BANKRUPTCY AND ITS INTERRELATIONSHIP WITH THE FAMILY COURT UNDER THE BANKRUPTCY REFORM ACT OF 1994

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The Bankruptcy Reform Act of 1994 which amended the Bankruptcy Case, Title 11, U.S.C. altered in some way the practitioner had previously dealt with each court, changed the law and some procedure. It is the purpose of this article to give practical means and provide various forms for the attorney who is faced with dealing with bankruptcy in the family law situation.

Prejudgment, the bankruptcy petition, filed by one party during the pendency of the matrimonial action, acts as a major impediment to its litigation and the enforcement of orders. Typically, one spouse unable to meet the demands of alimony or delay distribution of assets, files a petition in bankruptcy in the Federal Court while the matrimonial action is pending in State Court.

In that petition (see form No. 1 petition and transmittal letter) the filing spouse (herein after the debtor) lists all of their assets, liabilities, income and expenditures. They also state what part of their assets they deem exempt under 11 U.S.C. Section 522 (d)(1-5). All creditors are named in specificity setting forth the amount of the claim and whether or not the claim is secured or unsecured, and whether the claim has any priority.

They list all of their debtors, including their spouse as a creditor, and file the matter with the Clerk of the U.S. Bankruptcy Court and ask the Court to circulate the notices to creditors and to set this matter down for hearing.

Once the petition is filed, under Section 304(b) of the Act, the automatic provisions of the Code go into effect. Under the amendment to the Act, Section 362(b)(2) of the Code, the filing of the Petition in Bankruptcy does not operate as a stay of either the commencement or the continuation of an action either to (i) the establishment of paternity; or (ii) the establishment or modification of an order for alimony, maintenance or support.

Thus, if a payment can be established as an alimony or child support payment, there is not only no longer a stay, but no need to obtain relief from the automatic stay to collect alimony or child support from wages or from property that there are not part of the bankruptcy estate.

No longer need the dependent spouse apply to the Bankruptcy Court for relief from the stay, but can apply to the State Court. This benefit applies in Chapter 7 Liquidation Proceedings, as well as Chapter 13, Consumer Adjustment of Debt Proceedings, but not in a Chapter 11 proceeding.

If the alimony or support is to be paid from what is clearly wages, the filing of the bankruptcy petition would not stay a pendente lit application or a Motion for

Enforcement of Litigant's Rights under Rules of Court 1:10. If, on the other hand, it is either unclear where the alimony and support is coming from, not necessarily the wages, but assets, then the spouse must petition to the State Court for relief from the automatic stay (see form 2).

The attorney and the debtor have to very careful in making sure that the money for alimony and support is for wages, or if not, they may be subject to Section 362 (f) which provides that:

"An individual injured by any willful violation of a stay... shall recover actual damages, including costs and attorney's fees, and, in appropriate circumstances, may recover punitive damages. (emphasis supplied)

This of course applies not only to the debtor, but to the attorney who should have known better.

An immediate means in determining whether or not a bankruptcy petition is legitimate and certain assets exempt from the payment of alimony and support, is to hold a Section 341(a) hearing, which is the initial stage of the discovery process and wherein any creditor of the debtor may ask questions of the debtor concerning the bankruptcy filing and the debtor's assets and liabilities. The debtor must attend and be available for examination. Under Bankruptcy Rule 2004, a subpoena is issued in the bankruptcy case compelling the taking of the deposition and demanding any and all documentation regarding value and location of any of the assets that were listed in the bankruptcy petition. (See form 3)

In the Rule 2004 hearing, the debtor witness can be compelled to produce documents, a schedule of which should be attached to the Order compelling the exam as a Notice to Produce. This method can be used before the beginning of an adversary proceeding. After an adversarial hearing is begun, a creditor cannot examine the debtor under the Rule 2004, but must take the deposition pursuant to Rule 7030 which incorporates F.R.C.P. 30.

Proof of Claim in order to protect the spouse's interest. (See form 4)

In the absence of a dismissal of the bankruptcy case, it is important on behalf of the spouse that you file a Proof of Claim, especially under the amendment to the code where a dependent spouse is in a better position now than she/he was previously.

Section 507(a) deals with the distribution of funds of the bankruptcy estate. Prior to the amendment, the dependent spouse who was owed support arrears, was required to share pro-rata with all other general unsecured creditors, such as credit card companies or department stores.

Under the amendment to the Act, the spouse is given is a seventh priority position which improves their position.

Paragraph 507 states:

"(a) the following expenses and claims have priority in the following order...

(7) Seventh, allowed claims for debts to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, a divorce decree or other order of the court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt...

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes the liability designated as alimony, maintenance or support, where such liability is actually in the nature of alimony, maintenance or support."

Thus the spouse has a seventh priority position, which in itself is not wonderful, but it is better than it previously was. This should enable the dependent spouse to recover more easily if a Proof of Claim is filed. If as an attorney for the dependent spouse, you do not file on their behalf, the results can be onerous not only against your client but ultimately against you.

DISCHARGEABILITY CHANGE

Anther change which the practitioner should be aware of, involves a change in Section 523 (15) of the Act, which not longer permitted certain assets to be dischargeable. Before and after the amendment, a debtor's spouse's assets were able to be attached and not subject to discharge, if a debt was related to alimony, maintenance and support; but could be discharged if based upon equitable distribution of property.

The new amendment has added another challenge to discharge of equitable distribution. The amendment provides in Section 522(f) (1) (A), that despite the fact that the debtor can retain certain "exempt" property, both real and personal, from the estate, and may avoid the fixing of a lien on their interest in the

property, a judicial lien may prevent a discharge of a debt to a spouse, a former spouse or child of the debtor for alimony, maintenance or support. Thus, that residence or other property, which was once within reach of the dependent spouse or the dependent spouse had a judicial lien, is no longer automatically discharge.

The fourth change involves the discharge of equitable distribution obligation under Section 523 (15) of the Act.

Prior to the enactment of a new amendment, one spouse could discharge the debt to the other spouse if it was based upon equitable distribution of property, but could not discharge it if that debt was related to alimony, maintenance and support. Now, instead of an automatic discharge, the Court must first determine that the debt, regardless of how it is labeled, is not a debt for alimony, support or maintenance. This analysis can be done under Federal Law, see In re Gianakas, supra, or may be heard in the State Court which is concurrent jurisdiction.

After the Court has analyzed whether the debtor has the ability to pay such debt from income or property is not reasonable or necessary for the debtor's support or the support of the dependent of the debtor, (i.e. either a new spouse or child); or not needed by the debtor to engage in business, the Court can then perform a balancing debt to determine if the benefit to the debtor outweighs the detrimental consequences to a spouse, former spouse or child of the debtor. The Statute itself provides no standards for the Court to follow in making this judgment.

Under Section 523(c), it would seem as though the disaffected spouse must object to the discharge of the non-support related debt in the Bankruptcy Court, although the State Court will have concurring jurisdiction to determine dischargeability of support related debt.

Thus is seems that the Bankruptcy Court will be required to hold post-divorce, or post-property settlement agreement trials.

A procedural note. If a spouse must file an adversary proceeding related to the dischargeability of a debt, alleging that it is really for child support arrearages, then all fees are waived.

The final amendment of significance to matrimonial practitioners is Section 547 which provides that a debtor spouse, shortly before bankruptcy, and while insolvent, may pay bona fide arrearages to a former spouse without the spouse fearing an action by the Trustee to recoup the funds as preferential transfer, regardless of the timing of the payment.