IMPLICATIONS OF BANKRUPTCY ON ALIMONY, MAINTENANCE, AND SUPPORT IN THE SECOND CIRCUIT

I. INTRODUCTION

The divorce reforms that began in the 1970's rapidly signaled the decline of traditional alimony based divorces in the United States. Even the term "alimony" itself has been replaced in many jurisdictions by the labels "maintenance" or "spousal support". Contemporary divorce law not only terminates a couple's marital status, but encourages a conclusion of their economic interrelationship as well.[1] The widespread adoption of equitable distribution concepts of property as a substitute for alimony has become the means for providing a dependent spouse with a means of self-support. Although the theory of property division is based on an allocation of assets acquired during marriage, equitable division principles frequently take into account factors traditionally considered in awarding alimony. Despite the fact that such payments often resemble alimony, they actually represent ownership interests rather than support and are ordered by the court as a definite, liquidated sum. [2]

In recent decades the divorce laws throughout the United States have undergone fundamental changes. Similarly, the substantive divorce laws in New York have also changed. The New York marriage dissolution law of 1980 incorporates two distinct theories, partnership and rehabilitation.[3] The care and protection of dependent family members remains an important state

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[1] The Uniform Marriage and Divorce Act attempts to promote finality whenever practiced by encouraging division and temporary support rather than permanent alimony. *See* UNIFORM MARRIAGE AND DIVORCE ACT prefatory note, 9A U.L.A. 147, 149 (1987).

[2] Section 307 of the Uniform Marriage and Divorce Act directs the court to apportion a divorcing couple's assets equitably by considering:

> the duration of the marriage, and prior marriage of either party, antenuptial agreement of the parties, the age, health, station, occupation, amount and sources of income, vocational skills, employability, estate, liabilities, and needs of each of the parties, custodial provisions, whether the apportionment is in lieu of or in addition to maintenance, and the opportunity of each for future acquisition of capital assets and income. The court shall also consider the contributions or dissipation of each party in the acquisition, preservation, depreciation, or appreciation in value of the respective estates, and the contribution of a spouse as a homemaker or to the family unit.

UNIFORM MARRIAGE AND DIVORCE ACT § 307, 9A U.L.A. 147, 238 (1978).

[3] The UNIFORM MARRIAGE AND DIVORCE ACT, 9A U.L.A. 97, 149 (1987). The Act attempts to "reduce the adversary trappings of marital litigation and to encourage parties to make amicable settlements of their financial affairs."

concern when a divorce is granted. However, modern divorce law seeks a final separation of the divorcing partners, if possible, so that they may start new and independent lives. The goal is achieved by attempting to sever the financial obligations between former spouses through property divisions and the award of temporary spousal support as opposed to granting permanent alimony.[4] However, the new start after a divorce may not be realized because the dependent spouse's inability to achieve financial independence and provide for the 'necessaries' of life.[5]

Bankruptcy Law is predicated on the premise of a fresh start for the debtor, by discharging certain debts upon filing a bankruptcy petition,[6] thereby freeing the debtor from liability to their creditors.[7] The current Bankruptcy Code, enacted in 1978, permits the discharge of most debts, but does not allow for the discharge of certain divorce related debts and obligations designated as support for family members.[8] Divorce-related debt obligations for the benefit of dependent spouses and children, which are nondischargeable in bankruptcy, are found in Section 523(a)(5) of the Bankruptcy Code.[9] Accordingly, a divorced

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N.Y. DOM. REL. LAW §§ 236(B), (1)(c), (3), (5)(d)(6), (6)(a)(8) (McKinney 1988).

The partnership theory of the new Equitable Distribution Law (D.R.L. § 236(B)) is applied to the division of the accumulated assets of the marriage partners. The dependent spouse is awarded an equitable, rather than equal, share of the marital property, sufficient maintenance for support based on reasonable needs and, if appropriate, rehabilitation in preparation for a return to the labor market.

[4] As noted by the Assembly memorandum in support of the Equitable Distribution Law, independence cannot be achieved in all cases. Therefore, the legislature provided other criteria to guide the courts in distributing marital property and awarded maintenance to the recipient spouse who lacks sufficient resources to achieve financial independence. The criteria included age and health of the spouses, the length of the marriage, responsibility for rearing children, lost opportunities for career development and any other facts that would include any misconduct during the marriage that impaired the operation of the marital partnership in its economic and non-economic aspects. N.Y. DOM. REL. LAW §§ 236(B)(5)(d); 236(B)(2, 3, 10); 236(B)(6)(a)(2, 5, 9, 10) (McKinney 1988).

[5] *Id.*

[6] Bankruptcy law has struggled to find a balance between affording a debtor a fresh start on the one hand and protecting the debtor's family members on the other. Marital debts that a bankruptcy court determines are "in the nature of alimony, maintenance or support" are nondischargeable pursuant to the Bankruptcy Code, and continue despite the bankruptcy action. Marital debts that are not deemed to constitute support are regarded as property division and are dischargeable in bankruptcy. The debts are no longer enforceable through the divorce decree or by other means. Unfortunately, it is not always clear which debts are "in the nature of support." 11 U.S.C. § 523(a)(5) (1988).

[7] 3 COLLIER ON BANKRUPTCY § 523.15 (15th Ed. 1991). (This section of the Bankruptcy Code does not allow the discharge of an individual debtor from any debt.).

[8] BANKRUPTCY REFORM ACT OF 1978, 11 U.S.C. § 101-1330 (1983 and Supp. III 1985).

[9] The Bankruptcy Code of 1978 excepts from discharge a debt:

> to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation

debtor cannot escape the financial obligations to their family if the debts are found to be in the nature of alimony, maintenance or support. This is true regardless of the language used in the divorce document describing the debt owed by the debtor to the family.[10] The Bankruptcy Code does not permit the exception to nondischargeability merely because the debt is denominated as alimony, maintenance or support.[11] The bankruptcy court must find the debt obligation is actually in the nature of alimony, maintenance or support, or the debt is discharged.[12] Consequently, the bankrupt debtor party, saddled with continuing financial obligations resulting from the divorce action, may or may not be able to obtain an economic fresh start. Alternately, the financial expectancy of the divorced dependent creditor-spouse could be upset by the determinations of the bankruptcy court.[13]

The legislative history of the Bankruptcy Act of 1978 indicates that Congress intended for federal law, not state law, to determine when a debt complied with the statutory exception to discharge.[14]

Section 523(a)(5) of the Bankruptcy Code assigns to the bankruptcy court the responsibility for determination of the nature of debt. The lack of clear federal standards makes the task of distinguishing the debt obligations of alimony, maintenance and support from debts properly denominated as property divisions difficult. While alimony, maintenance and support are not dischargeable in bankruptcy, property divisions constitute ordinary debt and are dischargeable. This lack of federal standards has led to voluminous litigation between divorced spouses when one party seeks debt protection through bankruptcy. The bank-

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> agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement . . . .

11 U.S.C. § 523(a)(5) (1982 & Supp. III 1985).

[10] 11 U.S.C. § 523(a)(5)(B) provides that the exception does not extend to a debt to the extent that such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

[11] *See supra* note 7.

[12] *See In re* Calhoun, 715 F.2d 1103 (6th Cir. 1983).

[13] According to Collier, the Congressional intent makes it clear that the determination of alimony, maintenance, or support will be determined under the bankruptcy laws, not state law. In the absence of any federal law of domestic relations, Congress could not have intended that federal courts were to formulate the bankruptcy law of alimony and support in a vacuum, precluding from all references to the reasoning of the well-established law or the states. *See* COLLIER ON BANKRUPTCY § 523.15, at 523-117-8.

[14] *See* H.R. REP. No. 595, 95th Cong., 2d Sess. 364, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6320; S. REP. No. 989, 95th Cong., 2d Sess. 79, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5865; *See also In re* Spong, 661 F.2d 6 (2d Cir. 1981).

ruptcy courts, applying federal law, must classify the debt as either alimony or property divisions. Neither the debtor nor the obligee can feel assured that the terms of the state divorce decree will be upheld by the bankruptcy court. This problem stems from the new trend in state divorce laws which favor property divisions and short-term support awards instead of traditional permanent alimony.[15] A property division may be the legally mandated mechanism by which a dependent spouse receives support, but that property divorce award may become a dischargeable debt in bankruptcy.[16] Bankruptcy courts look to the divorce documents for guidance in the determination of nondischargeable support and dischargeable property divisions. However, the lack of federal standards has given the bankruptcy courts the task of attempting to reconcile the conflicting policies of providing the debtor with a fresh start while acknowledging the strong public policy of continued support for the dependent spouse and children.[17]

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15 "The leading model legislation of this era took the position that property division in divorce should be treated . . . like the distribution of assets incident to the dissolution of a partnership . . . as the primary means of providing for the future financial needs of the spouses . . . An award of maintenance can be made to either spouse under appropriate circumstances to supplement the available property . . . The Act does not continue the traditional reliance upon maintenance as the primary means of support for divorced spouses." The UNIFORM MARRIAGE AND DIVORCE ACT Prefatory Note, § 308, 9A U.L.A. 147, 149 (1987).

