WEDDED BLISS

WHEN BANKRUPTCY LAW AND FAMILY LAW COLLIDE

24th ANNUAL DFW AREA CHAPTER 13 CONSUMER BANKRUPTCY SEMINAR

October 27, 2014

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Eligibility to File: 302(a)

Bankruptcy Code Sec. 302(a) provides, in relevant part: "A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual's spouse."

An issue which comes up fairly routinely in my practice is whether a couple who are divorcing should file bankruptcy jointly or separately. If they file separately, there will be two fees and separate 341 meetings, and ….. If they can make nice for 90 days, they can file together and save the cost of one case and eliminate most of the issues related to who will be assigned which debts. If they can't make nice for the length of their consultation, don't go there. Filing a joint case prior to divorce can make the divorce less complicated (and contentious) because it eliminates the fight over who will pay which unsecured debts. In the case where a couple is living paycheck to paycheck during the marriage, the reality often is that after the divorce, neither spouse will be able to pay the unsecured debt.

I occasionally see clients who are in the process of a divorce and will not qualify together for Chapter 7 based on the means test. The means test assumes one household, which isn't the present or future reality for these couples. I tell these clients they need to actually separate so we can prepare budgets for each of them which reflect their actual living expenses. If there are or will be support issues (child or spousal), I suggest that they get temporary orders which address these issues so that we will have actual numbers. Assuming they will qualify separately with the real numbers, we file the B22A with the allowable expenses with a presumption of abuse, and file an affidavit of special circumstances with separate B22A's which show they would each qualify individually. Our U.S. Trustee is actually pretty reasonable about these cases.

If the divorce is final, they are not spouses and they are not eligible to file a joint case.

We infrequently file cases for couples who are "common law" married. It is surprising how many of these couples do not realize they are "really" married. There seems to be a common misconception that their marriage isn't "legal" unless there was a JP or minister involved. Look at their tax returns. If they are telling the IRS they are married, they are probably "really" married. Look at the ring fingers on their left hands. If they are wearing wedding rings, they have probably been holding themselves out as married. (Texas actually recognizes what the Family Code calls "informal marriages." Sec. 2.401. An informal marriage may be proved by evidence that they executed a declaration of marriage **or** that "the man and woman agreed to be married **and** after the agreement they lived together in this state as husband and wife **and** there represented to others that they were married.") (Emphasis added.)

An issue of recent concern is the ability of a gay couple to file a joint case, or more specifically, whether a gay couple qualify as "spouses" for the purposes of 302(a). There are two published cases on point, both prior to the Supreme Court's rulings in U.S. v. Windsor and Hollingsworth v. Perry. In In re Balas, 449 B.R. 567 (Bankr.C.D.Cal.2012), twenty bankruptcy judges joined in an opinion which held that in the context of a Chapter 13 filing by a same sex couple, DOMA did not

serve an important governmental interest, did not advance any valid governmental interest, could not be upheld under either heightened or rational basis scrutiny, and that it violated their rights under the equal protection provision of the due process clause of the Fifth Amendment, and denied the U.S. Trustee's motion to dismiss. In contrast, see In re Kandu, 315 B.R. 123 (Bankr.W.D.Wash.2004), which reached the opposite result. There are two cases where the UST filed motions to dismiss under 707(a) for "cause," but in both cases the courts held that 707(a) did not provide a statutory basis for dismissal and that dismissal was not in the best interest of creditors. In re Somers, 448 B.R. 677 (Bankr.S.D.N.Y.2011) and In re Ziviello-Howell, 2011 WL 2144417 (Bankr.D.E.D.Cal.2011). Apparently, The UST is no longer opposing cases filed by same sex couples even in states which do not recognize same sex marriage.

In an odd wrinkle on a related issue, I had a case involving a couple where one of them was transgendered. (Born female, but now male.) Apparently, Texas law recognizes their marriage because of what it says on their birth certificates. (One male, one female.) The U.S. Trustee's office raised some questions, but ultimately concluded that if Texas recognized the marriage, so would the UST.

Approximately 40 states have passed so-called "mini-DOMAs" which typically prohibit same sex marriages and prohibit the state from recognizing same sex marriages from other states. These statutes open up all kinds of issues which might arise in the context of a same sex bankruptcy:

- One member of a same sex couple files bankruptcy in a community property state. That state's mini-DOMA refuses to recognize the marriage. What impact does that have on community property issues under Section 541? If there is no marriage, how can there be community property?
- A same sex couple is divorced in a state which allows same sex marriage. One partner is ordered to pay spousal support to the other spouse. The partner who was ordered to pay moves to a state which does not recognize same sex marriage. Does the spousal support obligation qualify as a DSO?
- Many states allow increased exemptions for married couples. For instance, Texas allows a personal property exemption of $30,000 for a single person and $60,000 for "a member of a family" and a 100 acre rural homestead for a single person and 200 acres for a member of a family. A same sex couple moves to Texas, waits 731 days, and one files bankruptcy. Is he/she limited to the exemption for a single person? What if both file? Does that change the answer?

Because of the dearth of case law, I am not suggesting that I know the answers to these or any other questions regarding what happens in a bankruptcy involving a same sex couple, I am simply suggesting that there are many unresolved issues. As more and more states allow same sex marriage, it is inevitable that there will be more and more same sex divorces and same sex bankruptcies. (And more and more conflicts between the laws of the various states.) Stay tuned.

See the Texas version of the mini-DOMA at Texas Family Code Sec. 6.204 which provides:

(a) In this section, "civil union" means any relationship status other than marriage that:

(1) is intended as an alternative to marriage or applies primarily to cohabitating persons; and

(2) grants to the parties of the relationship legal protections, benefits, or responsibilities granted to the spouses of a marriage.

(b) A marriage between persons of the same sex or a civil union is contrary to the public policy of this state and is void in this state.

(c) The state or an agency or political subdivision of the state may not give effect to a:

(1) public act, record, or judicial proceeding that creates, recognizes, or validates a marriage between persons of the same sex or a civil union in this state or in any other jurisdiction; or

(2) right or claim to any legal protection, benefit, or responsibility asserted as a result of a marriage between persons of the same sex or a civil union in this state or in any other jurisdiction.

At present, there is a court of appeals ruling from Dallas which holds that because Texas does not recognize same sex marriage, a state district court had no jurisdiction to rule on a same sex divorce. In re Marriage of J.B. and H.B., 326 S.W.3d 654 (Tex.App – Dallas, 2010). There is little doubt that there will be more to come on this.

As a note, the Texas mini-DOMA prohibits "the state or an agency or political subdivision of the state" from recognizing a same sex marriage, but state law would not necessarily prevent a federal court from recognizing a same sex marriage.

The Automatic Stay: 362(b)(2)

Prior to BAPCPA, section 362(b)(2) provided an exception to the automatic stay for:

"(A) 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) the collection of alimony, maintenance, or support from property that is not property of the estate."

In a Chapter 13 case, post-petition earnings of the debtor are property of the estate, so the exception was very narrow in its application. In a Chapter 7, the stay did not protect a debtor's post-petition wages from garnishment.

The stay provisions regarding domestic relations issues changed considerably in 2005. BAPCPA extended the exception in 362(b)(2) much more broadly to include:

"(A) the commencement or continuation of an action or proceeding –

(i) for the establishment of paternity; or

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

(iii) concerning child custody or visitation;

(iv) **for the dissolution of 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 analogous State law; or

(G) of the enforcement of a medical obligation, as specified under Title IV of the Social Security Act." [Emphasis added.]

Subsections (A)(iii), (iv), and (v) and (C) through (G) are all new additions under BAPCPA. The exception for dissolution of a marriage under (A)(iv) is significant, but the focus has to be on the exception to the exception, which is that a family court may not "determine the division of property that is property of the estate." Assuming that all of the debtor's (or debtors') property is claimed as exempt and the exemptions are allowed, the stay as to the property division will typically terminate on the 31st day after conclusion of the creditors' meeting pursuant to 362(c)(1) and Rule 4003(b)(1). If the debtor (or debtors) own non-exempt property, the stay continues as to that property until the property is abandoned by the trustee. (This will, of course, absolutely boggle the mind of a state court family law judge, unless you can convince the state court judge to grant the divorce and divide the marital estate between the husband, wife, and the bankruptcy trustee.)

Subsection (C) allows for the withholding of income that ***is*** property of the estate to pay a domestic support obligation. This is a major change from prior practice primarily in Chapter 13 cases as the Code now allows a domestic support obligee to garnish post-petition wages without obtaining relief from the stay. Subsections (D), (E) and (F) allow for coercive remedies other than direct enforcement of payment of a domestic support obligation.

The "Domestic Relations" Theory of Federal Abstention

28 U.S.C. Sec 1334(c)(1) and (2) provide for discretionary and mandatory abstention, respectively. A detailed analysis of the application of the "rules" regarding abstention is far beyond the scope of this paper, but suffice it to say that bankruptcy courts have generally deferred to state courts in domestic relations matters, within the exception of property division and dischargeability litigation.

As stated in Crouch v. Crouch, 566 F.2d 486 (5th Cir.1978), "Federal courts have traditionally refused to exercise diversity jurisdiction in a variety of domestic relations cases, including suits for divorce and alimony, and actions to enforce separation or divorce decrees still subject to state court modification. The reasons for federal abstention in these cases are apparent: the strong state interest in domestic relation matters, the competence of state courts in settling family disputes, the possibility of incompatible federal and state court decrees in cases of continuing judicial supervision by the state, and the problem of congested dockets in federal courts."

Crouch went on to indicate that abstention by federal courts was not appropriate or required in every domestic relations case. "While we approvingly acknowledge the so-called domestic relations exception to diversity jurisdiction, we find it inapplicable to the instant case, which involves little more than a private contract to pay money between parties long since divorced. We are faced here with no questions of custody or parental rights, no pending state court action or agreement to litigate in state court, and no threat that the former spouses will seek to play off one court system against the other. Nor do we perceive any strong state interest in the adjudication of this suit or any special competence on the part of state courts, other than their superior ability to interpret state law, which is always present in diversity suits."

Division of the Marital Estate

362(b)(2)(A)(iv) provides an exception to the automatic stay for an action "for the dissolution of marriage, **except to the extent that such proceeding seeks to determine the division of property that is property of the estate**." The debtor's estate consists of any interest the debtor has in any property, including any interest the debtor has in community property. Effectively, a bankruptcy filing by either spouse stays the property division with respect to any joint management community property, any community property subject to the sole management of the debtor spouse, or any separate property of the debtor spouse. (The nature of the debtor's interest in community property is discussed in detail later in this paper.) The stay of "an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate." 362(c)(1).

If the parties wish to proceed with the property division, there are two options: seek relief from the stay to proceed with the divorce or wait until the property is no longer property of the estate. When a debtor files a bankruptcy case, they file several schedules, including Schedule A which lists the debtor's interest in real property, Schedule B which lists the debtor's interest in personal property, and Schedule C which lists the property the debtor claims as exempt. In the vast majority of consumer bankruptcy cases, there is little or no nonexempt property. The debtor is required to attend a meeting of creditors, which is held 21 to 40 days after filing in a Chapter 7 case and 21 to 50 days after filing in a Chapter 13 case. Rule 2003(a). The trustee or creditors have 30 days from the conclusion of the creditors' meeting or 30 days after any amendment to the exemptions, whichever is later, to object to the debtor's claimed exemptions. Rule 4003(b)(1). If no objection is filed, the exemptions are allowed by operation of law and the exempt property is no longer property of the estate, so the parties may proceed to divide the marital estate. If the creditors' meeting is reset for some reason, the 30 day objection period is extended until the meeting is concluded. If the trustee

does not adjourn the meeting on the record, it is deemed to have been concluded. Rule 2003(e). If the debtor fails to disclose an asset on his/her schedules, it cannot be exempt and remains property of the estate.

If the debtors own nonexempt assets, they will remain in the estate until they are administered by the trustee in a Chapter 7 or until they vest in the debtor pursuant to the terms of s confirmed plan in a Chapter 13.

Bankruptcy courts will routinely grant relief from the stay to allow the property division to proceed **if** it appears that all of the debtor's assets are exempt. If the debtor owns nonexempt assets, the court may allow the property division to proceed with respect to the exempt assets, but not the nonexempt assets. Some courts grant relief to go forward with the property division in state court, but retain jurisdiction to review the property division to make certain that it is not prejudicial to creditors. In many of the reported cases where the court declined to modify the stay to allow the property division to go forward, the trustee objected to the relief because there were nonexempt assets. See, e.g., In re Secrest, 453 B.R. 623 (Bankr.E.D.Va.2011), where the principal asset was a home which was not wholly exempt. The court stated that the keeping the property in the estate would "simplify" the equitable distribution because the trustee could sell both the debtor's interest and his spouse's interest and then divide the proceeds. See, also, In re Exum, 2008 WL 465818 (Bankr.E.D.Va.2008). In that case the court declined to let the property division to go forward because "The parties own several improved parcels of real estate as tenants by the entirety which, preliminarily, appear to have significant equity – possibly enough to pay all creditors in full." In contrast, see Claughton v, Mixson, 33 F.3d 4 (4th Cir.1994), where the court determined that "cause" existed to allow the debtor's ex to receive amounts awarded to her pursuant in a state court divorce after the stay had been modified to allow the division to go forward. (The divorce lasted 16 years and she was awarded, among other things, $710,000 which was one-half of her attorneys' fees.) The court found that even if the property division was effectuated, the debtor still had more than enough assets to pay his debts in full and his Chapter 11 filing was "just another tactical move to delay further" his ex-wife's distribution.

In In re Beasley, 2011 WL 1399072 (Bankr.M.D.Ala.2011), the court held that a post-petition divorce decree "to the extent that it violates the automatic stay, is void" and that because a bankruptcy court was required to consider the interests not only of the parties to the divorce, but also the rights of creditors, the court would not remand the matter to state court, but would conduct further hearings to determine "how to handle the divorce decree." It is, perhaps, significant that there were apparently several properties involved so the divorce decree was not simply disposing of property that would be exempt in any event.

Coercive Collection Actions

In a form vs. substance fight, the court in In re DeSouza, 2013 WL 2991034 (1st Cir. B.A.P. 2013), held that a post-petition state court domestic relations order did violate the stay because it ordered the debtor to pay alimony but did not require garnishment or any other form of withholding. The court recognized that some courts have concluded that an action to collect a DSO from post-petition

wages is excepted from the stay even if there is no garnishment, as long as there is a court order establishing the obligation. The DeSouza court rejected this position concluding that where the statutory language is clear, the sole function of the courts is to enforce it according to its terms.

