

Domestic Support and the Bankruptcy Code
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SUMMARY

- The Code, as currently drafted, is confusing and disjointed in its treatment of domestic support obligations owed to the spouse, parent, or child of the debtor, or to the state for its costs in connection with providing support to such persons. The treatment is not uniform among various applicable provisions, and there are substantial gaps in the protection for those debts.
- Bankruptcy filings are particularly disruptive in Chapter 13 cases because it interrupts the use of wage withholding against the debtor, the most effective means of collecting support obligations, until the plan is confirmed, a period that may take weeks or months to complete.
- Correcting these issues is a high priority for Attorneys General, both on behalf of the state and of citizens for whom they are obligated to provide assistance in collecting these debts.
- During 1998 and 1999, drafting suggestions were made to Congress and the current legislation reflect the drafters' acceptance of many of those suggestions.
- Highlights of the bill provisions (Section 211 to 219) are:
 - Creation of a universal definition of “domestic support obligations” that is used throughout the Code for priority, discharge, exemptions, and lien avoidance.
 - Exemption of wage withholding from the automatic stay so it continues during the Chapter 13 plan process.
 - Creation of checkpoints to ensure that debtor remain current on payments during the case, including making it a condition of confirmation and discharge.
 - Raising domestic support obligations to first priority for payment (except for amounts paid to compensate trustees for costs involving in obtaining and distributing assets for such claims)
 - Protection of all prepetition payments for domestic support claims from preferential transfer suits.
 - Trustees are obligated to provide information to support creditors about their rights under the Code.

¹ The author is bankruptcy counsel for the National Association of Attorneys General (NAAG). However, the views expressed herein are her own and should not be attributed to NAAG, any Attorneys General, or their staff, except to the extent reflected in official resolutions of NAAG, or sign-on letters submitted by the Attorneys General.

DISCUSSION

For the last twenty years, this country has paid increasing attention to ensuring that dependent children and spouses receive the support, alimony and maintenance to which they are entitled, spurred on by statistics about the shamefully small proportion of the monies owed that were actually being paid. That concern is reflected not only in provisions of the Social Security Act which deal with collection efforts by spouses and state collection agencies, but also in repeated amendments to the Bankruptcy Code to deal with the treatment of such obligations.

Virtually the only provisions initially applicable to such obligations were an exception for discharge for such debts when owed directly to the spouse, parent, or child, a limited exception to the automatic stay, and a preservation of the right to seek payment of some of those obligations from exempt assets. However, until 1994, such obligations were not a priority for the support creditor *or* the state, and, even now, the prepetition collection of such debts owed to the state is not protected from later challenge in a bankruptcy case as a preferential transfer. Thus, a person who finally managed to catch up with a delinquent spouse and obtain partial payment of the arrears owed could find the recalcitrant party filing an immediate bankruptcy provision and using the power of the United States government to demand return of the payment that had been made.

Other problems arise from the complex interrelationship between the amounts owed to the spouse, parent, or child and amounts owed to governmental entities. There are at least five (and probably more) variations of debts and collection practices that fall within the overall rubric of support obligations. First, there is the simple case of a spouse, parent, or child who is owed money and who is personally attempting to collect it directly from the delinquent parent or spouse. Second, there are state agencies, operating under the requirements of federal law, who are charged with assisting such spouses, parents, and children in collecting the amounts owed. In general, this is simply treated as the provision of a service, but in some cases, is referred to as an “assignment” of the claim, although such an assignment is purely for the purpose of collecting the debt.

Third, a spouse, parent, or child that is receiving public assistance from the state is required to assign his or her rights under a support order to the state to allow it to recoup some of the costs of the aid being provided.² Fourth, in some cases, a governmental entity will be

² The statutory provisions dealing with how funds received are allocated between the parties receiving the benefits and the states, are quite complex, and are based on when the debts were accumulated and the support creditor’s current aid status. For purposes of this discussion, it is sufficient to say that on some occasions obligations which are legally owed directly to the parent or child are required to be assigned to the state in return for its payment of support benefits to those parties, and that the state will be entitled to retain money received from the support debtor under that assignment. Some aspects of this type of policy were dealt with by the Supreme Court recently in *Washington State Dept. of Social and Health Services v. Guardianship Estate of Keffeler*, 123 S.Ct. 1017 (2003) which upheld the state’s use of Social

entitled under nonbankruptcy law to make a claim against a parent or spouse for care provided directly to the child, spouse, or parent. For instance, most states now have laws requiring some payment for the costs of a child who is incarcerated or placed in a state mental facility. These costs may be required even where the family is intact and there is no other support order in place. Finally, the spouse or child could assign the support obligation to some other entity and receive payment therefor. The Code generally attempts to distinguish such transferred claims from the enforcement of true domestic support obligations, but in doing so, it also swept in many cases “assigned” to the state where the obligation was still for the direct payment of support.

