

BANKRUPTCY OR DIVORCE... WHICH SHOULD COME FIRST??

A married couple considering divorce and faced with an insurmountable debt that likely will result in bankruptcy should file a joint bankruptcy, wipe out their mutual debts, and then proceed with their divorces if at all possible. Marital discord however often makes this impossible because a divorcing couple's communication usually has deteriorated to the point where joint financial decisions are no longer possible. In practicality, what occurs instead is the parties hire opposing divorce counsel and try to beat each other to Court with various filings and/or temporary orders in an attempt to gain a financial advantage over the other in Probate Court, leaving their financial debts to be handled by their respective divorce counsel in the final separation agreement.

Unfortunately, if the separation agreement is not crafted carefully enough to state credit card debt responsibility by one party to another is in the form of support (more commonly referred to as DSO), or even worse, if a lien is not placed on joint real estate property prior to the divorce decree taking effect (in a buy-out situation), the spouse responsible for the credit card debt or buyout could file bankruptcy and potentially wipe out the debts that he or she agreed to assume in the separation agreement. See 11 USC 523 generally and 2005 BAPCA changes. Even hold harmless obligations from a separation agreement can be discharged in certain chapter 13 cases.

It is important to note an ex-spouse considering bankruptcy will not be able to discharge assumed debt resulting from a divorce in a chapter 7 bankruptcy. In fact, these types of post-divorce debts can only be discharged through a chapter 13 bankruptcy. See in re Vicki Lynn Pagels, supra at pp. 11-12. On the other hand, if the parties heading for divorce had first hired bankruptcy counsel, they would have been able to jointly discharge their debt through a chapter 7 bankruptcy (a 3 month process in comparison to a chapter 13's 3 or 5 year process). Again though, it is atypical for spouses considering divorce to work together in filing a chapter 7 bankruptcy so as to discharge their joint debt prior to filing a heated divorce action against each other.

What individuals need to take away from this article is that short of a situation where the spouses can cooperatively file bankruptcies and divorces together ("the rarity"), filing one before the other can have long-term financial consequences, especially in the adversarial divorce process and how separation agreements are agreed to during that process. Thus, persons thinking of either divorce or bankruptcy, or who suspect their spouse of doing so, should consult with both bankruptcy and divorce counsel prior to proceeding with either. They may even want to hire an attorney that practices in both areas of law so that that attorney can more effectively advise while taking into account the client's entire financial picture.