In the pay attention to the procedural niceties department, in In re Payne, 2010 WL 3747806 (Bankr.D.D.C.201), the debtor filed a motion for sanctions against the District of Columbia Child Support Division for unilaterally increasing his monthly child support obligation to collect pre-petition arrears. The court held that such action did not violate the stay because of the 362(b)(2)(C) exception. The court also, however, declined to rule on whether the DCCSD could be held in civil contempt for violating the plan confirmation order as that relief was not pled. The court then went on to state: "Now that the District has been apprised of In re Gellington and In re Fort, it may unilaterally decide to cease collecting amounts owed on the prepetition arrears that are provided for by the plan, and to refund any such amounts collected post-confirmation in violation of the terms of the confirmed plan. If it does not so act, it is nevertheless entitled to fair notice and an opportunity to defend any motion that seeks to hold it in civil contempt for violating the confirmation order and Sec. 1327(a)." (Hint, hint.)

In In re Lawida, 2011 WL 4502060 (9th Cir BAP 2011), the debtor's ex-wife, through counsel, filed a post-petition motion in state court seeking a judgment against the debtor for child support arrears, a judgment against the debtor for fees and costs, and a judgment that "all sanctions, including incarceration," be imposed upon him. The debtor filed an adversary against his ex and her attorney for willfully violating the stay. The bankruptcy court granted the defendants' 12(b)(6) motion, finding that the filing of the motion did not violate 362(b)(2)(B) or (C). The BAP reversed, holding that the motion was "not clearly excepted" from the stay because it did not relate solely to collection of a DSO through withholding or from property that was not property of the estate, and remanded for further proceedings. (And, in a footnote, stated "Based on the record before us, it is possible to conclude that Seyffer and Lewis may have violated the automatic stay in filing and serving the OSC. The debtor may not be able to show he suffered any damages, however, as Seyffer and Lewis immediately withdrew the OSC petition upon the debtor's request, prior to his filing his adversary complaint." Hint, hint.)

In the don't try this at home department, see In re Lasley, 2010 WL 817232 (Bankr.D.Mont.2010) where the debtor filed a motion for sanctions against the Los Angeles Child Support Service Department ("LACSSD") for violating the stay by sending monthly billing statements and demands post-confirmation and for intercepting his $250 stimulus payment . The debtor did not list LACSSD or his ex as creditors so they had no notice of the claim deadline or the plan confirmation hearing and although LACSSD was trying to collect almost $50,000 from him, he filed a claim on its behalf in the amount of $250. The court rather casually and sketchily concluded that 352(b)(2)(C) provided an exception to the stay for withholding of income that is property of the estate or property of the debtor for payment of a DSO, so the request for sanctions was denied. One has to wonder (if not assume) that the court's displeasure with the debtor was also "grounds" for its conclusion. (At one point the court described his testimony as "unbelievable.")

In re Penaran, 424 B.R. 868 (Bankr.D.Kan.2010) confirmed that 362(b)(2)(D) means what it says and suspension of the debtor's driver's license for non-payment of support did not violate the stay.

In re Worland, 2009 WL 1707512 (Bankr.S.D.Ind.2009) and In re Chambless, 2008 WL 2782900 (Bankr.N.D.Aala.2008) both confirm that 362(b)(2)(F) means what it says and the state enforcement agency can intercept a debtor's tax refunds post-petition.

362(b)(2) v. 1327(a)

There has been a good deal of litigation over how the new exceptions to the stay are to be implemented. The one reported Texas decision is In re Gellington, 363 B.R. 497 (Bankr.N.D.Tex.2007), in which Judge Hale held that the Texas Attorney General's post-petition wage garnishment did not violate the stay under 362(b)(2)(C), but that AG's conduct did violate the debtor's confirmed plan which provided for payment of the claim. (This is an unusual case as there was some confusion about which of the debtor's four proposed plans was confirmed so the AG apparently started the garnishment because the confirmation order did not appear to provide for payment of its claim.)

See, also, In re Gonzalez, 2012 WL 2974813 (Bankr.S.D.Fla.2012), which held that whether or not the State of Florida's interception of a tax refund to enforce collection of child support violated the stay, it violated the order confirming the debtor's Chapter 13 plan. See, also, In re McGrahan, 448 B.R. 611 (Bankr.D.N.H.2011) which reached the same result.

The decisions in Gellington, Gonzalez, and Payne revolve around the conflict between 362(b)(2) and 1327(a) which provides: "The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." The basic rule is that 1327(a) trumps 362(b)(2) once the order confirming the plan is entered.

Void vs. Voidable

The Fifth Circuit has consistently held that actions taken in violation of the stay are voidable, not void. See, BroadStar Wind Systems Group, L.L.C. v. Stephens, 459 Fed.Appx. 351 (5th Cir.2012); Chapman v. Bituminous Ins. Co., 345 F.3d 338 (5th Cir.2003); Picco v. Global Marine Drilling Co., 900 F.2d 846 (5th Cir.1990). The reasoning is that because the court has the power to retroactively annul the stay, the violation cannot be void. Compare the Ninth Circuit which has consistently held that actions taken in violation of the stay are void, not voidable. See, In re Tippett, 542 F.3d 684 (9th Cir.2008); In re Schwartz, 954 F.2d 569 (9th Cir.1992).

Sanctions for Violation of the Automatic Stay

362(k)(1) provides: "Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." [(Note that this section was renumbered in 2005. Prior to that it was 362(h).]

In the family law context, stay violations may include other coercive actions not included in the list of actions excluded from the stay under 362(b)(2)(D) through (G). For Fifth Circuit authority see In

re Repine, 536 F.3d 512 (5th Cir.2008). (This was a Houston case at the bankruptcy court level.) In this case, the creditor was the attorney who had represented the debtor's ex-wife in a child support enforcement action. The attorney obtained a judgment for her fees and attempted to collect those fees before and after the debtor filed a Chapter 13. Of particular note, the debtor had been jailed for criminal contempt for not paying child support, but after the criminal contempt was purged, the ex's attorney opposed the debtor's release on civil contempt charges until her fees were paid, even though his ex was requesting his release. The debtor sought and was awarded sanctions for a willful violation of the stay.

Repine reviewed the factors required to prevail on a claim for willful violation of the stay: the claimant must show (1) the creditor knew of the existence of the stay (specifically, that there was a bankruptcy filing); (2) the creditor's acts must have been intentional; and (3) the creditor's acts must have violated the stay. For the non-bankruptcy lawyers in the audience, it doesn't matter if the creditor intended to violate the stay, the issue is whether the creditor intended the act which violated the stay. Repine also articulated the standard to prevail on a claim for punitive damages, which is "egregious conduct" on the part of the creditor. In that case, the court found that the creditor ignored written warnings from the debtor's attorney that her efforts violated the stay, she ignored her own client's request that the debtor be released from jail, she failed to appear in court in response to a court order for her to do so, and she continued her collection efforts despite an admonishment from the bankruptcy court that she cease any further collection efforts. (The court affirmed in part and reversed and remanded in part, but upheld almost all of the damages awarded by the bankruptcy court. The remand was ordered because the debtor was required to prove emotional distress by "specific information" rather than "generalized assertions.")

See, also, In re Caffey, 384 B.R. 297 (Bankr.S.D.Ala.2008), which reached a similar result. FYI, Repine awarded damages of $66,000, Caffey awarded damages of $40,000 plus attorneys fees yet to be determined. Stay violations can be expensive. Once a creditor has notice of the stay, any actions after notice tend to be even more expensive.

In In re Schroeder, 2009 WL 3526504 (Bankr.D.Neb.2009), the court sanctioned the Nebraska DHHS for willfully violating the stay where the state support enforcement agency sent demand letters threatening to report the debtor to credit reporting agencies and to intercept the debtor's tax refunds if he did not pay his support obligation, notwithstanding that the debtor had a confirmed Chapter 13 plan which provided for payment of the claim. Although 362(b)(2)(E) permits the reporting of overdue support and 362(b)(2)(F) permits the interception of a tax refund, the support enforcement agency did not report the overdue support to the credit reporting agencies and did not intercept his tax refund - it ***threatened*** to do those acts ***if*** he did not pay the past due amounts. Doing is excepted, threatening to do is not.

In In re Kallabat, 482 B.R. 563 (Bankr.E.D.Mich.2012), the court held that although the debtor's wife and her attorney were not stayed by the debtor's bankruptcy filing from proceeding with dissolution of the marriage, to determine custody and visitation and to establish DSO's, they were stayed from requesting that the marital home be awarded to her and that he be ordered to pay a credit card debt, and that the submission of a proposed judgment to the divorce court constituted a separate violation of the stay. The court held that the violation by the attorney was willful because the issue is

not whether the actor intended to violate the stay, but whether the actor intended the act which did violate the stay.

The Codebtor Stay - 1301(a)

1301(a) provides: "Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless -

> (1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or
> (2) the case is closed, dismissed, or converted to a case under chapter 7 or 11 of this title.

1301(c) provides that upon request of a party in interest, the court **shall** grant relief from the stay to the extent that

> "(1) as between the debtor and the individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;
> (2) the plan filed by the debtor proposes not to pay such claim; or
> (3) such creditor's interest would be irreparably harmed by continuation of such stay."

The first important limitation of the scope of this section is that it only applies to "consumer debt" which is defined by 101(8) as a debt "incurred by an individual primarily for a personal, family, or household purpose." In short, the codebtor stay would not apply to a guaranty or cosigning of a "business" (as opposed to consumer) debt. (The Code does not make a distinction between "consumer" and "business" debt – it makes a distinction between "consumer" and everything that is not consumer.)

The second important limitation to the effect of this section is that the court "shall" grant relief from the stay if certain conditions are not met. First, if the non-debtor received the consideration for the debt, the court shall grant relief. This most common scenario we see is where the debtor cosigned a debt for another individual and the nondebtor obtained possession of tangible property as a result of the transaction. The most common example of this would be where the debtor cosigns a car loan for another person and that person has possession of the car. Second, to the extent the debtor's plan proposes not to pay the claim, the court shall grant relief. Which raises the obvious question of what if the plan proposes to pay only part of the claim? (i.e., the plan proposes to pay 30% to unsecured creditors and the claim in question is unsecured.)

Not surprisingly (at least to me), there are not a ton of cases on this section. One case of interest is In re Reiter, 126 B.R. 961 (Bankr.W.D.Tex.1991), a pre-BAPCPA case in which the debtor filed a motion for sanctions against the IRS for violating the stay and the codebtor stay. Judge Clark ruled that a joint federal tax liability did **not** constitute a "consumer debt" under then section 101(7) [now (8) post BAPCPA], and also held that property subject to a non-filing spouse's sole management under the Texas Family Code did not constitute property under the sole, equal or joint management

of the **debtor** for the purposes of 541(a)(2)(A), but was property of the estate under 1306(a)(1). Therefore, the IRS attempt to levy on the non-filing spouse's post-petition wages to pay a pre-petition debt violated 362(a)(3) and (4).

In one of the few Texas cases addressing 1301(a), In re Pardue, 143 B.R. 434 (Bankr.E.D.Tex.1992), Judge Sharp held that where a plan provided for payment of the full amount of the creditor's claim as filed but did not provide for payment of interest and attorneys' fees, the creditor is entitled to relief from the codebtor stay to collect those additional amounts. The court specifically addressed the issue of the application of 506(b) and held that although it limited the ability of a creditor to collect interest and attorneys' fees from the debtor, it had no application to a non-debtor.

But see, In re Medaris, 884 F.2d 832 (5th Cir. 1989), in which the Fifth Circuit held that even though the debtor's spouse's wages were not subject to the claims of her husband's creditors under Texas law, the Internal Revenue Code trumped Texas law and the Internal Revenue Service was authorized to levy on one half of the wife's wages.

See, also, In re Westberry, 215 F.3d 589 (6th Cir.2000), which affirmed the district court's reversal of the bankruptcy court's holding that a debt owed to the IRS was a "consumer debt" for the purposes of the codebtor stay. Since the debt was not a consumer debt, the codebtor stay did not preclude the IRS from enforcing its claim against the non-debtor spouse.

In re Allen, 300 B.R. 105 (Bankr.D.C.2003) addressed the scope of the relief which could be granted pursuant to 1301(c), which provides only that the court shall grant "relief" from the stay. In Allen, the court was asked to annul the stay to validate a deed of trust foreclosure sale. The court held that it had the power to annul the stay to grant retroactive "relief" which was appropriate under the circumstances.

In In re King, 362 B.R. 226 (Bankr.D.Md.2007) the court held that although there was no stay with respect to the debtor because two prior cases had been dismissed due to failure to obtain credit counseling and failure to pay the filing fee, the codebtor stay still applied and the court declined to annul the stay retroactively for the benefit of a lender which had conducted a foreclosure sale.

In In re Lemma, 394 B.R. 315 (Bankr.E.D.N.Y.2008), the stay terminated with respect to a mortgage lender, but then a plan was confirmed which provided for continued payments to the lender and cure of the pre-petition arrearage. The lender posted the property for foreclosure and the debtor moved for a determination that the posting violated the codebtor stay. The court held that the confirmed plan was binding on the creditor under principles of res judicata even though the stay had terminated. The court declined to terminate the codebtor stay under the provision that the consideration was received by the codebtor finding that the debtor was the "primary beneficiary" of the consideration and holding that subsection applies only where the codebtor was the "exclusive" recipient of the consideration. The court further declined to terminate the codebtor stay where the creditor was not being paid in full immediately, but the full amount of the arrearage claim was being paid during the life of the confirmed plan. Finally, the court declined to terminate the stay under 362(d)(4)(B) where the lender failed to prove that the current filing was part of a scheme to hinder, delay or defraud creditors and where the debtor confirmed a plan providing for full payment of the

lender's claim, had been making the plan payments post-confirmation and had tendered post-petition mortgage payments to the lender.

In In re Galvan, 1998 WL 246015(D.N.D.Ill.1998), the district court reversed the bankruptcy court's termination of the stay with respect to a non-filing spouse with respect to a condo owners association's attempt to collect pre-petition condo owner's assessments. The district court held that condo owners fees constitute a "consumer debt" as it was primarily for "household" purposes. The court also reversed the bankruptcy court's finding that because the wife received some consideration, the stay should be lifted. The district court held that the codebtor stay was meant to apply in just this type of situation where terminating the stay would allow the creditor to exert indirect pressure on the debtor to pay the claim. The court finally held that the condo owners association would not be irreparably harmed by not terminating the stay as the debtor's plan provided for full payment of the claim over time.