The changes made to the Code over the years have not necessarily coped well with dealing with that complex set of payment obligations. As amendments have been made over the year, treatment of the four types of obligations have become increasingly divergent under different Code provisions, without any apparent coherent policy choices as to why debtors’ obligations to support their spouses and children should vary based on the party that is collecting the obligation. While there may be reasons to make distinctions, it is not clear that such reasons dictated the current structure of the Code as opposed to a disjointed accumulation of separate amendments. The result is a byzantine Code structure which draws lines among support obligations differently in virtually every provision and which has gaping holes in its overall treatment of these debts.

For instance, the discharge provisions initially omitted any reference to debts owed to the states. That was partially corrected in 1981 by an amendment that excepted from discharge debts owed to the state in an assignment of benefits in return for receiving state benefits. The statute was further amended in 1984 and 1986 to provide additional limits on dischargeability of debts for benefits assigned to the state. Those changes, though, still left open the question of dealing with debts that were owed directly to the state (as when it provided care for a child from a family that was not receiving state benefits). It was not until 1996, when as part of the Welfare Reform Act a new discharge exception, Section 523(a)(18), was added, that any debts directly owed to the state were made nondischargeable. Even so, there are still at least some debts owed directly to the states that do not fall within Section 523(a)(18) and remain dischargeable, even though they are for the support of a debtor’s child.

Similarly, Section 522(c)(1) allows debts assigned to the state (but not debts owed to the state directly) to be collected from exempt assets. On the other hand, Section 522(f)(1), which implements a complementary policy by voiding liens that would impair exemption of those assets, protects neither debts owed *or* assigned to the state. Thus, while the state theoretically can collect from the exempt asset, the debtor may void the lien and mortgage his property to someone else, thereby effectively precluding the state from actually collecting the debt. It is

Security benefits accruing to the child based on the parent’s earnings to repay the cost of foster care provided by the state.

difficult to believe that these highly disparate results were based on deliberate policy choices.

These problems had been raised repeatedly with the National Association of Attorneys General by various state enforcement personnel. As a result, the author sought to raise them before the National Bankruptcy Review Commission. While that group did not take up the issue, the concerns returned to the fore shortly after the House Judiciary Committee began work in 1998 on that year's version of bankruptcy reform legislation. For those who believed the bill was overly favorable to commercial creditors, the potential impact on women and children who were owed domestic support obligations became a highly visible proxy for all of the other problems in the legislation. In return, sponsors of the bill were anxious to make changes that would alleviate those concerns and, hopefully, reduce opposition to the bills. The states also saw the heightened awareness of domestic support issues as an opportunity to return to these issues and seek to impose a more consistent treatment of such debts that would look at all aspects of the problem and result in a coherent overall policy.

As a result, during 1998 and 1999, numerous provisions dealing with the treatment of domestic support obligations were included in various bills considered by the House and the Senate. By the fall of 1999, the basic framework for such provisions was agreed upon and included in the Senate legislation. That framework has been carried over intact through the various subsequent incarnations, with only one significant change (discussed below) dealing with the priority treatment for such claims. Those provisions (set out at Section 211 to 219) begin with a general definition of a domestic support obligation that takes in the first four types of obligations defined above.³ With that change, many provisions of the Code were then rephrased to apply broadly to any such obligation, regardless of whether owed to the support creditor directly or to the state.

This includes the discharge provisions in Section 523(a)(5),⁴ the exemption provisions, and the automatic stay provisions that allow for the establishment or modification of an order for such obligations, or for the collection of such obligations from non-property of the estate. In addition, a payment for a domestic support obligation is now excepted from the definition of a

³ It continues to leave out the case where a right to payment is simply assigned in return for a cash payment by some private party. In such cases, there is no longer a direct connection between the party collecting payment and a spouse or child in need.

⁴ Section 523(a)(18) would be deleted as unnecessary in light of the broadening of the Section 523(a)(5) exception.

preferential transfer and the conference report also broadly exempted wage withholding orders related to such obligations and the intercept of tax returns owed to debtors with such obligations from the automatic stay. A number of other methods of collecting such obligations, such as the withholding of licenses, the reporting of overdue support to credit agencies, and the interception of tax returns, would also be broadly exempted from the automatic stay

The bill also contains a comprehensive set of requirements for collection and enforcement of such obligations during the pendency of a case. They essentially set up four checkpoints to ensure that a debtor becomes current and stays current on his payment during the case if he seeks to obtain a discharge of his other debts. Failure to make payments as they come due is a ground for conversion or dismissal of the case; as priority claims (see below), the plan must provide for payment of arrearages in full;⁵ the plan cannot be confirmed unless the debtor is current on postpetition payments, and the court may not enter a discharge for the debtor until he has certified that he has made all postpetition payments and complied with the plan's terms for payment of prepetition obligations. Moreover, the bill imposes obligation on the case trustee or the United States trustee to provide certain information to the holder of a domestic support obligation claim about the resources available to them and the holder's rights under the Code.

