

Divorce, property settlements, and bankruptcy. Oh my!

There's nothing simple about divorce and bankruptcy. We'll peel off one leaf of that very large subject and see what can happen if someone files bankruptcy after a divorce with a property settlement.

One common provision of a divorce property settlement agreement is that when both spouses are liable for a debt, the agreement assigns the debt to one spouse (Spouse 1) and also says that Spouse 1 must indemnify (pay) the other spouse (Spouse 2) if Spouse 1 doesn't pay that debt and the creditor goes after Spouse 2 for it.

What happens if, after the divorce, Spouse 1 files bankruptcy and gets a discharge of debts?

Chapter 7 (the "simple" bankruptcy in which debts are discharged quickly)

- Spouse 1 no longer has a legal obligation to pay that debt.
- Spouse 1 still has the duty to indemnify Spouse 2 if the creditor attempts to collect that debt from Spouse 2.
- No surprises here.

Chapter 13 (the payment-plan type of bankruptcy)

- Spouse 1 no longer has a legal obligation to pay that debt. (Note that in a Chapter 13, that creditor may have been paid a small percentage of the amount owed, a larger percentage, or 100%.)
- **Spouse 1 no longer has the duty to indemnify Spouse 2 if the creditor attempts to collect that debt from Spouse 2.**
- The well-crafted property settlement agreement just went down in flames.

How would you avoid that result?

One way to avoid that result would be for the spouses (while still married) to do a joint Chapter 7 bankruptcy, which may or may not be possible or advisable depending on the circumstances. If that would work, then it would get rid of their debts so there would be none to assign to either spouse in the property settlement agreement.

What's the takeaway here?

- If you're married and thinking about divorce and you and your spouse have significant debts, make sure to discuss the possible scenario described above with your divorce/family lawyer.
- If you're already divorced and have significant debt including debt assigned by your property settlement agreement, do yourself a favor and consult with an experienced bankruptcy attorney in your area.

Malcolm Ruthven
Attorney at Law
San Francisco Bay Area
415.342.4666 Fax 415.869.6645
mruthven@mruthvenlaw.com
ca-bklaw.com



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