



THE ENFORCER

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IF HE'S BROKE, HOW CAN WE FIX IT?

It is well known that a domestic support obligation¹ ("DSO"), along with other certain types of debts under 11 U.S.C. § 523(a), are nondischargeable in bankruptcy. Further, a DSO is given first priority status² when assets are recovered by the trustee. Therefore, if the trustee collects funds in the administration of the bankruptcy estate; a Nondebtor Spouse is in a good position.

But what if the bankruptcy is a no asset case? Well, since the DSO is nondischargeable, it will survive the bankruptcy. And since any property obtained by the Debtor Spouse post-petition in a Chapter 7 and post-discharge in a Chapter 13 belongs to the Debtor Spouse (with several exceptions³), this property is available to satisfy the DSO.

However, what if post-bankruptcy property is insufficient to satisfy the debt? Is there any pre-petition property that the Debtor Spouse may take action against? The answer is yes, from the Debtor's exempt property. The Bankruptcy Code permits a debtor to exempt certain property from the bankruptcy estate⁴. Exempted property will not be administered by the trustee, nor is it "liable during or after the case for any debt of the debtor that arose . . . before the commencement of the case." 11 U.S.C. § 522(c). A creditor who attempts to levy on exempt property post-bankruptcy is violating the post discharge injunction. However, there is a narrow exception contained in 11 U.S.C. § 522(c)(1) that applies to a DSO⁵. The exception states:

Unless the case is dismissed, property exempted under this section is *not liable during or after* the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of this case, except—

(1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of the applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in section 523(a)(5)⁶);

11 U.S.C. § 522(c)(1) (Emphasis added) (Endnote added).

So the option to collect from pre-petition exempt property is available to the Nondebtor Spouse, but when is it permissible to undertake the task? During or after the bankruptcy? According to case law, exempt property is withdrawn from the estate. See *In re Covington*, 368 BR 38, 40 (Bankr ED Cal, 2006); *In re Szekely*, 936 F2d 897 (7th Cir, 1991); *In re Quezada*, 368 BR 44, 57 (Bankr SD Fla, 2007); *In re Farr*, 278 BR 171 (9th Cir, BAP 2002). And pursuant to 11 U.S.C. § 362(b)(2)(B), the automatic stay does not apply to bar a DSO from collecting "from property that is not property of the estate." Therefore, the Nondebtor Spouse may pursue exempt property during the bankruptcy without violating the automatic stay. See *In re Covington*, *supra* at 40.

This leads to another question, when does property become exempt during a bankruptcy? For property to become conclusively exempt, the first step is for the Debtor Spouse to claim the exemption on the bankruptcy schedules. Next, the trustee and creditors have 30 days after the 341 Meeting of Creditors⁷ to object to claimed exemptions. If there are no objections or the objections are overruled, the property is exempt. The actual time available to act while the bankruptcy is pending will be different for Chapter 7 and 13. Chapter 7 cases are generally short, therefore the case will be close to completion by the time the exemptions are final. On the other hand, Chapter 13 cases generally last for several years. Please use caution when attempting to collect from exempt property while a bankruptcy case is pending. If it turns out the Debtor Spouse's exemptions are not finalized, and therefore the property still belongs to the estate, this action will violate the automatic stay.

Finally, there are several factors to keep in mind with this enforcement option. First, § 522(c)(1) does not only apply to no asset cases. Therefore, if the Nondebtor Spouse did receive funds from the trustee but the full claim amount was not satisfied, this option is still available.



Second, the fact that a Nondebtor Spouse can collect from exempt property does not mean that the trustee is permitted or mandated to administer the exempt property for that purpose. In fact, the case law is consistent in finding that the trustee may not administer exempt property. See *In re Covington, supra*; *In re Szekely, supra*; *In re Quezada, supra*; *In re Farr, supra*; *In re Vandeventer*, 368 BR 50 (CD Ill, 2007)). Depending on your view, this may or may not be a beneficial rule. On the one hand, the Nondebtor Spouse must undertake the task of collecting the funds from the exempt property. Most laypersons (and many lawyers) do not have the first clue as to how to liquidate property. On the other hand, there will be no trustee fees to subtract from the recovered funds.

Third, even though the Bankruptcy Code permits the Nondebtor Spouse to collect from exempt property, state law permits certain property to be exempted from judgments. See MCL § 600.6023. By the language of § 522(c)(1), it appears the Bankruptcy Code preempts state law exemption statutes. It states:

. . . notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in section 523(a)(5).

11 U.S.C. § 522(c)(1).

The case law concerning preemption is split. Some courts have taken the view that § 522(c)(1) trumps state exemption statutes. For example, in *In re Quezada, supra* at 57, the court found that § 522(c)(1) "trumps state law that may otherwise shield this property from execution." Also see

In re Leicht, 222 BR 670 (1st Cir, 1998); *In re Whalen-Griffin*, 206 BR 277 (Bankr D Mass, 1997). However, other courts have taken the opposite view. See *In re Elmasri*, 369 BR 96, 100 (Bankr ED NY, 2007) where the court found that § 522(c)(1) "does not preempt state law, and does not provide means for creditors holding nondischargeable "support" claims to execute upon property that would have been exempt from such collection efforts under state law. . . " Also see *In re Davis*, 170 F3d 475, (5th Cir, 1999).

A final point to keep in mind is that exempt property may have little or no value. An investigation into the value of the exempt property is always wise so that there is no waste of time, money and effort.

ENDNOTES

1. 11 U.S.C. § 101(14A)
2. 11 U.S.C. § 507(a)(1)
3. 11 U.S.C. § 541(a)
4. 11 U.S.C. § 522(d)
5. § 522(c) further applies to other types of debts such as nondischargeable tax liens. See § 522(c) 2-4
6. 11 U.S.C. § 523(a)(5) states that a debtor's discharge, *does not* discharge an individual debtor from any debt that is a domestic support obligation. (Emphasis added).
7. 11 U.S.C. § 341

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