

WHAT BANKRUPTCY ATTORNEYS WISH FAMILY LAW ATTORNEYS KNEW

**JOHN K ROUNDS, ROUNDS & SUTTER LLP
RANDALL V SUTTER, ROUNDS & SUTTER LLP**

**VC FAMILY LAW BAR ASSOCIATION AND BANKRUPTCY SECTION
JANUARY 18, 2022**

THE 3 MOST COMMON REASONS WHY INDIVIDUALS FILE BANKRUPTCY*

- Job Loss
- Medical Problem
- Divorce

*Source: American Bankruptcy Institute

CONSULT BANKRUPTCY COUNSEL

- Timing of Bankruptcy
 - Asset Exemption Planning
 - Priority of Debts
 - Case Deadlines
 - Non-filing Spouse Rights
-

COMMON TYPES OF INDIVIDUAL BANKRUPTCY CASES

- Chapter 7 – Liquidation
 - Chapter 13 – Repayment Plan
 - Chapter 11 - Reorganization
-

JOINT

VS.

**INDIVIDUAL
BANKRUPTCY
FILING**

BOTH SPOUSES FILE BANKRUPTCY TOGETHER

- Spouses can, but don't need to, file bankruptcy together. Only spouses can file a joint case.
 - All eligible c/p and s/p debts discharged
 - Personal liability of spouses eliminated
 - Property protected by bankruptcy exemptions
 - Property acquired after bankruptcy protected from pre-petition creditors
-

INDIVIDUAL SPOUSE FILES BANKRUPTCY WHILE MARRIED

- All eligible debt discharged for filing spouse
 - c/p protected by bankruptcy exemptions
 - c/p acquired after bankruptcy protected during the marriage
 - s/p property of non-filing spouse not protected from creditors
-

SPOUSAL LIABILITY AFTER DIVORCE IF ONLY ONE SPOUSE FILED BANKRUPTCY PRIOR

- c/p divided now becomes s/p
 - Bankruptcy discharge only applies to the personal liability of the bankruptcy debtor
 - Non-filing spouse is personally liable for both c/p debt incurred and their s/p debt
 - Creditors can collect from non-filing spouse
-

ADVANTAGES OF FILING BANKRUPTCY PRIOR TO LEGAL SEPARATION / DIVORCE

- Discharged debts no longer need to be divided in the divorce.
 - All assets valued and disclosed on the bankruptcy schedules
 - Assets protected under applicable exemptions
 - Immediate protection from creditor actions
 - Reduced legal costs / combined legal proceedings
-

DISADVANTAGES OF FILING BANKRUPTCY PRIOR TO LEGAL SEPARATION / DIVORCE

- Both spouses must elect same set of exemptions
 - Risk of assets of one spouse being used to satisfy debts of other spouse
 - Disposable income may be higher
 - Generally, only Chapter 7 feasible
 - Chapter 13: Post-petition income & expenses may not reflect pre-petition income & expenses
-

ADVANCE AGREEMENTS TO WAIVE BENEFITS OF BANKRUPTCY FILING VOID

Advance agreements to waive the benefits conferred by a bankruptcy filing is wholly void as against public policy.

In re Tru Block Concrete Prods, Inc., 27 B. R. 486, 492 (Bankr. SD, Cal. 1983)

Pre-petition waiver of dischargeability of debt not enforceable

- *In re Cole*, 226 B. R. 647, 652, 9th Cir. BAP (Cal.)

AUTOMATIC STAY
11 U.S.C. § 362(C)

COMMON ACTS STAYED

1. Continuing a judicial proceeding [11 USC 362(a)(1)]
 2. Enforcement of judgment against debtor or estate property [11 USC 362(a)(2)]
 3. Acts to obtain possession or control over estate property [11 USC 362(a)(3)]
 4. Acts to create, perfect or enforce lien [11 USC 362(a)(4)&(5)]
 5. Acts to recover a claim arising prior to bankruptcy [11 USC 362(a)(6)]
 6. Collection of any set-off [11 USC 362(a)(7)]
-

