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Dissolution of Marriage and the Bankruptcy Act of 1973: "Fresh Start" Forgotten

The proposed Bankruptcy Act of 1973,1 if enacted, will completely revise both the substantive provisions of the bankruptcy law and the structure of the bankruptcy courts. As with most major legislation, the proposed Act has drawn a great deal of attention.2 While most of the attention has centered on the major revisions of the Act, this note will focus on a relatively minor, but potentially far-reaching, revision which provides a new and broadened discharge exception for debtor obligations arising from marital separations or dissolutions.3

In analyzing the revised marital discharge exception, this note will first discuss the marital discharge provision of the present bankruptcy law and its effect on the status of economic awards arising from marital separations or dissolutions. This discussion will illustrate how the tensions which inevitably arise between conflicting policy considerations are resolved under current bankruptcy law. In discussing the resolution of conflicting policy considerations, the note will attempt to provide some insight into

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3The federal statute concerning dischargeable obligations presently provides:

A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . (7) are for alimony due or to become due, or for maintenance or support of wife or child . . .


Under present bankruptcy law, obligations that are essentially for maintenance or support of the debtor's dependents are not discharged in bankruptcy, while obligations that are asset divisions are discharged. See, e.g., Nichols v. Hensler, 528 F.2d 304 (7th Cir. 1976); Merriman v. Hawbaker, 5 F. Supp. 432 (E.D. Ill. 1934); Remondino v. Remondino, 41 Cal. App. 2d 208, 106 P.2d 497 (Dist. Ct. App. 1940).

The proposed Act of 1973 provides, however, that:

[A] discharge extinguishes all debts of an individual debtor, whether or not allowable, except . . . (6) any liability to a spouse or child for maintenance or support, for alimony due or to become due, or under a property settlement in connection with a separation agreement or divorce decree. . . .

COMMISSION REPORT, supra note 1, § 4-506(a)(6).
the process by which bankruptcy courts presently distinguish maintenance and support obligations from asset divisions for the purpose of determining the dischargeability of the obligations.\textsuperscript{4} The discussion will then turn

\textsuperscript{4}Although bankruptcy courts are most frequently called upon to make this distinction, \textit{all} courts are called upon to give effect to the law in various procedural contexts. For example, Nichols v. Hensler, 528 F.2d 304 (7th Cir. 1976), arose under diversity jurisdiction in the context of creditor supplementary proceedings brought in district court by a bankrupt's spouse to enforce a judgment on the marital obligation. The debtor raised his bankruptcy discharge in defense. Thus, the Seventh Circuit ruled on the husband's motion to dismiss the wife's petition seeking supplementary proceedings, thereby giving effect to the husband's prior discharge. Therefore, although a bankruptcy court may grant a debtor a discharge of "all dischargeable debts," other courts may be called upon to decide how the discharge effects the particular issues before them.

The maintenance and division of assets distinction has ramifications that extend beyond the area of bankruptcy. The trial court's classification of the economic award either as for maintenance or as a division of the parties' assets is also significant at the state level. That is, if the trial court determines that the economic award is the latter, then the economic award is not modifiable irrespective of changes in the circumstances of the parties. Therefore, an obligee party who received a fixed sum of assets spread out over a period of time would be precluded from having his or her need reevaluated by the trial court even though the obligee party might have subsequently become disabled. By the same token, events might have made the obligee party less dependent upon the payments and, on the other hand, the financial burdens of the obligor party might have increased.

The second ramification of the classification of the economic award at the state level relates to enforceability, \textit{i.e.}, economic awards representing a division of assets are viewed simply as debts, and therefore the obligor party cannot be found in civil contempt for failure to pay. Conversely, economic awards representing maintenance carry with them the threat of a civil citation, possibly resulting in a jail sentence for failure to pay. Finally, whether or not the economic award constitutes maintenance will determine deductibility for income tax purposes. If the economic award is determined to be maintenance the obligor party is allowed to deduct the payments from his income resulting in a lower tax. See Note, \textit{Indiana's Alimony Confusion}, 45 Ind. L.J. 595, 600 (1970), for discussion of the burdens and benefits regarding deductibility. Note, however, that in order to be deductible under the Internal Revenue Code of 1954, the payments must be \textit{periodic} and that "periodic" is a term of art: Payments are periodic only if they are made after the decree or written agreement, thus they cannot be retroactive or prepaid. Payments are installment rather than periodic if the principal sum is specified in the decree instrument or agreement. However, if those installment payments are payable over a period of more than ten (10) years, from the date of the decree or agreement, they may qualify as periodic.

