The Dischargeability of Post-Divorce Financial Obligations Between Spouses: Insights From Bankruptcy in Business Situations

by

Allen M. Parkman*

Regents' Professor of Management
Anderson Schools of Management
University of New Mexico
Albuquerque, NM 87131

Family Law Quarterly, 31(3), Fall 1997, 493-511.

* The author expresses his appreciation to Michaela White for her valuable comments on drafts of this article.

Introduction

Often divorced couples, who separated with the goal of limiting their interactions except as parents, find that goal frustrated by ongoing financial obligations to each other. This frustration becomes particularly acute if one of them files for bankruptcy. Individuals can file for bankruptcy using three chapters of the bankruptcy code:[1] Chapter 7 if they want to discharge their debts and liquidate their non-exempt assets, Chapter 11 if they want to reorganize their financial affairs through a reorganization or Chapter 13 if they want to adjust their debts and they have a regular income. A limited number of people also avail themselves of bankruptcy using Chapter 12, in which the debts of a family farmer with regular income are adjusted. Here we are primarily interested in Chapter 7 and 13 filings. Under the Bankruptcy Code of 1978 (Code), awards or agreements in the nature of support between ex-spouses were non-dischargeable, while obligations arising from property divisions could be discharged in the same manner as ordinary commercial debts.[2] These provisions caused substantial concern because they were viewed as conferring substantial benefits on debtor ex-spouses, especially men.[3] The Bankruptcy Reform Act of 1994 (Reform Act) addresses these concerns by extending the restrictions on the dischargeability of support commitments to most property division obligations in Chapter 7, 11

---

[1] For a summary of the bankruptcy code, see MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY (1995)

[2] 11 U.S.C. § 523(a)(5) (1988) provided:

A discharge. . . does not discharge an individual debtor from any debt ---

(5) 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 agreement, divorce decree, or other order of a court of record, determination mad in accordance with State or territorial law by a government unit, or property settlement agreement, but not to the extent that--

> (A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 402 (a) (26) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); or
>
> (B) such debt includes a liability designed as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

[3] Suzanne E. Doherty, *The Interplay Between Bankruptcy and Divorce: Which Former Spouse Deserves the Fresh Start?*, 99 COMM. L. J. 192 (1994); Sheryl L. Scheible, *Defining "Support" Under Bankruptcy Law: Revitalization of the "Necessaries" Doctrine*, 41 VANDERBILT L. R. 1 (1988), Sheryl L. Scheible, *Bankruptcy and the Modification of Support: Fresh Start, Head Start, or False Start?*, 69 N.C.L.R. 577 (1993), Jana B. Singer, *Divorce Obligations and Bankruptcy Discharge: Rethinking the Support/Property Distinction*, 30 HARV. J. OF LEG. 43 (1993), Ellen B. Vergos, *Bankruptcy Issues Arising in Divorce Practice*, 24 MEM. ST. L. REV. 697 (1994). In line with this literature, in this article when debtors and creditors are discussed in the singular, the debtors will be presented as males and the creditors as females.

and 12 cases.[4] Still, obligations based on a property division can be discharged in Chapter 13 cases and even in Chapter 7, 11 and 12 cases under certain circumstances.[5] Under Chapters 7, 11 and 12, property division obligations can be discharged if the debtor does not have the "ability" to pay or the benefit of discharging the debt to the debtor outweighs the detrimental consequences to the creditor.[6]

Concerns about the impact of bankruptcy on ex-spouses have become particularly pertinent because of the growth in both divorces and bankruptcies, which increased the likelihood that a spouse will file for bankruptcy following a divorce. After the surge in divorces after World War II, the divorce rate fell to 9.3 per thousand married women in 1955 before rising in a pattern that has become well known during the last few decades.[7] It rose to 14.9 per thousand in 1970, peaked at 22.6 in 1980, and then fell gradually thereafter. Still, the number of divorces per year

---

[4] For an analysis of the provisions of the Reform Act that affect divorce, see Michaela M. White, *Divorce After the Bankruptcy Reform Act of 1994: Can You Stay Warm After You Split the Blanket?*, 29 CREIGHTON L. REV. 617 (1996). For a review of recent cases under the provisions of the Reform Act, see Richard H. Maloy, *Does the New Exception to Discharge in Bankruptcy Give the Marital Creditor a Benefit or a Trompe L'Oeil?*, 6 J. OF BANK. LAW & PRAC. 51 (1996).

[5] Bankruptcy Reform Act of 1994, Pub, L. No. 103-394 § 304(e), 108 Stat. 4106, 4133 (codified as amended at 11 U.S.C. § 523 (1994)). Section 523 (a) (15) provides:

(a) A discharge . . . does not discharge an individual debtor from any debt ---

(15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decrees or other order of a court of record, a determination made in accordance with State or territorial law by a government unit unless---
(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonablely necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business or
(B) discharging such debt would result in a benefit to the debtor than outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor. . .

[6] If the creditor ex-spouse does not file a timely complaint, the property division debt will be discharge and the opportunity to object to its discharge is lost forever. Margaret Dee McGarity, *When as Ex-spouse Goes Bankrupt*, 91 A.B.A. J. 64 (November 1995).