While these provisions were, in general, warmly received by all parties, there was one provision that aroused some controversy for an extended period. This had to do with the treatment of the priority to be accorded to these obligations. The discussion focused on two questions: what priority should be generally accorded to such obligations and should there be a hierarchy of treatment between payments owed to the spouse or child and those assigned to or owed to the state. In both cases, the question has been how to treat the debtor's limited funds to assure that there was not an inappropriate competition for such funds either with other general creditors and, to a lesser degree, with the governmental collectors.

The first question was answered by moving domestic support obligations to first priority under Section 507. Although the initial proposal was to move it to third priority behind the administrative expenses in the case, the sponsors of the legislation moved it even higher and

⁵ There is a distinction drawn in this regard between payments owed directly to the support recipient and those owed to the government. The payments owed to the recipient must be paid in full unless that party voluntarily agrees to accept any lesser amount. The debtor may pay less than the full amount owed to the government for such obligations but only if the debtor commits to a five year plan paying all disposable income during that period to the payment of claims.

pointed to that position as an example of the Congressional concern for such obligations. The problem, though, was that the sponsors' good intentions did not eliminate certain practical problems that arose from that status. The benefit of first priority status quickly would prove hollow if trustees abandoned efforts to pursue and collect assets because they could not be assured that they would be compensated for their efforts. While one might wish to avoid paying such fees, the reality is that the case administrator must be compensated or the system will break down.

The second question was dealt with first, by setting up subpriorities – claims owed directly to the spouse, parent, or child (whether or not filed by them or by a governmental entity on their behalf) had priority 1A, and claims assigned by the beneficiary to the government or owed directly to the government would be given priority 1B. And, after many revisions of the bill, after the change was first made to raise the priority of these claims, a section was finally added, that creates a 1C priority for trustees – which trumps the 1A priority. The administrative expenses of a trustee are given priority over the domestic support obligations “to the extent that the trustee administers assets that are otherwise available for the payment of such claims.”⁶

One other aspect of the priority provisions is worthy of note. While it is often the case that debtors wish to narrowly construe priority claims to reduce the amount of payments that *must* be made under a plan, the situation is somewhat different for domestic support obligations. There are a great many aspects of nonbankruptcy law that are directed at ensuring that domestic support obligations are paid. This is particularly true in that currently the vast bulk of such obligations, whether owed to the support beneficiary or the state, are nondischargeable. Thus, from the debtor's point of view the more that he can pay on such debts under his plan the better since this will reduce the amount that will be left undischarged at the end of his case and that will remain subject to enforcement under those nonbankruptcy laws.

Yet, under the Code, the fact that a debt is nondischargeable generally provides no basis for according it a greater payment preference under the plan. Only priority debts may receive that special treatment – thus, to the extent that these nondischargeable debts are given priority status, the debtor obtains the right to make payment preferentially on them. As a result, he may be able to pay most or all of those obligations while paying little or nothing to general unsecured creditors (including commercial creditors such as lenders or credit card companies.) Making all support debts priority claims will also benefit debtors by making it less likely that they will be forced into a Chapter 13 case by the means-testing language. Since that test depends on the proportion of required debts that can be paid in the Chapter 13 plan, the larger the amount of debt that is priority, the greater the likelihood that the abuse test will not be met.

One additional change from current law proposed by the bill would be to allow debtors

⁶ It is less than clear exactly how that section will operate or the degree to which the trustee can assert priority for his claim, but at least the general intent is obviously to deal with the problem of rewarding the trustee for his activities in collecting and disposing of assets.

who have sufficient resources to provide for payment of interest on a nondischargeable claim to include such payments in their plan.⁷ A recurrent source of consternation and complaints by debtors is their belated realization that interest continues to accrue on nondischargeable debts, even though the claim for interest is not allowed during the case. Thus, even if the debtor pays off the principal in full over the course of the case, he may find that he still faces a substantial bill for interest. This change would allow (but not require) the plan to provide for sufficient payments to amortize both principal and interest if the debtor can fund such payments in addition to paying off other debts in full.⁸

⁷ While this is contained in the domestic support provisions, it would apply across the board to any nondischargeable debt, including student loans, criminal sanctions, etc.

⁸ We do not believe the debtor should be able to pay such interest if other creditors do not receive full payment of even the principal of their claims.