Installment payments for less than ten (10) years may be deemed periodic if payment of a specified lump sum is made contingent upon a current or later event. For example, if the husband is to pay alimony to his ex-wife for six (6) years subsequent to the date of the decree unless she dies or remarries. (Baker vs. Commissioner, 205 F.2d 369 (2d Cir. 1953) Reg. § 1.71-1(d)(3) adopts the Baker ruling, and provides in part that payments made over a period of ten (10) years or less which are subject to one or more of the contingencies of death of either spouse, remarriage of the wife or change in the economic status of either spouse, are not installment payments; therefore, they are periodic payments includable in the wife's income under Section 71 and deductible by the husband under Section 215. This is the result whether those contingencies are cited in the written instrument or imposed by local law.

If the total amount to be paid is not specified or cannot be readily ascertained from the decree or written agreement, the payments will be deemed periodic. The contingency rule applies if the total amount is not set but can be determined. Such payments are deemed periodic if the installments may be cut off by contingent events such as death.
to an analysis of the proposed Act's revised marital discharge exception which purports to abolish the significance of the distinction between asset divisions and maintenance and support obligations. Specifically, the note will examine the effect of the revised marital discharge exception in favoring the economic interests of the non-bankrupt spouse over the current bankruptcy law's approach of balancing the non-bankrupt spouse's economic interests with the bankrupt's "fresh start." Finally, the note will argue that the revised marital discharge exception constitutes an unnecessary infringement on the bankrupt's fresh start.

**The Marital Discharge Exception: Section 17(a)(7)**

*Bankruptcy Discharge*

The primary purpose of the bankruptcy discharge is to relieve the debtor from a financially unproductive life and to give him a fresh start in the management of his financial affairs. As Justice Sutherland observed in *Local Loan Co. v. Hunt*:

One of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt. The various provisions of the bankruptcy act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act.

The bankruptcy discharge, however, is not absolute. There are many situations where competing policy considerations outweigh the debtor's

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5See notes 60-80 infra & text accompanying.

6See notes 81-84 infra & text accompanying.


It is generally agreed that the primary purpose of personal bankruptcy law is to give the debtor a "fresh start" in his financial affairs. See, e.g., Perez v. Campbell, 402 U.S. 637 (1971); Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934); Williams v. United States Fid. & Guar. Co., 236 U.S. 549 (1915); *In re Rinker*, 107 F. Supp. 261 (D.N.M. 1952).

This note argues that the language of section 4-506(a)(6) of the Act of 1973, impairs the debtor's "fresh start" rights. Note, however, that the Commission's recommendations, taken as a whole, are considered by some to be weighted too much in the debtor's favor. See Twine, *Bankruptcy Report: Some Limitations on Creditors' Rights*, 9 Bus. Law. 358 (1974).

8292 U.S. 234 (1943).

9Id. at 244 (emphasis in original) (citations omitted).
need for a "fresh start." Those situations require that the obligations involved be protected from the bankrupt's general discharge.

Under the original Bankruptcy Act the debtor was given no release from his previously contracted debts. Although his assets were divided ratably among his creditors, any property rights subsequently acquired by the bankrupt vested immediately in all of his creditors, both old and new. It was not until the second Bankruptcy Act was passed in 1841 that a discharge actually released the bankrupt from his debts. Even then, however, the discharge did not signal a complete termination of the bankrupt's obligations. Several types of obligations which created competing policy considerations were excepted. This scheme of a general discharge with specific exceptions has survived subsequent amendments to the Bankruptcy Act and forms the basis of the current law's discharge provision. Section 17 of the current Bankruptcy Act discharges only provable obligations and then only those provable obligations not specifically excepted.

The marital discharge exception is one example of those obligations which are not discharged in bankruptcy. Section 17 specifically provides

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10For example, the policy against fraud and deceit embodied in section 17(a) of the Bankruptcy Act prohibits the discharge of debts which (a) were created by the debtor's "fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity"; (b) were "due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment"; or (c) were "liabilities for willful and malicious injuries to the person or property of another other than conversion." Thus, the policy favoring the bankrupt's fresh start is balanced against competing policies. See Bankruptcy Act § 17a(2), 11 U.S.C. § 35(a)(7) (1970).


12Id.

13Id.

14See note 10 supra.

15See note 3 supra.

16Section 63 of the Bankruptcy Act, 11 U.S.C. § 103(a) (1970), defines a provable claim: (a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition ... and before consideration of the bankrupt's application for a discharge ... ; (8) contingent debts and contingent contractual liabilities.

Part of the rationale for the nondischargeability of claims that were not provable at the filing of bankruptcy appears to be that if the creditors of the bankrupt have not been able to reduce their claims to a fixed liability, it has been impossible for them to receive an opportunity to share in the distribution of the bankrupt's estate, and it is only fair that they should retain the rights to their claims.

Consequently, even awards that are clearly and exclusively asset divisions, if non-provable, i.e., not susceptible to a definite figure of liability at the time of filing, are also nondischargeable.

17Bankruptcy Act § 17a(2), 11 U.S.C. § 35(a)(7) (1970). See also Dunbar v. Dunbar, 190 U.S. 549 (1903). Thus, under present law, even though a maintenance or support provision is provable it is not subject to discharge.