[7] STATISTICAL ABSTRACT OF THE UNITED STATES, 1995, Table 142, 102.

continues to increase.[8] Bankruptcy filings also continue to rise, especially since the passage of the Code in 1978. For example, bankruptcy filings increased from 365,000 in 1985 to 845,000 in 1994 with most of the growth coming in non-business filings that rose from 297,000 to 788,000 over this period.[9] The growth in non-business filings was particularly noticeable as Chapter 13 filings that are only available to individuals rose from 98,000 to 248,000, Chapter 7 filings that are available to both individuals and businesses increased from 244,000 to 578,000, and Chapter 11, the third option open to individuals, fell from 21,000 to 17,000.[10]

With a bankruptcy filing, creditor spouses usually find themselves in a very different position that if the debts had occurred in a business setting. First, businesses commonly use private arrangements to limit the impact of debts discharged in bankruptcy, while spouses seldom avail themselves of these private arrangements with the result that bankruptcy can have a larger impact on creditor spouses. By securing transactions, businesses usually limit the impact of bankruptcy on their debts.[11] Bankruptcy only permits the discharge of personal liabilities of the debtor.[12] Therefore, while a debt on a note can be discharged, creditors with security interests and liens on the debtor’s property can exercise their rights in this collateral limiting the extent to which property may be available to satisfy the claims of other creditors. Only the debtor’s equity in secured property is subject to claims of other creditors.[13] To maintain possession of property in which a creditor has a security interest, the debtor often has to reaffirm the debt.[14] In effect, only debts without a security interest can be discharged and then only to the extent that they exceed

---

[8] The number of divorces continues to rise from 708 thousand in 1970 to 1.2 million in 1990. Ibid.

[9] STATISTICAL ABSTRACT, supra note 7, at 553.

[10] Ibid.

[11] See THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986).

[12] 11 U.S.C. 524(a).

[13] At bankruptcy, a secured creditor will receive either its collateral or a distribution equal to the amount of the claim. HERBERT, supra note 1 at 167. Often the only question is when. JACKSON, supra note 11 at 184. Corporations and partnerships are not eligible for Chapter 7 discharges, so if they want to discharge any debts they need to file under Chapters 11 or 12, which permit the discharge of debts under a reorganization plan. 11 U.S.C. § 1141(d); 1228(a), (c).

[14] HERBERT, supra note 1 at 228.

exempt and non-exempt assets.[15] The situation facing ex-spouses is very different. Seldom do spouses recognize that decisions during marriage have created a debt and, even if the debt is recognized, they are reluctant to create a security interest based on it. Therefore, the financial obligations at divorce usually are governed by the Code's provisions that treat support and property obligations differently. The impact of bankruptcy on these obligations can change over time as illustrated by the new provisions in the Reform Act. Second, the courts' concerns about the debtor and creditor's situations are different. To be blunt, a business debt is a business debt. Among businesses, the court is not concerned with whether the transfer of collateral imposes a hardship or is unfair. Meanwhile, with property division debts between ex-spouses, the courts can be asked to consider the ability of the debtor to pay an otherwise non-dischargeable debt without hardship or the fairness of the obligations of the debtor to the creditor.

It is asserted in this article that none of the financial obligations of ex-spouses should be dischargeable in bankruptcy.[16] This would increase efficiency and is generally fairer. This is illustrated using arms-length business arrangements to show that society is usually better off by limiting people's incentives to file for bankruptcy. Then, it is argued that both support payments and property divisions at divorce are based on compensating a creditor ex-spouse for obligations incurred during a marriage that in a business setting would be debts that would be difficult to avoid through bankruptcy.

Bankruptcy in Commercial Setting

Bankruptcy is seldom an attractive alternative for businesses, because most commercial debts are secured by property or guaranteed by a third party.[17] Many bankruptcies consist of

---

[15] Some of a debtor's property is exempt, which means that it is not subject to seizure by unsecured creditors. In the United States, while the Bankruptcy Laws have been federal, the exemption law has traditionally been the province of state governments. The 1978 Bankruptcy Code contained a set of federal exemptions, but authorized states to opt out, which is an option chosen by most states. Id. at 186. Exemptions fall into three categories: the homestead exemption, specific exemptions of tangible personal property, and specific exemptions of income equivalents. Id. at 42.

[16] A similar argument is made with special emphasis on pensions in Mary A. Thorne, *Pension Awards in Divorce and Bankruptcy*, 88 COLUM. L. REV. 194 (1988); using feminist theory in Peter C. Alexander, *Divorce and the Dischargeability of Debts: Focusing on Women as Creditors in Bankruptcy*, 43 CATH. U. L. REV. 351 (1994); and by the charging roles of maintenance and property divisions at divorce in David M. Susswein, *Divorce Related Property Division v. Alimony, Maintenance, and Support in the Bankruptcy Context: A Distinction without a Difference?*, 22 HOFSTRA L. REV. 679 (1994);.