See also In re Schaffrath, 214 B.R. 153 (6th Cir. B.A.P. 1997), where the Sixth Circuit BAP addressed the issue of whether the stay should terminate with respect to the codebtor when the debtor's plan provided for less than full payment of the creditor's claim and concluded that relief was mandatory when the plan provided for less than full payment.

In re Moore, 2008 WL 2225757 (Bankr.D.Al.2008), the court held that a creditor did not violate the codebtor stay where there had been a pre-petition garnishment but that order was vacated immediately after the bankruptcy filing, then reinstated sua sponte by the state court. Although the garnishee continued to hold the garnished funds post-petition, it was not at the request of the creditor. (Although the creditor took no affirmative action to maintain the garnishment, it took no affirmative action to release the garnishment either.)

In In re Hughes, 2005 WL 1293982 (Bankr.M.D.N.C.2005), the court held that J.C. Penney violated the codebtor stay by making no less than ten calls to the debtor's mother demanding payment on a joint debt, but also held that the court had no authority to sanction the creditor under 1301 and that 362(h) did not apply. (1301 makes no reference to 362.)

Executory Contracts – Engagement Letters: 365

Section 365 of the Bankruptcy Code addresses "Executory contracts and unexpired leases" in bankruptcy cases.

There is no definition of "executory contract"in either Section 365 or any other section of the Code. The definition most commonly adopted by bankruptcy courts (and the federal appellate courts) is called the Countryman definition, named after Professor Verne Countryman who first articulated the definition in *Executory Contracts in Bankruptcy: Part I, 57 Minn. L.Rev. 439, 460 (1973)*. His definition is that an executory contract is:

"a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."

I have to say that I really hate that definition. It was meant to be a refinement or clarification of the common law definition which merely required that to be "executory", there had to be some performance remaining due from both parties to the contract. The bankruptcy courts had typically opined that the common law definition was too vague and a definition that clarified the amount of the performance still due would be more useful. It seems to me that the Countryman definition is still so subjective that bankruptcy courts can find virtually any contract to be executory if it so desires.

(d) (1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

I didn't find any case law on this, but it would seem that an as yet incompletely performed contract to provide legal services is an executory contract which, if not assumed, is deemed rejected. I am not opining on what debtor's counsel should do, but it is an issue for consideration.

Property of the Estate: 541(a)(2) and 541(a)(5)

There is a common misconception about what marital property comes into a bankruptcy estate. Just because property is "community property" does not mean that it comes into the estate and/or that community property of a non-filing spouse is subject to claims against a filing spouse. In addition, property which does not come into the estate is not required to be exempted, thereby allowing a non-filing spouse to effectively increase or avoid the exemption limits.

541(a)(2) provides that property of the estate includes "all interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is -

> (A) under the sole, equal, or joint management and control of the **debtor**; or
> (B) liable for an allowable claim against the **debtor,** or for both an allowable claim against the debtor **and** an allowable claim against the **debtor's spouse**, to the extent that such interest is so liable." [Emphasis added.]

The issues of (1) what interest in community property is under the sole or joint management of the debtor or (2) is liable for a claim against the debtor or the debtor and the debtor's spouse is an issue of **state** law. There are no Bankruptcy Code provisions which purport to address this issue.

It is significant that a debtor's bankruptcy estate includes not only the debtor's interest, but the non-filing spouse's community interest which is subject to the debtor's control or is liable for the debtor's debts, as well. If the other spouse files a bankruptcy while the first spouse's bankruptcy is still pending, the second spouse's bankruptcy estate does not include any of the community property which was included in the first case. See, e.g., In re Herter, 456 B.R. 455 (Bankr.D.Idaho 2011). Herter demonstrates a common problem when reviewing case law on these issues. Although Idaho is a community property state, its community property laws may or may not be the same as Texas, so don't assume that the answer would be the same. In Herter, there was a divorce pending and the parties entered into a pre-petition "stipulation" regarding the sale of a home, but the copy provided to the court was not signed or acknowledged and there was no evidence that a copy had been filed in the real property records, so there was no pre-petition "transmutation" of the property from community property to separate property of each spouse with the result that all of the community interests came into the husband's bankruptcy estate.

There is another question which arises, which is to what extent does joint management community property come into the estate? See In re Wald, 2012 WL 2049429 (Bankr.W.D.Tex.2012), which addresses the extent to which a joint management homestead comes into the estate when only one spouse files. As indicated above, the general rule is that all joint management community property comes into the estate. The Wald court concluded, however, that under Texas law, each spouse has an undivided one-half interest in the homestead so only that one-half interest came into the estate. The debtor in Wald argued that the house was worth $364,930, so his one-half interest was worth $182,465, but the house was encumbered by a lien of $231,480, so his one-half had no value. Based on the opinion, it appears that Judge Clark rejected what is essentially a marshaling argument and held that the debtor's homestead was limited to $21,625 under 522(d)(1) and gave him 30 days to amend to claim state exemptions. I don't agree with the result based upon many years of Texas case authority which does apply marshaling in the context of a claim of exemptions with respect to a homestead. See, e.g., Kerens Nat'l Bank v. Stockton, 40 S.W.2d 7 (Tex.1931); Burg v. Hitzfeld, 89 S.W.2d 272 (Tex.Civ.App.-San Antonio, 1936); Henkel v. Bohnke, 26 S.W. 645 (Tex.Civ.App, 1894).

Remember also that 541 has an "after acquired property" provision which brings specified assets into the estate if they are acquired within 180 days of filing of the bankruptcy case. 541(a)(5) provides
that property of the estate includes: "Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date –

> (A)…
> (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or
> (C) …."

Finally, if only one spouse files and elects to use the federal exemptions, the non-debtor spouse is not entitled to claim any exemptions. 522(b)(1) provides "…an individual debtor may exempt from property of the estate the property listed in either paragraph (2), or in the alternative, paragraph (3) of this subsection." The rule for using Texas exemptions is different as the Texas exemptions allow different amounts for a single person and "a member of a family."

Texas Marital Property Law:

Texas common law generally provided that a husband was not only empowered to manage his separate property and community property, but the separate property of his wife, as well. It was not until Texas passed the Matrimonial Property Act of 1967 that spouses (women in particular) were granted the right to manage their separate property and sole management community property. These changes were codified in the first version of the Texas Family Code enacted in 1969. The "current" version of the Texas Family Code enacted in 2000 expanded these rights.

The relevant Texas Family Code sections are:
3.002
3.102
3.104
3.201
2.501
3.202
All of the foregoing sections are contained in Texas Family Code, Title 1. The Marriage Relationship, Subtitle B. Property Right and Liabilities, Chapter 3 Marital Property Rights and Liabilities. As we go down the list of cited sections, the subchapters become more specific. For instance, 3.002 is contained in Subchapter A. General Rules for Separate and Community Property. 3.102 and 3.104 are contained in Subchapter B. Management, Control and Disposition of Marital Property. 3.201 and 3.202 are contained in Subchapter C. Marital Property Liabilities.

The general rule that property acquired during marriage is presumed to be community is contained in Tex. Fam. Code Sec. 3.002 which provides that "Community property consists of the property, other than separate property, acquired by either spouse during marriage." That presumption is rebuttable by clear and convincing evidence that the property was ***not*** intended to be community property.

Just because property is community does **not** mean that it is liable for every debt of either spouse. Community property which is subject to the **sole management** of the non-debtor spouse is **not liable** for the **non-tortious debts** of the debtor spouse. Tex. Fam. Code Sec. 3.102 provides:

> "(a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:
> (1) personal earnings...
>
> (b) If community property subject to the sole management, control, and disposition of one spouse is mixed or combined with community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless

> the spouses provide otherwise by power of attorney in writing or other agreement." (If the non-debtor spouse deposits sole management community property, i.e., wages, in a joint management checking account, the sole management community property becomes joint management. Simple answer: keep separate bank accounts.)

With respect to personal earnings, see In re Nahat, 278 B.R. 108 (Bankr.N.D.Tex.2002), which held that the post-petition earnings of a non-filing spouse are not property of the estate, and that the debtor's failure to include all of the non-filing spouse's future earnings did not cause the debtor's plan to fail the best interest of creditors test. The court specifically cites to Sec. 3.102(a)(1) in holding that the non-filing spouse's personal earnings are not property of the estate.

Tex. Fam. Code Sec. 3.104(a) provides:

> "During the marriage, **property is presumed to be subject to the sole management, control, and disposition of a spouse if it is held in that spouse's name, as shown by muniment, contract, deposit of funds, or other evidence of ownership**, or if it is in that spouse's possession and is not subject to such evidence of ownership." [Emphasis added.]

Remember, the basic rule is that property of the estate includes:

1. The debtor's separate property;
2. Community property in the sole management of the debtor; and
3. Community property in the joint management of the debtor and the debtor's spouse.

Property of the estate ***does not*** include:

1. The separate property of the non-filing spouse; and
2. Community property in the sole management of the non-filing spouse.

See, e.g., In re Bounds, 2013 WL 2245140 (D.W.D.Tex.2013).

Section 3.104(a) identifies what property is under the sole management of one of the spouses. Basically, if the property has a title – a deed to real property, a certificate of title on a car or boat, a bank account, etc – and the asset in question is titled in the name of only one spouse, it is under the sole management of that spouse, even though it is community property. See, e.g., In re McCloy, 296 F.3d 370 (5th Cir.2002). In McCloy, the debtor spouse purchased a parcel of real property in her name only and she was the only party to the note and deed of trust which encumbered the property. Notwithstanding the fact that the property was purchased with community funds, it was still her sole management community property based on the title.

But, the community property issues are not always as easy to resolve as one might think. See, e.g., In re Chestnut, 422 F.3d 298 (5th Cir.2005). (Which started out in the Dallas Bankruptcy Court.) In that case, Ms. Chestnut acquired a piece of real property approximately 3 years after she married Mr. Chestnut. The court recites the simple facts: "Mrs. Chestnut attended the closing without her husband and signed all of the relevant legal documents alone, including the real estate lien note, the deed of trust, the title policy and the warranty deed. Although the warranty deed recites that the Eastland property was acquired by 'Jacqueline Chestnut, as her sole and separate property and estate,' Mr. Chestnut contended that the Eastland property was paid for with community funds, and Texas law provides for a rebuttable presumption that property purchased during marriage is community property."

Mrs. Chestnut fell behind on the note, the note was transferred, and the new lienholder posted the property for foreclosure. Mr. Chestnut filed a Chapter 13, in large part to stop the foreclosure, but the lienholder proceeded to foreclose having determined in its own mind that Mr. Chestnut had no ownership interest in the property. The Bankruptcy court entered judgment against the foreclosing creditor for willfully violating the stay. The District court reversed. The Fifth Circuit reversed the district court and affirmed the ruling of the bankruptcy court. The court explained: "The Eastland property was not clearly part of Mr. Chestnut's bankruptcy estate at the time of the foreclosure, but neither was it clearly *not* part of his estate. Whether an asset is property of the estate is a legal determination which frequently entails complex analyses involving a number of legal elements and a variety of facts. Here, the status of the Eastland property hinged on the application of Texas's legal presumptions regarding separate and community property as well as an examination of the factual bases underlying the transaction, including the text of the title documents, the source of purchasing funds, and even the possible existence of fraud. [Citations omitted.] These questions concerning the characterization of the Eastland property can only be answered with finality through the judicial process, which was not initiated here until after the foreclosure of the Eastland property. Regardless of whether the Eastland property is ultimately held to have been Mrs. Chestnut's separate property or the Chestnut's community property, at the time that Brown foreclosed on the Eastland property, it was uncertain whether it was property of Mr. Chestnut's estate and, therefore, was arguable property." [Emphasis in original.] (I think the Circuit reached the correct result, but I think the opinion reflects a lack of understanding of Texas community property law. The issue was not whether the property was separate or community, but whether the property was Mrs. Chestnut's sole management community property.)

See, also, In re Trammell, 399 B.R. 177 (Bankr.N.D.Tex.2007), which involved a car which was purchased during marriage with community funds, but titled only in the name of one of the spouses. The court held that the vehicle was the sole management community property of the non-filing spouse so it was not property of the estate. The court also engaged in a lengthy analysis of whether the vehicle was liable for an allowable claim against the debtor or the debtor and her spouse, in which case it would become property of the estate pursuant to 541(a)(2)(B). The court concluded that it was not property of the estate based upon Tex. Fam. Code Sec. 3.201, rejecting the line of cases following Cockerham v. Cockerham, 527 S.W.2d, 162 (Tex.1975.) Section 3.201 was enacted in 1987 (then numbered as Sec. 4.031), many years after Cockerham.

In an interesting twist see In re Martin, 2009 WL 1911760 (Bankr.N.D.Tex.2009) and In re Lummus, 2000 WL 33912318 (Bankr.N.D.Tex.2000), both of which deal with whether tax refunds constitute property of the estate when one of the spouses did not join in the bankruptcy filing. In both cases, the debtor and their spouse filed a joint federal income tax return which generated a refund payable to both spouses, but in both cases all of the income reported during the year in question was from the earnings of the non-filing spouse. In both cases, the court held that because the refund was a refund of the sole management wages of the non-filing spouse, the refund was also sole management property of the non-filing spouse and was not included in property of the estate.

Tex. Fam. Code Sec. 3.201 provides:

"(a) A person is personally liable for the acts of the person's spouse **only if**:

(1) the spouse acts as an agent for the person; or

(2) the spouse incurs a debt for necessaries as provided by Subchapter F, Chapter 2.

(b) Except as provided by this subchapter, community property is not subject to a liability that arises from the act of a spouse.

(c) A spouse does not act as an agent for the other spouse solely because of the marriage relationship."

Tex. Fam. Code Sec. 2.501 [Subchapter F, Chapter 2, referenced in 3.201(a)(2) above] provides:

"(a) Each spouse has the duty to support the other spouse.

(b) A spouse who fails to discharge the duty of support is liable to any person who provides necessaries to the spouse to whom support is owed."

I hear a lot of talk about going after the other spouse for debts for "necessaries," but it seems to be all talk. There is virtually no case law on the issue, with one result being that I am unable to articulate what constitutes a "necessary." I am fairly certain that it would include groceries, clothing and medical care, but what are the limits? Food is necessary, but filet mignon is not. What about rent? Does it matter how expensive the rent is for it be "necessary"? I would note that in almost 30 years of practice, I have never had a creditor actually pursue such a claim.