18See, e.g., Perez v. Campbell, 402 U.S. 637 (1971); Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934); Williams v. United States Fid. & Guar. Co., 236 U.S. 549 (1915); In re Rinker, 107
that obligations are not dischargeable if they "are for alimony due or to become due, or for maintenance or support of wife or child. . . ." \textsuperscript{19}

Although this language was added in 1903\textsuperscript{20} by an amendment to the Bankruptcy Act, the courts had long been achieving the same result by treating maintenance and support obligations as nonprovable and therefore nondischargeable debts.\textsuperscript{21} Clearly, both the legislative and judicial views of this exception indicate that the non-bankrupt spouse's need for continued maintenance and support outweighs the bankrupt's need for a fresh start.\textsuperscript{22}

The tension between these competing policies, one protecting the spouse's interest in continued maintenance and support and the other protecting the bankrupt's fresh start, was not eliminated, however, by the enactment of the marital discharge exception contained in section 17. Instead, the tension was heightened by the requirement that courts distinguish maintenance and support obligations, which are not dischargeable, from asset divisions, which are dischargeable.\textsuperscript{23} At least implicitly, this requisite distinction forced the courts to indicate the extent to which the policy favoring protection of the spouse's economic interests was to be favored over the policy of providing the bankrupt with a fresh financial start. The case law which has ensued has shown that the courts have met their obligation and have developed standards which adequately balance and safeguard both policy considerations.

The Current Approach to the Marital Discharge Exception

The federal policy underlying the marital discharge exception of bankruptcy law assures the maintenance and support of the non-bankrupt spouse. In order to effectuate the federal policy, the courts have devised certain general standards for distinguishing between an obligation for maintenance or support and an obligation that represents a division of the parties' assets. The broadcast of these standards was articulated in the case of \textit{Remondino v. Remondino}:\textsuperscript{24}

\textsuperscript{21}See, e.g., Wetmore v. Markoe, 196 U.S. 68 (1904); Dunbar v. Dunbar, 190 U.S. 340 (1903).
\textsuperscript{22}See notes 27-47 infra & text accompanying.
\textsuperscript{24}41 Cal. App. 2d 208, 106 P.2d 437 (Dist. Ct. App. 1940).
If, upon a consideration of the entire transaction the court determines that the purpose [of the economic award at the time of the dissolution or separation] is to guarantee the economic safety of the [obligee party] by the [obligor party], then his discharge does not effect his liability under the judgment.25

In Remondino, the court rejected the bankrupt's contention that the obligation embodied in the dissolution of marriage decree amounted to a dischargeable contract obligation between the bankrupt and his spouse. Rather, recognizing that a substantial part of the economic award pursuant to the dissolution decree would be used for the purpose of spousal support, the court held that the obligation under the dissolution decree represented unpaid maintenance and was therefore nondischargeable.26

Consistent with looking to the underlying nature of the entire agreement, the general rule where sections of a party agreement appear to seek a final and complete settlement of the parties' interests in their property is that the agreement will probably be interpreted by the courts as representing an asset division.27

Within this general framework, the courts have formulated other standards, which, although not conclusive,28 are persuasive29 in delineating asset divisions from awards of maintenance or support. First, if the payments are to continue irrespective of the death or remarriage of the non-bankrupt spouse, the payments will likely be treated as asset divisions.30 On the other hand, if the payments are specifically to terminate upon the death or remarriage of the non-bankrupt spouse, the reverse presumption is true.31 Second, if the amount or continuance of the payments is made

25Id. at 214, 106 P.2d at 441 (citing In re Ridder 79 F.2d 524 (2d Cir. 1935)).
26Id.
28Cf. H. Clark, Law of Domestic Relations in the United States § 14.8 (1968). In referring to the determinations that follow the application of these judicially formulated standards, it is made clear that while both asset divisions and maintenance will “ordinarily” or “generally” have certain distinct characteristics, in the final analysis it is the substance of the agreement that is determinant rather than form.
30In cases where the agreement or order does not provide that periodic payments are to stop in the event of death or remarriage of the wife, it is likely that the court will conclude that such payments are in satisfaction of a property settlement and do not create a liability for support of the [non-bankrupt spouse]. Loiseaux, Domestic Obligations in Bankruptcy, 37 Ref. J. 68, 70 (1968). See, e.g., Tropp v. Tropp, 129 Cal. App. 62, 18 P.2d 385 (Dist. Ct. App. 1933) (annual payments unaffected by the remarriage were held to represent dischargeable asset divisions).
31The courts have established another rule of thumb which is not conclusive, but which aids in distinguishing alimony from a property division: that ordinarily an obligation for alimony will terminate upon death or remarriage of the wife. In fact, one writer has concluded that the essential element [in determining] support is
contingent upon the future earning ability of the parties, the payments will probably be characterized as maintenance or support. Third, if the payments are to be made in gross, as opposed to periodic installments over long periods of time, they will likely be deemed asset divisions. Finally, if payment of the obligations embodied in the dissolution or separation decree is primarily designed as the method for the non-bankrupt spouse to pay, for example, for medical care, education, the balance on car installments or the mortgage on the home, the payments will generally be characterized as for maintenance or support.