[17] While some people have denied that people will take advantage of opportunities provided by the Code, most economic research tends to support that people will file for Bankruptcy if they feel that it is in their best interest. Lawrence Shepard, *Personal Failures and the Bankruptcy Reform Act of 1978*, 27 J. OF LAW & ECON 419 (1984), Michelle J. White,

splitting the debtor's property between the debtor and creditors holding a security interest in the property with the latter taking by far the largest share.[18] Only 56,748 of the 845,257 bankruptcies in 1994 were by businesses.[19] Surpringly enough, the limiting of opportunities for businesses to benefit from bankruptcy is generally in the best interest of all businesses. Creditors usually pass on any costs that they incur due to assuming additional risk to debtors with the prospect of bankruptcy being a major source of their risks. People do not like risk, so they usually take steps to limit their risks or to receive compensation from others for any risks that they assume.[20] If the discharge of debts through bankruptcy was a common occurrence, the normal response would be for creditors to shift that cost to all their debtors. All debtors are affected because it is often difficult for the creditor to determine the debtors who will file for bankruptcy and those who will not. Since most debtors do not anticipate filing, they would be incurring a cost that could be pared if the possibility of discharging debts through bankruptcy was reduced. Therefore, creditors and debtors have incentives to work together to limit the opportunities for debtors to gain from filing bankruptcy.

Businesses use a variety of methods to limit the opportunities for debtors to gain from filing for bankruptcy. In most cases, this is accomplished by limiting the availability of unsecured debt. Consider a situation in which a business is selling a product to another business. The most obvious way to avoid the risk of whether the buyer is going to pay for the product is to expect cash at the time of delivery. Still, numerous situations require a delay between the delivery of a product or service and payment, thereby, creating a creditor/debtor relationship between the seller and the buyer. While a loan and the associated risk of repayment can be an additional cost to the creditor, delaying payments has benefits for the buyer for which it is willing to pay a premium. Normal commercial credit arrangements attempt to maximize the net benefits for all parties to these financing arrangements. Initially, sellers attempt to reduce their risk by only dealing with established customers or making new customers fill out credit applications. If sellers feel comfortable that there is a high probability of payment, they often accept the cost of short delays as just being a normal cost of being in business--which of course they tend to pass on to the

---

Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis, 63 IND. L. J. 1 (1984) and *Note: A Reformed Economic Model of Consumer Bankruptcy,* 109 HARV. L. REV. 338 (1996). Still some authors have argued the Code continues to be too generous and than the Canadian regime, which has higher barrier to debtor opportunism, is preferable. Frank H. Buckley, *The American Fresh Start,* 4 S. CAL. INTERDIS. L.J. 67 (1994).

[18] Michael J. Herbert and Domenic E. Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-1987*, 22 U. RICH. L. REV. 303 (1988).

[19] STATISTICAL ABSTRACT, supra note 7 at 553.

[20] See Jonathan E. Ingersoll, Jr., *Interest Rates,* in JOHN EATWELL, MURRAY MILGATE AND PETER NEWMAN, THE NEW PALGRAVE: FINANCE (1989) 172.

buyers. They accept checks rather than cash knowing that the checks will not be honored for a short period or the buyers are billed at the end of the month with payment due after that billing. The sellers attempt to limit the period during which they are creditors without a security interest in property.

Sometimes the buyers are not able to pay for a longer period. Then, the buyers have to obtain credit from either the seller or a third party. A critical component of this credit arrangement is the rate of interest that the debtors have to pay the creditors. The interest rate on a loan tends to increases as the risk of repayment rises.[21] In some cases, the creditor's risk is perceived as small because either the debtor is well known to the creditor or the debt is expected to be repaid within a limited period of time. These transactions will command a low interest rate. Alternatively, in situations in which the debtor is not well known to the creditor or the credit has to be extended for a long period, then the creditor's perceived costs increase because the risk of delay or default rises with the result that it would charge a higher interest rate if other arrangements are not made.

A common alternative is for creditors to require an interest in property as security for their loan.[22] To minimize the costs associated with delay or default, debtors are usually required to provide security for long-term loans. Long term unsecured debts are particularly unattractive for both creditors and debtors, because of the higher risk and, therefore, higher interest rates associated with them. A creditor usually has only limited information about the ongoing operations of the debtor and cannot normally control the business activities of the debtor, so the creditor has incentives to treat the debt as particularly risky. This is especially true since some debts can be discharged in bankruptcy. The risks assumed by the creditor are usually passed on to the debtor in the form of higher interest charges. The debtors may feel that creditors are over estimating the risk, but it is difficult for a debtor to convince the creditors of its creditworthiness because the same assurances are being made by all debtors. Therefore, it is in the best interest of the parties to attempt to reduce the risk associated with these transactions. A common practice is for the debtor to provide the creditor with security for the debt or a guarantee from a more financially solvent third party.[23] When dealing with a corporation with limited net worth, it is a

---

[21] The interest rate on a bank loan reflects the customer's creditworthiness, previous relationship with the bank, the maturity of the loan, and other factors. Ultimately, the rate is determined by the risk-free return, which reflects the time value of money, plus a risk premium based on the borrower's credit risk. ALAN C. SHAPIRO, MODERN CORPORATE FINANCE (1989) 902.

[22] See JACKSON, supra note 11 at 184 and R.F. SALMONSON, JAMES DON EDWARDS, AND ROGER H. HERMANSON, A SURVEY OF BASIC ACCOUNTING (1985) 265.

[23] With unsecured debt, each creditor has incentives to monitor debtors potentially resulting in duplicate and inefficient costs that can be reduced with secured debt. The result will tend to be just enough monitoring. Saul Levmore, *Monitors and Freeriders in Commercial and*

common practice for the creditor to expect a personal guarantee from the primary shareholder for any credit transactions with the corporation.

