

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In re:

Scott H. Smith,

CASE NO. 96-22706

Debtor.

Rosamond B. Smith,

Plaintiff,

A.P. NO. 96-2317

vs.

Scott H. Smith,

DECISION & ORDER

Defendant.

BACKGROUND

On September 17, 1996, Scott H. Smith (the "Debtor") filed a petition initiating a Chapter 7 case. On December 6, 1996, Rosamond B. Smith ("Rosamond Smith"), the Debtor's former spouse, filed an adversary proceeding (the "Adversary Proceeding") to have the Court determine that the amounts due her pursuant to Article III of a December 27, 1990 Separation Agreement (the "Separation Agreement"), entered into between her and the Debtor, were nondischargeable under the exception to discharge set forth in Section 523(a)(15).

The Complaint in the Adversary Proceeding alleged that: (1) the Debtor and Rosamond Smith had been married for more than 20 years and during that time they had four children, all of whom were emancipated; (2) the Separation Agreement had been incorporated by reference into a December 28, 1990 Judgment of Divorce (the "Divorce Decree"); (3) Article III of the Separation

Agreement required the Debtor to pay to Rosamond Smith a distributive award in the sum of \$60,000.00, payable in monthly installments of \$1,000.00 for a period of five years, with payments to commence on February 1, 1991 (the "Marital Obligation")¹; (4) there remained outstanding on the Marital Obligation the sum of \$46,750.00, together with interest from November 7, 1996; and (5) the Debtor had the ability to pay the Marital Obligation and any benefit to him from discharging the Obligation would not outweigh the detrimental consequences of discharge to Rosamond Smith.

On March 7, 1997, after the Debtor had interposed an Answer which denied the material allegations of the Complaint, Rosamond Smith filed a Motion Requesting Leave to File an Amended Complaint (the "Motion to Amend"). The Motion sought to add a separate and additional cause of action for the Court to determine that the Marital Obligation was nondischargeable under the

¹ The complete provision in the Separation Agreement reads as follows:

As and for the Wife's distributive share of the marital estate of the parties, the Wife shall receive, and Husband shall execute and deliver to the Wife a Quit-Claim Deed conveying all of his right, title and interest in and to the marital residence located at and commonly known as 50 Idlewood Road, Rochester, New York. Husband waives any claim or interest he may have in any of the property held by his Wife in her name or in her possession, and the Husband shall also receive as his distributive share of the marital property of the parties his Retirement KEOGH Plan at Bayer & Smith, and the Wife makes no claim for a direct distributive award of the Husband's license to practice law, or his practice, or his partnership. In consideration of the foregoing, the Husband shall pay to the Wife a distributive award in the sum of Sixty Thousand (\$60,000.00) Dollars payable in monthly installments of One Thousand (\$1,000.00) Dollars, for a period of five (5) years. The payments shall be made on the first day of each and every month, commencing on February 1, 1991. In the event that a payment is received after the sixth day that it is due, a late charge of two percent (2%) per month shall be added.

exception to discharge set forth in Section 523(a)(5).² The Motion alleged that the Marital

² Section 523(a)(5) provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title 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 made in accordance with State or territorial law by a governmental 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 designated as alimony, maintenance, or support, unless such liability is actually in the

Obligation was a disguised maintenance agreement because there was a January 4, 1991 Addendum (the "Addendum") to the Separation Agreement, wherein Rosamond Smith affirmed that "in the event of her marriage, cohabitation or death, the undersigned does waive monthly installment payments as set forth in Article III of the said Agreement and that this waiver is binding upon the heirs, successors and assigns of the undersigned."

On March 24, 1997, the Court entered an Order granting the Motion to Amend. It entered the Order after it had heard oral argument and determined that: (1) a request for a determination of nondischargeability under the exception to discharge set forth in Section 523(a)(5) was not in any way time-barred; (2) the Court had jurisdiction to make such a determination; (3) the Addendum indicated that the intent of the parties regarding the Marital Obligation might be other than as set forth in the Separation Agreement; and (4) a determination under Section 523(a)(5) in the Adversary Proceeding, rather than in a separate adversary proceeding, would: (a) not prejudice the Debtor; (b) serve the interests of judicial economy; and (c) save added costs for the parties.