AUTOMATIC STAY IN FAMILY LAW CASES

- Bankruptcy stay prohibits family law proceedings to divide or split up property of the bankruptcy estate.
 - Party filing bankruptcy should file “Notice of Stay of Proceedings” [Judicial Council Form CM-180] with the family law court.
-

RELIEF FROM THE AUTOMATIC STAY

[11 U.S.C. 362(d)(1)]

- "On request of a party in interest and after notice and a hearing, the court shall grant relief stay provided under subsection (a) of this section, such as by terminating, annulling, modifying or conditioning such stay...(1) for cause."
- "Determination of whether cause exists for stay relief is made on a case-by-case basis since the Bankruptcy Code does not define "cause".

Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.) 912 F. 2d 1162, 1166 (9th Cir. 1990)

RELIEF FROM THE AUTOMATIC STAY [11 U.S.C. 362(d)(1)]

- "It is appropriate for bankruptcy courts to avoid incursions into family law matters 'out of consideration of court economy, judicial restraint, and deference to our state court brethren and their established expertise in such matters.'"
 - *In re MacDonald*, 755 F.2d 715, 717 (9th Cir. 1985)
-

RELIEF FROM THE AUTOMATIC STAY

[11 U.S.C. 362(d)(1)]

- US Bankruptcy Court, Central District of California requires a motion be filed to seek relief from the automatic stay
 - Mandatory Bankruptcy Form: Notice of Motion and Motion for Relief From the Automatic Stay under 11 U.S.C. § 362 (with supporting declarations) (Action in Nonbankruptcy Forum)
 - U.S. Bankruptcy Court website details calendar dates, judges requirements, local bankruptcy rules regarding filing the motion.
-

EXCEPTIONS TO THE AUTOMATIC STAY

11 U.S.C. 362(b)

- To establish paternity
 - To establish or modify an order for a domestic support obligation
 - Matters concerning child custody or visitation
 - To dissolve a marriage provided it does not determine the division of property
-

EXCEPTIONS TO THE AUTOMATIC STAY

11 U.S.C. 362(b)

- Collect domestic support obligations from property that is not property of the bankruptcy estate
 - Matters concerning domestic violence
 - Reporting overdue support obligations
-

DOMESTIC SUPPORT OBLIGATIONS

WHAT IS A DOMESTIC SUPPORT OBLIGATION UNDER THE BANKRUPTCY CODE?

Definition of a Domestic Support Obligation as defined under 11 U.S.C. § 101(14A):

- a) a debt owed to or recoverable by a spouse, former spouse, or child of a debtor or such child's parent, legal guardian, or responsible relative, or a governmental unit;
 - b) In the nature of alimony, maintenance, or support of such spouse, former spouse or child, without regard to whether such debt is expressly so designated;
-

WHAT IS A DOMESTIC SUPPORT OBLIGATION UNDER THE BANKRUPTCY CODE?

Definition of a Domestic Support Obligation as defined under 11 U.S.C. § 101(14A):

- c) established under a separation agreement, divorce decree or property settlement agreement, or an order of a court of record; and
 - d) Not assigned other than for collection purposes.
-

FACTUAL DETERMINATION BY BANKRUPTCY COURT DETERMINES IF DEBT IS A DSO

Whether a debt is actually in the nature of support is a factual determination made by the Bankruptcy Court as a matter of federal bankruptcy law.

Beaupied v. Chang (In re Chang), 163 F. 3d 1138, 1140 (9th Cir. 2000)

FACTUAL DETERMINATION BY BANKRUPTCY COURT DETERMINES IF DEBT IS A DSO

"The court must look beyond the language of the decree to the intent of the parties and to the substance of the obligation."