The New York Legislature provided for a new Equitable Distribution Law. *See* 1980 N.Y. Laws 434 (codified at N.Y. DOM. REL. LAW § 236(B) (McKinney 1988)). The New York statute directs the court considering maintenance to pay attention to "whether the party in whose favor maintenance is granted lacks sufficient property and income to provide for his or her reasonable needs" and to "the income and property for the respective parties including marital property distributed pursuant to [the disposition of property]." N.Y. DOM. REL. LAW § 236(B)(6) (McKinney 1986).

The memorandum from Governor Hugh L. Carey regarding the New York legislation recognizes this preference for property division. In it, Governor Carey observed that the legislation directed that the property accumulated during the marriage be distributed in a manner that reflects the individual needs and circumstances of the parties. Memorandum Filed with Assembly Bill No. 6200-A, at 608, Executive Chamber, State of New York (June 22, 1980). This memorandum enunciates the preference for using property division to address the issue of need of the dependent spouse upon the dissolution of a marriage.

However, the memorandum in support of legislation contains observations that subtly undercut this use of property:

The basic premise for the marital property and alimony (now maintenance) reforms of this legislation (§ 236) is that modern marriage should be viewed as a partnership of co-equals. Upon the dissolution of a marriage there should be an equitable distribution of all family assets accumulated during the marriage and maintenance should rest on the economic basis of reasonable needs and the ability to pay. New York State Assembly, Memorandum in Support of Legislation, Assembly 6200-A, Senate 6174-Aaa, Memo on amended bill (May 23, 1979).

16 *See supra* note 7.

17 *E.g.*, Forsdick v. Turgeon, 812 F.2d 801, 802, 804 (2d Cir. 1987); Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1107 (6th Cir. 1983); Mackey v. Kaufman (*In re* Kaufman), 115 B.R. 435, 439-440 (E.D.N.Y.1990); Petoske v. Petoske (*In re* Petoske), 16 B.R.

This Note will evaluate several issues confronting the bankruptcy court when determining the dischargeability of divorce-related debts. The Bankruptcy Reform Act of 1978 embraced an exception to dischargeability of alimony, maintenance and support for the dependent spouse and children. When enacted in 1978, the statutory language of the Bankruptcy Code created few conflicts for divorcing couples in New York, which was, at that time, a "title" state.[18] The marriage partner who held title to the property retained title to the property. However, the new Equitable Distribution Law for divorce, enacted in 1980, brought about a radical departure from the common law "title" basis of property and introduced the new concept of "marital property."[19] As a consequence of enacting the Equitable Distribution Law [20] for divorce, a new approach was established for determining support and distribution of property through the implementation of "maintenance", "distributive award", and "marital property".[21] Furthermore, by cross-referencing the property settlement provisions and maintenance provisions of the new Equitable Distribution Law, the state court has the authority to be flexible when establishing the structure of the dependent spouse's claim for an opportunity to achieve financial independence.[22] It may be in the form of a distribution of marital property, or maintenance, or both.[23] The old law of alimony based divorce has been replaced by a property distribution. The "marital property" may or may not be denominated as support necessary for providing the creditor-spouse with the 'necessaries'

412, 413 (E.D.N.Y. 1982). Congress made specific choice between the competing policies of giving a "fresh start" to the debtors and section 523(a)(5)(B) exception, which enforces the debtors' obligations to their families.

18 The award of both real and personal property was based on bare legal title. The holder of title retained the property denominated as their own. Jointly held property was shared in accordance with title. In the case of personal articles, devoid of title, property was awarded based on possession.

19 "The term 'marital property' shall mean all property acquired by either or both spouses during the marriage . . . regardless of the form in which title is held . . . ." N.Y. DOM. REL. LAW § 236(B)(1)(c) (McKinney 1986).

20 N.Y. DOM. REL. LAW § 236(B) (McKinney 1988).

21 New York State Assembly, Memorandum in Support of Legislation, Equitable Distribution of Property, p. 130 (1980).

22 *Id. supra* note 20, at § 236(B)(6)(a),

> [C]ourt may order . . . maintenance. . . to provide. . .[the] reasonable needs [of a party] lack[ing] sufficient property . . . to provide for [his or her] reasonable needs . . . .

23 N.Y. DOM. REL. LAW § 236(B)(5)(d)(5):

> In determining an equitable disposition of property . . . the court shall consider . . . any award of maintenance. . .

Id. at D.R.L. § 236(B)(6)(a)(1):

> In determining the amount and duration of maintenance the court shall consider . . . marital property distributed pursuant to subdivision five . . . .

requisite for an independent life.[24] Depending on the purpose of the marital property debt, it may be dischargeable in bankruptcy.[25]

Therefore, the 1980 New York Equitable Distribution Law has transmuted the old concept of alimony into a flexible, mutually dependent formula of property and maintenance.[26] The use of the term 'property' within the meaning of the Equitable Distribution Law and within the meaning of the Bankruptcy Act of 1978 is a source of current mischief and conflict. An individual debtor's "liability [may be] designated as alimony, maintenance, or support," [27] although, in reality, it is a state property division, and therefore dischargeable, "unless such liability is actually in the nature of alimony, maintenance, or support."[28] Alternately, a debtor's property liability, normally dischargeable in bankruptcy, may be found by the same bankruptcy court to be an intrinsic part of the maintenance award under the state Equitable Distribution Law and consequently not dischargeable because it is a debt "to a spouse . . . for alimony to, maintenance for, or support of such spouse . . . in connection with . . . [a] divorce."[29] The bankruptcy court will apply federal law, rather than state law, when confronted by the task of characterizing an obligation as maintenance or property.[30] Since there are no uniform federal standards for analyzing debts pursuant to section 523(a)(5), the courts must consider what constitutes the support exception under the bankruptcy code and also what the state law concepts of support and property division are used in the matrimonial action. Confronted by conflicting laws, the bankruptcy courts in the Second Circuit have enunciated a list of judicial criteria for evaluating divorce-bankruptcy issues. Until Congress amends the Bankruptcy Law to reflect the interdependence of alimony, maintenance, support and property in modern domestic relations law,[31] the matrimonial attorney must be vigilant that the expecta-

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[24] In reaction to the narrow application of the alimony provisions in the former law, the legislature directs that the matrimonial court consider the contributions of the spouses in awarding an equitable division of marital property plus sufficient permanent or time-limited maintenance that will confer independence on the dependent spouse. N.Y. DOM. REL. LAW § 236(B)(5)(d), (6), (8) and § 236(B) (6)(a)(3), (4), (6), (8).

[25] Exceptions to discharge: 11 U.S.C. § 523(a)(5).

[26] N.Y. DOM. REL. LAW § 236(B)(6)(a)(1); § 236(B)(5)(d)(5) (McKinney 1988).

[27] Exceptions to discharge: 11 U.S.C. § 523(a)(5)(B).

[28] *Id.*

[29] *Id.* at § 523(a)(5).

[30] *See* H.R. REP. No. 595, 95th Cong., 1st Sess., p. 363 [reprinted at 11 U.S.C.A. § 523 at 508].

[31] Rep. Henry J. Hyde proposed legislation to amend the Bankruptcy Code to make "property [awards or] any liability under the terms of a property settlement agreement

tions and obligations of the divorcing parties are not disrupted by a bankruptcy.

This paper analyzes Second Circuit case law that construes the language of U.S.C. § 523(a)(5). It is the author's intention to identify a clear line between dischargeable debts and debts excepted from discharge in bankruptcy. The cases which follow are used for the purpose of analyzing the doctrines and pursue the themes introduced above. Four basic questions will structure the discussion: (1) Is it in fact "property"? (2) Is it marital or nonmarital property? (3) How much is it worth? (4) How much of it does each spouse get? These questions are important to the practice of marriage dissolution law throughout the United States today.