For one of the few cases which even talk about necessaries, see Fallin v. Williamson Cadillac Co., 40 S.W.2d 243 (Tex.Civ.App. – San Antonio, 1931). In that case, the issue was whether the separate estate of the wife was bound where the creditor extended credit to the wife, having refused to extend credit to the husband. At the time, the law was "that a note or other document executed by the wife, not joined by the husband, is a nullity." Because the wife could not be bound by contract, the court then looked at the issue of whether her Cadillac was a necessary. The court stated: "The guide as to what are necessities is not a thing that is settled. What is a necessity for one family would be a luxury for another. The needs of the family with reference to social position, wealth, surrounding circumstances, etc., are the determining factors." Apparently, under the facts of this case, a Cadillac was a necessity. (This whole line of cases is awful as there is absolutely no guidance. I would suggest that a car ***might*** be a necessary ***if*** the debtor lives in a rural area and there is no public transportation, but a Honda Civic will get you back and forth to work. A Cadillac would seem to be a luxury.)

Tex. Fam. Code Sec. 3.202 provides:

"(a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouse's are liable by other rules of law.

(b) Unless both spouse's are personally liable as provided by this subchapter, the **community property subject to a spouse's sole management, control, and disposition is not subject to:**

(1) any liabilities that the other spouse incurred before marriage; or

(2) **any nontortious liabilities that the other spouse incurs during marriage**.

(c) The community property subject to a spouse's sole or joint management, control and disposition is subject to the liabilities incurred by the spouse before or during marriage.

(d) All community property is subject to tortious liability of either spouse incurred during marriage." [Emphasis added.]

I have been unable to find a single Texas case which addresses the application of 3.202(d). (There is one case which simply recites that because there was state court judgment which found tortious conduct, the non-debtor spouse's sole management community property was liable.) The issue of concern is whether fraud constitutes a tort for the purposes of this section. The most common scenario is one spouse owns a business and there is a claim of fraud under 523(a)(2)(A) or (B) or a claim of fraud in a fiduciary capacity under 523(a)(4). If the bankruptcy court determines that a debtor's debt is nondischargeable under one of these sections, does that expose the non-filing spouse's sole management community property to collection efforts arising out of conduct solely undertaken by the debtor?

Pay attention to cased law cited for the proposition that a spouse is liable for the debts of the other spouse. Most of this case law is ancient. One of the cases I am cited to regularly is Walling v. Hannig, 11 S.W. 547 (Tex.1889.) That's right folks: 1889. This is a case where the husband and wife went to a store and wife purchased "many articles of house furnishing goods." Wife made payments for a time, but then defaulted. Store owner sues husband who denies liability because he did not authorize the purchases. The Court ruled in favor of store owner stating: "Where a husband is living in the same house with his wife, he is liable to any extent for goods which he permits her to receive there. She is considered as his agent, and the law implies a promise on his part to pay the value." A few things have changed since 1889. Like Texas Family Code Sec. 3.201(c), which specifically provides that a spouse is ***not*** the other spouse's agent just because they are married.

* There really is no such thing in Texas as "community debt." Texas Family Code Sec. 7.001 provides that in a divorce decree, the court "shall order a division of the estate of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage." **The phrase "community debt" does not appear anywhere in the Texas Family Code**. (Try a Westlaw search of the Family Code for the phrase "community debt" and you get "no results match your request.") This is an unfortunate term that gained common usage **before** there was a Family Code and has survived as a shorthand abbreviation when it is really just a lazy way of saying "debt incurred during marriage" ***in the context of dividing the marital estate***.

There are some very specific and limited exceptions to a Texas spouse's future income being liable for the other spouse's debts. See, e.g., Medaris v. U.S., 884 F.2d 832 (5th Cir. 1989) which held that one-half of the non-filing spouse's earnings were subject to levy to satisfy the debtor's tax liability, but that resulted from application of the Internal Revenue Code, not the Texas Family Code.

Practice Point: Remember, property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case". That includes the retainer paid to the family law attorney but not yet earned by that attorney. If there is a divorce pending (particularly an ugly divorce), make sure to verify whether or not there is such a retainer.

Exemption of Marital Obligations: 522(d)(10)(D)

522(d)(10)(D) allows a debtor to exempt "alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." There is no exemption under 522(d) for amounts owed pursuant to a property division order or agreement.

Texas Property Code Section 42.001(b)(3) provides that "alimony, support or separate maintenance received or to be received by the debtor for the support of the debtor or a dependent of the debtor" is exempt and is ***not*** included in the aggregate dollar limits contained in 42.001(a). There is no exemption under 42.001 for amounts owed pursuant to a property division order or agreement.

The fight here is whether an obligation is in the nature of alimony or support or is in the nature of property division. Note that 522(d)(10)(D) does not use the defined term "domestic support obligation," so courts are permitted/required to look more broadly at what the parties and/or the divorce court intended the obligation to be. See In re Evert, 342 F.3d 358 (5th Cir.2003). This is THE case in the Fifth Circuit on this issue. In Evert, the debtor (Evert) and her husband (Colvin) were divorced in 1999. Under the terms of the divorce decree, there were three separately identified financial obligations owed by Colvin to Evert: (1) a section labeled "Child Support" which required Colvin to pay Evert $1,000 per month until the oldest child turned 18 with a reduction to $800 until the second child reached 18; (2) a section labeled "Property Settlement" which purported to divide the assets and liabilities of the parties, pursuant to which Evert was awarded a promissory note in the amount of $65,000 to be executed by Colvin payable at 8% interest in 60 monthly installments of $1,317.97; and (3) a section labeled "Post-Divorce Spousal Support (Alimony) Agreement" pursuant to which Colvin was to pay to Evert $1,350 per month for four years.

Evert filed Chapter 7 in March, 2001. She initially failed to disclose the existence of the note or to claim it as exempt, but amended Schedules B and C to exempt the note approximately 60 days later. The basis for the claimed exemption was 522(d)(10)(D), which exempts debts for "alimony, support or separate maintenance." The Chapter 7 trustee objected to the exemption of the note. The debtor then converted to Chapter 13 while the objection to exemptions worked its way through the legal process. In October, 2001, the bankruptcy court issued its opinion holding that the note was exempt as the parties intended the debt to be in the nature of support, regardless of how it was characterized. The trustee appealed. In April, 2002, the District Court affirmed. The trustee appealed. In April, 2003, approximately two years after the original bankruptcy filing, the Fifth Circuit reversed, holding that the note was not in the nature of support and was intended to be part of the division of the community estate. At that point, the trustee sued Colvin, but there was only approximately $2,000 left due on the note. None of the parties had ever moved to have the payments escrowed or deposited in the registry of the court.

The Evert court decided that it was not required to decide whether the Nunnally "test" for dischargeability purposes should be adopted to determine whether a payment due under a divorce decree was intended to be in the nature of support ***for exemption purposes***. (Discharge issues will be discussed later in this paper.) In Evert, the court found that the agreement entered into between the parties contained clear indication of the party's intent. There were separate provisions for "non-trivial" payments of child and spousal support in addition to the payment for property division. The spousal support payments ended on the death of the obligee (when she would no longer require

support), but the payments on the note ended only on full payment of the debt. The court also noted that the dollar division of the estate (the house and note to Evert, the equity in the business to Colvin) was substantially equal, further evidence that the property settlement was actually a property settlement.

Other than Evert, there is no published authority from Texas on 522(d)(10)(D).

For a glimpse at how other courts have struggled with this issue, see In re Diener, 483 B.R. 196 (9th Cir. BAP 2012) (Bankruptcy court did not clearly err in finding that a nonqualified retirement account was not alimony, support, or separate maintenance.); In re Brown, 391 B.R. 210 6th Cir. BAP 2008) (Remanded for further hearing to determine whether because of an ambiguity in the decree about whether amounts owed were intended to be in the nature of spousal support or property division.); In re Harbaugh, 257 B.R. 485 (D.E.D.Mich.2001) (Debtor was entitled to exempt $48,500 payable over 7 years as in the nature of alimony given that both parties and court identified the payments as alimony, payments terminated upon the death of the debtor, and the debtor had no other substantial income so she needed the payments for "sustenance.")

The Diener court reached the interesting conclusion that "Although the *Evert* court said it was not deciding the issue of whether the same criteria should be applied in case of nondischargeability and exemption, by rejecting the *Nunnally* factors… we believe the court essentially did decide the issue (in the negative) by its rejection of the notion that the same test should apply in both circumstances." I would suggest that the Diener court is reading too much into the Evert decision. Evert seems to say that if the decree meets these four criteria, the court doesn't need to look at the Nunnally factors, which suggests that if those four criteria are not met, then the court would look to the Nunnally factors. (But we are all guessing until the Fifth Circuit tells us.)

Exception to Exemptions: 522(c)(1)

Section 522(c)(1) provides:

> "(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose… before the commencement of the case, except -
> (1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in section 523(a)(5))."

This provision existed pre-BAPCPA, but was reworded slightly.

Although there are many cases which refer to 522(c)(1), most of them do so for comparison purposes. See, e.g., In re Galtieri, 172 Fed.Appx. 397 (3rd Cir.2006). There are only a few Texas cases on Section 522(c)(1) and most of them contain very little analysis. See, e.g., In re Crum, 414

B.R. 103 (Bankr.N.D.Tex.2007) and In re Gregory, 214 B.R. 570 (Bankr.S.D.Tex.1997). Gregory is a 522(c)(3) case, not a 522(c)(1) case, but the analysis is the same.

The one case worthy of note is the Cullen Davis Chapter 11 in which he fought with his ex over, among other things, whether she could reach his homestead to satisfy obligations owed to her under a divorce decree. There are two opinions on this subject, Matter of Davis, 105 F.3d 1017 (5th Cir.1997) and Matter of Davis, 170 F.3d 475 (5th Cir.1999). (The second opinion was *en banc* with three justices dissenting.) In the first opinion, the court concluded that 522(c)(1) did supersede the Texas homestead exemption and in the second opinion, the court concluded that 522(c)(1) did not "impliedly" preempt Texas homestead law. Clear as mud, apparently. I am not sure what the end result may be, but it seems that 522(c)(1) may apply if the debtor uses federal exemptions, but may not apply if the debtor uses state exemptions. (Note the use of the word "may." No warranties are expressed or implied.)

I am a little (pleasantly) surprised that this section is not used (and abused) more frequently. In (far too) many cases I see, there is a DSO creditor who hates the debtor and wants them to "pay." (With money, or blood, or both.) If there is a pre-petition arrearage claim, a DSO creditor could beg, request or demand that a Chapter 7 trustee auction off the debtor's clothes and dishes or object to a Chapter 13 plan which does not pay the full value of all non-exempt property. Taking the debtor's clothes isn't really about payment (used clothing is worthless), its about payback.

Avoidance (or Non-Avoidance) of Owelty Liens : 522(f)(1)

Current Sec. 522(f)(1) allows a debtor to avoid a lien which impairs an exemption if the lien is "a judicial lien, other than a judicial lien that secures a debt of a kind that is specified in section 523(a)(5)." Section 523(a)(5) is a debt "for a domestic support obligation." 101(14A) defines domestic support obligation, with exceptions, as an obligation for "alimony, maintenance, or support" owed to a spouse or former spouse. A debt for property division is ***not*** a 523(a)(5) claim, but is instead a 523(a)(15) claim, and therefore does not fall within the 523(a)(5) exception.

A lien granted in a divorce to equalize the property division is commonly referred to as an "owelty lien." (Owelty comes from Middle French and means "equality." Hence, an owelty lien equalizes the division of the community estate in a divorce proceeding.) Texas Property Code Sec. 41.001(b) lists "Encumbrances [which] may be properly fixed on homestead property" to include: "(4) an owelty of partition imposed against the entirety of the property by a court order or by a written agreement of the parties to the partition, including a debt of one spouse in favor of the other spouse resulting from a division or an award of a family homestead in a divorce proceeding." Note that this section only applies to homesteads, and not to non-exempt property.

There are two U.S. Supreme Court opinions that debtors counsel should be aware of. Both are dated in 1991. They are Farrey v. Sanderfoot, 500 U.S. 291 (1991) and Owen v. Owen, 500 U.S. 305 (1991). The holding in both of these cases depends on state law. Both were remanded for further proceedings and neither has any subsequent history which illuminates the issues.

In Farrey v. Sanderfoot, the spouses were divorced. The husband was awarded the marital residence and the wife was awarded a lien on the residence to secure payment of her share of the property division. (Practice Tip: Near the beginning of the factual recitation, the court stated: "Sanderfoot never made the required payments nor complied with any other order of the state court." Ignoring court orders and not paying your ex are rarely a good starting point when asking a court for relief.) The Supremes held that for a debtor to avoid a judicial lien, the debtor must have had a property interest in the property to which the lien attached prior to the time the lien attached. Under Wisconsin law, the husband did not have a prior ownership interest in the wife's interest in the homestead, so when the state court awarded the husband the wife's interest in the homestead and established a lien there was in effect a transfer of her interest to him subject to a lien to secure the transfer. The lien was therefore not avoidable.

In Owen, the ex-wife obtained a judgment against her ex. He later purchased a condominium which was not exempt at the time it was acquired. Florida subsequently amended its homestead exemption statute to provide protection for that type of property. Debtor ex-husband re-opened his case to avoid her lien on his newly acquired homestead. In Owen the court concluded that the focus should not be on whether the lien impairs an exemption to which the debtor ***was in fact entitled***, but whether the lien impairs an exemption to which the debtor "***would have been entitled***." (The language in the statute.) The lien was therefore avoidable.

In In re Parrish, 7 F.3d 76 (5th Cir.1993), the debtor inherited real property from his mother after marriage and the spouses apparently spent some $76,500 improving his separate property. The divorce decree granted the wife a judgment for that amount and established a lien on the property to secure the judgment. Citing Farrey and In re Finch, 130 B.R. 753 (D.S.D.Tex.1991), the court held that the property was always the husband's separate property and the decree did not create any new property interest for him. As such the lien was avoidable.

In In re Finch, 130 B.R. 753 (D.S.D.Tex.1991), the debtor and his spouse purchased two properties while they were married. Upon divorce, he was awarded both properties and she was awarded a judgment for $70,000 secured by an "equitable lien" on both properties. He subsequently filed a Chapter 13 and sought to avoid her lien on the properties. In a short summary of Texas case law, the court opined:

> In certain circumstances, a trial court may award one spouse a parcel of community property in whole, and award a money judgment to the other spouse to compensate the nonacquiring spouse for the loss of his or her interest in the property. [Citations omitted.] In this way, the acquiring spouse's undivided one-half community interest is divested, and he or she is revested with fee simple ownership – that is, the trial court terminates the acquiring spouse's joint undivided interest and grants him or her sole and separate ownership. [Citations omitted.]