Only as a last resort do creditors provide long-term unsecured credit and only then at much higher rates of interest than that of secured debt. Long-term unsecured debt would normally be expected to occur when a lender has numerous, small debts for which the securing of collateral or a guarantee are too costly for both the creditor and the debtor. The lender limits its costs by screening its debtors using personal characteristics or credit checks. These lenders also reduce their risk by establishing a large portfolio of small debts only a limited number of which are expected to default at any time.[24] Part of the explanation for the large number of individual bankruptcies is their relatively easy access to unsecured credit card debt. From the perspective of the credit card lenders, it is not cost effective to screen these debtors any closer or to attempt to secure the transactions as occurs with home equity loans.[25]

While the bankruptcy laws may appear to provide an opportunity for businesses to avoid their debts, seldom are they permitted to have the large unsecured debts that can be discharged at bankruptcy. Therefore, while the primary focus of the bankruptcy laws is on debtors, these laws provide substantial benefits for creditors that might not be obvious.[26] When unsecured debt exists, it is important to recognize the benefits to creditors from these laws. Since many of the debtor's assets cannot be sold instanteously, there is some set of timing and procedures that will maximize the value of the debtor's limited assets. Each creditor, however, has an incentive to move too quickly to satisfy its claim and too slowly to pay for any expenses required to maximize the value. Therefore, the bankruptcy laws can be viewed as creating the contract that the creditors collectively would have otherwise created so as to minimize their transaction costs.[27] It permits the creditors and the debtors to avoid negotiating an event that is not particularly likely to occur.

In summary, in a commercial setting creditors limit their risk of nonpayment of debts by requiring debtors to provide security or by making enough small loans that they have a diversified portfolio. Both efficiency and fairness tend to be increased by this process. Efficiency is

---

Corporate Settings, 92 YALE L. J. 49 (1982).

[24] See Nils H. Hakansson, *Portfolio Analysis*, in JOHN EATWELL, MURRAY MILGATE AND PETER NEWMAN, THE NEW PALGRAVE: FINANCE (1989) 227.

[25] Credit card debt has the second highest delinquency rate for banks after mobile home loans. STATISTICAL ABSTRACT, supra note 7 at 526. Secured home equity loans have delinquency rates that are half of those of unsecured credit card debt. Id.

[26] JACKSON, supra note 11 and RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, 4TH ED., (1992) 401.

[27] Thomas H. Jackson, *Bankruptcy, Non Bankruptcy Entitlement, and the Creditors' Bargain*, 91 YALE L.J. 857, 860 (1982).

increased when people are encouraged to make choices the benefits of which exceed the costs. Secured transactions between businesses for long-term debt obligations tend to be efficient because debtors who are in the best position to minimize the risks associated with transactions have incentives to assume only the debt that they have the ability to repay. They have incentives to borrow only so long as the benefits to them exceed the costs. Because of limited opportunities to benefit from bankruptcy, they cannot shift their costs to others. Fairness is also accomplished because people have incentives to be honest and candid with each other. If unsecured debts were common and they could easily be avoided through bankruptcy, then some debtors would be tempted to mislead creditors in the hope of ultimately being able to avoid their obligations. When debts are secured by collateral or guarantees, debtors have little to gain from misleading creditors.

Debts During Marriage

These insights from business relationships suggest that it should be difficult for ex-spouses to discharge obligations that were incurred during marriage through bankruptcy. Just like people invest in a business; spouses invest in their marriage. Protecting any debts associated with those investments would produce more efficient and fair outcomes, just as occurs in a commercial setting. Business and economic perspectives on marriage and the family have become increasingly popular.[28] While accepting the important roles of love and sexual attraction in family formation, this literature also pictures the family as an institution consisting of individuals who respond to changing incentives based on costs and benefits. Increasingly, marriage is being viewed as a partnership especially when it comes to the recognition and division of marital property.[29] In a manner similar to a business, spouses can incur costs during marriage that benefit the other family members. These costs, which produce many of the gains from marriage and a family, are more likely to be incurred if there is a reasonable assurance that the person incurring the costs will be repaid, in effect, creating a creditor/debtor relationship. Although the costs and benefits can be in monetary units that is not always the case. Certainly, a spouse can support the other spouse during graduate school with the expectation of benefitting financially from a higher income in the future. Alternatively, the costs and benefits will be more subjective such as when a spouse limits a career that will potentially reduce her income later to provide child care in expectation of the future affection of the other spouse and their children. The concept of cost is used here in its broader meaning of a sacrifice, rather than in its narrow meaning associated just with money outlays. When a spouse rejects the opportunity to move from a job paying $40,000 per year in one town to one paying $50,000 in another town, they incur a cost although there is no exchange of money. For example, marrying imposes a cost on the spouses because they have sacrificed the opportunity to have married someone else.

---

[28] Much of this work can be traced to Gary Becker, the University of Chicago Nobel Prize winning economist-sociologist. His work is summarized in GARY S. BECKER, A TREATISE ON THE FAMILY, ENLARGED EDITION (1991).

[29] See MARY ANN GLENDON, THE TRANSFORMATION OF FAMILY LAW (1989) 116 and Carol Bruch, *Of Work, Family, Wealth, and Equality*, 17 FAM. L. Q. 101 (1983).

