

# THE IMPACT OF THE BANKRUPTCY REFORM ACT OF 2005 UPON DIVORCE

By

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On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“Bankruptcy Reform Act”). The Bankruptcy Reform Act made significant changes to the provisions of the Bankruptcy Code that most often apply to family law, and **the new law will apply to all bankruptcy cases filed on or after October 17, 2005.** For example:

**1. Definition of “Domestic Support Obligation”:** The Bankruptcy Reform Act adds a definition of “domestic support obligation” to the Bankruptcy Code, which will become 11 U.S.C. § 101(14A), 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—

(A) owed to or recoverable by—

(i) a spouse, former spouse, or child of the debtor or such child’s parent, legal guardian, or responsible relative; or

(ii) a governmental unit;

(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;

(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 nonbankruptcy 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 highlights of the new “domestic support obligation” are as follows:

- It includes debts that accrue before, on, or after the date of the bankruptcy filing, and it includes interest that accrues on that debt as provided under applicable nonbankruptcy law.
- The domestic support obligation is a debt in the nature of alimony, maintenance, or support that runs to a broader universe of people including a spouse, former spouse, or child of the debtor, or such child's parent (thus acknowledging support obligations in situations in which the parents of a child were never married), legal guardian or responsible relative.
- The domestic support obligation is one that accrues, or can be established, before, on, or after the date that the bankruptcy is filed, and the statute clarifies that an obligation can be a domestic support obligation *irrespective* of its label in the divorce decree.
- The domestic support obligation retains its character if it is assigned to a governmental entity, but loses its character as a domestic support obligation if it is assigned to a non-governmental entity *other than* for purposes of collecting the debt.

**2. Nondischargeability of Domestic Support Obligations:** Under the Bankruptcy Reform Act, 11 U.S.C. § 523(a)(5) is amended to read as follows:

**§ 523. Exceptions to discharge**

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt - ...

(5) for a domestic support obligation;

Obviously, the Bankruptcy Reform Act’s detailed definition of a domestic support obligation enabled the legislators to simply refer to that definition in rendering domestic support obligations non-dischargeable.

**3. Nondischargeability of Property Settlement:** Before the Bankruptcy Reform Act, 11 U.S.C. § 523(a)(15) provided that property settlement was nondischargeable *unless* the debtor lacked the ability to pay it according to the criteria described in the statute, or unless

discharging the property settlement would result in a benefit to the debtor that outweighed the detriment to the non-debtor spouse, former spouse or child. The pre-Reform Act law also required that the non-debtor spouse commence an adversary proceeding in bankruptcy court to determine the nondischargeability of the property settlement and, pursuant to 11 U.S.C. § 523(c) the complaint in that adversary proceeding was required to be filed within 60 days after the first date set for the meeting of creditors pursuant to 11 U.S.C. § 341. If a nondischargeability complaint was *not* timely filed, the property settlement was automatically discharged under 11 U.S.C. § 727. 11 U.S.C. § 523(c) often resulted in non-debtor spouses having to spend limited funds in order to “protect” their property settlements.

11 U.S.C. § 523(a)(15) was added to the Bankruptcy Code in 1994 and it is oddly written. Courts, attorneys, and litigants have consistently struggled with it. The Bankruptcy Reform Act resolves the difficulty by revising § 523(a)(15) so that it reads as follows:

### **§ 523. Exceptions to discharge**

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt - ...

(15) to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record or, a determination made in accordance with State or territorial law by a governmental unit; ~~unless~~

~~(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or~~

~~(B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor.~~

Thus, under the Bankruptcy Reform Act, *even if* a debtor's obligation in a divorce decree does not come within the definition of “domestic support obligation” so as to be nondischargeable under § 523(a)(5), it is *still* nondischargeable under § 523(a)(15) if it is a debt to a *spouse, former spouse or child*. In applying the Bankruptcy Reform Act, bankruptcy judges are now more likely to view *any* obligation in a divorce decree as being nondischargeable by a party to that divorce who later becomes a bankrupt debtor.

Also, the Reform Act amends 11 U.S.C. § 523(c) so that the non-debtor spouse is not required to file an adversary proceeding in order to preserve the nondischargeability of the debtor's obligations that fall within the scope of 11 U.S.C. § 523(a)(15). This is an important change in

the law, designed to protect non-debtor spouses and children by eliminating the need for them to spend precious resources trying to “protect” the property settlement by commencing an adversary proceeding in the bankruptcy court.

Taken together, the Reform Act’s changes to 11 U.S.C. § 523(a)(5) and (15) operate to exempt from discharge all alimony, maintenance, support, property settlements, hold-harmless obligations, etc. to a spouse, former spouse or child so long as they are incurred in the course of a divorce or separation, or in connection with the divorce decree, separation agreement or other order. Consequently, practitioners might wonder if there are any remaining differences between nondischargeable domestic support obligations under 11 U.S.C. § 523(a)(5) and nondischargeable property settlement under the Reform Act’s 11 U.S.C. § 523(a)(15). The answer remains “yes”—even under the Reform Act. Although the Reform Act erodes somewhat Chapter 13’s super discharge, a debt which is nondischargeable under 11 U.S.C. § 523(a)(15) (e.g. a property settlement that is not in the nature of alimony, maintenance or support) *remains* dischargeable in a Chapter 13 *if* the debtor makes all payments under the Chapter 13 plan. However, a domestic support obligation which is nondischargeable under 11 U.S.C. § 523(a)(5) is nondischargeable *even* under Chapter 13, *even if* the debtor makes all of its payments due under the plan and receives a super-discharge. See 11 U.S.C. § 1328(a).