It should be emphasized that the aforementioned circumstances are only persuasive factors that a court might consider rather than absolute determinants of the eventual characterization of the obligation in bankruptcy. For example, payments representing asset divisions may in fact be

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a continuing obligation on the husband which will terminate either when the need ends or when the duty is assumed by another. In those cases where the terms of a settlement or decree do not provide for termination on death or remarriage, the court will usually find this to be a property settlement with the result that the obligation is a provable claim which may be discharged in bankruptcy. If the settlement or decree expressly provides that the liability will not be affected by death or remarriage, it is quite certain that the court will find the arrangement to be a property settlement.


See, e.g., Nichols v. Hensler, 528 F.2d 304, 309 (7th Cir. 1976) (case remanded to lower court for a determination whether the economic award was intended to be an asset division or based on the incomes of the parties, in which case it would be viewed as nondischargeable maintenance).

Cf. H. Clark, Law of Domestic Relations in the United States § 14.8 (1968), stating that asset divisions are "usually . . . payable . . . by a single payment or transfer . . . ." (emphasis added).

See notes 76-78 infra & text accompanying. In this regard, it has been noted that [if] . . . a husband and wife execute an agreement which provides that the husband will purchase a house for the wife to live in and that he will also pay certain monthly payments, the obligation to purchase the house is part of the husband's obligation to support his wife and therefore unaffected by any subsequent bankruptcy of the husband. Furthermore, the liability of a bankrupt husband to make mortgage payments on a residence which his wife occupies is nondischargeable.


A factor which complicates the determination is that a court may award either alimony or a division of property in the form of periodic payments, and a single document may contain both types of periodic payments.


Note that the Supreme Court has expressed some concern that earning ability does not become a factor in asset divisions:

The earning power of an individual is the power to create property; but it is not translated into property within the meaning of the bankruptcy act until it has brought earnings into existence.

Local Loan Co. v. Hunt, 292 U.S. 234, 243 (1934). This language indicates that the concept of
spread out over long periods of time,\textsuperscript{35} and payments representing maintenance or support may be paid in a lump-sum\textsuperscript{36} or made noncontingent upon death or remarriage.\textsuperscript{37} Indeed, in some cases the exact conditions of the party agreements may be equivocal or not truly consistent with either an award of maintenance or support or a division of the parties’ assets.\textsuperscript{38} In those cases, the courts will either sever those payments within the agreements themselves representing maintenance or support from those payments representing asset divisions\textsuperscript{39} or, alternatively, the courts will consider the essential purpose of the entire set of transactions.\textsuperscript{40}

\textit{The Application of the Marital Discharge Exception}

Underlying the application of the marital discharge exception of the Bankruptcy Act are two competing policy considerations: (1) the concern that the debtor’s rehabilitative chances be viable\textsuperscript{41} and (2) the concern that the non-bankrupt spouse’s maintenance or support needs be met.\textsuperscript{42} The earning ability is distinct from the concept of assets. The negative implication is that until earning ability is translated into assets, it remains exclusively an element of support.


\textsuperscript{3} See, \textit{e.g.}, Sloan v. Mitchell, 28 Cal. App. 3d 47, 104 Cal. Rptr. 418 (1972), where the agreement to make payments irrespective of the remarriage of the non-bankrupt spouse was held to constitute “alimony.”

\textsuperscript{4} A borderline case can result when the court issues a general dissolution decree, incorporating a perfunctorily drafted party agreement without sufficient scrutiny. For example, such an incorporated agreement may simply provide that, upon dissolution of the marriage, one half of the total assets is to go to the wife and the other half to the husband “in lieu of all other claims” between the two. Thus, since the assets will invariably be in various degrees of liquidity, it will be up to the bankruptcy court to determine which portions constitute nondischargeable maintenance, and vice versa.

\textsuperscript{5} E.g., Avery v. Avery, 114 F.2d 768 (6th Cir. 1940), where it was held that the master appointed by the bankruptcy court properly inquired into the judgment to determine what portions represented payments of maintenance and what portions represented a release of dower and property rights.

\textsuperscript{6} Cf. Remondino v. Remondino, 41 Cal. App. 2d 208, 214, 106 P.2d 437, 441 (Dist. Ct. App. 1940) (\textit{citing In re ridder, 79 F.2d 524 (2d Cir. 1935))}.


