County Superior Court entered an Order awarding the ex-husband attorney's fees of $101,719.41 and, in an Order prepared by the ex-husband, stated that the money due the ex-husband was in the nature of support and, therefore, non-dischargeable. The ex-wife appealed on the sole issue of the language categorizing the award as in the nature of support and non-dischargeable. The Court of Appeals affirmed, stating as follows:

We have previously determined that the court may characterize attorney's fees awarded under A.R.S. § 25-324·to be in the nature of support. *See* Birt v. Birt, 208 Ariz. 546, 555, ¶ 32, 96 P.3d 544, 553 (App. 2004) (“If the trial court reaffirms the prior award of attorneys' fees to Wife, it shall clarify whether such an award is based on Wife's financial circumstances and whether it was in the nature of maintenance or support rather than part of a property division." (emphasis added)); *see also* Magee v. Magee, 206 Ariz. 589, 592, ¶ 13, 81 P.3d 1048, 1051 (App. 2004) ("[C]ourts have discerned the broader rationale for the statute; namely, that requiring payment of fees by one spouse on behalf of the other is derived from and justified by the duty of support.").

¶ 12 Mother cites In re Catlow, 663 F.2d 960 (9th Cir. 1981), to support her argument, in Catlow, the Ninth Circuit considered whether attorney's fees awarded under A.R.S. § 25-324 in a post-dissolution proceeding concerning child custody were dischargeable under the now-superseded Bankruptcy Act. *Id.* at 961. Mother focuses on the fact that the court rejected the father's argument that the characterization of attorney's fees as spousal support should not extend to post-dissolution proceedings unrelated to enforcing spousal support obligations. *Id.* at 962-63. The court held that "[a]s Arizona law considers attorney's fees to be spousal support if awarded in the original divorce action, this characterization must therefore also apply to fees awarded in post-divorce child custody proceedings." *Id.* at 963. But Mother misconstrues Catlow to stand for the proposition that attorney's fees awarded under A.R.S. § 25-324 may only be considered to be in the nature of spousal support and not in the nature· of child support. The father in Catlow did not argue that the court should have characterized the award to be in the nature of child support instead of spousal support-he argued that the court should not have characterized the award to be in the nature of support at all. *See Id*. at 962-63. And the court did not hold that the award should be characterized as spousal support even though the proceeding concerned children, but rested its decision on the fact that

Arizona law does not distinguish the nature of attorney's fees awards depending on the timing of the proceedings. *See Id*. at 963.

¶ 13 Relying in part on Catlow, the Bankruptcy Court for the District of Arizona has held that ''[f]ees incurred in a child custody dispute are in the nature of support for the child, even if payable to someone else." In re Jarski, 301 B.R. 342, 347 (Bankr. D. Ariz. 2003). Notably, the court reasoned:

> Under Arizona law the best interests of the child is the dispositive issue: "The court shall determine custody, either originally or upon petition for modification, in accordance with the best interests of the child." A.R.S. § 25-403(A). With Arizona's statutory requirement that custody disputes be resolved in the "best interests of the child," and that any award of attorney's fees must be based upon consideration of "the financial resources of both parties and the reasonableness of the positions each party has taken" in the child custody dispute, it would take a strong showing by the Debtor to demonstrate that an award of attorney's fees was intended to be, or in fact was, something other than in the nature of support for the child. Perhaps such a showing could be made if the fees were awarded purely as a sanction.

Id. We agree with this reasoning and hold that the court may characterize attorney's fees awarded under A.R.S. § 25-324 as in the nature of child support. Contrary to Mother's assertion, we do not find support in the record for the proposition that the court intended to award Father attorney's fees solely as a sanction against Mother.

¶ 14 Mother also argues that "A.R.S. § 25-324 creates a support obligation only if a disparity exists between the patties' financial resources," and that "fees awarded under A.R.S. § 25-324 to redress a party's unreasonableness do not give rise to a support obligation." We disagree. "The legal question is not whether repayment of the debt will benefit the children, but whether the basis of the

> debt benefitted the children.'' In re Leibowitz, 217 F.3d 799, 803 (9th Cir. 2000). There can be no question here that Father's attorney's fees were Incurred in a proceeding concerning modification of child custody and parenting time intended to benefit the children.
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> ¶ 15 Having concluded that the court Intended to characterize the attorney's fees award as in the nature of child support, and that it had the authority to do so, we decline to express any opinion regarding whether the award is dischargeable under federal bankruptcy law. Because Mother has not yet filed for bankruptcy protection, our resolution of that issue would be merely advisory.