As the marital relationship has changed from one that usually lasted for the life of one spouse to one that is often dissolved long before that time, the importance of the financial arrangements when a marriage is dissolved has increased. If the potential for bankruptcy by an ex-spouse increases the likelihood that compensation will not be received for prior sacrifices, then spouses *ex ante* are discouraged from making efficiency enhancing decisions for which the benefits exceed the costs.[30] In many cases, the direct benefits to a spouse from a choice will not exceed the costs, but the essence of marriage consists of reciprocal arrangements. While neither washing the family car by one spouse nor cooking dinner by the other spouse will result in positive net benefits for that person, the combination of activities will result in positive net benefits for the couple. Neither activity is done in isolation, but is part of the reciprocal arrangements of marriage. One was done in anticipation of the other. The car wash and the meal are activities that are reasonably contemporary, so the spouses have less concern that reciprocal actions will occur. However, the costs and the benefits may occur at different times resulting in a debt of the beneficiaries to the person incurring the cost.

Spouses often incur costs that may not be in their narrowly defined best interest, but are incurred because they are viewed as in the best interest of their marriage. If these investments are not made, the overall quality of the marriage is reduced. For example, a couple's children might benefit from one parent limiting her career to provide important child care services. The parents might, however, be reluctant to incur the potential cost of limiting a career, if they are not sure that they will be compensated financially and emotionally by the other spouse and the children.[31] This lack of compensation can be due to the financial and custodial arrangements, if there is a divorce, not recognizing systematically some costs incurred during marriage such as those due to a sacrificed or limited career.[32] In addition, even if these costs are recognized in a property division, they might be avoided by an ex-spouse if he files for bankruptcy.

Costs are incurred during marriage in a number of situations. When people marry, they sacrifice the opportunity to marry someone else. The couple may choose to have children recognizing the future time, money and emotional costs that the children will require. The spouses may sacrifice current consumption to save, thereby, accumulating marital property. To accommodate their spouse and children, spouses may limit their career potentially reducing their

---

[30] Because no-fault divorce permits unilateral divorce often accompanied by limited financial compensation for women who have limited their careers to benefit their families, married women have been forced to take steps to protection themselves from the potential adverse effects of divorce. Since they are acting in their best interest rather than that of their families, this lack of protection for their investments often induces them to make inefficient decisions for their families because the benefits do not exceed the costs. See Allen M. Parkman, *Why Are Married Women Working So Hard*?, INT. REV. OF LAW & ECON., forthcoming.

[31] Id.

[32] Allen M. Parkman, *Unilateral Divorce and the Labor-Force Participation Rate of Married Women, Revisited*, 82 AM. ECON. REV. 671 (1992).

future income. Last, spouses may sacrifice some of their earnings to finance the education of their spouse.

All of these sacrifices are costs that should be viewed as creating debts if the marriage is dissolved. These debts can be either to the other spouse or to their children. Because the returns from these outlays will not be received until long after the sacrifices are made, in a commercial setting these debts usually would not be incurred without a security interest in property or the ability to build a diversified portfolio. Since a diversified portfolio of marriage specific investments is not a possibility in a country in which marriage is monogamous, the only other option to individuals would be for them to treat these intra-family investments as transactions secured by property if the marriage is dissolved. This alternative is, however, unrealistic because most couples will not have adequate real or personal property to provide security for these investments. Usually, the most valuable asset owned by the spouses is their income earning capacities, which cannot provide effective security for a debt because it is not recognized as property in bankruptcy proceedings. Also, while the concepts of an investment made and a debt incurred are equally appropriate in marriage as in business, most people hesitate to view marital choices that way making them reluctant to require security for a debt between spouses. The lack of opportunities for security is even more obvious with debts between parents and children. Therefore, arrangements created by businesses voluntarily have to be created for families by statute. Specifically, the law should make these debts created within families non-dischargeable in bankruptcy. In the next section, these debts will be discussed in more detail.

Maintenance

When the primary role for adult women was as a housewife and mother, the chief cost of divorce was the sacrificed opportunity to have married someone else.[33] Even though many women now are shifting away from being primarily housewives and mothers, this sacrifice continues although the financial impact may be smaller. This cost has been treated as a non-dischargeable debt by providing for alimony or spousal support that could not be discharged through bankruptcy after a divorce. Since it was reasonable to assume that the women--except for this marriage--would have married someone similar to the person that they married, the cost of the divorce and the resulting debt was a lifestyle similar to the one enjoyed during the marriage. Therefore, maintenance in the form of alimony based in part on the standard of living during the marriage was reasonable. This cost would be reduced or eliminated with remarriage or death, so it is legitimate to terminate alimony at that time.

Child Support

The costs associated with children continue even if the marriage is dissolved. The children still will need to be feed, clothed, and nurtured. Parents historically had children because they were a source of financial support, love and companionship. More recently, the financial incentives for parenthood essentially have been eliminated. Still, in return for the anticipated benefits of parenthood, society imposed an obligation on the parents to support their minor

---

[33] Margaret F. Brinig and June Carbone, *The Reliance Interest in Marriage and Divorce*, 62 TULANE L. R. 855 (May 1988).

children. These ongoing costs are a debt, which cannot be discharged by bankruptcy.[34] In effect, when parents conceive children, the Code imposes a non-dischargeable obligation on the parents to provide these children with support during their minority.