II. Case Analysis

A. The Brody *Case*

The Brody[32] divorce commenced in 1982 under the auspices of the New York Equitable Distribution Law of 1980. The language of the voluntary settlement agreement provided for child support to the minor children,[33] support and maintenance to the wife for a specific time period, with earlier termination of payments based on the death of the wife or her remarriage or cohabitation, and a distributive award of one million dollars. Under the terms of the 1986 separation agreement, Mr. Brody paid his wife $400,000. He then defaulted on the balance of $600,000 in distributive award and support payments. One year after the Brodys were finally divorced, in 1987, Mr. Brody failed to comply with a default judgment granted to Mrs. Brody by the state court. Then, Mr. Brody attempted to avoid paying the $600,000 by filing for Chapter 11 bankruptcy protection, pursuant to 11 U.S.C. 523(a)(5).[34]

The bankruptcy court first determined that the issue of dischargeability of a divorce debt is a matter of federal law.[35] The court announced that fundamental to making a determination of dischargeability of debt was the intent of the parties, reflected in the divorce or settlement document, which created the obligation

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. . . [or divorce decree] in accordance with state . . . law [in addition to support awards] to a spouse, former spouse or child" of the individual debtor, a nondischargeable debt in bankruptcy. *See* H.R. 1242, introduced by Rep. Hyde in March 1991.

32 Brody v. Brody (*In re* Brody), 120 B.R. 696 (Bankr. E.D.N.Y. 1990).

33 *Id.* at 697.

34 *Id.* at 698.

35 *Id.*

that was now the debtor's liability.[36] The bankruptcy court declared that it was bound neither by the terminology nor the heading of the divorce document in which the obligation appeared. The court enunciated several criteria for determining the intent of the parties, either expressed or inferred, from the function of the obligation.[37] The criteria used by the court are especially important when the intent of the parties is unclear. Each creditor and debtor may hold differing views of the intent of the obligation. The court resolved the problem by applying its criteria to determine the purpose of the obligation — support payment or a property settlement.[38] When the intent or purpose was not expressed in the divorce document, the bankruptcy court would look to its own criteria for determining the nature of the debt.[39] The court did not look to the Domestic Relations Law of the state. The new Domestic Relations Law created a system of support based on a cross-over formula of property and support. The amount of property was the essential factor for determining the amount of support granted. Elimination of the property award would have the effect of leaving in place a support award that was inadequate for its purpose, because the underlying basis of the support had been removed. To achieve spousal independence, the new Domestic Relations Law favors property instead of support awards.[40] The property award is the foundation of the support award necessary to help the dependent creditor-spouse achieve independence.[41]

The divorce decree is often the culmination of difficult negotiations or a trial. Consequently, the results may not fully reflect

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36 *Id.* at 699.

37 *Id.* at 703; *See* Forsdick v. Turgeon, 812 F.2d 801, 803 (2d Cir. 1987).

38 *Id.* at 699.

39 *In re* Brody, 120 B.R. at 701; *See, e.g.,* Freyer v. Freyer *(In re* Freyer), 71 B.R. 912, 918 (Bankr. S.D.N.Y. 1987), reciting the court's criteria:

1. whether the obligation terminates on the death or remarriage of either spouse;
2. the characterization of the payment in the decree and the context in which the disputed provisions appear;
3. whether the payments appear to balance disparate income;
4. whether the payments are to be made to the spouse or a third party;
5. whether the obligation is payable in a lump sum or in installments over a period of time;
6. whether the parties intend to create an obligation of support;
7. whether an assumption of debt has the effect of providing the support necessary to insure that the daily needs of the former spouse and any children of the marriage are met;
8. whether an assumption of debt has the effect of providing the support necessary to insure a home for the spouse and minor children.

40 *See supra* note 15.

41 *Id.*

the intent of the law. The bankruptcy court has the role of determining dischargeability and must look to state law to understand the statutory definition for the meaning of the law. The divorce documents may not reflect the meaning of the Domestic Relations Law. Looking only to the settlement, which is one step removed from the actual law, creates more confusion. The criteria used by the bankruptcy court may misconstrue the purpose of the divorce decree because its language suffers from ambiguity. Criteria set in stone lack the flexibility necessary to react properly to the massive number of combinations and permutations of term, demands and obligations arising from the ingenuity of warring spouses.

The *Brody* court found that the property settlement, while on the surface dischargeable property, had the purpose of providing both a property division and support. The Brodys had agreed that Mrs. Brody required, and would receive, $100,000 per year in support. However, that proposal was rejected by Mrs. Brody, who feared that Mr. Brody would not honor the agreement and make the payments.[42] Having Mrs. Brody rely on her former husband to make timely payments certainly does not make her an independent person as conceptualized by the policy of the new Domestic Relations Law.[43] The court held that the one million dollar distributive award had the earmarkings of a property award, but was intended by the parties to be invested in order to provide $100,000 per year income to Mrs. Brody. Monthly payments, denominated as support and spanning a three-year period, were intended to supplement income until Mrs. Brody received the distributive award and the full income it would generate. The court found that this financial arrangement was, under the circumstances, the substance of the divorce decree.[44] The court was not compelled to apply its criteria because the parties had expressed the intent and purpose of the financial arrangements.[45] In order to avoid tax obligations, support is often called "property." The court found that the lump-sum property award had all the trappings of common law property. It was devisable, whether or not Mrs. Brody continued to live or if she remarried. According to the court criteria, the support terminates upon death or remarriage of the dependent spouse, or after a specific period of time. "A property settlement otherwise

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42 *Id.* at 702.
43 *See supra* note 2.
44 *Brody*, 120 B.R. at 702.
45 *Id.* at 703.

dischargeable may be rendered actually in the nature of . . . support"[46] and thus not dischargeable where both of the spouses intend that one of the primary functions to be served by the property settlement was to secure the source and the means to generate support. However, such property settlement is nondischargeable only to the extent actually necessary to service this function.[47] The *Brody* court held that the amount of the property award may not be necessary to generate the agreed-upon support of $100,000. If the original lump sum of $1,000,000, invested by Mrs. Brody, generated more than $100,000, a portion of the principal sum was to be returned to Mr. Brody.[48]

The court held that the when "the intent is clear from the document, and the intent is consistent with the function actually served by the clause out of which the obligation was created . . . there is no reason for the bankruptcy court to go further." [49]

This result is consistent with the divorce decree and the Domestic Relations Law mandate to use property as the basis of support, contributing to the independence of the dependent spouse.[50] The directive of the bankruptcy law is to determine debt that is "actually in the nature of . . . support."[51]

B. The Hilsen *Case*

The *Hilsen* case focused on the difference between "marital property" and property within the common law meaning of the word.[52] Mr. Hilsen filed for divorce in 1984, pursuant to the new Equitable Distribution Law. After the divorce trial, but before the final judgment, the judge appointed a receiver for the 'marital property', which comprised three apartments to which Mr. Hilsen held "title."[53] Under the new Equitable Distribution Law, New York was no longer a "title" state.[54] The statutory creation of 'marital property' included all things of value acquired during the marriage, regardless of which party held title.[55]

Mr. Hilsen then filed for Chapter 11 reorganization bankruptcy and sought an automatic stay from the action of the state

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46 *Id.* at 703-4.
47 *Id.*
48 *Id.* at 704.
49 *Id.* at 699.
50 *See supra* note 2.
51 *See supra* note 4.
52 Hilsen v. Hilsen (*In re* Hilsen), 100 B.R. 708, 710-11 (Bankr. S.D.N.Y. 1989).
53 *Id.* at 709; Hilsen v. Hilsen, 516 N.Y.S.2d 901 (App. Div. 1987).
54 *See supra* note 18.
55 *See* O'Brien v. O'Brien, 489 N.E.2d 712, 717 (N.Y. 1985).

court receiver. According to section 362(b)(2) of the Bankruptcy Act of 1978, the automatic stay provision "does not operate as a stay . . . [from] the collection of alimony, maintenance, or support from property that is not property of the [debtor's bankruptcy] estate."[56] By stipulation of the bankruptcy court, the parties allowed the state divorce court to render the judgment of divorce, provided that there would be no enforcement of the award.[57]

The final divorce decree gave Mrs. Hilsen, among other items, lifetime support of $750 per week; child support; one of the condominiums as her residence; a temporary maintenance award of $3,000 per month to pay the past-due mortgage of $90,000; and a fifty-percent share in the other two condominiums.[58] Mr. Hilsen appealed the terms of the divorce decree, which was affirmed.[59] The New York Appellate Court also found that the equitable distribution award of the property was "part of the award for maintenance and not subject to an automatic stay."[60] The state appellate court, citing 11 U.S.C. § 523(a)(5) and the *Raff* case [61], further recognized that it was the bankruptcy court that made the ultimate decision as to whether the equitable distribution award of marital property was dischargeable as a property settlement or nondischargeable maintenance and support.[62]

After the final divorce decree, Mr. Hilsen filed for Chapter 7 bankruptcy liquidation. The bankruptcy court appointed a trustee for the bankruptcy estate of Mr. Hilsen. The trustee brought an adversary proceeding to remove Mrs. Hilsen and her children from occupancy in the awarded condominium residence. In addition, the trustee sought to deny Mrs. Hilsen the interest she had received from the divorce court in the other condominium properties.[63] The bankruptcy judge, by way of dicta, observed that in this case, the results of applying the bankruptcy law to the divorce decree produced a distasteful result.