The Court of Appeals did not opine on the ultimate question of dischargeability but did find that the Superior Court could determine that the obligation was in the nature of support. Since the Bankruptcy Court and the Superior Court have concurrent jurisdiction on that issue, it is hard to imagine that a Bankruptcy Court would find otherwise.

The impact of a determination that an obligation is a DSO means that the obligation is non-dischargeable in any Chapter of the Bankruptcy Code. If the obligation is not a DSO it is still non-dischargeable in a Chapter 7 proceeding or a Chapter 11 proceeding but is dischargeable under 11 U.S.C. § 1328(a). It is one of the few remaining vestiges of the "super discharge'' that survived the enactment of BAPCPA in 2005. However, a Debtor seeking relief under Chapter 13 for the primary purpose of obtaining the "super discharge" may still face a "good faith" hurdle to overcome. The fact that the underlying debt is not dischargeable in Chapter 7 may be a factor for the Bankruptcy Court in analyzing whether a plan has been proposed in good faith. It is clearly not the only factor, since there would be no point in allowing the discharge of a § 523(a)(15) obligation in one Chapter but not another if it was bad faith to do exactly that. However, Courts will consider it as a factor and Counsel is advised to tread carefully in this area and be sure that "i's are dotted and t's are crossed." *See* In re Page, 519 B.R. 908 (Bankr. M.D.N.C. 2014); In re Hopper, 474 B.R. 872 (Bankr. E.D. Ark. 2012); ln re Green, 2010 WL 396253 (Bankr. E.D. Va. 2010).

The facts of Green are similar to the facts of our hypothetical in that the husband had fallen on hard times after the entry of his divorce and his § 523(a)(15) obligation to his ex-wife constituted 80% of his debts. The Court ultimately denied confirmation of the plan for reasons associated with the increase in a line of credit on a house in excess of what was owed the ex-wife. However, the Court made the following analysis as to the issues discussed hereinabove:

> In the present case, the debtor's financial situation would support a need for chapter 13 relief. Although his mortgage payments were current and he was able to pay his household expenses, he testified that he had fallen behind on his credit card payments and did not have the ability to pay the equitable distribution award. He is paying into the plan his entire disposable income for the maximum five-year period that chapter 13 permits. The percentage payment, although relatively low at 21%, is nevertheless not insignificant. Although the equitable distribution claim--which represents slightly over 80% of the unsecured debt dealt with by the plan--would be non-dischargeable in a chapter 7 case, that fact alone does not compel a finding of bad faith. Put another way, a debtor in financial distress does not act In bad faith in simply taking advantage of a benefit Congress has chosen to provide.

DRAFTING THE DECREE: (Material herein provided by Iva S. Hirsch, Esq. with permission)

1. Practice Points on Drafting, Negotiating, and Enforcing Divorce Settlements

a. LIENS

For the Family Law practitioner, understanding the value of a perfected lien is significant, as it will impact how a non-debtor spouse is treated if the former spouse files for relief under the Bankruptcy Code. A creditor cannot be treated as a secured creditor unless there is a perfected lien, which has been perfected in accordance with applicable State law. For example, recording a judgment with the county recorder simply creates a judgment lien against real property owned by the debtor in the county in which the lien is recorded. In non-DSO situations the judgment lien is secured to the extent it does not impair the homestead exemption and there is excess equity in the real property to pay the lien, in whole or in part.

Judgment liens in a divorce are created by recording the judgment and Decree of Dissolution of Marriage in a county where the debtor owns real property. Do not underestimate the value of recording the Judgment and Decree of Dissolution of Marriage. Recording a judgment with the county recorder creates a judgment lien against real property owned by the debtor in the county in which the lien is recorded. A.R.S. Sec. 25-318(F) requires that the legal description of real property be included in the decree or judgment. Once the lien has been recorded, the underlying debt is considered "secured" to the extent of non-exempt equity and will be treated as such in any Bankruptcy proceeding. While it may be subject to attack as a preference (depending upon when the lien was recorded and "attached") it is almost always preferable to be a "secured" creditor in a Bankruptcy instead of an unsecured creditor.

A judgment lien may be set aside pursuant to 11 U.S.C. § 522(f)(1) if it impairs the homestead exemption of a Debtor. An exception is carved out in § 522(f)(1)(A) for "a judicial lien**,** other than a judicial lien that secures a debt of a kind that is specified in section 523(a)(5)." This would include child support, spousal maintenance, unreimbursed medical expenses, and some attorney's fees awards.

