THE SUFFOLK LAWYER

PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION

DEDICATED TO LEGAL EXCELLENCE SINCE 1908 Vol. 26 No.1 September 2009

CONSUMER BANKRUPTCY

Can Matrimonial Settlements Survive Bankruptcy?

Recent case protects divorce transfers

by Craig D. Robins, Esq.

CRAIG D. ROBINS, ESQ.

With bankruptcy filings so prevalent these days, and divorce being a major reason for seeking bankruptcy relief, matrimonial attorneys are frequently concerned as to whether a divorce settlement will hold up in a bankruptcy proceeding.

Fraudulent Transfer Theory. Here's the reason for concern: If a debtor transfers a valuable asset to a spouse (or soon-to-be ex-spouse) prior to filing for bankruptcy, and the debtor-spouse does not receive reasonable value in return, then the transfer is deemed a "fraudulent transfer." In such a case, the bankruptcy trustee can sue the person who received the asset to bring it back into the bankruptcy estate, so that all creditors can share in its value. One additional element of a fraudulent transfer is that the debtor must have been insolvent at the time of transfer.

The general principle for demonstrating that a transfer was not a fraudulent transfer is to show that there was "reasonably equivalent value."

Since a divorcing spouse will frequently enter into a matrimonial settlement by giving the other spouse valuable assets such as an interest in real estate, bank accounts, investments, or other personal property, both parties do not want a bankruptcy trustee to try to set the transfer aside.

For a period of time, some courts have held that innocent spouses who received such a transfer were no different from any other party who received a large transfer without sufficient consideration.

However, a case just decided by the United States Circuit Court of Appeals will give many divorcing spouses greater comfort that a trustee will not be able to set aside a marital settlement.

Recent Circuit Case. *In the Matter of Bledsoe*, decided June 25, 2009, the Ninth Circuit had to decide under what circumstances a bankruptcy court may avoid a transfer made pursuant to a state-court divorce decree.

I previously mentioned this case in an article two years ago, when Long Island Chapter 7 bankruptcy trustee Robert L. Pryor discussed the lower court's decision, at a symposium on the new bankruptcy laws.

The Circuit Court affirmed that decision and held that a trustee can only set aside a matrimonial settlement if he alleges and proves "extrinsic fraud." The Court also held that a divorce decree that follows from a regularly conducted, contested divorce proceeding conclusively establishes "reasonably equivalent value" in the absence of fraud or collusion.

Practice Tip #1: Be wary that the bankruptcy court will always access the totality of the facts. In a local case in the Central Islip Bankruptcy Court decided by Judge Dorothy Eisenberg last year, Long Island bankruptcy trustee Marc A. Pergament brought suit to set aside a transfer of real estate made pursuant to a divorce. *Pergament v. Cersosimo,* (2008). Judge Eisenberg dismissed the trustee's suit, stating:

"A review of case law has shown that it is the rare bankruptcy court that will intrude on a state court divorce judgment and declare a transfer made therein to be a fraudulent conveyance. However, rare does not mean never. If the court, upon review of the conveyance, determines that it was done to defraud creditors or was done for little to no consideration, then the court may make a finding that the transfer was a fraudulent conveyance."

Practice Tip #2: There is no guarantee that New York bankruptcy courts will follow the *Bledsoe* Ninth Circuit case. However, considering that our Second Circuit is fairly liberal and desirous of protecting innocent spouses, it is highly likely that any New York bankruptcy court reviewing this issue will give the *Bledsoe* decision a great deal of weight.

Practice Tip #3: In order for a divorce settlement to be upheld by the bankruptcy court, it must be ratified in some way by the matrimonial court. That means that any transfer should be accurately described in a stipulation of settlement. In addition, the stipulation must be specifically referred to and adopted by the divorce decree. It is not enough that the parties merely stipulate to a settlement; the court must specifically approve the settlement. This can be accomplished by using the typical language in the divorce decree, that the stipulation survives the divorce decree and is not merged into it.