Shaver v. Shaver, 736 F.2d 1314, 1316 (9th Cir. 1984)

DSO DETERMINATION FACTORS IN BANKRUPTCY COURT

1. Did the parties intend the obligation to provide support to the debtor's spouse, former spouse or child?
 2. Did the payment obligation derive from a duty to provide for the well-being of the spouse, former spouse or child?
 3. Did the recipient spouse, former spouse or child actually need support at the time of the divorce?
-

IMPORTANCE OF A DEBT CLASSIFIED AS A DSO FOR BANKRUPTCY FILING

1. Exception from the automatic stay
 2. DSO are non-dischargeable debts under 11 USC §523(a)(5)
 3. DSO are priority debts and must be paid in full in Chapter 13 and Chapter 11 bankruptcy cases
-

DEBTS FOUND TO BE IN THE NATURE OF SUPPORT BY THE BANKRUPTCY COURT

- Non-Filing Spouse Atty Fees
 - Child's guardian ad litem
 - Mortgage payments for ex-spouse residence
 - Debts of ex-spouse
 - Education expenses of children
-

CLASSIFYING DEBT AS DSO TO AVOID DISCHARGE IN BANKRUPTCY

- More than labels and declarations needed
 - Document with emphasis on intent, reason and importance
 - Direct payments to spouse and not a third party
 - Payments cease upon remarriage or death
-

PROPERTY OF THE BANKRUPTCY ESTATE

ESTATE CREATED UNDER BANKRUPTCY FILING [11 U.S.C. 541]

- Section 541 of the Bankruptcy Code defines what assets and legal rights become property of the bankruptcy estate
 - “All legal or equitable interests of the debtor in property as of the commencement of the case.”
 - All property that the trustee recovers by use of avoiding powers
 - Any profits from any assets that are property of the estate
-

ALL COMMUNITY PROPERTY BECOMES PROPERTY OF THE BANKRUPTCY ESTATE

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.

11 U.S.C. § 541(a)(2)

(Even when only one spouse files for bankruptcy)

STATUS OF COMMUNITY PROPERTY NOT YET DIVIDED IN DISSOLUTION

Community property not yet divided by a state court at the time of the bankruptcy filing is property of the bankruptcy estate.

Miller v. Walpin (In re Miller), 167 B.R. 202 (Bankr. C.D. Cal. 1994)

Community property of divorcing couple was property of the bankruptcy estate where division of the community property had not occurred as of the date of the bankruptcy filing.

Dumas v. Mantle (In re Mantle), 153 F.3d 1082, 1085 (9th Cir. 1998)

SEPARATE PROPERTY OF A NON-FILING SPOUSE IN BANKRUPTCY PROCEEDING

- Separate property of non-filing spouse is excluded from the bankruptcy estate
 - Includes separate property even if transmuted to another form
 - Good practice to list non-filing spouse known separate property on bankruptcy petition for disclosure purposes
-

PROPERTY INTERESTS DETERMINED BY STATE LAW

State property law is used to determine the property that is included in the bankruptcy estate.

Butner v. U.S., 440 U.S. 48, 49 (1979)

- Property rights determined by state law
 - Includes the liabilities of the property
 - Form of title examined
-

***In Re Brace* (2020) 9 Cal.5th 903**

- Originated from a bankruptcy case appeal [*Brace v. Speier* (In re Brace), 908 F.3d 531 (9th Cir. 2018)]
 - “Community property” presumption vs. “form of title” presumption
 - Importance: All community property becomes property of the bankruptcy estate.
-

EXEMPTIONS

EXEMPTIONS USED TO REMOVE PROPERTY FROM THE BANKRUPTCY ESTATE

- Under 11 U.S.C. 522, some assets are removed from the bankruptcy estate by the use of exemptions
 - California opted out of federal bankruptcy exemptions and uses alternative exemption systems in CCP 703 and 704
 - Some federal bankruptcy exemptions despite state opt out provision (i.e., retirement accounts)
 - Property claimed as exempt is protected from claims of creditors existing at commencement of case
-

EXEMPTION ISSUES WITHIN FAMILY LAW

1. Exemptions are not effective against Domestic Support Obligations and tax liens
 2. Married debtors filing separate bankruptcy can only elect one set of exemptions
 3. Non-debtor spouse cannot claim exemptions already used in debtor spouse bankruptcy
-

HOMESTEAD EXEMPTION

- California increased homestead exemptions under CCP 704 as of January 1, 2021 to minimum of \$300K up to \$600K
 - Homestead exemption still subject to limitations of 11 U.S.C. §522(p) and (q) that limits the exemption to approximately \$170K
 - Married debtor filing alone can claim the entire homestead exemption to protect equity in a residence in which the debtor resides (also available in some situations where debtor's spouse or dependents reside even if debtor does not)
-

AVOIDANCE OF JUDICIAL LIENS THAT IMPAIR AN EXEMPTION

- Under 11 U.S.C. §522(F), bankruptcy law allows for the avoidance (removal) of judicial liens that impair a claimed exemption
- Liens securing debts between spouses arising from the division of property in divorce are shielded from avoidance.

