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Bankruptcy Court Finds Debt To Third Party To Be A Non-Dischargeable Debt Incurred In Connection With a Divorce

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Bankruptcy Judge Albert Dabrowski was faced with a unique set of circumstances arising as a result of the intersection of a state court divorce action and a Chapter 7 bankruptcy case. In the matter of Corrine Sawyer v. Scott Sawyer, Adv. Pro. No. 14-2013, the Court found itself facing the question of whether the debt of a Chapter 7 debtor owed to his mother-in-law by operation of a divorce agreement, was a debt of the debtor incurred to his former wife that is non-dischargeable pursuant to Bankruptcy Code §523(a)(15).

As a result of the separation agreement, which terminated the marriage between Scott Sawyer (the "Debtor") and his wife, Corrine Sawyer (the "Plaintiff"), the Debtor agreed to be solely responsible for two loans totaling approximately \$86,600 (the "Loans") that he had received from his then mother-in-law, Ann Crotty ("Mrs. Crotty") and to indemnify and hold harmless the Plaintiff with respect to the Loans. On October 6, 2013, within a year following the divorce, the Debtor filed a Chapter 7 and received a discharge of his debts thereby discharging the remaining balance of the Loans which approximated \$61,000.

Thereafter, on March 14, 2014, the Plaintiff filed an adversary proceeding seeking to have the Loans determined to be a debt that is non-dischargeable as to her as a "former spouse" as a debt incurred by the Debtor in the course of a divorce or separation or in connection with a separation agreement under Bankruptcy Code §523(a)(15) (the "Complaint").

The Debtor responded to the Complaint by filing an answer and special defenses in which he asserted that although he assumed the obligation to pay the debt as part of the separation agreement, since the debt was not owed to the Plaintiff as a former spouse, the debt was dischargeable. Thereafter, the Debtor filed a

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Motion to Dismiss or Alternatively, for Judgment on the Pleadings (the "Motion to Dismiss").

At a non-evidentiary hearing on the matter held on October 2, 2014, the Court made a preliminary determination that unless the Plaintiff could establish that she is validly indebted to her mother such that the liability would be recoverable by a non-collusive judgment against her in a court of law, she cannot prevail under §523(a)(15). The Court then scheduled a hearing for October 30, 2014, to provide the Plaintiff with an opportunity to present evidence and law on that issue.

In the interim, Mrs. Crotty commenced a state court action against the Plaintiff seeking to establish the Plaintiff's liability to repay her the balance of the Loans.

On October 30, 2014, the Court held an evidentiary hearing which admitted documentary evidence and heard testimony from the witnesses. Subsequently, on November 6, 2014, the Court gave the parties an opportunity to appear telephonically and present additional oral arguments in support of their respective positions and at the conclusion of same the matter was taken under advisement.[1]

On December 12, 2014, the Court entered an order requiring the parties to file post-trial briefs limited to the question as to "whether the Plaintiff is validly indebted to Mrs. Crotty, so that the liability would be recoverable by a non-collusive judgment against the Plaintiff in a court of law under a claim of unjust enrichment?" The Plaintiff and the Defendant filed their post-trial briefs on January 8, 2015 and January 9, 2015, respectively.

In a procedural twist, the Court determined that the Motion to Dismiss must be treated as a Motion for Summary Judgment, as required by Fed. R. Civ. Pro. 12(b) (applicable to bankruptcy proceedings pursuant to Fed. R. Bankr. P. 7012) which provides: [i]f on a motion under 12(b)(6) or 12(c), matters outside the pleadings are presented to and not excluded by the court, the motion must be treated as one for summary judgment under Rule 56. All parties must be given a reasonable opportunity to present all material that is pertinent to the motion.

The Court found that although the matter presently before the Court was triggered by the filing of a Motion to Dismiss by the Debtor seeking dismissal of the Complaint, because the Debtor argued that the Plaintiff had no liability for the debt at issue and as a consequence, matters outside of the pleadings were presented by the parties and not excluded by the Court, that the Motion to Dismiss should be treated as one for summary judgment under Fed. R. Civ. P. 56. Federal Rule of Civil Procedure 56(a), made applicable through these proceedings by Fed. R. of Bankr. P. 7056, directs that: [t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.

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In applying the summary judgment standards, the Court found that a critical issue in the dispute is the yet undetermined liability of the Plaintiff to Mrs. Crotty in connection with the remaining balance on the Loans. The Court went on to find that because the issue had been properly raised by Mrs. Crotty in her state court action because she may very well prevail, the Plaintiff's liability related to the Loans had been triggered. As such, by operation of the divorce agreement, the Debtor is obligated to indemnify and hold harmless the Plaintiff's obligations on the Loans, and such is a non-dischargeable debt in this Bankruptcy Case as to the Plaintiff under §523(a)(15), but only to the extent that it is determined by the state court action that the Plaintiff is liable to Mrs. Crotty.

Had the indemnification language not been contained in the separation agreement at issue here, the debt would have clearly been dischargeable as to the Plaintiff. So, as a practice note to practitioners, especially family law practitioners, it is important to keep this issue in mind when drafting separation agreements where one party assumes responsibility for the payment of a debt owed to a third party.

[1] Although no party sought to file any additional supporting briefs or pleadings upon the conclusion of the telephonic hearing on November 6, 2014, the Plaintiff, on November 10, 2014, filed a motion for an order in which she asked the Court to consider a new argument that the debt to Mrs. Crotty to which the Debtor agreed to hold the Plaintiff harmless was not discharged because the Plaintiff was not listed as a creditor on the Debtor's bankruptcy schedules in connection with the debt to Mrs. Crotty, which the Court summarily dismissed as not being relevant to a determination of Plaintiff's liability to repay a debt to a third person who is not a party to a divorce.

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