Editor's Note: Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. He has offices in Patchogue, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. You can visit his Bankruptcy Website and his bankruptcy blog:

- BankruptcyCanHelp.com
- LongIslandBankruptcyBlog.com.

THE SUFFOLK LAWYER

PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION

DEDICATED TO LEGAL EXCELLENCE SINCE 1908 Vol. 22 No. 9 May 2006

CONSUMER BANKRUPTCY

Matrimonial Fundamentals Under the New Bankruptcy Laws

by Craig D. Robins, Esq.

CRAIG D. ROBINS, ESQ.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which went into effect on October 17, 2005, provided innocent spouses with much greater rights against debtor-spouses, usually husbands, who previously sought bankruptcy relief as a means to thwart matrimonial obligations. Whether you represent clients with bankruptcy matters or matrimonial matters, you will certainly come across cases involving these issues sooner or later.

Just as most bankruptcy attorneys find matrimonial issues confusing, most matrimonial attorneys find bankruptcy issues confusing. Nevertheless, in order for the matrimonial attorney to be able to effectively represent his or her client, certain bankruptcy fundamentals should be recognized, especially considering that divorce is one of the major factors which drives consumers into bankruptcy. Although bankruptcy-matrimonial matters can easily fill a treatise, I will concisely summerize some of the most important aspects of how BAPCPA affects matrimonial rights and issues.

The Basic Premise Still Exists: Maintenance and Support Are Not Dischargeable. The Bankruptcy Code excepts from discharge, maintenance or support payments owed to a spouse, former spouse or child of the debtor, in connection with a separation agreement, divorce decree, court order, administrative determination, or property settlement. See section 523(a)(5).

Equitable Distribution is Now Non-Dischargeable. First some history. Prior to October 1994, when the Bankruptcy Code received a major overhaul, it was easy for attorneys to advise clients: Maintenance and support were dischargeable; equitable distribution was not. However, the 1994 Bankruptcy Amendment Act changed that with the introduction of a new provision, section 523(a)(15), which made equitable distribution "potentially" non-dischargeable. From 1994 through 2005, aggrieved spouses had to bring an adversary proceeding to make equitable distribution non-dischargeable. To do so, the aggrieved spouse had to prove a two-prong test: a) the debtor had the ability to pay the debt; and b) the detrimental consequences to the aggrieved spouse outweighed the benefits to the debtor spouse in discharging the debt. In addition, the aggrieved spouse, under the old laws, had to act very quickly to file the adversary proceeding complaint within weeks

of the filing of the bankruptcy. The urgency to file under the old laws resulted in a potential trap for many unwary matrimonial attorneys who were not aware of this requirement. However, all of that is now history. Property settlements are now non-dischargeable pursuant to Bankruptcy Code section 523(a)(15).

New BAPCPA Term: Domestic Support Obligations. Under BAPCPA, the rights of innocent spouses are rigorously expanded. Congress has done away with the prior distinction between a nondischargeable support obligation and a dischargeable property settlement obligation. In doing so, BAPCPA creates a new term, "Domestic Support Obligation," which is defined in Bankruptcy Code section 101(14A). This contains a rather wide definition covering almost any possible matrimonial obligation.

Bankruptcy and Matrimonial Judges Have it Easier Under BAPCPA. We all know that bankruptcy judges hate matrimonial law issues, and Supreme Court judges hate bankruptcy law issues. Previously, two courts were often needed as state court judges tend to have limited familiarity with bankruptcy law issues and did not seem to be eager to get involved with interpreting bankruptcy law. BAPCPA now greatly simplifies issues concerning dischargeability for those bankruptcy cases filed after October 17, 2005. Since all domestic support obligations are non-dischargeable, hearings to determine dischargeability of these debts are no longer necessary.