Farrey v. Sanderfoot, 500 U.S. 291 (1991)

DISCHARGE OF DEBTS IN BANKRUPTCY

DISCHARGEABILITY OF DEBTS

- Discharges the liability of Debtor
 - Voids any judgment
 - Injunction against any action to collect, recover, or set-off a discharged debt
 - Violation of Discharge Order subject to contempt action and punishable
-

DOMESTIC SUPPORT OBLIGATIONS ARE NOT DISCHARGEABLE IN BANKRUPTCY

- A debt determined to be a domestic support obligation is not dischargeable in *any* chapter of bankruptcy.
 - A domestic support obligation debt has a first priority for payment from the bankruptcy estate.
-

EXCEPTIONS TO DISCHARGE INJUNCTION (NON DSO) 11 U.S.C. 727(a)

1. Intent to hinder or defraud;
 2. Destroyed, falsified or failed to keep records regarding the debtor's financial condition or business transactions;
 3. Knowingly & fraudulently made a false oath, false claim, offered or gave a bribe, or withheld records from the officer of the estate;
 4. Debtor fails to satisfactorily explain the loss of assets
 5. Granted discharge in prior bankruptcy and not eligible under statutory code.
-

EXCEPTIONS TO DISCHARGE INJUNCTION (NON DSO) 11 U.S.C. 523(a)

1. Debts incurred via fraud;
 2. Debts incurred for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
 3. Debts incurred as a result of willful or malicious injury by the Debtor to another entity or property of another entity.
-

FAMILY LAW RELATED DEBTS DISCHARGED IN CHAPTER 13 BUT NOT IN CHAPTER 7

- Equalization payments.
 - Obligation to indemnify a former spouse created in divorce from debts of the marriage.
 - Non-filing spouse should file Proof of Claim for such debts subject to discharge in Chapter 13 case.
-

SOME TAXES ARE DISCHARGEABLE IN BANKRUPTCY

- Income taxes (no fiduciary taxes such as payroll taxes)
 - No tax fraud or willful evasion to pay taxes committed.
 - Return due at least 3 years ago.
 - Return actually filed at least 2 years prior to bankruptcy
 - Client must have actually filed a return
 - No assessment within 240 days of bankruptcy
-

AVOIDANCE POWERS

FRAUDULENT TRANSFERS

11 U.S.C. 548

- Trustee has avoiding powers under Section 548 of the bankruptcy code as to fraudulent transfers
 - Trustee also acquires the state law rights of a creditor to avoid such transfers under Section 544
 - Debtor has avoidance powers in a Chapter 11 (unless trustee appointed) and Chapter 13 cases
-

AVOIDANCE POWERS UNDER 11 U.S.C. §548

Bankruptcy trustee can seek to AVOID any transfer of property and has the power under the bankruptcy code to seek the return of any property:

1. While Debtor was insolvent;
2. Debtor did not receive reasonably equivalent value in return for the property transferred; and
3. Transfer was within 2 years prior to filing bankruptcy.*

*NOTE - Bankruptcy trustee can use the California Uniform Fraudulent Transfers Act [Cal. Civ. Code §3439.04(a)(1)] to seek return of property for up to 4 years.

INTENT TO DEFRAUD CREDITOR IS NOT REQUIRED

- Transfers may be avoidable if:
 - (1) they are made with the actual intent to defraud creditors, or
 - (2) if they are constructively fraudulent whereby the transferor gets less than reasonable equivalent value for the property transferred.
 - Intent to defraud is not required. Intent to hinder or delay a creditor will suffice.
-

DIVISION OF PROPERTY BETWEEN SPOUSES SUBJECT TO FRAUDULENT TRANSFER

Uneven division of property between spouses can be a fraudulent transfer.