While a judgment lien may be set aside in the Bankruptcy, if the underlying debt is a debt described in 11 U.S.C. Sec. 523(a)(5) (a "DSO") the lien cannot be set aside. *See* 11 U.S.C. § 522(f)(1)(A); Hamel v. Hamel, 2009 WL 888648 (Ariz. App. Div. 1, April 2, 2009) (Not reported); A.R.S. § 33-1103(A)(3)(a).

It is important for the family law practitioner to understand the difference between the underlying debt and the security interest. In a situation where the debt would be characterized as a debt pursuant to § 523(a)(15), in a Chapter 7 or 11, the debt will not be discharged-even if the lien is "set aside" pursuant to 11 U.S.C. § 522 or § 506. The important concept for non-bankruptcy practitioners to bear in mind is that "avoiding the lien" does not discharge the debt-it merely results in the debt being treated as an unsecured claim in the Bankruptcy proceeding in the distribution of assets of the estate. If the debt is not subject to discharge, the remaining balance will remain due after the estate is terminated and the non-debtor spouse will still be entitled to collect the balance due. The lien is simply a security instrument.

To obtain preferred treatment of your client's claim as a secured creditor, as opposed to an unsecured creditor, it is imperative that the obligee hold a perfected lien. It may well be beyond the scope of a family law practitioner to draft the appropriate documents to create and perfect a valid lien on property. If a lien is not validly perfected, then it will not be treated as a secured claim, and although your client may still have a nondischargeable debt, there may be insufficient property of the estate for your client to collect in full. Liens which have not been properly perfected are subject to attack by the Trustee or a Debtor-in-Possession under 11 U.S.C. § 544 and is beyond the scope of this seminar. The important lesson to be learned is to be careful to properly and timely perfect your lien. If you are in doubt, consult appropriate counsel for assistance.

The key to perfection of a lien is to consider: Will a third-party bona fide purchaser for value have notice, or should he/she reasonably have notice? If your client is being cashed out of a business or professional practice, you need to be sure that his/her interest is properly secured if there is not sufficient cash to pay your client in full. To perfect a lien on personal property, such as equipment, inventory, and receivables, you need your client to obtain a promissory note, a chattel security agreement and a UCC-1 Statement. The UCC-1 needs to be filed with the Secretary of State where the collateral is located. It can be tricky and it is best to consult a business attorney and not do it yourself. If a UCC-1 Statement is not filed, your lien is not perfected and your client's claim will be treated as an unsecured creditor.

Perfection of a lien on real property requires a promissory note, Deed of Trust, and a recordation of the Deed of Trust in the county in which the real property is located. It is possible that a Judgment and Decree of Dissolution of Marriage which recites the legal description and orders a lien on real property, which is recorded, may be sufficient to create a lien and to provide notice to creditors and bona fide purchasers for value.

Liens created pursuant to A.R.S. § 25-318(E)[1] are probably not perfected simply by the judge declaring that there is a lien. There is no case law on this point, and don't let your client

[1]E. The court may impress a lien on the separate property of either party or the marital property awarded to either party in order to secure the payment of:
1. Any interest or equity the other party has in or to the property.

be the test case. Recording a Judgment and Decree of Dissolution of Marriage which contains the judicial lien language will probably create a judgment lien; it Is probably the most that you can do.

b. FINDINGS OF FACT IN DECREE

There is a distinction between how debts are treated under § 523(a)(5) and § 523(a)(15). A determination that a debt is a DSO pursuant to § 101(14)(A) will give your client preferred treatment as a priority creditor under § 507(a)(1)[A). To do so, be sure that there are findings of fact and conclusions of law in the decree (or ask the judge to make them, and help out the judge by providing Proposed Findings of Fact and Conclusions of Law) which address the relative financial status of the parties in detail- including relative income and assets -available to each of them. This is important in identifying the direct support needs of your client such as child support, payment of medical expenses for the children or former spouse, car insurance, school tuition, psychologists, etc.

It Is also important in several other circumstances such as an award of attorneys' fees under A.R.S. § 25-324(A) and A.R.S. § 25-403.08(B). You want to be sure that, in any award for fees, the findings of fact recite either specifically § 25-324(A) instead of § 25-324(B) (you want the other party to be found to be financially better off and have more access to financial resources- not the bad guy taking unreasonable positions) to have the fees treated as a DSO and receive priority treatment. The same is true of A.R.S. §§ 12-349 and 12-350; establishing findings of fact that the other party is unreasonable or taking unreasonable position or has obstructed the proceedings doesn't necessarily help your client once the matter ends up in Bankruptcy. These factors are important not only for the "elevation" of a claim to DSO status but also to protect your non-debtor client in the event that the Debtor spouse files for Chapter 13, in which a non-DSO debt under § 523(a)(15) is dischargeable.