Other Automatic Stay Exceptions for Domestic Situations. There are a number of new provisions designed to protect innocent spouses and the like who were previously stymied from seeking support from spouses who filed for bankruptcy relief. New automatic stay provisions under Code section 362 basically indicate that the stay does not apply to certain designated domestic proceedings which do not have an impact on bankruptcy. Thus, proceedings involving child custody, visitation rights, domestic violence and divorce (to the extent that the divorce proceeding does not seek to divide property of the estate) are not stayed. In addition, now the stay does not apply to any proceeding seeking to enforce payment, or withhold payment, of a domestic support obligation.

Debtors Cannot Avoid Matrimonial Liens. Generally, debtors have the right to avoid any lien that impairs the homestead exemption. However, a new provision in Code section 522 (f)(1)(A) now prohibits a debtor for avoiding a judicial lien for a domestic support obligation.

Trustees Now Obligated to Notify Innocent Spouses. BAPCPA just gave trustees another job. They now have the additional obligation of having to notify domestic support creditors and agencies whenever a debtor owes a domestic support obligation. This is now a standard question at meetings of creditors. Some trustees are requiring debtors to amend their schedule of creditors to include spouses who are owed domestic support obligations if the spouses are not already scheduled, even if obligations are current.

BAPCPA Increases Priority of Domestic Support Obligations. Matrimonial debts are now at the top of the list of claims that take priority when there are funds to distribute to creditors. In first position is support payable to a spouse or child and in second position is support assigned to a governmental entity. (Code section 507(a)(1)(A)).

Innocent Spouses Can Now Pursue Exempt Assets. A new provision in Code section 522(c)(1) enables an innocent spouse to pursue the debtor's otherwise exempt assets to satisfy domestic support obligations, notwithstanding any provision of applicable bankruptcy law to the contrary.

Payments of Matrimonial Debts Are No Longer Preferences. Previously, if a debtor paid a matrimonial debt to a former spouse, the trustee, under certain circumstances, had the right to set that payment aside as a preference. However, under BAPCPA, Code section 547(c)(7) was amended to indicate that payments made to a former spouse for a domestic support obligation are not avoidable and therefore, not recoverable by the trustee as a preferential payment to a creditor.

Chapter 13 Debtors Must be Current with Matrimonial Debts. A new Code provision (section 1325(a)(8)) now prevents Chapter 13 debtors from being able to confirm their plan unless they are current with domestic support obligations. Accordingly, Chapter 13 trustees are requiring debtors to provide a statement setting forth whether the debtor has any domestic support obligations, and if so, whether the debtor is current. In addition, both the trustee and the aggrieved spouse now have the right to seek dismissal or conversion of a Chapter 13 case if the debtor is not current with post-petition domestic support obligations.

Editor's Note: Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. His office is in Westbury (516) 228-9800. He can also be reached by e-mail at CraigRobinsLaw@aol.com.

THE SUFFOLK LAWYER

PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION

DEDICATED TO LEGAL EXCELLENCE SINCE 1908 Vol. 22 No. 8 April 2006

CONSUMER BANKRUPTCY

The New Bankruptcy Laws Continue to Be Mired in Controversy

by Craig D. Robins, Esq.

CRAIG D. ROBINS, ESQ.

I have devoted a substantial amount of column space in the last year to report on the numerous problems and lack of popularity besetting the new bankruptcy laws which went into effect in October 2005. Criticism and controversy continue to dog the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) as practitioners and judges alike describe it as everything from tricky and cumbersome to inane and unjust. The consensus is that BAPCPA is not working as intended. Prior to its enactment, many people predicted the problems that we are now seeing, but the law passed anyway after heavy lobbying from the banking industry. Here is a summary of the various criticisms to date.