The court then went on to hold:

> For a court to have the power to divide community property, it must have the power to divest the parties of their preexisting interests in that property. If a trial court can divest the

> nonacquiring spouse of all interest in a parcel of community property, so too can it divest the acquiring spouse of his or her preexisting community interest and revest the acquiring spouse with fee simple title. After such a division, the interest of both ex-spouses' in that property are characterized anew. Any other reading of Texas law would frustrate a trial court's statutorily explicit mandate to achieve and enforce equitable division of community property upon divorce. Finch, at 757.

Bases upon this analysis, the court concluded that the wife was not awarded a lien on property in which the debtor held a prior interest, but that the interest upon which she was granted a lien was created pursuant to the divorce decree. See also, In re Buffington, 167 B.R.833 (Bankr.E.D.Tex.1994) and In re White, 408 B.R. 677 (Bankr.S.D.Tex.2009).

In 1995, the bankruptcy court for the Eastern District, relying largely on Finch, concluded that an ex-husband could avoid a lien awarded pursuant to a divorce decree on his separate property homestead, but could not avoid a lien on the cash value of life insurance policies. The results were different for the two types of property as the wife had no preexisting ownership interest in the homestead, but she did have a preexisting interest in the insurance policies. Pursuant to the terms of the decree, each spouse was divested of their community interests in the policies and a new separate property interest was created in the husband, subject to the wife's lien. In re Norton, 180 B.R. 168 (Bankr.E.D.Tex.1995). This case is significant in at least one respect – it reminds us that a lien may impair exempt property other than a homestead.

In 2008, Judge Lynn issued an opinion in In re Beyer, 2008 WL 2783515 (Bankr.N.D.Tex.2008). In that case, he summarized the law as:

> As originally enacted, section 522(f)(1) enabled a debtor to avoid a lien awarded to an ex-spouse by a divorce court to effect divisions of marital property. However, in 1991 the Supreme Court in Farrey v. Sanderfoot, 500 U.S. 291 (1991), severely curtailed this practice, and then in 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") ended it completely. Now, for a court to order the avoidance of a lien under section 522(f)(1)(A), it must determine that: (1) the lien is a "judicial lien"; (2) the lien impairs an exemption to which the debtor is otherwise entitled; (3) the lien is fixed against the debtor's interest in the property; and (4) the lien does not secure a "domestic support obligation."

Not to pick a fight with Judge Lynn, but I am not sure I concur completely. I agree that prior to BAPCA, 522(f)(1) appeared to allow a debtor to avoid a judicial lien to secure a property division. It did not allow a debtor to avoid a lien to secure what we now call a 523(a)(5) claim. This hasn't really changed in decades. I am not sure that Farrey v. Sanderfoot "severely curtailed" avoiding liens to secure property divisions. What Farrey did was tell us how to apply the "to the extent that such lien impairs an exemption to which the debtor would have been entitled" language. Given the cases cited above, it appears that Judge Lynn's third factor could be more clearly stated.

Judge Lynn addressed two of the four issues. With respect to the judicial lien issue, the debtor's ex argued that she was awarded an "equitable lien" rather than a "judicial lien," so it was not avoidable.

Judge Lynn brushed right past that one, stating:

> In the instant case, Respondent obtained the Lien through a judgment in a divorce proceeding. The divorce proceeding was "legal or equitable under any definition of those terms. [Citation omitted.] While the Divorce Court classified the Lien as an "equitable lien," such classification does not preclude the Lien from falling within the Code's definition of a "judicial lien" in section 101(36). [Citation omitted.] The court therefore concludes that the Lien is a judicial lien pursuant to sections 522(f)(1)(A) ad 101(36).

Judge Lynn skipped the second issue ("the lien impairs an exemption to which the debtor is otherwise entitled") altogether. With respect to the third issue ("the lien is fixed against the debtor's interest in property"), the court cited Finch in holding that because the debtor's separate property interest was created pursuant to the divorce decree, the lien awarded to his ex did not attach to a preexisting interest. Finally, the court stated that it did not need to determine whether the lien secured a "domestic support obligation" because it had determined the debtor did not satisfy the third element.

In In re White, 408 B.R. 677 (Bankr.S.D.Tex.2009), in which Judge Bohm held that a debt which arose under a marital settlement agreement in a section labeled "Division of Marital Estate" was not a domestic support obligation, that even though the ex-wife failed to perfect her judicial lien, it was enforceable as between the parties and would not be disallowed as "unenforceable against the debtor," and citing Farrey with a nod to Finch, concluded that the lien was created contemporaneously with debtor's acquisition of the fee simple interest and was not avoidable.

In an odd wrinkle case, in In re Herman, 315 B.R. 381 (Bankr.E.D.Tex.2004), the debtor and her ex purchased a community property homestead using, in part, a loan from her children. In their divorce decree, she was awarded the property and a judicial lien was granted to the children to secure repayment of the debt. She subsequently filed Chapter 13 and sought to avoid the lien to her own children. Citing Farrey and Finch, the court held that as part of the divorce, the community property interests of her and her ex were terminated and that she was vested with title to the property. The lien to the children was granted as part of the divorce decree so it did not attach to a pre-existing interest, but to the her interest created through the divorce decree. As such, the lien was not avoidable.

These cases don't give us a huge amount of guidance for interpreting Texas law. There is case law in Texas that says that each spouse owns a one-half interest in each community asset. Assuming that is, in fact the law, then if spouses own a homestead together and it is awarded to one spouse with a lien awarded to the other spouse with a lien imposed on the property to secure payment of the property division, the lien would not be avoidable if the property was community property, but would be avoidable if the lien was imposed on separate property. Keep in mind that lien avoidance only applies to exempt property. I get lots of potential clients who want to file Chapter 7 and avoid an owelty lien or abstract of judgment lien on a rent house. 522(f)(1) does not apply to non-exempt (read non-homestead) property and the debtor cannot avoid a judicial lien on a rent house.

Homestead Exemption Cap: 522(p)

522(p)(1) provides that a debtor who elects to use state exemptions "may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $146,450 in value in -

(A) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

(C) a burial plot for the debtor or a dependent of the debtor; or

(D) real or personal property that the debtor or dependent of the debtor claims as a homestead."

There are two statutory exceptions listed in 522(p)(2):

(A) The limitation does not apply "...to an exemption claimed... by a family farmer for the principal residence of such farmer."

(B) The limitation does not include "...any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State."

Note that the amount of the cap is adjusted for inflation, so you will see cases where the amount of the cap is $125,000, $136,875 and, more recently, $146,450. 522(m) provides "Subject to the limitation in subsection (b), this section shall apply separately with respect to each debtor in a joint case." In other words, if a married couple file a bankruptcy jointly, the cap doubles, but if only one spouse files, it does not. See, In re Rasmussen, 349 B.R. 747 (Bankr.M.D.Fla.2006)

One of the issues courts have grappled with is what constitutes "acquiring" an "interest" in a homestead. See, e..g., In re Rogers, 354 B.R. 792 (D.N.D.Tex.2006). In that case the debtor inherited a tract of land in 1994. She subsequently married, she and her husband purchased a home, and then were divorced in 2004. After the divorce, she moved to the inherited tract. She then filed a Chapter 7 in September, 2005 and claimed the property valued at $359,000 as her homestead. A creditor objected because the property had not been her homestead for 1215 days prior to filing. The bankruptcy court denied the objection and the district court affirmed because it interpreted the meaning of an "interest" as being an ownership interest in the property and does not encompass the classification of the property as a homestead. Because it resolved the case on that issue, the court declined to reach the issue of what acquire means. See, also, In re Lyons, 355 B.R. 387 (Bankr.D.Mass.2006), which reached the same result.

Judge Bohm addressed the acquisition issue in In re Presto, 376 B.R. 554 (Bankr.S.D.Tex.2007). The 522 issue arose because the debtor acquired his current homestead within the 1215 day period

and rolled the prior equity from another homestead located in Texas. The wrinkle is that he had acquired his ex-wife's ½ community property interest in the prior homestead incident to a divorce finalized within the 1215 day period. Judge Bohm held that the conveyance from her to him by Special Warranty Deed transferred an "interest" which he "acquired" during the 1215 day period. The court did hold, however, that ***his*** community interest in the property was acquired more than 1215 days prior to filing, so his one-half interest was not subject to the $125,000 cap. Judge Bohm then undertook a detailed analysis of what portion of the total value of the property, if any, was subject to the cap. (Judge Bohm even admits that he had to "fashion a value from circumstantial evidence in the record" and that he had "no better evidence " of the amount of the lien on the property than the balance at the time of the divorce some months ago. Essentially, this was all an educated guess.) At the end of the analysis, Judge Bohm concluded that the final nonexempt portion of the homestead pursuant to 522(p) was $105,000.

There have been several unreported cases in Texas involving the 522(p) cap issue, many of which have involved unfortunate fact patterns in that the debtor acquired an interest in property incident to a divorce or received the money to acquire the homestead as a result of a gift from parents or as a result of an inheritance. ***How*** the debtor acquired an interest in the property is not at issue. The only issue is the timing of the acquisition. If the debtor acquired an interest during the 1215 day period, the interest acquired is limited.

Dischargeability of Marital Obligations: 523(a)(5) and (a)(15)

The principal distinction here is whether a debtor's obligation (typically to a former spouse) is a domestic support obligation (alimony, maintenance, or support) or some other form of obligation (typically a division of property and/or liabilities.)

523(a)(5) excepts from discharge debts for "a domestic support obligation." ("DSO".)

101(14A) defines "domestic support obligation" as "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 date 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;

(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 short version: if the obligation is a DSO, it is ***never*** dischargeable.

523(a)(15) excepts from discharge a debt "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."

523(a)(15) was substantially rewritten in the 2005 amendments to the Bankruptcy Code. Prior to October 15, 2005, 523(a)(15) was substantially the same as now, except there was a huge exception. After "governmental unit" it provided: "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 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.

Under 523(a)(15)(B), courts were required to undertake an analysis balancing the relative benefit to the debtor of discharging the obligation against the harm to the ex if the debtor failed to fulfill his obligations. This typically involved situations where a debtor was ordered to pay debts owed by the former spouse or debts owed jointly with the former spouse, and if the debtor did not pay the debts, the creditors would pursue collection against the former spouse. This balancing analysis was completely abrogated by the 2005 amendments, so keep that in mind when reading cases.

1328(a)(2) provides that a discharge does not discharge certain debts, including domestic support obligations under 523(a)(5). 1328(a)(2) does not except marital obligations under 523(a)(15), so as long as the debtor pays his/her disposable income during a 60 month plan, the property division portion of a divorce decree is dischargeable in Chapter 13.

As an initial matter, remember that bankruptcy courts have concurrent jurisdiction over determination of the dischargeability of debts under 523(a)(5) and (15). This concurrent jurisdiction is based upon the less than perfectly clear language of 523(c)(1) which provides: "Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection(a) of this section." Although this section references "the court," the less than overwhelming consensus is that ***bankruptcy*** courts have exclusive jurisdiction over dischargeability actions under 523(a)(2), (4)

and (6), but have concurrent jurisdiction over dischargeability actions under the other subsections of 523(a), including 523(a)(5) and (15). See, e.g., In re Kincaid, 445 B.R. 731 (Bankr.N.D.Tex.2011), which is a 523(a)(15) case. I was unable to locate a Texas case under 523(a)(5), but the analysis is the same.

The fight here becomes whether an obligation owed to a spouse is a 523(a)(5) obligation or a 523(a)(15) obligation. The leading Fifth Circuit case is (was?) In re Nunnally, 506 F.2d 1024 (5th Cir.1975), which first articulated the factors to be considered in making this determination. The Nunnally court started by noting that Texas did not have alimony, so payments which were really intended to be in the nature of future support are frequently called property division for practical reasons so the court was not bound by the characterization contained in the decree. The factors enumerated were: "the disparity of the earning power of the parties, as well as their business opportunities,… the physical condition of the parties, probable future need for support, and educational background;… the fault in breaking up the marriage and the benefits [the] innocent would have received from a continuation of the marriage." The Nunnally factors were followed again in Matter of Benich, 811 F.2d 943 (5th Cir.1987); In re Joseph, 16 F.3d 86 (5th Cir.1994); and In re Dennis, 25 F.3d 274 (5th Cir.1994). Evert, cited above in the section dealing with 522(d)(10)(D), is not a 523(a)(5) or (a)(15) case, but the analysis **should be** substantially the same.

One lesson from Nunnally and subsequent cases is that issue preclusion (collateral estoppel and/or res judicata) do not necessarily apply. Just because a state court or the parties labeled an obligation as property settlement does not preclude a bankruptcy court from "looking behind" the decree to determine whether the obligation was actually intended to be in the nature of support. IF the state court makes specific findings that match the requirements for a finding of nondischargeability, the bankruptcy court may find that issue preclusion applies. One case where issue preclusion clearly (?) applies is where there has been a determination of nondischargeability in a prior bankruptcy case and the debtor seeks a second bite at the apple in a subsequent case. See, Swate v. Hartwell, 99 F.3d 1282 (5th Cir.1996). (A case which started in the Houston Bankruptcy Court).

There are several bankruptcy court opinions from around Texas addressing 523(a)(5) and 523(a)(15).
In In re Hutton, 463 B.R. 819 (Bankr.W.D.Tex.2011), Judge Gargotta held that an award of attorneys fees was not dischargeable as being in the nature of alimony, maintenance, or support. There were several issues addressed, including whether the fees were owed to the former spouse or the attorneys and whether the fees which were awarded as a "sanction" were intended to be in the nature of support. If you have a case where dischargeability of attorneys' fees is an issue, you will want to read this case. Judge Gargotta cites several cases addressing the dischargeability of attorneys' fees, both at the Fifth Circuit and the bankruptcy court level. One case worthy of note is In re Brooks, 371 B.R. 761 (Bankr.N.D.Tex.2007), which held that attorneys fees were dischargeable, but because they were owed directly to the attorneys and not to the former spouse. In that case, the law firm had intervened in the divorce and obtained separate awards owed directly to the firms from each spouse.