Marital Property

Under the Code and the Reform Act, property and support are treated differently with it being easier to discharge property obligations. Yet, both can be viewed as debts that should not be easily avoided through bankruptcy. As the employment opportunities have increased for women, the focus at divorce has shifted from sacrificed suitors before marriage to sacrificed opportunities during marriage.[35] In most cases, these sacrifices will result in costs after divorce that will not disappear even with remarriage. The result has been a shift in the financial arrangements between ex-spouses from a focus on alimony or spousal support to property divisions at divorce.[36] It is unfortunate that the Code provides less protection to obligations based on property division than those based on support, because most marital obligations are best viewed as property rather than as support.[37]

Most marital property should also be viewed as creating a debt--this time between the spouses--that should not be discharged at bankruptcy. Wealth, which is another word for property, is usually accumulated by people saving, so a couple creates marital property by sacrificing some of their current consumption.[38] Basically, couples have two options for their

---

[34] Child support obligations of the non-residential parent tend to be understated, because some costs incurred by the residential parents such as employment limitations are not recognized. See ALLEN M. PARKMAN, NO-FAULT DIVORCE: WHAT WENT WRONG? (1992) 136.

[35] Ira Mark Ellman, *The Theory of Alimony,* 77 CAL. L. R. 1 (1989).

[36] The comment to Uniform Marriage and Divorce Act, § 308 (Section 9A, Uniform Laws Annotated, 1973) on maintenance states: "The dual intention of this section and Section 307 (property division) is to encourage the court to provide for the financial needs of the spouses by property disposition rather than by an award of maintenance. Only if the available property is insufficient for the purpose and if the spouse who seeks maintenance is unable to secure employment appropriate to his skills and interests or is occupied with child care may an award of maintenance be order."

[37] Most of the obligations between spouses that are created during marriage are best treated as debts and, therefore, part of the property division at divorce. Only in the unusual situation in which the sacrifice is clearly based on having sacrifices the opportunity to have married someone else who would have provided a better way of life than is now available after divorce should maintenance be a primary concern at divorce. See PARKMAN, supra note 33 at 137.

[38] Wealth from gifts and requests is usually treated as separate property rather than as marital property and, therefore, is not divided at divorce. Uniform Marriage and Divorce Act, §

after-tax income: they can spend it or save it. By saving, they are able to acquire property such as mutual funds or a house from which they expect future benefits. But saving is usually a sacrifice, because people would generally prefer to have the immediate benefits of consumption. Both spouses make a sacrifice in anticipation of the future benefits from the saving.

Since the Code and the Reform Act treat support and property obligations differently, both spouses might incur sacrifices acquiring property while only one receives the benefits. For example, prior to 1994, a couple could divorce with the husband receiving the family house, which was the only significant marital asset, with the wife receiving a series of payments as her share of the property settlement.[39] The husband could then file for bankruptcy retaining what had been marital property that was covered by the homestead exemption, while the marital property allocated to the wife is completely wiped out. Under the Reform Act, this still can occur. If there is a lien on property securing a property settlement obligation, it can still be avoided if it is a judicial lien that impairs an exemption to which the debtor would be entitled in the absence of the lien.[40] This problem is particularly acute if the property settlement consists of illiquid property such as pensions. Then there are no assets that can be used as security for the payment of any future obligations. The possibility exists that these obligations can be avoided through bankruptcy.

Not only is this unfair, it is potentially inefficient as the dischargeability of property-based payments discourages couples from accumulating marital property, especially if the marriage is perceived to be fragile. Efficiency enhancing investments may not be made. In a commercial setting, these costs usually would not be incurred in an environment in which the benefits are delayed unless there was some form of security against property for the debt. Obligations based on marital property similarly should be treated as obligations that cannot be avoided through bankruptcy.

Educational Support

Another obvious debt occurs when a spouse provides support for the education of the other spouse.[41] Spouses usually contribute their earnings to the enhancement of their family's

---

307 (Section (A, Uniform Laws Annotated, 1973).

[39] Phyllis A. Klein, *Fresh Start with Someone Else's Property: Lien Avoidance, the Homestead Exemption and Divorce Property Divisions Under Section 522(f)(1) of the Bankruptcy Code,* 59 FORDHAM L. REV. 423, 428 (1990).

[40] Even though the debt may be non-dischargeable under 11 U.S.C. 523(a)(15), that is not relevant if the requirements of judicial lien avoidance are met. See WHITE, supra note 4 at 644.

[41] A more systematic approach to the costs incurred by the supporting spouse would recognize more than just the direct costs of the education such as books, tuition, and living expenses. A major cost of the education is the income sacrificed by the student spouse, which is a cost that is shared by the spouses. See Allen M. Parkman, *An Investment Approach to Valuing Spousal Support of Education*, in RONALD L. BROWN, VALUING PROFESSIONAL

welfare. Most products and services purchased during marriage are for the benefit of both spouses and their children. However, some of one spouse's earnings may be used to increase the income earning capacity of the other spouse, especially though additional education. Usually the intention is to make an investment rather than to confer a gift, because the expectation is that the increased future earnings will benefit the entire family, obviously including the supporting spouse. Funds are being sacrificed that could be used for current consumption. If the marriage is dissolved before the supporting spouse has received a reasonable return on the investment, then there is a debt of the student spouse to the supporting spouse. If this debt is not recognized and protected, spouses will be reluctant to make these welfare enhancing investments.[42] Spouses will be discouraged from becoming students or, if they become students, they may not find enthusiastic support from their spouse. Most other lenders are reluctant to make these student loans without some guarantee or security, so these obligations between spouses should be recognized as a non-dischargeable debt.[43]