The court found that the new statutory property created by the equitable distribution award after the commencement of the bankruptcy filing could not divest the bankruptcy estate of prop-

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56 11 U.S.C. § 362(b)(2).
57 *Hilsen*, 100 B.R. at 708, 710.
58 Hilsen v. Hilsen (*In re* Hilsen), 122 B.R. 10, 13 (Bankr. S.D.N.Y. 1990).
59 Hilsen v. Hilsen, 555 N.Y.S.2d 370 (App. Div. 1990).
60 *Id.* at 460, 371.
61 *See infra* note 136.
62 *See supra* note 58.
63 *Hilsen*, 100 B.R. at 708.

erty rights to which Mr. Hilsen held title at the time of the bankruptcy petition. The bankruptcy court held that, under the Equitable Distribution Law, 'marital property' is created upon the commencement of the matrimonial action, and no rights vest at the commencement of the equitable distribution matrimonial action. The wife, as a debtor's spouse, obtained merely a general unsecured claim against her debtor husband's estate.[64]

On appeal, the United States District Court for the Southern District of New York,[65] affirmed the bankruptcy court. At the time of the separation and before the final divorce judgment, Mr. Hilsen held legal title to the residential condominium. The court found that although 'marital property' means all property acquired during the marriage by either spouse, it would not become a vested property right until the final divorce decree was granted.[66] Therefore, Mrs. Hilsen did not have a vested property right in the residential condominium granted to her during the separation order. The marital property right would only be created after the granting of the final divorce decree, and must occur before a filing of bankruptcy. Thus title did not transfer to Mrs. Hilsen.[67]

In the preceding bankruptcy action, Mrs. Hilsen raised the issue of a constructive trust. The district court addressed that issue on appeal. The court suggested that there may be a constructive trust imposed on the property at the time of the bankruptcy filing.[68] A constructive trust imposed on the property held by the debtor at the time of a bankruptcy filing would be an equitable interest superior to the bankruptcy estate [69] and would establish an equitable property right to Mrs. Hilsen prior to the bankruptcy.[70] Mrs. Hilsen cited to facts that supported her allegation that Mr. Hilsen had purchased the condominium fraudulently. Indeed, the court found that Mr. Hilsen used the bankruptcy process to defraud Mrs. Hilsen of her share of the marital property.[71]

A constructive or equitable trust would protect the 'marital

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64 *Id.* at 710-711.
65 Hilsen v. Hilsen (*In re* Hilsen), 119 B.R. 435 (Bankr. S.D.N.Y. 1990).
66 *Id.* at 439.
67 *Id.* at 438.
68 *Id.* at 439.
69 BLACK'S LAW DICTIONARY 314 (6th ed. 1990), defines a constructive trust as a "trust created by operation of law against one who by . . . fraud . . . or by any form of unconscionable conduct . . . holds legal right to property . . . [such] title . . . is held to an equitable duty to convey it to another . . . [to avoid] unjust enrichment."
70 *Hilsen*, 119 B.R. at 439.
71 *Id.* at 440.

property' from discharge.[72] A constructive trust for the 'marital property' rights, which are inchoate rights in property acquired without title, await the final divorce decree for transfer of title. It would require legislative action in New York to make 'marital property' protected against a title holder when the divorce or separation agreement is first filed.[73] Since title is not relevant for determining equitable distribution awards, then an equitable interest should be recognized by the property laws of New York to prevent the title property holder from thwarting the state divorce court property award by means of a fortuitous bankruptcy filing.

C. *The* Farrey v. Sanderfoot *Case*

In the divorce case of *Farrey v. Sanderfoot*,[74] the Supreme Court confronted the issue of avoiding a judicial lien by filing for bankruptcy. The state court gave the marital home to the debtor-husband and simultaneously secured a distributive award of half the value of the house for the creditor-wife by judicial lien. The Supreme Court held that the judicial lien was placed on the property interest of the debtor at the same time the debtor acquired the property. This determination was made by reference to the state of Wisconsin's property laws.[75]

Justice Kennedy, in his concurring opinion, observed that the state divorce court had the power to strip and transfer property interests between the parties to a matrimonial action.[76] However, the Court observed that if the marital property awards were not formalized according to state property law before a bankruptcy action was instituted, the bankruptcy code may be used in a manner that permits a spouse to avoid an obligation otherwise valid under the divorce court decree.

Justice Kennedy went on to state that:

> [T]hough adept drafting of property decrees or the use of court orders directing conveyances in a certain sequence might resolve the problem, it appears that congressional action may be necessary to avoid in some future case the perhaps

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72 *Hilson*, 119 B.R. at 440.

73 *Id.*

74 Farrey v. Sanderfoot, 500 U.S. —, 111 S. Ct. 1825 (1991).

75 *Id.* at 1830-31.

The parties agreed that under Wisconsin law, a divorce decree simultaneously awarded to the debtor a fee simple interest in the entire property while granting a lien to the former wife. Thus, the decree only reordered the parties' preexisting interests. Accordingly, the debtor did not previously possess his former wife's interest in the property to which the lien was attached.

76 *Id.* at 1831.

> unjust result the Court today avoids having to consider only because of the fortuity of a litigant's concession.[77]

The parties had stipulated that, under state law, the divorce decree extinguished their joint tenancy and created a new interest in place of the old. Thereby, the lien was fixed on the new property interest awarded in the decree. [78]

Although New York became a non-title state in matrimonial actions, the state property laws continue to be based on common law property notions. The unjust result that Justice Kennedy spoke to in *Farrey v. Sanderfoot* became a reality in *Hilsen*. In *Hilsen*, the bankruptcy court had the legal obligation to apply state property law to the case. The shameful results in this case reflected the need for reform of the state property laws to protect the 'marital property' award granted by a state divorce court. The property transferred to the spouse as the marital home would become the property of that spouse, and the mortgagee would still be a secured creditor. The recipient spouse, now holding title, would have possession of the property and would be responsible to the bank for the mortgage. The state divorce court would then be in a position to modify the support award in such a manner as to make the mortgage payment to the bank part of the support decree. Thus, the debtor spouse would lose the advantage of simultaneously encumbering the property with debt, discharging the debt in bankruptcy, and displacing the former wife and children from their home. The mortgage creditor is still secured. If the former spouse in possession cannot pay the mortgage, the bank is then allowed to exercise its legal remedies of foreclosure.

Before the issue of the constructive trust could be resolved, the bankruptcy court ruled in the action brought by Mrs. Hilsen in opposition to the bankruptcy regarding dischargeability of "temporary spousal maintenance" within the meaning of section 523(a)(5) of the Bankruptcy Law of 1978.[79]

The bankruptcy judge criticized the state court divorce decree for not clearly enunciating the intent of the temporary spousal support,[80] creating a situation where the bankruptcy judge could only infer the intent, function and purpose of the award from the language of the divorce decree.[81] However, the

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77 500 U.S. at —, 111 S. Ct. at 1832-33.
78 *Id.* at 1830.
79 Hilsen v. Hilsen, 122 B.R. 10 (1991).
80 *Id.* at 12.
81 *Id.* at 14.

judge did not make any reference to the New York divorce law for guidance when determining intent. Rather, the bankruptcy judge looked only at the matrimonial court's award and applied his list of criteria to the award with consideration of the totality of circumstances surrounding the case.[82]

Nor did the bankruptcy court address the district court's recommendation to consider a constructive trust. The court simply stated that the residence of Mrs. Hilsen, awarded by the divorce court, was a property award and the temporary support was a part of that award for the purpose of bringing the mortgage payments current.[83]

According to the New York Equitable Distribution Law, maintenance and property are mutually determined, based upon the need of the dependent spouse to become independent. The bankruptcy judge determined that, since the award was to correct mortgage arrears, it was only for property. Further, he ruled that since the award was not contingent on remarriage or death cancellation and would be in effect for a short period of time, it was not an award in the nature of support.[84]

Inasmuch as the divorce judge did not specify the intent of the award, the bankruptcy court was free to apply its own interpretation of the divorce. From the standpoint of the Equitable Distribution Law, the temporary award could be viewed as the means for bringing the mortgage current and was thereby intended to constitute a combined temporary maintenance and child support award. As such, the award would be part of a maintenance award geared to the independence of the dependent spouse. Denied the award that brought the mortgage current, Mrs. Hilsen and the children may not be capable of paying both the mortgage arrears and current expenses. After consideration, the bankruptcy court rejected this line of argument because the award was not prospective, but only retrospective. The bankruptcy court stated that the support award was sufficient maintenance for Mrs. Hilsen and that she did not require any further support.