\textsuperscript{8} Williams v. Department of Social & Health Serv., 529 F.2d 1264, 1264-69 (9th Cir. 1976) (“obligations to dependents are beyond [the Bankruptcy Act’s] remedial purposes”).

The Court in Wetmore v. Markoe, 196 U.S. 68 (1904), declared: [U]nless positively required by direct enactment the courts should not presume a design upon the part of Congress in relieving the unfortunate debtor to make the law a means of avoiding enforcement of the obligation, moral and legal, devolved upon the husband to support his wife. . . . [S]o far as . . . support is concerned,
Supreme Court has noted that any interpretation of the Bankruptcy Act must be tempered by the intent of Congress "to leave the bankrupt free after the date of his petition to accumulate new wealth in the future" and thus be able to make an unencumbered fresh start. In practice, however, courts have understandably favored findings involving maintenance and support, especially where the rights and responsibilities of family relationships are involved. In the recent case of *Williams v. Department of Social & Health Services*, for example, the court adopted a rather elastic definition of maintenance or support in order to prevent the discharge of a debtor's familial obligation. In *Williams*, the debtor had not abided by a court decree rendered in connection with his marriage dissolution which required him to make monthly payments in support of his minor children. As a consequence, the Department provided the mother with public assistance toward the children's support. The debtor thereafter filed for bankruptcy, and in a later action by the Department to recover the monies paid, the bankrupt claimed that any obligation to repay the Department had been discharged in bankruptcy. In rejecting this contention, the court stated that the recoupment from the bankrupt of public assistance money provided for the support of his dependent children is essentially an obligation for "maintenance or support" and falls within the bankruptcy law's marital discharge exception.

One of the more significant developments in the application of the marital discharge exception of the Bankruptcy Act has been the treatment of prior state law decisions regarding the nature of the obligation. When faced with the question of giving effect to the discharge of a debtor from an obligation incurred under a dissolution of marriage, courts generally deny effect to the classification of the economic award under state law. Rather, they apply standards from bankruptcy law to determine maintenance obligations, which are nondischargeable, and obligations that represent a division of the parties' assets, which are dischargeable. This denial of effect may be important because some states have very liberal maintenance laws, while other states have just the reverse. Thus, giving great weight...
to the various state court classifications would not only operate to frustrate the debtor's fresh start or his spouse's maintenance goals where genuinely warranted, but would also serve to destroy whatever uniformity was intended in the application of the marital discharge provision. *Nichols v. Hensler* illustrates the typical problem. *Nichols* involved the interpretation of a separation agreement made by the husband and wife and incorporated by an Indiana court into the dissolution decree. The dispute arose when the husband, resisting the wife's attempt to enforce the agreement, set up as a defense his discharge in a previous bankruptcy proceeding. Under the terms of the agreement, certain monthly installments owed to the wife were payments of "alimony." Alimony in Indiana at the time of the agreement constituted a division of the parties' assets, and thus was subject to discharge under the Bankruptcy Act. The

1610(c) (1975 Supp.) (alimony may be awarded in such amount as the court shall find to be fair, just and equitable under all of the circumstances); Mich. Comp. Laws § 552.13 (1975 Supp.) (the court "may require either party . . . to pay such sums as shall be deemed proper and necessary . . ."); N.J. Rev. Stat. § 2A:34-28 (West 1975) ("the court may make such order . . . as the circumstances of the parties and the nature of the case shall render fit . . .").

Compare those statutes in Illinois, Kansas and Michigan set forth in note 50 supra, with, for example, the more restrictive wording of Ky. Rev. Stat. § 403.200 (1975 Supp.) ("court may grant a maintenance order . . . only if . . . the spouse seeking maintenance: (a) [l]acks sufficient property . . . to provide for his reasonable needs; and (b) [i]s unable to support himself through appropriate employment . . ."), and Ind. Code § 31-1-11.5-9(c) (1975) ("[t]he court may make no provision for maintenance except that when the court finds a spouse to be physically or mentally incapacitated to the extent that the ability of such incapacitated spouse to support himself or herself is materially affected . . .").

The effect of these contrasting laws inevitably leads to a finding of maintenance in one state where an asset division would be found in another, and vice versa.

For example, in Temple v. Temple, Ind. App., 328 N.E.2d 227 (1975), the Indiana Court of Appeals upheld the trial court's decision denying maintenance to the wife who was afflicted with grand mal epilepsy. In another Indiana case, Liszkai v. Liszkai, Ind. App., 343 N.E.2d 799 (1976), the trial court's rejection of a wife's claim for maintenance was also approved. The court held that a poorly educated middle-aged woman with few marketable skills is not incapacitated.