The New Laws Weren't Needed in the First Place. Commentators have suggested that there was a perception that some debtors who filed for Chapter 7 relief were able to discharge their debts even though they had the ability to repay some or all of their debt. In response to this perceived imbalance, the credit card industry pushed for passage of tougher bankruptcy laws. However, the credit card industry has not accepted any share of the responsibility for the problem. The industry gives credit to high-risk people and then is shocked to find that people cannot make their payments. One commentator said we have a classic case of poetic injustice: Congress is bought by the credit card companies in order to pass a bill that hammers those people who can't afford to pay their bills. Thus, Congress has listened to the banks who have complained for years that they get shortchanged by debt-crazy consumers seeking bankruptcy.

The Supposed Purpose of the New Laws is Not Being Accomplished. A major provision of the BAPCPA is to require credit counseling as a prerequisite to filing for bankruptcy. The ostensible purpose of this counseling requirement is to push the debt-ridden consumer into a non-bankruptcy debt repayment plan in lieu of bankruptcy. Most people in debt are so far over their head that debt repayment plans are totally

unrealistic. Most people go into debt for reasons beyond their control, such as loss of a job, divorce and matrimonial issues, sickness and medical expense, or death of a family member. According to a highly-publicized preliminary study by the National Association of Consumer Bankruptcy Attorneys in February, a mere three percent of those seeking credit counseling had the ability to repay any debts.

The New Laws are Poorly Written. The laws were primarily written by the lobbyists who supported the legislation, rather than by scholarly academics, judges and committees who have written most of the existing bankruptcy law.
There have been a number of commentators, including judges, who have suggested that the poorly written laws are often ambiguous and will result in a number of cases needed to interpret them.

The New Laws are Cumbersome. BAPCPA makes filing a case unnecessarily complex. We now have many "obstacles" that are in the way of obtaining bankruptcy relief. These include the means test, the credit and budget counseling requirements, the requirement of producing documents and tax returns, etc. In addition, the increased burden and time on consumer bankruptcy attorneys to personally verify all information in the petition has driven up the cost of bankruptcy legal services. The commentators have been very vocal about their belief that the primary goal of the creditor community in supporting bankruptcy reform legislation was to make bankruptcy for consumers so difficult that it would cause overall bankruptcy filings to go down. The proponents of the harsher laws thought that if there are too many obstacles, then consumers will not file bankruptcy. For now, credit counseling is exactly what the opponents of the bill predicted – a device to delay and to drive up the costs of bankruptcy for the poorest people.

Double Filing Fee Increases Compound Problem. When BAPCPA went into effect in October 2005, filing fees for Chapter 7 cases increased from $199 to $274. Then, on April 9, 2005, filing fees increased again. Now Chapter 7 costs $299. This filing fee increase is surprising because it had already gone up significantly when the new laws went into effect, and now we are seeing an increase in a very short period of time. $299 is a great deal of money for those who can barely afford to pay their bills. The quick increase is like kicking people when they're already down. Don't forget, consumers also have to shell out $100 for the two counseling sessions, making the total cost of filing, not including attorney's fees, about $400.

The Press Has Created the False Impression that Bankruptcy Relief is No Longer Available. There were so many news articles that painted bankruptcy after BAPCPA as gloom and doom that the public began to perceive bankruptcy as so difficult that they would not be able to utilize it any more. However, it appears that the new laws are not preventing most of those who need bankruptcy from filing; BAPCPA is just making it a little more of a nuisance. It appears that about 85% of those who could have filed for Chapter 7 relief under the old laws can still file under the new laws.

How Will We Know for Sure if BAPCPA is a Success or a Failure? The answer probably lies several years away after studies can be done to determine whether debtors are repaying a larger portion of their unsecured debts, which was the underlying objective of this legislation. In addition, there will have to be an analysis of those consumers who did not file for bankruptcy relief and how they dealt with their debt problems. In the meantime, consumers and bankruptcy practitioners are forced to deal with a harsh, difficult and unpopular law

Editor's Note: *Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. His office is in Westbury (516) 228-9800. He can also be reached by e-mail at CraigRobinsLaw@aol.com.*