After Rosamond Smith served the Amended Complaint, the Debtor, an attorney, interposed an Answer with Counterclaims which alleged that: (1) during the calendar years 1991 and 1992 he had paid Rosamond Smith \$21,000.00 in \$1,000.00 monthly installments, as partial repayment of the Marital Obligation; (2) in August, 1995, he had made an additional payment of \$25,000.00 on

nature of alimony,
maintenance, or
support.

the Marital Obligation; (3) an August 12, 1994 Order of the New York State Supreme Court, which granted Rosamond Smith a judgment in the amount of \$20,220.00 for the unpaid installments then due from the Debtor on the Marital Obligation, denominated the Obligation as a "distributive award"; and (4) if this Court determined that the Marital Obligation was a disguised maintenance agreement, the Debtor should receive a credit for income taxes which he had unnecessarily paid in the amount of \$17,020.00, together with interest, since spousal alimony, maintenance or support is otherwise deductible by the payor.

In a May 29, 1997 Reply to the Debtor's Counterclaim, Rosamond Smith admitted that the Debtor had made partial payments on the Marital Obligation to the extent of \$21,000.00 in the calendar years 1991 and 1992 and \$25,000.00 in August, 1995.

On July 1, 1997, the Court conducted a trial in the Adversary Proceeding, at which the following witnesses testified: (1) George K. Forsyth, Esq. ("Attorney Forsyth"), Rosamond Smith's matrimonial attorney; (2) James A. Valenti, Esq. ("Attorney Valenti"), the Debtor's matrimonial attorney; (3) Rosamond Smith; and (4) the Debtor.

DISCUSSION

I. SECTION 523(a)(15)

After discovery and by the time of the trial, the parties had agreed that the Debtor did not have the ability to pay the Marital Obligation within the meaning and intent of Section 523(a)(15)(A), and Rosamond Smith elected to proceed only with her cause of action pursuant to Section 523(a)(5).

II. SECTION 523(a)(5)

_____ From the decision of the United States Court of Appeals for the Second Circuit in *In re Brody*, 3 F.3d 35 (2d Cir. 1993), and the cases cited therein, we know that: (1) the intent of the parties at the time a separation agreement was executed determines whether a payment pursuant to the agreement is alimony, support or maintenance within the meaning of Section 523(a)(5); (2) all evidence, direct or circumstantial, which tends to illuminate the subjective intent of the parties, is relative to this determination; (3) courts have looked to a variety of factors ("523(a)(5) Factors") in seeking to ascertain the mutual intent of the parties, including the following non-exclusive list: (a) the length of the marriage; (b) whether the obligation is subject to such contingencies as death or remarriage; (c) whether there are minor children; (d) whether the obligation appears to balance disparate incomes; (e) whether the obligation is payable periodically or in a lump sum; (f) whether there is an actual need for support; (g) whether the award is modifiable; (h) the section of the order or agreement where the award is found; (i) whether the obligation imposed was designed to rehabilitate or assist the spouse's rehabilitation after the divorce; (j) the structure of the terms of the final decree; (k) whether there was a division of property and debts; (l) whether the former spouse was shown to have suffered in the job market, or was otherwise disadvantaged because of any dependent position held in relation to the debtor during the marriage; (m) the age and health of the former spouse; (n) the nature of the obligations assumed; (o) the relative earning power of the spouses; and (p) the parties' negotiations and understandings of the provisions; (4) although a written

manifestation of agreement is persuasive evidence of intent, the labels that the parties attach to a payment are not dispositive; (5) the court must look to the substance, and not merely the form, of the payment; (6) the Parol Evidence Rule does not apply in a case under Section 523(a)(5), since a factual inquiry is never limited to the four corners of a separation agreement or divorce decree; and (7) whether a payment is alimony, support or maintenance within the meaning of Section 523(a)(5) is a question of federal bankruptcy law, not of state law, and although the status of a payment under state law is relevant to the determination, it is not dispositive.

A. Equitable Distribution Awards for Enhanced Earnings in New York State

In an unpublished Decision & Order by this Court in *Carol L. Zazzaro v. Arthur D. Zazzaro*, Case #96-22956, A.P. #96-2327 (September 12, 1997), it was expressed that: (1) because awards of "Enhanced Earnings" (equitable distribution awards of a percentage of the present value of a degree earned by one spouse during a marriage) were at that time being almost mechanically awarded by the New York State Courts as the division of a property interest, parties must factor these potential awards into their negotiations when they attempt to arrive at a settlement agreement which presents an economic package that will induce both parties to settle the marital action and finally legally end the marriage; (2) the payment provisions in such settlement agreements are often more dependent upon income tax considerations, whether payments will end on death, remarriage or cohabitation, economic pressures from the mounting costs of the matrimonial action, the fact that one party may not have good "grounds" in fault states like New York, some items which for one or the other of the spouses are non-negotiable deal-breakers, often for emotional rather than economic

reasons, and a seemingly endless list of other factors; (3) this mix of factors and the resulting labels placed upon the payment provisions in a settlement agreement often obscure the actual intention of the parties as to whether a payment is in the nature of support or in the nature of the division of a property interest; (4) the existence of a potential award of Enhanced Earnings often serves to further confuse the intention of the parties as to whether a payment is in the nature of support or the division of a property interest; and (5) to the extent that the decision in *In re Raff*, 93 B.R. 41 (Bankr. S.D.N.Y. 1988), could be read to hold that all awards of Enhanced Earnings made by a New York State court, or all awards of Enhanced Earnings, even those contained in separation agreements, are in the nature of alimony, support or maintenance, this Court disagreed, believing that the income stream from awards of Enhanced Earnings could be true divisions of a property interest in some factual situations, in the nature of alimony, support, maintenance in other factual situations, and even partially property division and partially support in yet other factual situations.