Roosevelt v. Ray (In re Roosevelt), 176 B.R. 200 (B.A.P. 9th Cir. 1994)

MARITAL SETTLEMENT AGREEMENT TRANSFERS CAN BE AVOIDED

Under California law, while there is no requirement that a marital settlement agreement divide property equally, but such an agreement cannot divide property in a manner fraudulent to creditors. When such a finding is determined, these transfers within the marital settlement agreement can be avoided as a fraudulent transfer.

Wokowitz v. Beverly (In re Beverly), 374 B.R. 221 (B.A.P. 9th Cir. 2007)

EXTRINSIC FRAUD REQUIRED TO AVOID TRANSFER OF PROPERTY IN MSA

To avoid transfer of property under the terms of a marital settlement agreement one must prove extrinsic fraud.

Batlan v. Bledsoe (In re Bledsoe), 569 F.3d 1106 (9th Cir. 2009)

AVOIDANCE OF PREFERENTIAL TRANSFERS

11 U.S.C. §547

- A transfer;
 - Of the debtor's property;
 - To or for a creditor's benefit ;
 - On account of an antecedent debt;
 - Within 90 days prior to filing of the petition (or within one year if the transferee was an “insider”);
 - Made while the debtor was insolvent;
 - That prefers the creditor receiving the transfer.
-

OTHER AVOIDANCE POWERS

1. Unperfected Liens
 2. Perfection of a Judicial Lien
 3. Turnover Powers
-

**FAMILY LAW
ATTORNEY'S FEE
LIENS**

SECURED LIENS IN BANKRUPTCY

- Bankruptcy discharge order has NO effect on a validly recorded and perfected secured lien
 - Debtor's personal liability on the debt is discharged but the lien against the debtor's property remains in force
 - Lien creditor can use applicable state law to enforce its lien after debtor receives discharge in bankruptcy
 - Statutory lien – lien arising solely by force of a statute under specified circumstances or conditions and does not include a security interest or judicial lien – if properly recorded will survive avoidance and discharge.
-

FAMILY LAW REAL PROPERTY ATTORNEY LIEN (FLARPL)

- FLARPL are not avoidable by debtor as impairing homestead exemption to which debtor is otherwise entitled
- FLARPL is a “statutory lien” of kind not subject to avoidance on exemption-impairment grounds.

In re Scott, 400 B.R. 257 (Bankr. C.D. Cal. 2009)

ATTORNEY'S CHARGING LIENS

California law governs whether the Debtor's share of the community property is subject to the attorney's charging lien on the bankruptcy petition date. The lien remains on the property unless some provision of bankruptcy law permits it to be avoided.

Butner v. United States, 440 U.S. 48 (1979)

ATTORNEY'S CHARGING LIEN NOT SUBJECT TO AVOIDANCE AS A CONSENSUAL LIEN

In California, an attorney's charging lien may arise *only pursuant to contract*. [See *Fletcher v. Davis* (2004) 33 C4th 61, 66.]

As a consensual lien, an attorney's contractual charging lien is not subject to avoidance under Section 545 of the Bankruptcy Code.

PROPERTY REMAINS SUBJECT TO ATTORNEY'S CHARGING LIEN UPON BANKRUPTCY FILING

If a debtor's share of community property was subject to a lien in favor of the debtor's divorce attorney at time of bankruptcy filing, then that property enters the bankruptcy estate subject to attorney's lien.

In re Bouzas, 294 B.R. 318 (Bankr. N.D. Cal. 2003)

ATTORNEY'S CHARGING LIEN ENFORCEABLE EVEN IF JUDGMENT NOT RENDERED AT TIME OF BANKRUPTCY

In the Ninth Circuit, an attorney's charging lien is enforceable in bankruptcy even if the judgment has not been rendered at the time the bankruptcy petition is filed.

In re Bouzas, 294 B.R. 318 (Bankr. N.D. Cal. 2003)