This case highlights the crucial importance that a divorce decree or settlement agreement state explicitly the intent and purpose of the award. The bankruptcy court is not bound by the denomination of the award as property or support, but will use

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82 *Id.* at 12-13.
83 *Id.* at 15.
84 *Id.*

the matrimonial documents as its starting point for analysis of the divorce judgment or settlement. If the intent and expectations of the divorcing parties are not clearly delineated, the bankruptcy court will consider the substance rather than the form of the award in its review for dischargeablity of the debt.

Because of the liberal view of the bankruptcy law, which favors giving debtors a fresh start, the plaintiff in opposition to discharge has the burden of proof. Even when a debtor is obviously using the bankruptcy law to avoid paying a spousal award, the court favors the debtor's request for discharge of liabilities. In *Hilsen*, the bankruptcy court took the view that her condominium home was in the bankruptcy estate. Therefore, Mrs. Hilsen was not entitled to mortgage support because the mortgage payment was no longer required due to the bankruptcy. However, if the arrears were treated as support, Mrs. Hilsen may have, if allowed, been able to rescue the marital residence from the creditor bank by assuming the mortgage from the bankrupt's estate.

D. The Spong *Case*

The case of *Spong*[85] was one of the first cases to focus on the conflict between the bankruptcy and divorce laws. The case involved the Bankruptcy Law of 1978 and the Equitable Distribution Law of divorce. The court held that dischargeability must be determined by the substance of the liability rather than its form. This case addressed the issue of whether counsel fees were actually part of the alimony award.

The bankruptcy court found that Congress was aware that the federal courts have no jurisdiction over divorce or alimony awards.[86] There was no federal law of domestic relations and the entire subject was under the jurisdiction of the states. The court held that "Congress could not have intended that federal courts were to formulate the bankruptcy law of alimony and support in a vacuum, precluded from all reference to the reasoning of the well-established law of the States."[87] Further, the husband's obligation to support the wife's needs for 'necessaries' of life was a directive of both common law and statute. The court went on to say that the state does not wish to have a class of public charges as a result of divorce. Therefore, an award of attorney's fees was essential for a spouse to have the ability to sue or defend a matri-

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85 Pauley v. Spong (*In re* Spong), 661 F.2d 6 (2d Cir. 1981).
86 *Id.* at 9.
87 *Id.*

monial action, and thus was a 'necessary' within the meaning of the law. After reviewing decisions of other circuits, the court found this to be the law.[88]

E. The Freyer *Case*

In *Freyer*,[89] as in *Spong*,[90] the bankruptcy court held that a payment to a third party does not preclude determination that the debt is in essence a payment for alimony, maintenance and support, and nondischargeable in bankruptcy.[91]

The court began its analysis by announcing that federal bankruptcy law will determine the nature of the debt obligation as property or alimony. The creditor-spouse, as plaintiff in an action to determine the dischargeability of the debt, carries the burden of proof as to the true nature of the debt. The fact that the debtor was responsible for payment of the second mortgage did not mean that it was for support. The court must look to the substance of the obligation. The termination of the payment responsibility upon death of the creditor-spouse was but one determining factor.

The court examined the structure of the debt. It found that the debtor's obligations continued despite any subsequent action of the former spouse. The debtor was obligated to pay even upon death or remarriage of the former spouse. The obligation also appeared in the section of the divorce agreement under the property heading, and not in the section for support. There was no indication in the settlement agreement that the division of debts was to balance disparate incomes. The debts were treated as property obligations of the former marriage. However, the second mortgage was on the marital home where the children of the marriage resided. The wife assumed all responsibility for the first mortgage and taxes. The separation agreement contained a section on child and spousal support for payment of a certain sum, which would terminate at death or the remarriage of the former wife. The court concluded that this was the structure of a support agreement.[92]

The formula followed in the separation agreement conforms with Domestic Relations Law section 236, which asks for temporary support to help the dependent spouse achieve financial inde-

88 *Id.*
89 Freyer v. Freyer (*In re* Freyer), 71 B.R. 912 (Bankr. S.D.N.Y. 1987).
90 661 F.2d at 6.
91 71 B.R. at 916.
92 *Id.* at 916-17.

pendence. A division of the debts incurred during the marriage to various consumer credit card companies and the second mortgage were treated as a property division of the obligations of the marriage. According to the Domestic Relations Law, these were property divisions of the marriage. However, to the extent that the property division relieved the wife of a portion of the consumer debts, her need for support was determined to be less. The divorce settlement determined the amount of support she was to receive by taking into account the amount of her income, her financial responsibilities, and the fact that she was relieved of a portion of the debts. To the extent that the husband is now relieved of the debt, the wife will now be held liable for the entire obligation to the creditors. The original support payments the wife was receiving did not anticipate the wife having to pay the entire marital debt.

The bankruptcy court was very confident of the language of the divorce agreement, which was specific in delineating property and support. The court found the divorce decree clearly separated the property from the support awards.[93] The bankruptcy court maintained that the agreement for payments to continue independent of the future situation of the former wife or the emancipation of the children was probative of intent and purpose that the award was a property settlement only. There was no suggestion in the divorce agreement that the debts were incurred for expenses of the family, and thereby for support.[94]

The court looked at the plain language of the document and not to the reasoning of the Domestic Relations Law. Had the support payments terminated upon the death of the wife, the court would have viewed the debtors payment as nondischargeable support. If the wife had died, and the children were emancipated, the debt would then be dischargeable. In the meantime, the wife would have been protected from the debtor-spouse's discharge in bankruptcy.

The *Freyer* court went on to list the criteria to be used in determining whether the obligations are alimony, maintenance and support, or property:

> 1. whether the obligation terminates on the death or remarriage of either spouse;
> 2. the characterization of the payment in the decree and the context in which the disputed provisions appear;

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[93] *Id.* at 917.
[94] *Id.* at 919.

> 3. whether the payments appear to balance disparate income;
> 4. whether the payments are to be made to the spouse or a third party;
> 5. whether the obligation is payable in a lump sum or in installments over a period of time;
> 6. whether the parties intend to create an obligation of support;
> 7. whether an assumption of debt has the effect of providing the support necessary to insure that the daily needs of the former spouse and any children of the marriage are met;
> 8. whether an assumption of debt has the effect of providing the support necessary to insure a home for the spouse and minor children. [95]

The court pointed out that there was no proof that the divisions were for support. It assumed that if the divorce agreement, to which it looked for guidance, was absent proof of the plaintiff-wife's claim of support, it must be a property award. This illustrates the essential point that the divorce agreement be scrupulous in assigning an award to a category which correctly reflects the intent and purpose of the award as support or property division. The agreement must explain whether or not the purpose of the property division was intended as a form of support. In the Domestic Relations Law, the distinction between the two categories is a blurred line, not clearly demarcated for the needs of the bankruptcy court.

Had the divorce agreement allowed for the assumption of debt as a form of support rather than a division of property, the debt probably would not be held to be discharged. Had the payments for consumer debt been viewed as support, the divorce agreement would have protected the wife from having to assume the entire debt of the marriage. The one fortunate aspect of the situation was that, because there was an award for maintenance, the wife could return to divorce court and petition for more support in light of the fact that she was now responsible for the second mortgage and any other debts to which she was co-signatory.

The bankruptcy court would not hold an evidentiary hearing to decide whether the wife has sufficient income to support herself with the new obligations after the husband was relieved of his responsibility. The bankruptcy court may very well be the cause of a bankruptcy filing by the wife at some future date. This is the

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95 71 B.R. at 918.

reason the purpose of the award must be clearly spelled out. The wife's lawyer may have helped her by stating that the assumption of the debts comprised an additional category of support.

F. The Petoske *Case*

In the bankruptcy case of *Petoske*,[96] citing *Calhoun*,[97] the court enumerated several factors the bankruptcy court must consider in its inquiry as to whether the purpose of the debts assumed by the debtor were in lieu of regular alimony payments or only a means of dividing property. The purpose test includes several factors, none of which are controlling. These include:[98]

1. The nature of the obligations assumed; necessities, indicating that the agreement is more in the nature of alimony;
2. The structure and terms of the contract, *i.e.*, does the agreement evidence an intent or purpose to grant alimony?;
3. Whether the agreement includes a provision for the support of children;
4. The relative earning power of the spouses;
5. The parties' negotiations and understandings of the provisions;
6. The reasonableness of the assumption given the financial conditions of the debtor;
7. Whether there was a division of property and a division of the debts relating to that property;
8. Whether the former spouse was shown to have suffered in the job market, or was otherwise disadvantaged because of any dependent position held in relation to the debtor during the marriage; and
9. The age and health of the former spouse.

