

Domestic Support Obligations, Part 2-- Protecting Support Creditors in Bankruptcy. What's in a Name?

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Previously in Part 1, we discussed Arizona's rising bankruptcy filings and the prioritization of domestic support obligations (DSOs) in personal bankruptcy. DSOs include both child support and [spousal support](#).

In today's struggling economy, there is nothing novel about someone filing for bankruptcy relief. On the one hand, a petitioner may hope to be discharged of as many debts as possible so that sufficient funds remain available to pay support obligations. On the other hand, a petitioner may hope to avoid support obligations by filing for bankruptcy protection.

Although distinct differences exist between Chapter 7, 11, and 13 filings, here's the basic rule under 11 U.S.C. § 523(a)(5,15) of the Bankruptcy Code: spousal maintenance and [child support](#) are not dischargeable in bankruptcy.

In the 2008 decision *In re Wallace*, Arizona bankruptcy Judge James M. Marlar analyzed a DSO claim in an adversarial proceeding initiated by the plaintiff ex-wife. Here are the essential facts of that case...

Jason and Kimberly Wallace were divorced in September 2006. As part of their consent decree, the couple had agreed to joint custody of their two minor children, one with special needs. They also agreed that Kimberly would receive a single payment of \$100,000 instead of periodic alimony. The decree stated that the one-time payment to Kimberly was "in lieu" of spousal maintenance--a fair exchange.

In mid-December 2007, barely a year after the [divorce](#) was finalized, Jason filed for bankruptcy protection under Chapter 7. Shocking as it may seem to some, he never paid Kimberly the \$100,000. (Child support was not an issue in this bankruptcy proceeding.)

The issues raised in *Wallace* first required interpretation of the definition of DSO in the Bankruptcy Code. The court had to decide whether a lump-sum payment was: (a) a valid domestic support claim, or (b) a divorce property settlement. A valid DSO is not dischargeable. A divorce property settlement is dischargeable. How was the \$100,000 to be characterized?

The burden was on Kimberly to prove that she gave up spousal maintenance in exchange for a single lump-sum payment. That under the 11 USC § 101(14A) definition of a DSO, her claim was still domestic support even though it was not technically labeled such.

The Wallace's divorce consent decree clearly stated that Jason "shall pay the lump sum of \$100,000, . . . to [Kimberly] in lieu of a spousal maintenance award." Judge Marlar found that the parties intended that the money be "in the nature of" spousal support and within § 101(14A)'s definition of a DSO claim.

The court carefully examined the 2006 divorce decree to determine the parties' intent in their agreement. There had been a "specific list of [property divided](#), attached to the [divorce] decree, where all of the couple's tangible property was equitably divided." In contrast, the one-time payment to Kimberly was "dealt with in a separate section . . . entitled 'Spousal Maintenance/Support.'" Jason avoided alimony by agreeing to a single payment to Kimberly.

Furthermore, the bankruptcy court was "not bound by the labels" that the Superior Court used in characterizing support awards. The substance is important, not the label. An award to a spouse "in the nature of alimony, maintenance, or support" is a DSO for bankruptcy purposes, regardless of how it is tagged. Was the money to serve the purpose of spousal support for Kimberly? This court answered "Yes."

Ruling for Kimberly's DSO claim, the court analyzed three essential factors:

- (1) Support payments were absent from the divorce decree;
- (2) There were minor children of the marriage (and she was the primary custodian);
- (3) Differences in income between husband and wife indicated a need for support. (This was "evidenced by [Jason's] agreement to pay \$913,000 in community debt obligations, while [Kimberly] was responsible for none.")

The end result? Jason's \$100,000 debt was non-dischargeable in bankruptcy--he still owed the money. Kimberly was free to seek enforcement of her domestic support claim back in Superior Court.

The family law attorneys at the Law Offices of David Scott Stewart are always there to provide sound legal advice on support obligation issues in divorce and separation. We'll be finishing up this series with practical suggestions for protecting claims in Domestic Support Obligations, Part 3--Protecting Support Creditors in Bankruptcy.

Resource:

In re Wallace, No. 4:07-bk-02592-JMM (Bankr.Ariz. 9/15/2008) (Bankr.Ariz., 2008)

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