Before passage of the Dissolution of Marriage Act, Ind Code § 31-1-11.5-1 et seq. (1975 Supp.), a majority of the Indiana appellate courts considered any economic award rendered at the time of the dissolution of marriage solely as a present and complete division of the economic assets or property rights of the parties. See, e.g., Doner v. Doner, Ind. App., 302 N.E.2d 511 (1973); Sidebottom v. Sidebottom, 140 Ind. App. 657, 225 N.E.2d 772 (1967); Smith v. Smith, 151 Ind. App. 38, 169 N.E.2d 130 (1960); Shula v. Shula, 255 Ind. 210, 132 N.E.2d 612 (1956). Oddly enough, this division of assets was termed an award of "alimony," a word generally thought of as payments to an obligee party for support or maintenance purposes. See Merrium v. Hawbaker, 5 F. Supp. 432, 433 (E.D. Ill. 1934). However, this somewhat variant view prevailed despite ambiguities in the "alimony" statute that, arguably, could have been interpreted in a way to permit the granting of maintenance awards. See Note, Indiana's Alimony Confusion, 45 Ind. L.J. 595, 599-601 (1975).

Under this view, the courts technically could not consider the future support of the obligee party when determining the parties' respective property rights. Nonetheless, the courts could properly consider other factors such as the "source of the property, income of the parties and the nature of abuse inflicted upon the [obligee party], particularly if that abuse
Court of Appeals for the Seventh Circuit did not view the lower court's characterization of the obligation as determinative and remanded for the purpose of determining whether the payments represented a division of the parties' assets, in which case the husband's obligation would have been discharged in bankruptcy, or whether the payments were based on the incomes of the parties, in which case the obligation would not have been discharged. Thus, by looking beyond party labelling discrepancies and idiosyncratic state court characterizations of the obligations owed, it is apparent that the standards devised and applied by the courts have been fairly uniform and effective in accommodating both the fresh start of the debtor and the maintenance and support needs of his spouse.

**THE PROPOSED DISCHARGE EXCEPTION:**

**SECTION 4-506(a)(6) IN PERSPECTIVE**

The Bankruptcy Commission was apparently concerned with thwarting the devious and scheming debtor who would attempt to hold up his discharge in bankruptcy as a defense in order to escape familial obligations. Specifically, the Commission felt that obligations to support family dependents in the future may take the form of either a duty to make periodic payments based on need or an obligation to pay a settlement based on the debtor's present or anticipated wealth. The choice of form frequently turns on tax considerations or other factors not directly related to the duty to provide support.

There are at least two general categories of commonly encountered circumstances that potentially threaten the policy of assuring maintenance

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Nichols v. Hensler, 528 F.2d 304, 307 n.1 (7th Cir. 1976).

See note 1 supra.

COMMISSION REPORT, supra note 1, at 189 (emphasis added).
or support for the non-bankrupt spouse in bankruptcy. These include situations where (a) contemplating bankruptcy and its collateral discharge benefits, the parties have mislabelled provisions of the agreement actually intended as maintenance, making them appear to be a division of assets, or such a mislabelling has occurred inadvertently; or (b) miscalculating the non-bankrupt spouse's maintenance or support requirements, an erroneously high proportionate share of the total assets has been included in the asset division. As a response to these perceived threats, the Commission proposed section 4-506:

A discharge extinguishes all debts of an individual debtor, whether or not allowable, except . . . (6) any liability to a spouse or child for maintenance or support, for alimony due or to become due, or under a property settlement in connection with a separation agreement or [dissolution of marriage] decree.59

This language broadens the marital discharge exception by, presumably, treating all property settlements in connection with a separation or dissolution decree as nondischargeable maintenance. The effect of this change, arguably, detracts from the policy of giving the debtor an opportunity for a fresh start.

Section 4-506 and Third Party Creditors

The effect of section 4-506 would be keenly felt with respect to third party creditors. In interpreting the current discharge provision, the courts indicated very early that not all obligations incurred for the benefit of the debtor's dependents are nondischargeable.60 Rather, obligations to third party creditors are treated specially and are generally discharged in bankruptcy.61 Schellenberg v. Mullaney62 aptly illustrates the situation. In that case a merchant had sold clothing to the debtor for his children's use. The merchant thereafter alleged that the debtor's subsequent discharge in bankruptcy did not bar him from collecting this debt on the ground that the clothing constituted "necessaries" for the debtor's children.63 The Appellate Division of the Supreme Court of New York disagreed and ruled that the exception to discharge found in section 17 of the Bankruptcy Act referred

59Commission Report, supra note 1, § 4-506(a)(6) [Section 4-506(a)(6) will be hereinafter referred to as section 4-506].
63Id. at 384, 98 N.Y. Supp. at 432.
only to the involuntary liability under the common law for support of wife
and children, and to any one who relieves their want; and under bonds, or
the like, given for such support by requirement of courts and magistrates.
It does not refer to liabilities for goods purchased by a husband or parent
. . . and used by wife or child. This latter fact does not change the
character of the debt. 64

Under section 4-506, however, the result might be different. If the
debtor makes an arrangement incorporated into the separation or dissolu-
dtion decree whereby he agrees to pay for "necessaries," e.g., clothing,
nourishment, medical care and education, the resultant debts incurred
could conceivably be construed as "in connection with" 65 the particular
decree, thus becoming nondischargeable obligations.