B. The Marital Obligation

From the testimony at trial in this Adversary Proceeding, it appears that: (1) during 1986 the parties separated and began living apart; (2) although she may have worked briefly in the early years of the marriage, Rosamond Smith generally did not work during the marriage, and she did not work at all during the separation period from 1986 through December, 1990; (3) upon her mother's death in 1981, Rosamond Smith received a substantial inheritance, the principal of which increased during the marriage so that during the separation period it provided her with an annual income of approximately \$28,000.00 (exclusive of any capital sales); (4) during the separation period, the

Debtor paid: (a) the real estate taxes on the jointly owned marital residence where Rosamond Smith continued to reside; (b) some or all of the mortgage payments, telephone bills, repairs, water bills, and refuse removal bills for the residence; (c) Rosamond Smith's health insurance; and (d) at times other monies to Rosamond Smith which she used for her general living expenses; (5) during the separation period, the parties discussed a stream of payments that Rosamond Smith desired to receive in order to supplement the income she would continue to receive from her inheritance, and thus be able to maintain her pre-separation lifestyle for a number of years after she lost any contribution from the Debtor; (6) the parties' discussions concerning such a payment stream, once the amount of \$1,000 a month was agreed to, focused primarily on the number of years the payment would continue and the income tax treatment of the payment; (7) the Addendum was negotiated by Rosamond Smith and the Debtor privately, and was purposely not included in the Settlement Agreement in order to eliminate any argument (primarily by the Internal Revenue Service) that the payment was for maintenance or support, since Rosamond Smith had made it clear that she wanted the payments to her to be non-taxable; (8) the Debtor was interested in finalizing a separation agreement and obtaining a divorce before the end of 1990 so that he could immediately remarry and secure certain income tax benefits for the 1990 tax year; and (9) throughout the negotiations and discussions regarding a separation agreement, the Debtor believed that he would have to pay something to Rosamond Smith because of the Enhanced Earnings issue, and he was concerned with minimizing the amount of any such payment since he believed that if a direct award were made by the State Court, it might have been for an amount significantly greater than the \$60,000.00 finally

agreed to with Rosamond Smith.

Based upon all of the facts and circumstances presented, and having considered the 523(a)(5) Factors, I find that the Marital Obligation (\$60,000) was in the nature of alimony, maintenance or support within the meaning and intent of Section 523(a)(5) for the following reasons: (1) during the separation period, notwithstanding the income from her inheritance, Rosamond Smith was in need of some additional funds for her support; (2) the Debtor's payment of some of Rosamond Smith's expenses and health insurance during the separation period, and as late as 1990, indicated an acknowledgment by the parties, and specifically by the Debtor, of Rosamond Smith's need for some level of support; (3) Rosamond Smith had not worked for the majority of the marriage and was not easily employable at the time of the parties' separation or Divorce Decree, however, she apparently made no concerted effort to become employed or more employable during the separation period; (4) there was a substantial income disparity between the parties at the time of the separation and the Divorce Decree, the Debtor's annual income being approximately three times Rosamond Smith's regular income from her inheritance; (5) it would not have been unreasonable, clearly erroneous or an abuse of discretion for a New York State court at the time of the Divorce Decree, after considering all of the factors set forth in the New York Domestic Relations Law, to have awarded Rosamond Smith support in the amount of \$1,000.00 per month for a 60-month period, although it may have been on the high side of the reasonable range; (6) the terms of the Addendum, which terminated the Marital Obligation on Rosamond Smith's death, remarriage or cohabitation, indicated an acknowledgment by the parties, and specifically Rosamond Smith, that she was looking only for

a short-term payment stream to help her maintain her pre-separation lifestyle while she got back on her feet, and that the payment stream would not be necessary if she died, remarried or cohabitated, indicating that she did not view the payment solely as a division of property.