On the procedure side, see In re Dise, 2013 WL 53844 (Bankr.S.D.Tex.2013), which held that

523(a)(5) is self executing and the fact that neither the debtor nor the Texas Attorney General filed a proof of claim did not make the debt dischargeable. See also In re Nugent, 484 B.R. 671 (Bankr.S.D.Tex.2012) in which Judge Bohm made a detailed review of Nunnally and Evert and held (1) that the divorce court's judgment was ambiguous as to whether the obligations in question were intended to be in the nature of support so the court had to look to extrinsic evidence, (2) that the former spouse failed to present sufficient evidence that the debt was meant to be in the nature of support and therefore filed to satisfy his burden of proof, and (3) because the former spouse failed to plead in the alternative (i.e., that the debt was 523(a)(15) obligation), the debt was discharged. It is also worthy of note that Nugent was a contested trial, so it was the intent of the court that was relevant, not the intent of the parties.

One issue which has been litigated more than I would have expected is whether a debt owed to a spouse ***prior to*** marriage can qualify as a 523(a)(15) obligation as "incurred by the debtor ***in the course of*** a divorce or separation." The debtors' argument is that the debt was incurred prior to the marriage (and the divorce), so it could not be incurred in the course of the divorce. The courts have uniformly rejected this argument. One of the most cited cases is In re Short, 232 F.3d 1018 (9th Cir.2000), which held that because the requirement to repay the debt and terms of repayment were expressly incorporated in the divorce decree, they were incurred in the course of a divorce or separation. See, also, In re Lulow, 2007 WL 4556682 (Bankr.D.Mont.2007); In re Hall. 285 B.R. 485 (Bankr.D.Kan.2002); In re Delos, 2009 WL 4052151 (Bankr.D.R.I.2009); Delos is noteworthy because it was a contested divorce and the court held that the prenup "spells out the rights of the parties." In that case, the prenup "was incorporated, but not merged, into" the judgment of the court. See, also, In re Yelverton, 2012 WL 4434087 (Bankr.D.D.C.2012) where the terms of the prenup were not expressly incorporated or merged into the decree. The court held "That the agreement itself was not incorporated or merged into the divorce decree does not change the fact that some of the underlying obligations constitute the domestic support obligations and obligations that were incurred by Yelverton in the course of his divorce from his non-debtor spouse."

The Community Property Discharge: Section 524(a)(3)

Section 524(a)(3) provides:
"A discharge in a case under this title -
-operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived."

Probably because there are only a limited number of community property states, there really aren't that many reported opinions on the community discharge. For some reason, however, when I talk to creditor's attorneys about non-filing spouse issues, they always want to talk about the community

discharge like it is depriving their clients of significant substantive rights on a frequent basis. In very few of my cases is it an issue because (being in Texas) all of the "effected" property is typically exempt in any event.

The only Fifth Circuit case I could find which mentions this issue is In re Gauthier, 349 Fed. Appx. 943 (5th Cir.2009), which really addressed the issue of whether fraud by one spouse could be imputed to the other spouse for the purpose of contesting dischargeability of a debt. (The court held that it could not absent any evidence that the non-debtor spouse participated in the fraud.) The creditor also complained that a discharge as to the wife would effectively preclude any recovery from the husband - specifically, that the creditor would be unable to garnish the husband's future wages which are community property under Louisiana law. Calling that argument "questionable," the court declined to rule on the issue as it was not before the court on appeal.

There are only a handful of Texas bankruptcy court cases addressing 524(a)(3). One of the first was In re Karber, 25 B.R. 9 (Bankr.N.D.Tex.1982). In that case, the husband filed Chapter 7 as a result of a failed business. No creditor filed any adversary under 523 or 727. After his discharge, his non-filing spouse sold a separate property asset (an apartment complex), paid off all of the debt related to the asset, paid a substantial IRS liability, and refused to tell the bank what she did with the other $140,000. As a result, the bank sued the wife in state court and later filed an involuntary Chapter 7 against her. Because her husband received a discharge in his Chapter 7, Judge Brister held that his creditors were enjoined from attempting to collect their debt from her after-acquired community property. (But not necessarily from her separate property.)

In re Braziel, 127 B.R. 156 (Bankr.W.D.Tex.1991), was a case where the husband filed Chapter 7 and a creditor filed an adversary objecting to both his discharge and her hypothetical discharge under 727. Judge Monroe made the candid admission: "At the hearing, counsel for all parties, and the Court, confessed a certain amount of uncertainty with regard to the effect that should be given Section 524(a)(3) in this case." After taking the matter under advisement, the court concluded that she was a necessary party to the adversary because if the adversary proceeded without her and her husband was discharged, the creditor would thereafter be precluded from proceeding against her after-acquired community property. Apparently finding very little authority, the court cited Collier as "the clearest statement of the purpose of this section, and therefore what Congress intended." Collier states:

> "In short, Congress has chosen to grant fresh-start protection for after-acquired community property when *both* spouses are *innocent* of any wrong doing, although one spouse chooses not to file a bankruptcy case. In the other situation, when a *wrongdoer seeks to hide behind* his or her *spouse's discharge*, a partial *discharge for the non-debtor is denied*, and after-acquired community property remains liable for the debts of the non-discharged spouse thereby frustrating the innocent spouse's fresh start."

Avoidance Issues: 544 and 548

For Fifth Circuit authority on cases involving fraudulent transfers related to a divorce proceeding see In re Erlewine, 349 F.3d 205 (5th Cir.2003) and In re Robertson, 203 F.3d 855 (5th Cir.2000). In Erlewine, the court held that neither the *Rooker-Feldman* doctrine nor the preclusion doctrines of res judicata or collateral estoppel barred the trustee's avoidance action under Section 548, but that the bankruptcy court did not err as a matter of law in finding that the debtor received reasonably equivalent value in exchange for the property division in the divorce, even though the property division was admittedly unequal. (The court found that the debtor had dissipated community assets and increased the costs of the divorce proceedings by taking unreasonable positions.) The message from this case is that the property division does not have to be equal, as long as there is an articulated reason for the disparity.

Robertson is an avoidance action under Section 544 where the trustee asserted his status as a hypothetical bone fide purchaser. In that case, the divorce decree provided for partition of community property. Under Louisiana law, the decree effectuated the partition, so that any property awarded to the debtor's former spouse became her separate property and did not become part of his bankruptcy estate. Because the judgment of divorce had been recorded in the real property records, the trustee was on notice of her rights to the property and a hypothetical transfer of the debtor's interest on the petition date would convey nothing. The message from this case is that if one of the spouses is in financial trouble, make sure to record the decree if there are titled assets which are divided in the divorce.

Although the bankruptcy trustee lost in both of these cases, the court did not hold that the avoidance powers did not apply in the context of a divorce, they held that the trustees were not able to avoid the transfers under the facts of those cases. In contrast, see In re Bledsoe, 569 F.3d 1106 (9th Cir.2009), which held that a regularly conducted contested divorce proceeding "conclusively" establishes reasonably equivalent value. In order to collaterally attack a judgment, a party must show "extrinsic fraud," which consists of collateral acts not involved in the fact finder's consideration of the merits. (i.e., collusion.) Although the divorce was "contested,",the court struck the debtor's pleadings and a default judgment was entered. The court relied on the Supreme Court decision in BFP v. Resolution Trust Corp., 114 S.Ct. 1757(1994), which held that the price received at a regularly conducted, non-collusive foreclosure sale properly conducted under state law conclusively establishes reasonably equivalent value for the purposes of Section 548(a). I would suggest that a foreclosure sale which is typically some form of public auction, is not functionally the same as a divorce which is a private transaction between the parties. See, also, In re Zerbo, 397 B.R. 642 (Bankr.E.D.N.Y.2008) for the same analysis.

In contrast to the contrast, see In re Beverly, 374 B.R. 221 (9th Cir. BAP 2007). In that case, the debtor (an attorney) was about to have a very large judgment entered against him on a legal malpractice claim. He and his estranged wife entered into a marital settlement agreement which required him to take full responsibility for the debt and awarded $1,000,000 in non-exempt bank deposits to her and $1,100,000 in exempt pension funds to him. The court held that the transfer was made with intent to hinder, delay, or defraud an existing creditor and was avoidable by the trustee under Section 544(b). (This was a clear finding of "actually" fraudulent, as opposed to

“constructively” fraudulent where there is no finding of intent, but the debtor receives less than reasonably equivalent value in exchange for the transfer.)

The Beverly BAP, which reversed the bankruptcy courts ruling denying the trustee’s claims under 544(b) and 727(a)(2)(A), started its opinion by stating: “The bankruptcy planning dispute presented in these related appeals requires us to transit waters made turbulent by cross-currents of exemptions, fraudulent transfer, denial of discharge, and divorce. We publish to dispel the myth that the toleration of bankruptcy planning for some purposes insulates such planning from all adverse consequences – it does not. In matters of bankruptcy and insolvency planning, supposed safe harbors from one danger are exposed to dangers from other quarters and may, in any event, be too small to shelter large capital transactions.” Just a note for us Texas lawyers, the court concluded by stating: ‘Second there is a principle of “too much.” In classical terms, it is the Sword of Damocles. In the agrarian terms used by the Fifth Circuit affirming the denial of a discharge, “when a pig becomes a hog it is slaughtered.” Domoclean or agrarian, the limiting concept is the same.’ [Citations omitted.]

In the bad facts make bad law category, see In re Kaczorowski, 87 B.R. 1 (Bankr.D.Conn.1988). In that case, the wife filed for dissolution of the marriage. After consultation with a bankruptcy attorney who advised that she should pay her spouse $37,000 representing the value of his one-half interest in the marital residence, the parties entered into a marital settlement agreement pursuant to which she paid him $10,000 for his one-half interest. The agreement stated the parties were “living separate and apart,” when in fact, he never vacated the marital residence, the parties later reconciled, and the divorce proceeding was dismissed. The court held: “Under the facts of this proceeding, where an insolvent husband transfers his only significant asset to his wife as “lump-sum alimony,” the husband never leaves the family home, no dissolution of marriage or meaningful separation ever takes place, and within four months of the transfer the parties resume marital relations with the husband fully contributing to family support, no finding of reasonably equivalent value for the transfer can possibly be made.”

Also in the bad facts make bad law category, see In re Teague, 2013 WL 1796080 (Bankr.W.D.N.C.2013). In that case, the debtor was experiencing financial problems with a business he owned and made significant transfers of funds to his then wife, with vaguely articulated reasons. The court noted the “multitude of inconsistencies and contradictions” in the testimony of the debtor and his ex which caused the court to view that testimony with “a high degree of skepticism.” The court concluded: ‘Bankruptcy provides a refuge for the “honest but unfortunate debtor.” While the debtor may have been unfortunate, he chose to respond to his financial difficulties by transferring the majority of his assets to his wife in an attempt to shield them from his creditors, and the parties used a sham separation agreement in an attempt to add an air of legitimacy to the transfers.’

Take note that Section 548(c) provides: “…a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.” “Value” is defined in Section 548(d)(2)(A) as “property, or satisfaction, or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the

debtor."

Chapter 11 Issues: 1129(a)(9)(B)

1129(a) provides that the court shall confirm a plan only if all of 16 enumerated requirements are met, including:

> "(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that –
>
> > (B) with respect to a class of claims of a kind specified in section 507(a)(1)… of this title, each holder of a claim of such class will receive –
> >
> > a. if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
> >
> > b. if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim."

The list of claims specified in section 507(a)(1) is included in the section on Chapter 13 issues, but basically includes DSO claims, whether assigned or not.

There is a significant distinction in the plan requirements for 523(a)(5) claims and 523(a)(15) claims in Chapter 11. 523(a)(5) claims must be paid in full on the effective date of the plan unless the DSO claimant has agreed to accept other treatment. 523(a)(15) claims are not dischargeable in Chapter 11, but they may be paid out over the life of the plan.

Note the different treatments of 523(a)(5) claims and 523(a)(15) claims in Chapter 13 and Chapter 11. Although these are both reorganization chapters, the treatment they provide for these types of claims are very different.

Chapter 13 Issues

1322(a)(2) provides that a plan shall "provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim."

1322(a)(4) provides "notwithstanding any other provision of this section, a plan may provide for less than full payment of all amounts owed for a claim entitled to priority under section 507(a)(1)(B) only if the plan provides that all of the debtor's projected disposable income for a 5-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan."

507(a) provides a list of priorities among unsecured debts. 507(a)(1) provides for a first priority for

"(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."

In more simple terms, the first priorities are:

(A) DSO's owed to a spouse, former spouse or child (whether or not they have been assigned voluntarily to a governmental unit for collection);
(B) DSO's assigned involuntarily or owed directly to a governmental unit;
(C) Administrative expenses of a trustee in a Chapter 7 or 13, which take priority to obligations under the preceding subparagraphs.

This is a potentially significant change from pre-BAPCPA law which required a debtor to pay any pre-petition domestic support obligations in full over the life of a Chapter 13 plan. Under 1325(a)(8), a debtor must pay all DSO obligations (payments or otherwise) which come due after the filing of the petition, but with respect to a DSO claim which was involuntarily assigned for collection, a debtor only has to commit his projected disposable income for the life of a five year plan (regardless of what the applicable commitment period might be), even if the assigned pre-petition domestic support obligation is paid less than in full under the plan. The balance of the assigned DSO claim will not be discharged, but during the life of the plan, the debtor should be protected from collection actions on the claim.

For a discussion of the difference between voluntarily assigned claims and involuntarily assigned claims, see In re Edwards, 2010 WL 318304 (Bankr.E.D.Va.2010) in which the court overruled the Chapter 13 trustee's objection to confirmation solely on the basis that the plan did not pay an assigned DSO claim in full. The court held that the objecting party had the burden to show whether the claim had been assigned voluntarily or involuntarily and the trustee produced no evidence on the issue. The court summarized the distinction as follows: "Child support that is owed to or recoverable by a parent has priority over child support that has been assigned to, or is owed directly to or recoverable by, a government unit. Sec. 507(a)(1)(A) and (B). An assigned claim is not subordinated, however, if it is "assigned voluntarily… for the purpose of collecting the debt." Sec. 507(a)(1)(B). The distinction in important in this case because an exception to the requirement for full payment of priority claims exists for domestic support claims that fall under Sec. 507(a)(1)(B). Specifically, a chapter 13 plan may provide for less than full payment of such claims if the plan provides that all of the debtor's projected disposable income for 5 years will be applied to make payments under the plan. Sec. 1322(a)(4). There is no free lunch, however: any amount remaining unpaid at the conclusion of the plan is not discharged and may still be collected from the debtor. Sec. 1328(a)(2). Additionally, if there is, as here, an existing wage deduction order the bankruptcy filing does not stay enforcement of the order. Sec. 362(b)(2)(C)."