G. The Peters *Case*

In the *Peters* case,[99] the court held that the debtor-spouse was obligated to pay attorney's fees for the attorney who represented the interests of the minor child involved in a custody dispute which was part of the marital action. The court held that the lawyer's fee was in the nature of maintenance or support. The lawyer's services were performed to protect the interests of the debtor's minor child, and the fees were held to be "as and for

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96 Petoske v. Petoske (*In re* Petoske), 16 B.R. 412 (Bankr. E.D.N.Y. 1982).
97 Calhoun v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1108 n.7 (6th Cir. 1983).
98 16 B.R. at 414.
99 Peters v. Peters (*In re* Peters), 124 B.R. 433, *aff'd* 964 F.2d 166 (S.D.N.Y. 1991).

additional child support."[100] Under 11 U.S.C. § 523(a)(5)(B), the obligation is nondischargeable if owed "to a child of the debtor"[101] and arose as part of a divorce decree, agreement or other court order. The attorney's fee is for the benefit of the child, whether or not paid directly to the lawyer.[102] This is a rational and fair policy. It allows for the debtor's children to avail themselves of the equitable power of the court.

H. The Kavanakudiyil *Case*

In *Kavanakudiyil,*[103] the court followed the general rule that attorneys' fees were classified as support if there exists an underlying purpose to provide each party with the financial means to represent adequately the party's interests during the divorce proceedings.[104] The court must examine the substance of the obligation to determine the nature of support or property settlement. Only then can the dischargeability of the attorney fee be determined.[105]

In *Kavanakudiyil,* the state divorce court did not specifically designate the judgment of divorce as support or property; rather, the court classified the award as child support. The award contained no alimony for the dependent wife. The responsibility of the payments for the second mortgage were imposed on the debtor-husband, along with child support. The bankruptcy court had to determine the actual nature of the obligation in order to determine dischargeability.

Following the two-tier test of *Calhoun,*[106] the court first determined whether the state court intended to create an obligation to provide support through the assumption of joint debts. "The nature of the obligations assumed [if they provide for] daily necessities indicates support . . . ." [107] If the bankruptcy court found such an intent, then the second tier of inquiry would determine if the support obligation had the effect of providing for the daily needs of the former spouse and children.[108] The bankruptcy

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100 *Id.* at 434.
101 *Id.* (citing 11 U.S.C. § 523(a)(5)).
102 *Id.*
103 Kavanakudiyil v. Kavanakudiyil (*In re* Kavanakudiyil), 143 B.R. 598 (Bankr. S.D. N.Y. 1992).
104 *Id.* at 603.
105 *Id.* at 604.
106 *In re* Calhoun, 715 F.2d 1103, 1108 n.7 (6th Cir. 1983).
107 143 B.R. at 602.
108 *Id.* at 602-3.

court found that the primary concern of the divorce agreement was the welfare of the children. It was in the best interest of the children's upbringing that the marital residence remain intact. The bankruptcy court found that the state court intended to place responsibility for the second mortgage on the husband, which is in the nature of child support and therefore nondischargeable in bankruptcy.[109]

I. The D'Atria *Case*

In the *D'Atria* case,[110] the court held that the debtor was discharged from the obligation of paying the second mortgage on the marital home. The divorce decree contained an expressed waiver of any and all alimony, maintenance or support. The obligation to pay the second mortgage was contained under the heading of property settlement. [111] The fact that the parties waived support and relied upon an exchange of property satisfied the intent of the Equitable Distribution Law. The court held that the plaintiff-wife could not overcome her self-imposed waiver of support in order to prevent the debtor from being discharged from his responsibility to pay the second mortgage.[112]

Presumably, the creditor-wife would have to assume the mortgage obligation on the former marital home with no contribution from the debtor-husband, despite the fact that there are minor children of the marriage. Since the divorce agreement expressed no intent of the parties that the second mortgage obligation was for the support and maintenance of the wife and children, the debt was discharged.

J. The Kaufman *Case*

This case concerned a short-term marriage with no children.[113] Under the terms of New York's Equitable Distribution Law, pursuant to Domestic Relations Law section 236(B), the debtor had a time-limited payment of maintenance and support. In addition, the debtor was obligated to pay for credit card balances.[114]

Following the two-tier test of *Calhoun*, the court found these

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109 *Id.* at 603.
110 Fuda v. D'Atria (*In re* D'Atria), 128 B.R. 71 (Bankr. S.D.N.Y. 1991).
111 *Id.* at 77.
112 *Id.*
113 Kaufman v. Kaufman (*In re* Kaufman), 115 B.R. 435 (Bankr. E.D.N.Y. 1990).
114 115 B.R. at 438.

obligations to be in the nature of alimony. [115] The court found the lump sum of $150,000 owed to the wife by the debtor husband, less the support payments, was an arbitrary sum. Its opinion was based on the fact that the divorce decree was devoid of any rationale for the amount of the award or for its purpose. The bankruptcy court was required to construe the law in favor of a fresh start for the debtor. Although the court and Congress did not want creditor-spouses on the public dole, the court will not delve deeply into the undisclosed rationale of the divorce agreement.

In the instant case, the balance owed was secured by a mortgage in favor of the creditor-wife when she conveyed her interest in the marital home in return for a distributive award. Although the marital home was sold, the sale did not produce sufficient funds to satisfy the lump sum payment due from the distributive award. For the bankruptcy court, this arrangement had the appearance of a property settlement. The divorce agreement contained no reference that the lump sum was to provide for the support needs of the wife. The fact that the wife was an unemployed nurse did not deter the court from determining that the lump sum was part of a property division, and not for support. Nor did the court find that the time-limited payments for the credit cards were support, necessary until the wife was able to support herself. Even though she had no home or job, the court was able to say that it could not find justification that the lump sum was necessary for support.

This underscores the need to be specific as to the intent and function of the divorce awards. Left to ambiguous terms in divorce documents, the court will construe large lump sums as dischargeable rather than an award for support.[116]

The bankruptcy court suggested that the $150,000 distributive award may be related to a professional degree. However, the record is absent any consideration of a professional degree. Due to the failure to specify a need for support for the creditor-wife, the court was compelled to discharge the unpaid lump sum as a property award. The court held that an equitable distribution lump sum payment, absent a clear intent for support and maintenance, may be characterized as a dischargeable property settlement. Only periodic support payments represented nondischargeable obligations in the nature of alimony, maintenance

115 *Id.* at 441.
116 *Id.*

and support.[117]

Of course, the Domestic Relations Law recognized that a distributive award, intended by the parties in lieu of and for support, may be paid as a lump sum.[118]

This points out the potential conflict: The dependent spouse may be in need of support for her "necessaries," yet decide to take a distributive award in a lump sum in lieu of the timely support payments. If the divorce decree does not clearly establish the purpose of the lump sum as being in lieu of periodic support payments, the award may be viewed by a bankruptcy court as a distributive property award and dischargeable. If the divorce decree granted a lump sum, intended for maintenance but labeled as an equitable distribution of 'marital property', absent any support award, the wife may be precluded from asking for a modification of the divorce award because there was no periodic support award to be adjusted.[119]

K. The Altchek *Case*

This case[120] concerned the debtor's assumption of the obligation to pay the home equity loan on the marital residence. The intent of the obligation was clearly for the purpose of maintaining the children in the family residence. Both parties to the divorce action waived their rights to support.[121]

The court applied the two-tier *Calhoun* test and determined that the parties intended the assumption of a joint debt to be a support obligation. The court was satisfied that both prongs of the *Calhoun* test were satisfied. The first consideration was the intent of the parties to the divorce action to create a support obligation: Both wanted the children to continue to live in the marital residence. Second, the obligation was necessary to provide the support necessary for the daily needs of the debtor's former wife and child.[122] The assumption of the second mortgage was to supplement the inadequately low direct support payment that the former husband was willing to pay.[123] The court also noted that the husband assumed financial responsibility for the secondary

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117 115 B.R. at 441.

118 N.Y. DOM. REL. LAW § 236 B(1)(b) (McKinney 1988).

119 *Compare with* Brody, note 32 (the differing results based upon the clearly denominated intent of the distributive award as support).

120 Altchek v. Altchek (*In re* Altchek), 124 B.R. 944 (Bankr. S.D.N.Y. 1991).

121 *Id.* at 948.