C. Debtor's Counterclaim

The Bankruptcy Court's determination that an obligation is in the "nature" of alimony, maintenance or support for purposes of Section 523(a)(5), is only a determination that under federal bankruptcy law, which is the applicable law, the obligation is nondischargeable. *See Grogan v. Garner*, 498 U.S. 279, 284 (1991). Such a determination does not mean that under state law or for purposes of the Internal Revenue Code the obligation is thereafter transformed into a maintenance obligation. Therefore, this Court's finding that the Marital Obligation (\$60,000) is in the "nature" of alimony, maintenance or support for nondischargeability purposes, does not directly affect the parties' income tax liabilities with regard to any payments made on the Obligation. As a result, the Debtor's counterclaim for a credit against the Marital Obligation for income taxes paid in connection with the funds used to make prepetition partial payments or any future payments is denied.

D. Late Charges and Attorney's Fees

Based upon the facts and circumstances of this case, I find that only the principal amount of the Marital Obligation, or \$60,000.00, was at the time of the Separation Agreement and Divorce Decree in the "nature" of alimony, maintenance or support for Section 523(a)(5) nondischargeability purposes. As partial payment of this principal amount due, the Debtor has paid \$46,000.00, leaving a balance of \$14,000 due and nondischargeable.

I find that Rosamond Smith has not met her burden to show by a preponderance of the evidence that the late charges of 2% per month, which appear to be more of a penalty than an amount even reasonably calculated to compensate for a loss of the use of funds, were intended by the parties to be support or that they are in the "nature" of support within the meaning and intent of Section 523(a)(5). Further, although attorney's fees for the enforcement or collection of the amounts due on the Marital Obligation are collectible under Article XIX of the Separation Agreement, I find that Rosamond Smith has not met her burden to show that such fees, if incurred, were intended by the parties to be support or that they are in the "nature" of support within the meaning and intent of Section 523(a)(5). These amounts, although they may be legally due and owing, are unsecured dischargeable claims.

This Court believes that there will be times when an award of attorney's fees, whether made by a state court in a prior proceeding or this Court in connection with an adversary proceeding to have the Court determine whether an obligation falls within the exception to discharge set forth in Section 523(a)(5), will be found by this Court also to be in the "nature" of support, and therefore nondischargeable. Similarly, it may be that interest or late charges, required to be paid by the terms of a separation agreement or by a prior state court award, will be found by this Court to be in the "nature" of support for purposes of Section 523(a)(5). At times late charges, interest or attorney's fees may be "...essential to a spouse's ability to sue or defend a matrimonial action...", *See In re Spong*, 661 F.2d 6 (2nd Cir. 1981), or essential for that spouse to be able to receive or to collect support. However, after reviewing all of the facts and circumstances presented by this case,

including the Section 523(a)(5) Factors, and the parties' testimony at trial, I find that Rosamond Smith has not met her burden to show that the parties intended that any late charges from non-payment of installments or attorney's fees incurred in order to enforce the Marital Obligation would be support or in the "nature" of support for the following reasons: (1) although Rosamond Smith may have continued to require some additional support, which it appears that the parties acknowledged and intended: (a) she did have independent wealth; (b) she did not appear to have made any substantial efforts to work or become more employable during the separation period; and (c) any additional support required was principally to keep her in a pre-separation lifestyle without invading her substantial inheritance, rather than to provide for her actual and necessary daily living expenses; (2) although he acknowledged by his actions during the separation period that there was a need for some level of ongoing short term support, the Debtor was primarily motivated to resolve the Enhanced Earnings issue, knowing that he would have to pay something to Rosamond Smith because of it, and he was not as concerned with how the payment was labeled once he insured that it: (a) would end on death, remarriage or cohabitation; and (b) was less, even after income tax consequences, than he was concerned that it might have been; (3) the parties did agree to treat the payment in the Separation Agreement as a property distribution, even with the advice of sophisticated counsel, and thus to forego related special state court enforcement remedies for the collection of any unpaid amounts; and (4) Rosamond Smith could afford to pay any counsel fees incurred in connection with the enforcement of the "distributive award" and did not require the late charges for her actual and necessary daily living expenses. Therefore, the unpaid late charges and

any attorney's fees incurred in connection with the enforcement of the Marital Obligation are dischargeable as not being in the "nature" of support for purposes of Section 523(a)(5).

CONCLUSION

The Debtor's counterclaims are in all respects denied. The obligation of the Debtor to pay \$14,000.00 to Rosamond Smith is nondischargeable pursuant to the exception set forth in Section 523(a)(5) because the Court finds that it was and is in the "nature" of alimony, maintenance or support. The obligation of the Debtor to pay any additional sums to Rosamond Smith pursuant to the parties' Separation Agreement is dischargeable because the Court finds that such obligation does not fall under either of the exceptions to discharge set forth in Sections 523(a)(5) or (a)(15).

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY JUDGE

Dated: November 19, 1997