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2. Community debts that the court has ordered to be paid by the parties.
3. An allowance for child support or spousal maintenance, or both.
4. All actual damages and judgments from conduct that resulted in criminal conviction of either spouse in which the other spouse or a child was the victim.

Another planning technique to protect non-exempt properly is to award the non-debtor spouse that property. However, such activity is not without risk and the parties and their counsel need to be cognizant of the potential claims of "fraudulent conveyances" if the parties simply "conspire" to transfer non-exempt properly to one spouse in anticipation of a bankruptcy filing by the other spouse. Findings of Fact and Conclusions of Law can help protect your client if properly drafted. A.R.S. § 25-318(A) mandates an equitable division of property, not an equal division of property. A.R.S. § 25-318(B) allows the court to consider the exempt status of particular property and all debts and obligations which are related to the property, "including accrued or accruing taxes that would become due on the receipt, sale or other disposition of the property."

Spousal maintenance is exempt from creditors (including for set-off from the payor). If there is a basis for an award of maintenance and appropriate findings are made, it is possible to ''disguise" a property distribution (which is non-exempt to the recipient) as spousal maintenance in order to protect that flow of payments. A.R.S. §§ 25-319(A) and (B) provide a road map for factors to address in your findings of fact.

A.R.S. § 25-318(R) is an often over looked section which states, "If any part of the court's division of joint, common or community property is in the nature of child support or spousal maintenance, the court shall make specific findings of fact and supporting conclusions of law in its decree." It is your job to be sure those Findings of Fact and Conclusions of Law are in the Decree.

c. EXEMPTION PLANNING AND FRAUDULENT CONVEYANCE CONSJDERATIONS

Exemption planning needs to be thoughtful. Remember: Pigs get fat and hogs get slaughtered. A Trustee or a creditor may seek to set aside a decree or settlement agreement if you try to award a disproportionate share of exempt property on the spouse most likely to file for Bankruptcy relief, or if the non-filing spouse gets too large a share of non-exempt property. The parties need to divide property to avoid the risk of a Trustee setting aside a lopsided division of property and/or exempt property under the Trustee's strong arm powers under § 544(b) including fraudulent conveyances. *See* In re Beverly, 374 B.R. 221 (9th Cir. BAP 2007).

Keep in mind that A.R.S. § 25-318(B) provides in part, "The Court may also consider the exempt status of particular property pursuant to title 33, chapter 8." (A.R.S. §§ 33-1100 et seq.). Review Title 33 and be sure that if a bankruptcy is on the horizon that your client gets his/her fair share of exempt property. Since Spousal maintenance and child support are also exempt, these can also be used to create a protected flow of income to the recipient and at the same time, an Income Withholding Order (IWO) will also protect the non-exempt portion of the payor's wages.

Family law practitioners should also be generally aware of state law personal property exemptions (A.R.S. § 33-1121 et seq.) and be aware that child support payments and spousal maintenance payments are always exempt from third party creditors. A.R.S. § 33-1126(A)(3). However, exemptions under A.R.S. § 33-1126, such as proceeds from life insurance policies, annuities, periodic payments, proceeds from insurance, etc., are not exempt from child support collections. A.R.S. § 33-1126(D); *see also* A.R.S. § 33-1103(C) (in contempt proceedings to enforce the payment of child support or spousal maintenance the court may consider the homestead value as a resource from which the obligor has the ability to pay). Query whether the latter section provides an involuntary source of payment (such as a foreclosure or a Court-ordered sale) or simply a factor for the Court to consider in determining how to handle the payment of arrears.

d. HOMESTEAD CONSIDERATIONS

A.R.S. § 33-1101 provides for the $150,000 homestead exemption. How does one divide the homestead exemption in a divorce if there is one primary marital residence? At what point can a former spouse create his/her own new homestead by purchasing a new primary residence? Does the debtor in bankruptcy where the other spouse has not filed get to claim the entire homestead in a home titled as "joint property with rights of survivorship?" Does the result differ if the home is owned in community with rights of survivorship? Remember that "joint tenancy" property, as opposed to property where title is held as community property, is presumed to be the sole and separate property of each spouse. Skinner v. CIT Communications Finance Corporation, 2009 WL 3163499 (Ariz. App. Div. 1, October 1, 2009). Assuming that the title makes a difference, what will a Trustee do with jointly held property when only one spouse

files for Bankruptcy relief? If jointly owned property is not "community property" then what actually is in the estate?