1325(a) provides that the court shall confirm a plan if it satisfies certain requirements, including:

> "(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation, and that first became payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation."

1328(a)(2) provides that a discharge does not discharge certain debts, including domestic support obligations under 523(a)(5). 1328(a)(2) **does not** except marital obligations under 523(a)(15), so as long as the debtor pays his/her disposable income during a 60 month plan, the property division portion of a divorce decree is dischargeable in Chapter 13. In re Smith, 586 F.3d 69 (1st Cir.2009); In re Young, 425 B.R. 811 (Bankr.E.D.Tex.2010).

Plain language version of 1322(b)(2), 1322(b)(4), 1325(a)(8) and 1328(a)(2) read together:

i. The debtor has to be current on post-petition domestic support obligation payment at the time of confirmation or the plan cannot be confirmed;

i. DSO obligations owed to a spouse, former spouse or child must be paid as due during the pendency of the plan;

ii. Pre-petition DSO obligations owed to an ex or child must be paid ion full under the debtor's plan;

iv. DSO obligations involuntarily assigned for collection or owed to a governmental unit do not have to be paid in full during the term of the plan;

iii. DSO obligations are not dischargeable; and

iv. 523(a)(15) obligations are dischargeable in a 60 month plan.

Note, however, that the hardship discharge in Chapter 13 is more limited and does ***not*** discharge 523(a)(15) obligations. See 1328(c)(2) which provides:

> "A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt –
> (1) …or
> (2) of a kind specified in section 523(a) of this title."

Accounting for the Non-Filing Spouse's Income: 707(b)(2) and (3) and 1325(b)(1)(B)

Form B22A, Line 17 and **B22C, Line19** are the means test provisions for dealing with the income of a non-filing spouse. The problem is, the form doesn't match the Code. The definition of "current monthly income" contained in 101(10A)(B) includes amounts regularly contributed to the household expenses of the debtor or a dependant of the debtor. The form assumes that all of the non-filing spouse's income is contributed and places the burden on the debtor to establish that it is not. Until the powers that be fix the problem, this is how we get to deal with it. The analysis I provide here for Line 17 (and the analysis for Line 19 is the same so I will refer only to Line 17) is based upon MANY filings with a non-filing spouse and the local US Trustee's office statements about how (they think) we are supposed to apply the marital adjustment.

Income

To account for the non-filing spouse's income, fill in the appropriate information for the spouse on Line 3 (**gross** wages for an employed person), Line 4 (**gross** revenue and expenses for a self employed person), Line 5 (**gross** revenue and expenses for rental income), etc.

Expenses

The instructions for Line 17 say: "If you checked the box at Line 2.c, enter on line 17 the total of any income listed in Line 11, Column B that was NOT paid on a regular basis for the household expenses of the debtor or the debtor's dependents. Specify in the lines below the basis for excluding the Column B income (such as payment of the spouse's tax liability or the spouse's support of persons other than the debtor or the debtor's dependents) and the amount of income devoted to each purpose. If necessary, list additional adjustments on a separate page. If you did not the check box at Line 2.c, enter zero." [Line 2.c is "Married, not filing jointly, without the declaration of separate households set out in Line 2.b above."]

Basically, you include all of the non-filing spouse's income on Lines 3, 4, and 5, then back out amounts ***not*** regularly contributed to the household expenses of the debtor on Line 17.

Start with the obvious. Take the spouse's pay checks and itemize amounts which are deducted from the spouse's gross income, such as taxes, insurance, child support, retirement deductions (including contributions and loan repayments), and anything else. (We see deductions for uniforms, parking, union dues, charity, gyms.)

Our software (BankruptcyPro) takes payroll deductions and deducts them on the appropriate lines in the form. Some expenses which are payroll deducted are not allowable on the software (i.e., a voluntary retirement contribution), so you have to manually deduct those expenses on Line 17.

Be careful with cafeteria plan deductions (health savings accounts and dependent care savings accounts) as these amounts will typically be contributed toward the household expenses of the debtor or a dependent. This is an easy double or triple dip. Line 19B gives you the National Standard for out of pocket health care costs. ($60 per person under age 65.) Line 31 gives you out of pocket health care in excess of the National Standard. (Be prepared to document.) If the debtor has a health savings account (Line 34.c.), you would normally deduct the payroll deduction for that amount from Line 31.

Next, go the spouse's credit report. (The UST will ask you to prove the amount of any debt payments which you are excluding from the spouse's income and this will have all of it in one place.)

1. Deduct any payments for secured installment debt (ie, car, boat, motorcycles, jet skis) which are **not** going to be listed on Line 42, payments on secured debt. (i.e., debts which are only in the name of the non-filing spouse or which are joint debts but are not allowable for the debtor - the ski boat loan.) **Remember**, just because an expense is not allowed for a debtor does not mean that expense is not allowed for a non-debtor.
2. Deduct any payments for other installment debt (ie, student loans, installment agreements with the IRS).
3. Deduct at least the minimum monthly payments on revolving debt. If the spouse makes more than the minimum payments and you can document this from the monthly statements, use the higher amount.

4, Be careful about the double dip. If the non-filing spouse owns the home they live in and the debtor is not obligated on the debt, you should be able to take the actual payment as a marital deduction here, or the IRS allowance for rent on Line 20B, but you don't get both. (Same for autos and other secured debts.)

(E) Ask questions. I get a lot of cases where there are past due amounts owed to the IRS but no formal repayment plan and the spouse is sending in $200 per month. I get a lot of cases where child support is being paid without a court order. I see quite a few cases where there is a probation fee for DWI or bad checks.

The UST will argue with you on some of these and may even file a motion to dismiss [usually under 707(b)(3), not 707(b)(2)], but in Austin they frequently withdraw the motions prior to hearing.

Remember, the issue is "any amount paid by any entity other than the debtor (or in a joint case the

debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent)." Sec. 101(10A)(B). Our local UST's office frequently opines that certain expenses of the non-filing spouse are "not allowed" based upon what expenses are allowed ***for a debtor***. It's not the same. Congress says so. So does the case law.

The Law

Analysis and understanding of current monthly income (and by extension, disposable income in a Chapter 13) and a non-filing spouse **must** include an analysis of both the Bankruptcy Code and Texas marital property law.

General Bankruptcy Code Provisions:

The relevant Bankruptcy Code sections which apply in both Chapter 7 **and** 13:
101(10A)(A)
101(10A)(B)
101(13)
541(a)(2)

Definitions:

101(13) defines "**debtor**" as "a person or municipality concerning which a case under this title has been commenced." A non-filing person (including the non-filing spouse of a filing person) is **not** a debtor.

101(10A)(A) defines "currently monthly income" as "the average monthly income from all sources that the **debtor** receives (**or in a joint case the debtor and the debtor's spouse receive**)... [for the six month period prior to filing]."

101(10A)(B) further defines "current monthly income" as including "any amount paid by any entity **other than the debtor** (**or in a joint case the debtor and the debtor's spouse**), on a regular basis for the household expenses of the **debtor** or the debtor's dependents (**and in a joint case the debtor's spouse** if not otherwise a dependent).

Both 101(10A)(A) and (B) speak specifically in terms of income received by the "**debtor**" [singular]. Under the express terms of 101(13), **"debtor"** does **not** include a **non-filing** spouse. (No case has been commenced with respect to the non-filing spouse.) Under the express terms of 101(10A)(A) and (B), "current monthly income" does **not** include the income of a non-filing spouse **unless** that income is an amount paid "...on a **regular** basis for the **household expenses** of the **debtor** or the debtor's dependents."

Chapter 7:

The relevant Bankruptcy Code sections in a Chapter 7 case are:
707(b)(2)(A)(i)
707(b)(2)(A)(ii)(I)
707(b)(2)(A)(ii)(II)
707(b)(2)(C)
707(b)(3)(B)

707(b)(2)(A)(i) provides that in determining whether the granting of relief would be an abuse, the court shall presume abuse if the "**debtor's** current monthly income" (singular possessive) reduced by the amounts in the following subparagraphs exceeds certain specified amounts.

707(b)(2)(A)(ii)(I) specifies what certain of the debtor's expenses shall be for the purposes of the means test "for the debtor, the dependents of the debtor, **and the spouse of the debtor in a joint case**." 707(b)(2)(A)(ii)(II) provides for additional allowable expenses paid by the debtor for care and support of an elderly, chronically ill, or disabled member of the debtor's immediate family, including "**the spouse of the debtor in a joint case** who is not a dependent."

707(b)(2)(C) provides that "As part of the schedule of current income and expenditures required under section 521, the debtor shall include a statement of the **debtor's** (singular possessive) current monthly income." (There is no requirement that the income of the non-filing spouse be disclosed.)

707(b)(3)(B) provides that in considering whether the granting relief under paragraph 1 in a case where the presumption does not arise, the court "shall" consider whether the debtor filed the petition in bad faith "or the totality of the circumstances ... of the **debtor's** (singular possessive) financial situation demonstrates abuse."

I routinely receive requests for information and even the occasional motion to dismiss from the UST that refers to "debtors' household current monthly income." Could someone please show me the Bankruptcy Code section that refers to "debtors'" (plural possessive) "household" current monthly income? (I will save you the time, there isn't one.)

Chapter 13:

The relevant Bankruptcy Code sections in a Chapter 13 case are:
1306(a)(2)
1322(d)
1325(b)(1)(B)
1325(b)(2)
1325(b)(3)
1325(b)(4)

1306(a)(2) provides that property of the estate in a Chapter 13 case includes (in addition to the property listed in 541), "earnings from services performed by the ***debtor*** after the commencement of

the case." [Emphasis added.] In other words, the debtor's post-petition wages are property of the estate in a Chapter 13. If there is a non-filing spouse, that spouse is **not** a debtor and his/her earnings are **not** property of the estate.

1322(d)(1) provides that "if the current monthly income of the debtor **and the debtor's spouse** combined" is more than the median family income for a family of the same size, the plan term may not exceed five years. 1322(d)(2) provides that "if the current monthly income of the debtor **and the debtor's spouse** combined" is less than the median family income for a family of the same size, the plan term may not exceed three years, unless the court, for cause, approves a longer period not to exceed five years.

1325(b)(1)(B) provides that the court may not approve a plan unless it provides that "all of the **debtor's** projected disposable income to be received" during the applicable commitment period will be paid to unsecured creditors. Note that the statute refers to the "**debtor's**" (singular possessive) disposable income, **not** the income of the debtor **and the debtor's spouse**.

1325(b)(2) provides that for the purposes of that section, the term "disposable income" means "current monthly income received by the **debtor**" (singular) less certain exceptions.

1325(b)(3) provides that amounts reasonably necessary for the maintenance or support of the debtor or a dependent of the debtor shall be determined pursuant to 707(b)(2) "if the **debtor** (singular) has current monthly income" greater than the median family income for a family of the same size.

1325(b)(4) provides for determination of the applicable commitment period, which is not less than five years "if the current monthly income of the debtor ***and the debtor's spouse*** combined" is more than the median family income of the same size. Although there is certainly an argument that all of the spouse's income should be included for purposes of determining the applicable commitment period, the case law **so far** is saying that interpretation does not make sense given the definitions in 101(10A)(A) and (B) and so income of the non-filing spouse is considered only to the extent it is regularly contributed to household expenses of the debtor or a dependent.

Case Law Post-BAPCPA:

Chapter 13 Cases

Texas Cases

In In re Charles, 375 B. R. 338 (Bankr.E.D.Tex.2007), the debtor's non-filing spouse had a car note which the non-filing spouse would continue to pay directly and the note would pay off during the term of the Chapter 13 plan. The plan did not propose to increase the plan payment when the car loan paid off. The Trustee objected to confirmation on the ground that the plan did not satisfy 1325(b)(1)(B) in that the plan did not apply all of the debtor's projected disposable income to the plan during the applicable commitment period (in that case, 36 months).

Judge Parker acknowledged pre-BAPCPA jurisprudence which had generally required that a non-filing spouse's income be considered in determining the amount of income available to fund a plan, but also noted "courts disagreed to varying degrees as to whether this requirement mandated the actual dedication of all excess family income, including that of the non-debtor spouse, to the proposed plan, and whether a non-debtor spouse could be precluded from utilizing non-estate earnings to address any debts which he may have incurred."

Judge Parker acknowledged that "The rationale behind including non-debtor spouse's income in debtor's individual plan under the disposable income test is simple: a portion of the non-debtor spouse's income is likely to be applied to the basic needs of the debtor and to potentially increase the share of the debtor's own income that is not reasonably necessary for support. In other words, it is fair that the non-debtor spouse's income should be considered in calculating the appropriate chapter 13 plan payment." Citing In re Carpenter, 318 B.R. 645 at 647 (Bankr.E.D.Va.2003).

Judge Parker concluded, however, that "While the Trustee's position might be viable under the former [pre-BAPCPA] standard, its foundation has been completely eradicated by the BAPCPA amendments in this area." (Oh, by the way, plan confirmed over objection.)

In re Louviere, 2008 WL 925824 (Bankr.E.D.Tex.2008) is kind of a goofy case where the debtor retired the month before she filed so her income on the means test was approximately double her income on Schedule I. (I'm thinking wait a few months and avoid at least one issue, but there may have been some creditor poking her with a sharp stick that prompted an earlier filing.) The Chapter 13 trustee, apparently having not read Hardacre or the "projected" appended to disposable income, objected because her plan did not pay her disposable income under the job she didn't have anymore to unsecured creditors. That one didn't work.