A Sacrificed Career

There are other debts that are less obvious, but should also be recognized at divorce. Some debts occur because spouses usually assume more specialized roles during marriage.[44] It is reasonable during marriage for the spouses to alter their activities or increase their specialization relative to what they would have done if they were not married. Rather than pursue her best career opportunities, a spouse may elect to make concessions that are in the best interest of the family, while not being in her best interest. These sacrifices are particularly obvious when a couple has children. The arrival of children usually results in one parent, usually the mother,

---

PRACTICES AND LICENSE, 2ND EDITION (1994 Supplement), (Clifton, NJ: Prentice-Hall, 1994), 18-1 - 18-25.

[42] If educational contributions are recognized in a state--and that is not the case in some states, they are usually used as a basis for an adjustment in the property division, which of course may be discharged in bankruptcy. For example, see Linda D. Elrod and Timothy B. Walker, *Family Law in the Fifty States*, 27 FAM. L. Q. 701 (1994).

[43] Section 523(a)(8) of the Code restrictions, although it does not entirely prohibit, the bankruptcy discharge of student loans made, insured, or guaranteed by the government. These loans are not dischargeable unless (1) the loan first became due more than seven years before the bankruptcy or (2) excepting the loan from discharge would impose undue hardship on the debtor and the debtor's dependents. A similar argument has been made for spousal support. Nancy S. Erickson, *Spousal Support Toward the Realization of Educational Goals: How the Law Can Ensure Reciprocity*, 1978 WIS. L. REV. 947 (1978).

[44] Allen M. Parkman, *Human Capital as Property in Divorce Settlements*, 40 ARK. L. REV. 439 (1987) and Allen M. Parkman, *The Economic Approach to Valuing a Sacrificed Career in Divorce Proceedings*, 2 J. OF THE AM. ACAD. OF MATRIMONIAL LAWYERS 45 (1986).

increasing the emphasis that she places on work in the home to the detriment of her career. The parents may be tempted to share the responsibility for child rearing, but usually it is less costly to the couple for just one parent to alter his or her employment than for both to alter theirs. Higher paying jobs often require unexpected overtime and travel. If both parents reject that type of employment to be available for child care responsibilities, they may be worse of than if only one parent makes that choice. Lower average wages generally available to women often make the mother the lower-cost provider of child rearing.[45] Because that specialization may potentially reduce her earnings later, the mother would rationally want a long-term agreement to protect herself from the potential costs of that decision.

These personal sacrifices are an important source of the gains from the family for its participants and, therefore, should be encouraged.[46] This sacrifice has not usually been recognized in property settlements and, even if it has been recognized, it may be discharged in bankruptcy.[47] As a consequence, parents have been encouraged to emphasize their careers rather than their children, often to the detriment of the children. In effect, the primary income earning spouse has incurred a debt to the spouse who has limited a career to assume primary responsibility for child care. The debt is not based on the serviced provided, but rather on the costs that she will incur in the future because her commitment to her career has been reduced. She will normally earn less later than if she had not made this sacrifice. The debt is the reduction in the earning capacity of the mother due to her absence from the labor force and it normally should be shared based on an implied contract of indemnification unless there was socially unacceptable behavior. This type of behavior occurs when, for example, a woman sacrificed an opportunity that is no longer available based on assurances that the marriage was durable and yet the husband was having an affair that ultimately resulted in the dissolution of the marriage. It that case, the husband should be responsible for the entire debt.

This debt should be recognized as property at divorce rather than as a basis for support. As noted above, alimony was appropriate when the primary sacrifice made by a married woman

---

[45] The percentage of fathers who assume the primary child care role should increase as women's earnings rise. The ratio of female to male wages for median year round earnings remained in the range from .57 to .61 during the 1960s and 1970s, but this ratio has had a steady increase in the 1980s, rising to .66 in 1987. CLAUDIA GOLDIN, UNDERSTANDING THE GENDER GAP 60 (1990). That ratio has continued to increase to .72 in 1993. STATISTICAL ABSTRACT, supra note 7 at 477.

[46] Allen M. Parkman, *The Deterioration in the Family: A Law and Economics Perspective*, in GARY MELTON, ED., THE INDIVIDUAL, THE FAMILY AND SOCIAL GOOD: PERSONAL FULFILLMENT IN TIMES OF CHANGE (1995) 21. It has been shown that no-fault divorce has encouraged married women to work outside the home, often to their and their family's detriment. Allen M. Parkman, *Why Are Married Women Working So Hard*?, INT. R. LAW & ECON. (forthcoming).

[47] Parkman, *Human Capital*, supra note 43.

was the opportunity to have married someone else. Then, it was appropriate for alimony to end with her remarriage or death. However, if a woman sacrifices opportunities to maintain or enhance her career, those sacrifices will continue even if she remarries. For example, a woman could be making $50,000 per year at age 45 if she had made decisions during the marriage that were in the best interest of her career, but now can only make $35,000 a year because of sacrificed opportunities. While the earnings difference may eventually diminish or disappear if she now more aggressively pursues a career, a loss has occurred for the benefit of her prior marriage that will not disappear if she remarries. When there are gains from specialization for which the benefits exceed the costs, these choices ought to be encouraged by their costs being recognized as debts at divorce. In addition, they should not be dischargeable in bankruptcy.