In addition, a Chapter 13 debtor’s failure to maintain a domestic support obligation post-petition is a ground for denial of confirmation of the Chapter 13 plan, and if the failure occurs post-confirmation, it is a ground for dismissal or conversion of the Chapter 13 case. Furthermore, the debtor’s plan is required to cure all domestic support obligation arrearages during the life of the Chapter 13 plan, unless the recipient affirmatively agrees to a different treatment.

Another difference between domestic support obligations and debts which are nondischargeable under 11 U.S.C. § 523(a)(15) is that the Reform Act amends the priority scheme which is embodied in 11 U.S.C. § 507 so as to make unsecured claims for domestic support obligations *first* priority, subject only to the fees and expenses incurred by a trustee in collecting them.

**4. First Priority for Domestic Support Obligations:** The Bankruptcy Reform Act amended the priority scheme embodied in 11 U.S.C. § 507 so as to make unsecured claims for domestic support obligations *first* priority, subject only to the fees and expenses incurred by a trustee in collecting them. The pertinent section of the Bankruptcy Reform Act reads as follows:

#### **§ 507. Priorities**

(a) The following expenses and claims have priority in the following order:

(1) First:

(A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard

to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.

(B) Subject to claims under subparagraph (A), allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless such obligation is assigned voluntarily by the spouse, former spouse, child, parent, legal guardian, or responsible relative of the child for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition be applied and distributed in accordance with applicable nonbankruptcy law.

(C) If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under paragraphs (1)(A), (2), and (6) of section 503(b) shall be paid before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims.

The iron-clad nondischargeability and higher priority of domestic support obligations means that the distinction between a domestic support obligation and property settlement remains critically important under the Reform Act. Practitioners representing non-debtor spouses and children will continue to strive for the more desirable treatment of a “domestic support obligation”.

**5. Exceptions to the Automatic Stay:** Bankruptcy’s automatic stay is a comprehensive injunction that stays actions against the debtor, property of the debtor and/or property of the bankruptcy estate.<sup>1</sup>

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<sup>1</sup> The automatic stay is contained in 11 U.S.C. § 362(a) and the Reform Act modifies 11 U.S.C. § 362(a)(8). Consequently, under the Reform Act, 11 U.S.C. § 362(a) reads:

**§ 362. Automatic stay**

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of -

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

The Bankruptcy Reform Act amends the exceptions to the automatic stay which pertain to family law matters. Historically, those exceptions to the automatic stay have been embodied in 11 U.S.C. § 362(b)(2): the Bankruptcy Reform Act modifies 11 U.S.C. § 362(b)(2) to clarify that a broader range of family-law proceedings can continue even when one party files bankruptcy, and that the following activities do not constitute a violation of bankruptcy's automatic stay:

**§ 362. Automatic Stay ...**

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay -

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

~~(2) under subsection (a) of this section—~~

~~(A) of the commencement or continuation of an action or proceeding for—~~

~~(i) the establishment of paternity; or~~

~~(ii) the establishment or modification of an order for alimony, maintenance, or support; or~~

~~(B) of the collection of alimony, maintenance, or support from property that is not property of the estate;~~

~~(2) under subsection (a)—~~

~~(A) of the commencement or continuation of a civil action or proceeding—~~

~~(i) for the establishment of paternity;~~

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(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

(ii) for the establishment or modification of an order for domestic support obligations;

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466 (a) (16) of the Social Security Act;

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the Social Security Act;

(F) of the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the Social Security Act or under an analogous State law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act.

The highlights of this new exemption from automatic stay:

- In addition to criminal proceedings, a wide variety of civil actions can proceed against a person who files bankruptcy including civil actions regarding paternity, civil actions to establish or modify domestic support obligations, civil actions regarding custody or visitation, civil actions regarding domestic violence, and civil actions to dissolve a marriage (but not issues concerning property of the debtor's estate).
- Income/wage withholding orders can still proceed, even if they target the debtor's property or property of the estate.

- Suspension of driver's license or professional license to the extent that state law provides for such a suspension, reporting of overdue support, can proceed.

### **Conclusion**

The Bankruptcy Reform Act of 2005 will have a dramatic impact on how divorce and family-law related obligations are treated in bankruptcy. The new law demonstrates a sense that Congress *finally* understands the plight of spouses, former spouses, children, and other who tend to suffer disproportionately when bankruptcy and divorce collide. These amendments to the Bankruptcy Code are clearly designed to ameliorate and cure many of the issues present under the current law. Time and judicial interpretation will provide valuable insight on the implementation of the Reform Act's important changes to the Bankruptcy Code relative to family law matters.



