
What Do You Do When the Roads of Divorce and Bankruptcy Intersect?

Bob and Agnes Smith are a married couple with two children, ages 8 and 6. Bob and Agnes have been married for ten years, but they no longer see eye to eye. Agnes is the primary wage earner; Bob is a stay at home dad, who now works part-time since the children are both in school. Bob has primary responsibility for maintaining the home and taking care of the family's needs during the day. There is a great deal of distance in the relationship between the Smiths. They have been struggling to make ends meet for several years. The Smiths have tried to do everything they can to improve their relationship including counseling and visiting their spiritual advisor, but nothing has worked. Bob and Agnes are miserable and their children know it. The children sense that their parents are no longer "together". Divorce appears inevitable.

If this scenario seems real, it is. In particular, since the most recent recession there have been many couples that have found themselves in similar situations where the roads of divorce and bankruptcy intersect. After all, one of the most frequent causes of divorce is the issue of money. So what should this couple do? Is there the potential of a financial benefit for them to proceed in a certain manner given their predicament? Although the Smiths no longer act in a harmonious manner, they have always placed their children's welfare before their own and are capable of working together to act in the best interests of the family. They are also acutely interested in strategically trying to minimize their expenses and take advantage of any available opportunities, if possible.

Obviously, one of the parties is ultimately going to file for divorce. However, should the Smiths file for divorce first? Should they file for bankruptcy first? Should only Bob file for bankruptcy since he earns substantially less than Agnes? Does it make any difference? Will the party that will be responsible for payment of child and spousal support (alimony) obligations be able to discharge either or both of those obligations in bankruptcy court?

These are just a few of the questions to ask your legal advisors specializing in family law and bankruptcy. The answers to these questions are very fact specific and depend on a myriad of factors.

If the couple has the ability to work together to dissolve their marriage amicably and seek protection under the bankruptcy laws to try and get a fresh financial start, it is generally preferable to file for bankruptcy first. The reason is that when a bankruptcy petition is filed, the concept of an “automatic stay” is introduced. An automatic stay, section 362 of the US Bankruptcy Code, in simple terms is a financial “time-out”. It stops, at least temporarily, all creditors who are attempting to recover or collect on an obligation. However, in family law matters, there are certain exceptions to which the automatic stay does not apply: see section 362(b) of the Bankruptcy Code for a more definitive list, but issues such as paternity, visitation, child custody, and domestic violence are some examples. See sections 362(b)(2)(A) and 362(b)(2)(B). Additionally, an automatic stay will generally impact the timing of the divorce. If the couple needs to file a joint bankruptcy petition, their obligations may often be resolved in the bankruptcy case and they will be able to discharge their joint obligations and take advantage of exemptions (i.e. value of the home up to a certain amount, vehicles up to a certain amount, household furnishings and jewelry, etc.) that may be available to them. Filing jointly may also be beneficial if the couple is under water with respect to a joint home mortgage or they want to eliminate various joint contracts or obligations.

However, filing for divorce before filing for bankruptcy may be preferable in certain situations. For example, if one spouse earns significantly more than the other (i.e. the example used in this article), the spouse who earns significantly less, Bob, may qualify for Chapter 7 protection under the Bankruptcy Code, commonly referred to as a liquidation. The spouse with the higher income, Agnes, may not be able to qualify for Chapter 7 liquidation. Agnes may have to file a Chapter 13 bankruptcy petition, commonly known as a reorganization or payment plan proceeding. Agnes may not be able to file for bankruptcy protection at all. The point of the discussion is that by filing for divorce first, the parties may be able to negotiate the division of their assets in a more favorable manner before a bankruptcy petition is filed.

Regardless of whether a divorce or bankruptcy proceeding is filed first, there are certain obligations that will not be discharged in bankruptcy court. Pursuant to section 523(a) of the Bankruptcy Code, certain obligations, including but not limited to child support, spousal support, and certain kinds of property settlements are not dischargeable in bankruptcy. See sections 523(a)(5) and 523(a)(15) as examples.

We cannot emphasize enough that a thorough analysis is dependent on the

specific facts faced by the client. Therefore, we encourage individuals that are dealing with this kind of situation to consult with divorce and bankruptcy counsel as part of their planning and evaluative process.

If you find yourself in a similar situation, you don't have to face these issues alone. Our experienced family law and bankruptcy attorneys can help you develop a plan that will give you the fresh start, both emotionally and financially, that you deserve.

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