Concerns About the Reform Act

While the Reform Act's new limits on the dischargeability of debts other than support appear to be an improvement that could be an illusion. Property divisions have become the preferred vehicle for dealing with the financial arrangements between ex-spouses and the Reform Act's provisions still make the receiving of property divisions less certain potentially producing inefficient and unfair outcomes. The two conditions under which a property settlement debt can be discharged under Chapters 7, 11, and 12 are when the debtor lacks the ability to pay and when the benefits of discharging the debt to the debtor outweigh the detrimental consequences to the creditor. First, if the debtor ex-spouse files for bankruptcy, his property settlement obligations will automatically be discharged unless a determination of non-dischargeability is made by the bankruptcy court upon the timely filing of an adversary proceeding. Asserting her rights as a creditor is potentially costly for the creditor with the result that she may be unwilling to assert those rights. Therefore, these provisions create a strong incentive for debtor ex-spouses to file for bankruptcy with the expectation that they will be able to discharge their property division obligations.[48] Second, even if the creditor asserts her right, the same income that was available before the divorce to support one household is now supporting two households with the result that both households are incurring financial difficulties. This provision only addresses the financial difficulties of debtors and, since their financial resources can be limited, one can only speculate that it often may be the basis for a discharge based on the debtors' limited ability to pay. The test used in Chapter 13 filings has been adopted by most courts in the context of filings under other Chapters.[49] Third, the weighing of the benefits of discharging the debt to the debtor and the

---

[48] This creates a particular problem because the burden of proof is usually on the creditor ex-spouse. See C. R. Bowles, *Escaping the Bankruptcy Trap: The Dischargeability of Marital Obligations After the Bankruptcy Reform Act of 1994*, 10 AM. J.OF FAM. LAW 171 (1996). For example, the Bankruptcy Court for the District of Vermont discharged a husband's marital settlement agreement obligations to his wife holding that the burden of proof of non-dischargeability was one the creditor wife and the wife failed to satisfy her burden. Kessler v. Butler, (In Re Butler), 186 Bankr. 371 (Bankr. D. Vt. 1995).

[49] Most courts are applying the test under 11 U.S.C. § 1325(b)(2) in the context of 11 U.S.C. § 523(a)(15)(A). Bowles, supra note 47 at 177. Other courts have applied the student

detrimental consequences to the creditor is very ambiguous and, therefore, prone to increase litigation to the detriment of both spouses.[50] Litigation is more likely to occur when there are uncertain outcomes because both parties may anticipate victory. With a more certain outcome, the prevailing party becomes more predictable avoiding wasteful litigation. A far better situation would be to recognize that these obligations incurred during marriage are debts that in a business situation would only have been made if they were secured with property and, therefore, should be difficult to avoid through bankruptcy.

Chapter 13 continues to be a major concern because it contains its own non-dischargeable debt provisions that permit the discharge of property division obligations and it was not amended in 1994.[51] The creditor ex-spouse who is holding a property settlement obligation must raise good faith objections to the filing of Chapter 13, the plan confirmation, or both in order to prevent discharge of a property division debt under this Chapter.[52] It would be naive not to anticipate a substantial increase in Chapter 13 filings by ex-spouses to take advantage of this obvious loophole. This is especially true because Congress has taken steps to make Chapter 13 more attractive.[53]

Conclusion

This article questions the dischargeability of any financial obligations between ex-spouses after divorce due to one of their filing bankruptcy. Their financial obligations to each other should be viewed as debts based on sacrifices that were made during marriage. Efficiency and fairness call for these debts to be non-dischargeable. Efficiency is increased when people are encouraged to make decisions for which the benefits exceed the costs. Many sacrifices during marriage can be efficient, but will be discouraged if the persons incurring the sacrifices are not confident that they will be rewarded by either the continuation of the marriage or compensation at

---

loan test to the new property settlement exception. See WHITE, supra note 4 at 636.

[50] When both parties to litigation have a reasonably clear idea of the outcome of the litigation, they have incentives to settle to avoid the costs of a trial. Alternatively, when outcomes are uncertain, both parties may overestimate their chances of success with the result that they will continue to incur the costs of litigation increasing the probability of a trial. See POSNER, supra note 25 at 555.

[51] 11 U.S.C. § 1328(a) (1994). Non-dischargeable debts under § 1328(a) include long term debts for which the final payment is due after completion of the plan, support obligations, educational loans, and debts for death or personal injury arising out of the debtor's use of a motor vehicle while intoxicated. Id.

[52] WHITE, supra note 4 at 639.

[53] The courts can dismiss abusive consumer Chapter 7 filings and thereby push debtors into Chapter 13. Also, lawyers are required to certify that they have informed consumer debtors of the availability of Chapter 13. See HERBERT, supra note 1 at 354.

divorce. The outcomes will also be fairer because spouses share the cost of the sacrifices incurred for their and their children's benefit during marriage. In addition, predictability reduces the incentives for deceitful behavior.