The Chapter 13 trustee also objected to confirmation because "the Debtor failed to demonstrate that a sufficient contribution [from the non-filing spouse] is being made to the household expenses of the family unit." The court described the testimony on the non-filing spouse as "somewhat disjointed" (a polite way of saying "not credible"?) On the amended I and J, the debtor took out her non-filing spouse's gross income altogether and included a line for "husband's contribution to household." Correct interpretation of 101(10A)(B), but doesn't disclose what the form asks for. The court found that despite "the Debtor's difficulty in quantifying her husband's income and expenditures" the evidence "clearly" indicated that the non-filing spouse contributed "a minimum" of 69.5% of the household expenses. The Court confirmed the plan, concluding "Under whatever standard one might wish to apply, that does not constitute an inequitable apportionment of the household expenses nor can it be said that the Debtor in this case is improperly diverting potential plan payments in order to subsidize the lifestyle of her non-filing spouse." He does conclude, however: "In this case [her] income is dedicated to paying creditors. To the extent there is a surplus after payment of obligations incurred by her, it is devoted to necessities and satisfaction of the terms of the Plan. Were that surplus being used to underwrite luxuries to be enjoyed by the Debtor and [her spouse], while the Debtor used Chapter 13 for lien stripping, extensions of indebtedness and discharge of unsecured claims, there might exist grounds for dismissal of the case or denial of confirmation on the basis that the chapter 13 filing was in bad faith." He does not address the fairly common (at least in my

practice) situation where the non-filing spouse simply chooses not to help the debtor pay his or her unsecured credit card debt and simply elects to put his or her "surplus" funds into saving, or to pay for a child's college expenses, or to indulge in recreational activities, or........

In In re Barfknecht, 378 B.R. 154 (Bankr.W.D.Tex.2007), Judge Clark held that the debtors exclusion of Social Security benefits in determining projected disposable income was proper under the definition of current monthly income contained in 101(10A)(A). He also concluded that failing to include those amounts did not constitute lack of good faith under 1325(a)(3) because the debtors were simply taking an exclusion that Congress authorized them to take. This is **not** a non-filing spouse case, but Judge Clark correctly follows the definition in the statute to get to the answer. As a debtor's attorney, I cite this case for "the correct approach is to read the statute." In re Thompson, 2010 WL 3583400 (8th Cir.2010) reached the same result as Judge Clark in Barfknecht, holding that the debtors' failure to devote all of their social security income to the plan, without more, did not establish lack of good faith based upon the statutory provision excluding social security benefits from disposable income.

Not Texas cases, but see, also, In re Cranmer, 463 B.R. 548 (Bankr.D.Utah 2011) and In re Vandenbosch, 459 B.R. 140 (Bankr.M.D.Fla.2011), two recent cases where the bankruptcy courts denied confirmation of plans for bad faith based upon the failure to include Social Security benefits in projected disposable income. In both cases the District Courts reversed and remanded.

In In re Aprea, 368 B.R. 558 (Bankr.E.D.Tex.2007), the court held that a debtor's voluntary payment of his non-working fiancé's car ownership and operating expenses were to be excluded in calculating the debtor's disposable income for purposes of 1325(b)(2)(A). [This is an expense case, not an income case, and so not directly on point, but it's from Texas and its in the neighborhood, so be aware.]

In re Ariyaserbsiri, 2008 WL 5191200 (Bankr.E.D.Tex.2008) held that 1325(b)(4) means what it says and that all of a non-filing spouse's income is used in determining the applicable commitment period. The opinion does not address to what extent, if any, the non-filing spouse's income must be included in determining disposable income for determining if all of the debtor's disposable income was being committed to the plan.

I would also refer you to a pre-BAPCPA case out of the Northern District. Although it is a pre-BAPCPA case, I recommend it to you because I would suggest that Judge Lynn reached the correct result under the old law, thus establishing a continuity of result under both versions of the Code. See, In re Nahat, 278 B.R. 108 (Bankr.N.D.Tex.2002). Specifically, Judge Lynn held that post-petition earnings of a non-debtor spouse were not property of the estate under either 541(a)(2) or 1306(a), because she was not a "debtor" and that for the same reason, her earnings were not included in the "debtor's" disposable income. He further held that "it stands to reason that [she] should have the right to pay obligations in her name before contributing to the disposable income under the plan." In an interesting side note, the non-filing spouse actually filed a later, separate Chapter 13, which Judge Lynn also confirmed over the trustee's objection. See, In re Nahat, 315 B.R. 368 (Bankr.N.D.Tex.2004). See, also, Judge Clark's opinion in In re Reiter under the codebtor stay

section of this paper in which he held that the post-petition earnings of a non-debtor spouse are not property of the estate under 1306(a)(1).

See In re King, 2008 WL 1808522 (Bankr.S.D.Tex.2008) in which Judge Steen held that a debtor was not entitled to take a deduction from her non-filing spouse's income for "court ordered payments" for a wage order in his Chapter 13 which had subsequently been converted to Chapter 7. (No more payment, no more deduction. Seems obvious.)

Elsewhere

The most cited case on this issue is In re Quarterman, 342 B.R.647 (Bankr.M.D.Fla.2006). This case states several noteworthy conclusions. First, the opinion clearly states: "The burden is on the objecting party, here the Trustee, to provide satisfactory evidence in order for the Court to make a decision." In that case the court concluded that due to the "absence of evidence" on what amount of the non-filing spouse's income was contributed to household expenses of the debtor or a dependent of the debtor , the court "cannot presume" that the non-filing spouse's income was contributed to such expenses. The same analysis applies to the UST in a Chapter 7 case.

The Quarterman court analyzed the statutory language in 101(10A)(A) and (B) and concluded: "...current monthly income does not include all the income of the non-debtor spouse, but rather only amounts expended on a regular basis for household expenses. If income is not (1) expended regularly (2) on household expenses, then it is not included in the debtor's current monthly income." Simple enough, right? But wait, the above quote ends with a footnote which states: "Problems may arise with respect to determining the non-debtor spouse's contribution to household expenses. If the family maintains joint accounts, it may be difficult to determine what part of the income of the non-debtor spouse is used for household expenses and what part is used for that spouse's personal expenses or investments." [Citation omitted.]

I would agree that if the family maintains joint accounts, there may generally be a fundamental problem with making that distinction, but not in all cases. I had a case where the UST filed a motion to dismiss under 707(b)(2) and (3) in which the non-filing husband was the sole breadwinner for the family and the filing wife's debts resulted primarily from a failed business. (They were recently married and she was pregnant with their child which was born while the motion to dismiss was pending. Not directly relevant, but what judge would not want to know those facts?) The couple maintained a joint checking account and she could write checks for whatever she wanted. Their total monthly household expenses were $5000. His monthly take home pay was $6500. The UST's position was that if the $1500 net was funded into a Chapter 13, it would pay $90,000 to her creditors. Sounds good, but the issue is, were those "excess" funds "regularly contributed to household expenses of the debtor or a dependent of the debtor." The answer is absolutely, unequivocally, no. They went into savings. Remember, the undisputed facts were that total household expenses were $5000. If there was money beyond that, it went to something else, not household expenses, and is not included in current monthly income pursuant to 101(10A)(A) and (B).

Perhaps the larger issue, regardless of whether the family maintains joint accounts, is what constitutes "household expenses of the debtor or a dependent of the debtor." This gets complicated where the non-filing spouse (or non-married significant other) and the debtor share expenses. If they each pay half of the rent, is the half contributed by the non-filing spouse contributed to the household expenses of the debtor? What if the debtor has two kids not from the non-filing spouse and they have to rent/own a bigger house so they have enough space for the debtor's kids? How do you allocate percentages where the expense is higher because of the debtor's situation and the non-filer would have a much lower expense but for the debtor?

In re Grubbs, 2007 WL 4418146 (Bankr.E.D.Va.2007) addresses inclusion of the non-filing spouse's income for purposes of determining the applicable commitment period in a Chapter 13. The court concludes that the use of "current monthly income of the debtor and the debtor's spouse" in 1325(b)(4)(A)(ii) includes the income of the non-filing spouse **only to the extent** that is contributed to household expenses of the debtor or a dependent under 101(10A)(A) and (B). See, also, In re Borders, 2008 WL 1925190 (Bankr. S.D.Ala.2008), which reaches the same result citing Grubbs extensively.

Elsewhere

You have to start here with Baldino and Travis because they were two of the early cases and everybody since then cites them. They are actually both good opinions except for some wayward statements in Travis which will be discussed below.

In In re Baldino, 369 B.R. 858 (Bankr.M.D.Pa.2007) the debtor earned approximately $1200 per month. Her non-filing spouse earned $6722 per month. The debtor provided a list of the monthly expenses paid by the non-filing spouse (mortgage payment, ad valorem taxes, insurance, groceries, utilities, car insurance, medical insurance, and home maintenance) totaling $1978 per month. On Form B22A (the opinion says B22C, but that is the form in a Chapter 13 case) the debtor listed a marital adjustment of $4794 which represents the balance of the non-filing spouse's income. There was no explanation what the non-filing spouse did with the rest of his income.

The UST argued for dismissal on two grounds: first, that the non-filing spouse's income should be considered as a relevant factor when determining the filing spouse's ability to repay her debts, and second, that the non-filing spouse's income should be included under the totality of the circumstances test of 707(b)(3)(B).

The Baldino court rejected both of these arguments. The court focused on the "plain meaning" of the language of 101(10A) and (B), which speak in terms of the **debtor's** (singular possessive) income. The non-filing spouse's income is included **only** to the extent that it is regularly contributed to household expenses of the debtor. The court rejected the UST's second argument as well, concluding that the general language of 707(b)(3)(B) cannot override the express language used elsewhere in the statute.

The court also considered it of "some import" that all of the debts listed in the debtor's schedules were in the debtor's name only, "meaning therefore, that the creditors extended the Debtor the credit based on her creditworthiness alone, and thus assumed the risk in doing so, i.e., losing her higher paying job and becoming unable to repay her debts."

Finally, the court noted that it was also of "some import" that the debtor's creditors would not be able to reach the income of the non-filing spouse under Pennsylvania state law. (Check the language of the statute. It is very similar to Texas law.)

In re Travis, 353 B.R.520 (Bankr.E.D.Mich.2006), reached the correct result, but contained some language which will no doubt be of comfort to the UST. (The fact that the language is dicta and is patently wrong will not stop the UST from citing that language, so be prepared.) In Travis, the debtor earned $3500 per month and his non-filing spouse earned $3291 per month. The UST contended that the debtor filled out the B22A incorrectly and that if the form was filled out properly, a presumption of abuse resulted. After much wrangling over the proper amount of expenses which might be deducted the court came up with a negative disposable income number, so no presumption of abuse resulted.

In its analysis of the marital adjustment the court started by stating: "As a preliminary matter, the Court notes that the calculation of current monthly income when there is a non-filing spouse is complicated. The requirements which the Code imposes on a non-filing spouse in reference to the non-filing spouse's income are not clearly defined and are subject to interpretation." The first sentence is correct, the analysis is complicated. (Fifteen Bankruptcy Code sections and six Family Code sections are relevant.) The second sentence is nonsense. Although the analysis may be complicated, the requirements of the Code with respect to a non-filing spouse's income are very clearly defined. In addition, the notion that the Code imposes some requirement on the non-filing spouse is clearly incorrect. The Code imposes a duty on the **debtor** to account for the non-filing spouse's income, but it imposes no obligation on the debtor's non-filing spouse who is not a party to the bankruptcy case.

The Travis court did correctly note that some expenses of the non-filing spouse may contribute to the debtor's household expenses. For instance, if the non-filing spouse chooses to spend his/her income on a luxury home in which the debtor resides, some portion of that expense **might be** imputed to the debtor as an amount contributed for the household expenses of the debtor.

The UST also moved to dismiss the case under 707(b)(3) under the totality of the circumstances test. The Travis court did agree with the UST that the non-filing spouse's income should be considered under 707(b)(3)(B) [based upon pre-BAPCPA law], which led to two questions: "first, how much consideration does the Court give to the non-filing spouse's income and, second, even if all of the non-filing spouse's income is available to the Debtor, is there an ability to commit any of that income to repayment of unsecured creditors?" The court answered the first question that "the non-filing spouse's income should be considered only if his/her income is substantial enough to significantly raise the debtor's standard of living and generate total household income in excess of the reasonable costs of food, clothing, shelter and other necessities." The court answered the second

question with a factual analysis that concluded that in this case, the debtor and the non-filing spouse spend all of their combined income in supporting their extended family and that there is no money left at the end of the day. The court faied to address the legal issue of whether the debtor spouse has any ability to compel the non-filing spouse to contribute their income to pay the debtor spouse's debts. This author would suggest that is the more relevant analysis. This author also agrees with the Baldino court that the plain language of the sections defining a debtor's current monthly income precludes use of 707(b)(3)(B) to "override" those express provisions.

In re Springirth, 2008 WL 748138 (Bankr.S.D.Ind.2008) is one of those "bad facts make bad law" cases. The debtor earned $1443 per month. His non-filing spouse earned $10,331. Ultimately, the court concluded "...the Court finds that the Debtor has the ability to pay under the 'totality of the circumstances'" test,' based entirely on the fact that "Susan's income easily covers and exceeds the costs of household necessities." This court conveniently never mentioned 101(10A)(A) and (B). The court would no doubt say that they had no application here because the case was dismissed under 707(b)(3), not 707(b)(2). Nice try, but the statutory definition of current monthly income should not be so cavalierly ignored. As noted in the discussion of Travis, there is dicta in that opinion that will give comfort to the UST. It also gave comfort to the Springirth court which quoted Travis for the proposition that a non-filing spouse's income should only be counted if that income "is substantial enough to significantly raise the debtor's standard of living and generate total household income in excess of reasonable costs of food, clothing, shelter and other necessities." Would someone please cite me to the Code section which even mentions "total household income?" (Oh, by the way, the Travis court denied the UST's motion to dismiss).

One can certainly argue that this is exactly the kind of result BAPCPA was intended to avoid. In case we forget, one of the principal arguments for the new Code was that the old "substantial abuse" standard was too subjective and we needed a more objective standard (ie, the means test) to take discretion away from soft hearted (or soft headed) bankruptcy judges in favor of a more uniform standard written, bought and paid for by the credit card industry. If the credit card industry was gracious (or asleep at the wheel) enough to exclude income of a non-filing spouse, what business do the courts have giving them something they didn't even ask for?

In a recent case, In re Kulakowski, (Bankr.M.D.Fla.2011), the court held that all of the non-filing spouse's income had to be included in the debtor's current monthly income because (1) it had historically been contributed to expenses of the household and (2) as a married couple, the spouses had operated as a single economic unit. This is one of those bad facts make bad law cases. The non-filing husband earned $101,000 per year, yet the debtor had $135,000 in non-priority unsecured debt. The court opined that all of the husband's take home pay had to be included as the debtor's income under 101(10A)(A) without ever making reference to 101(10A)(B).

Behave Yourself

The debtor cannot "assume" responsibility for all of the household expenses leaving all of the non-filing spouse's income available for frivolousness. See, Louviere, infra, and In re Bush, 120 B.R. 403 (Bankr.E.D.Tex.1990). (A pre-BAPCPA case, but lack of good faith is still lack of good faith.)