Easier issues pertain to the impairment of the homestead by a judgment lien in favor of a former spouse. A.R.S. § 33-1103(A)(3)(a) prevents the debtor from asserting the impairment of his or her homestead as a defense against a judgment for child support or spousal maintenance. *See* Hamel v. Hamel, *supra*. The U.S. Supreme Court held in Farrey v. Sanderfoot, 500 U.S. 291, 111 S.Ct. 1825, 114 L.Ed.2d 337 (1991), that a Chapter 7 debtor could not avoid a judicial lien awarded to his former wife on properly awarded to him in a divorce, absent a showing that the debtor held interest in property to which the lien attached prior to the attachment of the lien.

e. INDEMNIFICATION AGREEMENTS

An indemnification agreement in favor of the other spouse is a separate claim in and of itself. It will survive the bankruptcy discharge under § 523(a)(15) in a Chapter 7 or Chapter 11 proceeding. If appropriate findings can be made by the Superior Court, it may even be possible to convince a Bankruptcy Court that the indemnification was intended as a form of family support and thus a DSO and therefor non-dischargeable in Chapter 13 and a Priority Claim. Your client may discharge the deficiency judgment on the repossession of the vehicle, but if your client is subject to an indemnification to the former spouse on the debt, then to the extent that the former spouse pays the debt, your client will owe the former spouse the reimbursement which will survive a bankruptcy under § 523(a)(15) and perhaps their fees and costs, depending upon the language of the indemnification. Think about which debts should or should not include in an indemnification clause. Perhaps not every debt should be treated the same way. You may want to consider treating nondischargeable debts such as tax liability differently than dischargeable debts. The failure to include an indemnification in the decree may result in no obligation to reimburse surviving a Bankruptcy even if the decree ''assigns" the debt to the filing spouse. *See* Mayes v. Mayes, U.S. Bankruptcy Court WD Virginia 10-50261; *see also* In re Burton, 242 B.R. 674 (Bankr. W.D. Mo. 1999).

The timing of the entry of a Decree of Dissolution of Marriage and entry of a discharge can also impact the effect of an indemnification agreement obtained in a divorce. In re Heilman, 430 B.R. 213 (9th Cir. BAP 2010), shows how bad facts make bad law. In that case, Debtor and his wife lived ln the state of Washington, a community properly state. Debtor filed for relief under Chapter 7. He did not list his in-laws or his wife as creditors. Approximately five months after debtor's discharge was entered, his wife filed for divorce. The parties entered what appears from the record to be an agreed upon division of debts pursuant to their divorce decree, where debtor agreed to assume and hold harmless his soon-to-be ex-wife from the debt the parties owed to her parents. Debtor's ex-wife sought a declaratory judgment to declare that Debtor was obligated by the terms of their dissolution decree to hold her harmless on the pre-petition debt owed to her parents. Debtor prevailed at the Bankruptcy Court level and dismissed the Adversary. The BAP affirmed. The BAP held that the debt was dischargeable, and it could not be revived by a Hold Harmless Provision. It found because the obligation was "joint and several" (community) that the ex-wife was entitled to a contribution claim from debtor under Washington law. It noted that federal law dictates when the claim arises and in this case, the claim arose during the marriage "at the time of the events giving rise to the claim, not at the time plaintiff is first able to file suit on the claim." *Id*. at 220 (citations omitted). The BAP stated that ex-wife could have fairly contemplated that she had a reimbursement claim when the loan was made by her parents but certainly by the date Debtor flied his petition.

The Heilman panel also found that the Hold Harmless Provision cannot resurrect an otherwise dischargeable debt and that the resurrection of the debt through the divorce decree could not act as a reaffirmation because it was not made prior to discharge and did not meet the statutory requirements of a reaffirmation under 11 U.S.C. § 524(c). Thus, as of the date of the petition, the ex-wife had a contingent claim against Debtor for contribution. The dissent concluded that the hold harmless obligation was a new debt imposed upon Debtor by the state court and was not discharged, even if it was a pre-bankruptcy debt.

The lessons from Heilman indicate how complex a problem the timing of a bankruptcy and divorce are in relation to hold harmless provisions, and the practitioner should tread carefully when giving advice.