An argument can be made that extending the exception to discharge to
include liabilities owed to these types of general creditors would reduce the
risk that the debtor will not repay and, would in turn, make such creditors
more willing to extend credit to the debtor. In the short run, this would
facilitate support of the debtor's dependents. But credit extended due to
reduced creditors' risk may be of illusory benefit to the debtor, who faces a
concomitantly increased risk of insolvency. 66 This is especially true
because these types of obligations are of the very sort that often precipitate
consumer bankruptcy. 67 Moreover, since the debtor has already demon-
strated a proven inability to manage his financial affairs, widening the
scope of post-bankruptcy pursuit to include the claims of all professional
persons or merchants who contributed to the support of the debtor's
dependents would directly undermine his ability to start anew in his
financial affairs.

Section 4-506 and "Hold Harmless" Agreements

The area of "hold harmless" agreements is another example where
section 4-506, arguably, would retreat from the current balancing approach 68
and favor the economic interests of the non-bankrupt spouse over the
bankrupt's need for a fresh start. "Hold harmless" provisions again raise
the problem of third party creditors in that they involve the formal
allocation between the parties of their obligations to such creditors. 69
Suppose, for example, that $H$ and $W$ during the period of their marriage
have incurred certain debts in the joint operation of their business. In a

64Id.
65See note 59 supra & text accompanying.
66This is true because, while the debtor's credit limit might be rendered more flexible by
this process, his ability to pay remains constant.
67See generally Commission Report, supra note 1.
68See notes 7-10 supra & text accompanying.
later dissolution proceeding the parties submit to the court, among other things, an agreement that $H$ is to hold $W$ "harmless" on what would have been $W$'s pro rata share of the debt. Here again, it is entirely possible that upon $H$'s filing a subsequent petition in bankruptcy this agreement might be held to be a nondischargeable obligation in connection with the dissolution decree under section 4-506.\(^{70}\)

The rationale behind treating "hold harmless" agreements as maintenance or support is that (a) such agreements reduce the non-bankrupt spouse's total monetary obligations and thereby increase the resources available for that spouse's support,\(^{71}\) and (b) maintenance obligations may be secreted within such agreements.\(^{72}\) First, the rationale fails in that almost any asset is capable of being made liquid in order to augment maintenance. Thus, this approach, followed to its logical conclusion, would treat all such asset divisions as maintenance, whatever their true nature.

Second, many "hold harmless" agreements only remotely relate to maintenance needs. Their provisions focus upon the equitable distribution between the parties of their outstanding debts,\(^{73}\) especially since maintenance and support provisions have likely been inserted elsewhere in the decree.\(^{74}\) But whatever the case may be, as previously demonstrated the courts have been fairly successful in ferreting out and separating obligations representing maintenance from those representing asset divisions in a particular agreement.\(^{75}\) Under the current marital discharge provision, obligations to pay off the mortgage\(^{76}\) or to pay off loans secured by furniture and other household items\(^{77}\) or an automobile awarded to the non-bankrupt spouse\(^{78}\) are generally held to be nondischargeable maintenance obligations.

Finally, whether extending the marital discharge exception to apply, as section 4-506 proposes, directly to third parties who contribute to maintenance or indirectly to third parties via "hold harmless" agreements, the results would be the same. The third parties would reap the substantial

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\(^{70}\)See Commission Report, supra note 1, § 4-506.

\(^{71}\)Swann, Dischargeability of Domestic Obligations in Bankruptcy, 43 Tenn. L. Rev. 231, 269 (1976).

\(^{72}\)See note 58 supra & text accompanying.

\(^{73}\)Cf. Swann, Dischargeability of Domestic Obligations in Bankruptcy, 43 Tenn. L. Rev. 231, 253 (1976).

\(^{74}\)Id.

\(^{75}\)See, e.g., Williams v. Department of Social & Health Serv., 529 F.2d 1264 (9th Cir. 1976); Nichols v. Hensler, 528 F.2d 304 (7th Cir. 1976); Remondino v. Remondino, 41 Cal. App. 2d 208, 106 P.2d 437 (Dist. Ct. App. 1949); Lyon v. Lyon, 115 Utah 466, 206 P.2d 148 (1949).