122 *Id.* at 952-3.

123 *Id.* at 952.

mortgage in the *pendente lite*[124] order issued prior to the final divorce judgment.[125]

In contrast to the *Freyer* case, this court held that the obligation was in the nature of support because the obligation ended either when the youngest child graduated from high school or upon the sale of another property to which the creditor-wife held a mortgage in the sum of the home equity loan the debtor was obligated to pay. [126] The debtor-husband was not to receive any proceeds derived from a future sale of the marital home, which had been given to the creditor-wife as sole owner.[127] In *Freyer*, any proceeds derived from the sale of property were to be divided between the parties, constituting a property division. In the present case, title in the property had already passed to the wife. The obligation of the debtor-husband was not for a joint property debt, but rather additional child support.[128] The court had confidence in this appraisal of the intent of the parties based on the well-structured, detailed provisions of the divorce agreement.

L. The Katz *Case*

The court, in *Katz*[129], held that the balance of monies owed by the debtor to his creditor wife, which were not offset by the equitable distribution award, were nondischargeable.

The creditor-wife received title to the marital home in exchange for an equitable distribution award, along with temporary alimony, child support and legal fees. The wife owed the debtor-husband a surplus amount of money from the value of the home over and above the distribution award. The husband owed the wife arrears in real estate taxes and mortgage payments. The balance of payment obligations were in favor of the wife at the time the husband filed for bankruptcy protection. The debtor-husband claimed that the debt owed his wife was part of a prop-

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124 Pending the lawsuit; during the actual progress of a suit; during litigation. Matters "pendente lite" are contingent on outcome of litigation. BLACK'S LAW DICTIONARY 1134 (6th ed. 1990).

The court properly attached significance to the fact that the husband assumed the mortgage payments in a *pendente lite* order. *Pendente lite* is ordered for support of the dependent spouse. Since the divorce court recognized the necessity of such support payments to the wife pending the final outcome of the divorce, the bankruptcy court correctly assumed that the true intent of the financial obligation for the mortgage was indeed for support, and not a part of the property settlement.

125 *Id.*

126 *Id.* at 947.

127 *Id.* at 953.

128 *Id.* at 949.

129 Katz v. Katz (*In re* Katz), 119 B.R. 22 (Bankr. S.D.N.Y. 1990).

erty settlement because it was part of a property offset and therefore a dischargeable debt.[130]

Citing Kaufman,[131] the *Katz*[132] court reasoned that when:

> a separation agreement contains both an equitable distribution lump sum payment. . .and. . . separate. . . periodic payments for support. . .the lump sum [is] dischargeable property [and] the periodic support. . . represent[s] nondischargeable . . . alimony, maintenance and support.

The court found the remaining obligations for attorney fees and child support were expressly nondischargeable in bankruptcy under 11 U.S.C. 523(a)(5). The fact that the sums due each party for support and property were calculated as an offset to each other did not make the balance due the wife a property award.

When a debtor files for bankruptcy protection under 11 U.S.C. § 523, the court begins with an assumption for dischargeability which favors the debtor.[133] The creditor-spouse, acting as the plaintiff in opposition to the bankruptcy action, has the burden of establishing that the debt is nondischargeable alimony, maintenance or support. [134] The burden of proof requires evidence of the intent of the parties to make a property division or support obligation or both in accordance with the equitable distribution laws. The best evidence for the bankruptcy court is a well-drafted divorce document clearly stipulating the rights, duties and obligations of the parties to the divorce action. Absent an explicit statement as to the true intentions of the parties, the bankruptcy court will apply its own judicially-determined criteria in the attempt to determine the actual intent of the divorce award. Due to the disparate meaning of the word 'property' in the world of state equitable distribution law and common law, the court may totally misinterpret the true expectations of the divorcing parties. The matrimonial attorney must be vigilant to the potential disruption a bankruptcy action can cause to a well thought out divorce agreement. It is incumbent upon the attorney to structure the settlement to withstand the meddling of the bankruptcy court.

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130 *Id.* at 23.
131 *See supra* note 109.
132 119 B.R. at 24.
133 *In re* Calhoun, 715 F.2d at 1111; *In re* Vittorini, 136 B.R. at 635.
134 *In re* Vittorini, 136 B.R. at 634; *In re* Kaufman, 115 B.R. at 439.

M. The O'Brien *Case*

Understanding the concept of 'marital property' is essential to understanding the Equitable Distribution Law. In the case of *O'Brien*, the New York Court of Appeals defined marital property as "things of value arising out of the marital relationship."[135] Marital property consists of anything of economic value acquired by either or both spouses during their marriage. This includes items that the common law would not categorize as property.

In *O'Brien*, the Court of Appeals declared a professional license acquired during the marriage and before the commencement of the matrimonial action to be 'marital property'. This opinion reversed the holding of *Conner*.[136] In *Conner*, the New York Appellate Division, citing *Lesman*[137], held that the professional degree acquired during the marriage was not marital property within the meaning of the Equitable Distribution Law. "By classifying an education or degree as property, the courts, in reality, treat as property the future enhanced earning capacity that may result from the education. Enhanced earning capacity is not property. It is not vested; it is only an uncertain expectancy, for it is dependent upon the future success and efforts of the degree holder."[138]

The *O'Brien* court held that the license was a valuable property right. The value was reflected in the money, effort and enhanced earnings the license afforded its holder. The fact that the license was not capable of being sold, assigned, transferred or encumbered was of no dispositive value because a distributive award may be made in lieu of a property distribution.

The re-classification of a professional license is of great significance in divorce law. Although there is a crossover between maintenance and property awards, the amount of the award the dependent spouse would receive is dependent on whether the license is classified as property. If the professional license was not property, then it represented only the ability of the holder to pay for maintenance and support, if the dependent spouse required such support. To the extent that the dependent spouse contributed to the acquisition of the professional license, he/she would receive a reimbursement of said funds. However, as a property

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135 O'Brien v. O'Brien, 489 N.E.2d 712, 715 (N.Y. 1985).

136 Conner v. Conner, 468 N.Y.S.2d 482 (App. Div. 1983).

137 Lesman v. Lesman, 452 N.Y.S.2d 935 (App. Div. 1981).

138 *Conner*, 468 N.Y.S.2d at 486.

interest, the dependent spouse would receive a sum of money regardless of need for maintenance and support.

A distributive award for the value of a professional degree may be paid in a lump sum.[139] Traditionally, lump sum awards indicate to a bankruptcy court that the nature of the award is for property award and not actually for support. Mischief may arise if the 'marital property' award was large enough to make the need for support unnecessary. A sizable 'marital property' award would lead the state divorce court to the find no need for awarding support. This would tend to minimize the support needs of the recipient spouse. In the event of a bankruptcy, this can result in a distorted view of the support needs of the recipient spouse. Unless the matrimonial divorce documents state that the intent and purpose of the property distribution was actually for the support of the former spouse, that party may be left with no financial means of providing for the 'necessaries' of life. [140]

N. The Raff *Case*

The issue of the professional degrees was encountered head on in the case of *Raff*.[141] The bankruptcy court held that the divorce decree award to the former wife, which represented a percentage of the present value of the debtor former husband's medical degree, was in the nature of nondischargeable alimony, maintenance and support. This determination by the court was made despite the fact that the state divorce decree described the award as a distributive award of marital property. The award was in satisfaction of the former wife's expectation that her standard of living would improve after the debtor former husband acquired his medical degree.

The state divorce distributive award was granted pursuant to New York Domestic Relations Law 236(B). The bankruptcy court cited the state court's distributive award as the means of effectuating a division of property of the marriage. The bankruptcy court, citing to the state Equitable Distribution Law, found the award may be paid either in a lump sum or over a period of time in fixed amounts. [142]

Prior to 1980, the domestic relations law did not allow for a lump sum payment for alimony. Under the Domestic Relations Law of 1980, the divorce court "may combine in one lump sum

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139 N.Y. DOM. REL. LAW § 236(B)(1)(b) (McKinney 1988).
140 489 N.E.2d 712, 715 (N.Y. 1985).
141 Raff v. Raff (*In re* Raff), 93 B.R. 41 (Bankr. S.D.N.Y. 1988).
142 N.Y. DOM. REL. LAW § 236(B)(1)(b) (McKinney 1988).

any amount payable to either spouse [for alimony] . . . with section two hundred forty [for maintenance]."[143]

Citing the *O'Brien* court, the bankruptcy court in *Raff* described the concept of marital property as a creature of statutory design that has no meaning during the course of marriage. It comes to life only upon the signing of a separation agreement or the commencement of a matrimonial action. "[The] traditional common law property concepts do not fit in parsing the meaning of 'marital property'." [144]

The *Raff* bankruptcy court stated that "[a]lthough under state law a distributive award may appear to be in the nature of a property settlement, the issue is whether under federal law it is a property settlement." [145] The court continued its analysis by reviewing several cases decided in other circuits. The court found that while the state courts have determined that professional degrees acquired during marriage are marital property, bankruptcy courts have determined that the distributive awards based on this marital property are, in actuality, in the nature of alimony, maintenance and support. Thus, the award is nondischargeable in bankruptcy.