\(^{76}\)See, e.g., Poolman v. Poolman, 289 F.2d 332 (8th Cir. 1961); Henson v. Henson, 366 S.W.2d 1 (Mo. App. 1963).


benefits of nondischargeability, and the bankrupt would continue to bear the burdens.\textsuperscript{79} This is diametrically opposed to the fresh start policy that underlies the bankruptcy law.\textsuperscript{80} In addition, section 4-506 would have the undesirable effect of discouraging parties from formally allocating between themselves their obligations to third parties for fear that they might thus become nondischargeable irrespective of their intended nature.\textsuperscript{81} Likewise, parties would be discouraged from amicably formulating agreements regarding the settlement of their obligations to each other.\textsuperscript{82} This would, in turn, put all parties in a more precarious and uncertain situation whether they be creditors or debtors.

\textit{Subsequent Developments}

As stated earlier, there has been little discussion about the possible ramifications of section 4-506. In fact, the Commission Report itself is surprisingly devoid of any statistical evidence to support its view that obligations representing support are presently being successfully discharged in bankruptcy.\textsuperscript{83}

One of the most striking indictments of the language of section 4-506 came from the National Conference of Bankruptcy Judges. Reacting adversely to the Commission Report in general\textsuperscript{84} and to section 4-506 specifically, the National Conference of Bankruptcy Judges proposed its own marital discharge provision.\textsuperscript{85} It provides that:

\begin{quote}
A discharge extinguishes all debts of an individual debtor, whether or not allowable, except . . . (6) any liability to a spouse or child for maintenance or support, or for alimony due or to become due: \textit{Provided, however}, That a debt shall not be excepted from discharge hereunder merely to hold the spouse harmless on her obligation in any manner to pay the debt.\textsuperscript{86}
\end{quote}


The question reduces essentially to a policy determination of which types of obligations will survive the general discharge in bankruptcy, thereby preserving creditors' remedies to enforce them. Bankruptcy law offers a debtor no fresh start with respect to nondischargeable obligations.

\textsuperscript{80}\textit{See} notes 7-9 \textit{supra} \& text accompanying.

\textsuperscript{81}\textit{See} note 58 \textit{supra} \& text accompanying.

\textsuperscript{82}\textit{Id.}

\textsuperscript{83}\textit{See generally} \textit{COMMISSION REPORT, supra} note 1.

\textsuperscript{84}The National Conference of Bankruptcy Judges formulated and introduced its own proposals, often referred to as the Judges' Bill for amendments to the Bankruptcy Act. National Conference of Bankruptcy Judges' Bill, H.R. 32, 94th Cong., 1st Sess. (1975) [hereinafter cited as Judges' Bill].

\textsuperscript{85}Judges' Bill, \textit{supra} note 84, at § 4-506(a)(6).

\textsuperscript{86}\textit{Id.} (emphasis in original).
The Judges' Bill apparently reflects a concern in favor of the continuance of a balancing approach in this area. It does so by reaffirming the policy toward maintenance of the non-bankrupt spouse, while at the same time clearly limiting the extension of the marital discharge exception to the entire category of "hold harmless" agreements. Thus, the negative implication under this approach is that a "hold harmless" agreement will not be held nondischargeable simply because it might supplement maintenance or support. Rather, it must be designed to facilitate maintenance or support in order to be nondischargeable.

The Judges' Bill has two primary advantages over the Commission Report. First, it deletes the broad and ambiguous "in connection with" language of section 4-506. Second, it specifically limits its applicability to general "hold harmless" agreements, which in turn increases the chance of resolution of the dischargeability issue in a manner which coincides with the parties' intentions.

Despite its potentially devastating effects, there apparently remains some support for the Commission's version of the marital discharge exception. This has created the possibility of a compromise, but the outcome is yet fairly uncertain. What is hoped is that the potentially far-reaching provisions of section 4-506 will ultimately obtain the attention they deserve, thereby preserving what was intended to be a narrow exception to the general rule of discharge.

**CONCLUSION**

Under present bankruptcy law, the types of obligations that survive a petition in bankruptcy are purposely circumscribed in order to permit the debtor a fresh start financially. However, the debtor's plight is rightfully viewed in conjunction with the maintenance and support needs of his dependents, and thereby both policies are accommodated. Unfortunately, the parties ultimately favored by section 4-506's potential extension of nondischargeability to merchants or professionals who merely contribute to support of the debtor's dependents or to obligations embodied in "hold harmless" agreements are general creditors rather than the debtor's dependents. On the other hand, the Judges' Bill successfully maintains the present Act's balancing approach. In sum, any recommendations to revise

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87Id.
88See note 59 supra & text accompanying.
89See note 86 supra & text accompanying.
90The parties probably have no idea that the obligations which they allocate between themselves might thereby become nondischargeable against the very creditors from whom the bankrupt spouse seeks relief.
92Id.
the marital discharge exception of the Bankruptcy Act should reflect the need to maintain this balance and should not be worded in such a fashion as to automatically sweep nonmaintenance or nonsupport claims into the nondischargeable category. Section 4-506 does not accomplish this, nor does it do anything to increase the compatibility of the bankruptcy system with family law concerns. In fact, if enacted unqualified, it will almost certainly be counterproductive in both areas.

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