The state marital property concept gives to the non-degree-holding spouse a monetary stake in the value of the acquired degree. If such a spouse were denied any distributive award based on the value of the degree, the spouse would then receive a lesser financial award. That in turn would make the dependent spouse even more dependent on support for the 'necessaries'. The success of an equitable distribution concept requires more, not less, things of value in the pot in order to attain the goals of the law. However, having attained the enhanced pot of value for the distribution, it must be recognized that, in most cases, the monetary award was intended for the support of the former spouse, who probably has less opportunity for future financial gain. Because the debt of the *Raff* award for the value of the degree was intended to benefit the former wife, the court held that it was in the nature of support. The court cited with approval the *Stranathan* court.[146] In *Stranathan*, the debtor's spouse was awarded a lump-sum alimony payment intended to compensate his wife for her contribution to the debtor's professional education. Citing

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143 N.Y. DOM. REL. LAW § 236(A) (McKinney 1980).

144 93 B.R. at 46 (citing O'Brien v. O'Brien, 489 N.E. 712, 715 (N.Y. 1985) (citation omitted).

145 *Id.* at 47.

146 *In re* Stranathan, 15 B.R. 233 (Bankr. D. Neb. 1981).

Stranathan,[147] the court stated:

> [The] alimony [was] intended to compensate [the wife] for her contribution to [his] professional education . . . this does not mean . . . the award is thereby excluded from the category of alimony : . . intended to compensate the recipient spouse for efforts and resources devoted to the marriage.

The court went on to determine that although the recipient spouse did not need the award for support of her "necessaries" for survival:

> [The Bankruptcy Law] § 523(a)(5) does not contain a "needs" test, although . . . needs . . . at the time of divorce [are] a major factor in determining whether an award was intended [for] support . . . . However, other factors [are] also considered [including] the efforts of a spouse toward the successful completion of the [other spouse's] professional education. [The court went on to] find that the award was in the nature of alimony and is nondischargeable.[148]

The *Raff* court held that the distributive award for the type of 'marital property' in *O'Brien* was not, in concurrence with *Stranathan*, a property settlement. The distributive award was not based on property like a house or land or payment of debts to the creditors of both spouses, which often indicate a dischargeable property settlement.[149]

It is apparent that the degree could never be used as collateral for security interest, other creditors could not be affected by the finding that the distributive award to the wife denied the creditors of a portion of the funds available in the bankruptcy proceedings. The distributive award to the wife was to be paid in the future, after the bankruptcy stay, and the past creditors would have no claim to the future earnings. Therefore, the creditors would not be prejudiced by the debtor's post-bankruptcy spousal support payments. The only party affected by a discharge of debt would be the debtor's wife, who would "lose the benefit of the marital award to which the state court believed she was entitled [to receive]." [150]

The *Raff* court acknowledged that there was no federal law of domestic relations. The obligation of support was determined by state laws. But the federal bankruptcy courts were not re-

147 93 B.R. at 47.
148 *Id.* at 48.
149 *Id.*
150 *Id.*

quired to follow the state divorce courts' determination of the amount of the award. However, at the same time, the federal court must look to the divorce arrangement for guidance in determining the intent of the matrimonial award.[151]

The state court in the *Raff* case determined that the spouse in opposition to discharge was entitled to the award for "support, sacrifices and services as a homemaker,"[152] in addition to the monetary contributions toward the degree and the future rewards flowing from the degree.[153] This accords with the concept of the Equitable Distribution Law, which seeks to divide everything of value acquired during the marriage.[154] In *O'Brien*, the state divorce court stated:

> If the license is marital property, then the working spouse is entitled to an equitable portion . . . not [as] a return of funds advanced [but for] its value [of] enhanced earning capacity it affords the holder. . . .[155]

The *Raff* court continued:

> As with alimony, the future support . . . is at issue, not in terms of a "need" for support which is not relevant to a decision pursuant to section 523(a)(5). . . . Each spouse is entitled to acquire support and benefit from the enhanced standard of living . . . to satisfy the expectation of income which [the former spouse] worked to help both the spouses to receive. . . . [T]he debtor's obligation has the earmarkings of alimony in that it is paid directly to the spouse and is intended to support the spouse after the divorce. . . . Merely because the support is in the form of an annuity does not change the fact that it is in the nature of alimony and support.[156]

III. PRACTICAL SUGGESTIONS

Having reviewed the conflicting results of the preceding cases, it should be apparent to the matrimonial attorney that all settlement agreements and judgments must be drafted and/or litigated with the possibility of bankruptcy as a realistic concern. The settlement agreement and judgement are subject to review

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151 *In re* Calhoun, 715 F.2d at 1103.
152 93 B.R. at 48.
153 *Id.*
154 N.Y. DOM. REL. LAW § 236(B) (McKinney 1980).
155 *In re* Raff, 93 B.R. at 46 (citing *O'Brien*, 489 N.E.2d at 718).
156 93 B.R. at 48-49.

and revision in the event of a bankruptcy filing by the debtor spouse.

A bankruptcy judge in the Second Circuit, in the course of determining dischargeability, will look to the substance, not the form, of the divorce agreement or judgment. The judge will make a determination as to whether or not the parties or divorce court intended to create a nondischargeable debt, whether the debt was based on a need for support of "necessities" of the creditor-spouse, and whether the amount of the debt could be considered reasonable as a support payment.

When the payments are for the client's necessities and legal fees, the matrimonial attorney, charged with the duty to protect the client, should draft all settlement agreements specifically stating that the intent of the obligation is to pay periodic support "as maintenance and support." Property settlements, intended for support of the dependent spouse, should be denominated as necessary for support. If the divorce decree does not provide for alimony or if the parties waive any claim to alimony, then the sections of the divorce decree providing for child support payments, legal fees, and property settlement necessary for, or in lieu of, support should be included in the section of the divorce documents preceding the paragraph where the parties waive "any further" claim to alimony, maintenance or support. The placement of the divorce provisions in the settlement agreement or decree may be persuasive to the bankruptcy judge when attempting to ferret out the true intent of the divorcing parties.

A divorce agreement may provide for one spouse to make periodic payments of support, but the obligation is labeled as a property settlement for income tax purposes. In such a case, the matrimonial attorney should include facts and language in the settlement agreement to indicate that the parties intended to create a maintenance and support obligation for the 'necessities' for the recipient spouse, and furthermore, that the amount of the payment is reasonable. Language should also be included to show that the parties understand that debts incurred during the marriage, and the payment obligation for them, are part of the support obligation of the divorce; that the payment of the debts, whether a mortgage or credit obligation, are for the maintenance and support of the "necessities" of the recipient spouse; and that these payments for the debts of the marriage are necessary for the support of the former spouse, who would be financially unable to assume those obligations based on that spouse's own income and assets.

The divorce attorney may consider asking the divorce court to make additional findings of fact and law as to the intent and purpose of the divorce obligations. The court should be asked to identify the support obligations in the divorce decree. The state divorce laws of New York favor marital property divisions instead of alimony. The goal of the marital property division is to make the recipient spouse financially independent. The amount of the matrimonial award that has the function of providing for the necessary independent support of the recipient spouse should be so denominated. The bankruptcy court would look to this finding for guidance in determining the intentions of the divorcing parties when the obligations were created.

The matrimonial attorney must use a degree of caution and common sense when classifying the matrimonial award. The attorney cannot simply label all property distributions as alimony, maintenance and support. The bankruptcy court is a court of equity. The judge, starting from the presumption of a fresh start for the debtor, will look to the divorce decree for guidance in determining the dischargeability of the debt. Careful planning in the drafting of the divorce papers, with due consideration of the relationship between divorce and bankruptcy, will avoid running the risk of insulting the bankruptcy court by suggesting that excessive property divisions are necessary for maintenance and support. The bankruptcy court may ignore the divorce documents and apply federal law, with the potential for unintended results.

The role of matrimonial attorney is to serve the client. The attorney, when considering the bankruptcy-divorce scenario, has the obligation to achieve a proper balance between federal and state interests to ensure an equitable protection of the fresh start goals of both the debtor and ex-spouse. Debtors should not be permitted to use federal bankruptcy laws to avoid legitimate state divorce obligations.

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