United States Bankruptcy Court
District of New Mexico

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Filer Information

Submitted By: Mary B. Anderson

Comments: Minutes of Hearing Held on February 22, 2001 regarding Claim of Rita Jawort. Claim granted priority status.

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

Clerk's Minutes

Before the Honorable James Starzynski

James Burke, Law Clerk
Jill Peterson, Courtroom Deputy

Joe Jameson Court Reporters
(505) 242-2809

Sara XXXXX

Date:
Thursday, February 22, 2001

In Re:

DAVID IVERSON
No. 13-00-12058 SR

Oral Ruling on Claim of Rita Jawort

Atty for Debtor: Gary Ottinger
Atty for Rita Jawort: Steve Mazer
Atty for Trustee: Annette DeBois

Summary of Proceedings:

Exhibits _____

Testimony _____

Claim granted priority status.

IVERSON ("Debtor") 13-00-12058
ORAL RULING ON PRIORITY STATUS OF CLAIM OF RITA JAWORT

Issue is the priority status of the claim of Rita Jawort ("Claimant" or "Jawort") for $1500/month: §1322(a)(2) –> §507(a)(7). Trial of the matter took place on November 21, 2000. Counsel: Gary B. Ottinger for Debtor Iverson; Steve Mazer for Claimant Jawort.

Jurisdiction of parties and subject matter – 1334 and 157
Core proceeding – 157(b)(2)(B)
Findings and conclusions – 7052

Have reviewed exhibits, read and reread notes from trial (JSS and JEB), reviewed portions of file, and reviewed statutes and case law. Incorporate decision in Wylie v Wylie, 98-1072 (Doc. 30).

Partial factual summary:
Parties were married to each other, and during that time they lived first in Chicago and then in Ruidoso, where she worked as his office assistant for his insurance sales business. In May 1996 they went to attorney Don Dutton in Ruidoso to get a divorce petition and MSA (Marital Settlement Agreement) filed. Although the attorney was representing Jawort, he testified that he also told the Debtor he would be fair to the Debtor and would not deceive him. (Court finds no evidence that attorney did anything other than treat Debtor fairly and not deceive him.) (No children, so the issue of child support does not arise.) The MSA provided that Debtor would pay Jawort $2m/month for about 36 months, which money was to go to pay back debts they incurred to her family members. He was also to pay her enough money to pay for health and dental coverage. And he was supposed to pay her $1500/month from his future premium renewal income for 12 years. The MSA characterizes these $1500 payments explicitly as an equalization of assets and not as support. The $2m/month payments, explicitly denominated as 523(a)(5) obligations, have been paid; the $1500/month payments have about 7 years to go.
On April 12, 2000, the Debtor filed a chapter 13 petition. Claimant asserts that the $1500/month payments are in reality support, and therefore entitled to priority status pursuant to §507(a)(7). Debtor disputes that claim, and says they are in fact a property distribution, as the MSA says, and therefore dischargeable.

Analysis:

Test from 10th Circuit (In re Young, 35 F.3d 499, 500 (1994)) is:
- spouses's shared intent about nature of payment, at the time of the decree; and
- whether substance of payment is in nature of support at the time of the decree (whether surrounding facts and circumstances, esp financial, lend support to such a finding).

Additional standards to be used as applicable:

start with MSA but can and should go behind it if need to;
claimant has burden of persuasion (in this case, Jawort);
construe "support" broadly, at least for §523 purposes, and given that the definition of "support" is to be the same under 523(a)(5) and 507(a)(7) because of the virtual identity of the language of those two sections, Dewey v Dewey (In re Dewey), 223 BR 559, 563-64, 565 (10th Cir. BAP 1998); and
strong aversion to sanctioning a sham transaction (taxes).

Note that language of 507(a)(7) is virtually identical to that of 523(a)(5). 523(a)(15) deals with a claim that explicitly is not 523(a)(5), so the Court has assumed that a support claim (that would fit into 523(a)(5)) can also be a priority claim whereas a "mere" property settlement (that is, a claim that is a genuine property settlement and not a support claim, even if in a chapter 7 §523(a)(15) adversary proceeding it would be determined to be nondischargeable) is not a priority claim. See discussion in Dewey, at 566. I think that Claimant argued that somehow the $1500/month should be treated as 523(a)(15) debt and therefore could fit under 507(a)(7). Court rejects that argument as not supported by law or the facts.

Language of MSA (Ex 1) taken alone is quite clear: 3(c) payments of $1500/month are to be treated as property distribution, called "equalization of assets", while para 9 pmts (incorporating para 5(H)) of $2m/month for 36 months for debt repayment to family members are treated explicitly as 523(a)(5) payments and therefore non-dischargeable. Para 6 also distinguishes between the two types of payments. The MSA constitutes what seems to be a clear expression of the parties' intent, and as such also constitutes a "substantial obstacle" to Jawort's characterization of the $1500 payments as support rather than a property distribution. Sampson, 997 F.2d at 723. But as instructed by the statute and case law (eg, Dewey at 566; Sampson at 722-23), I need to go behind the language of the MSA to determine if the written agreement reflects the "reality" (my term) of the true nature of the agreement between the parties. More discussion about this below.

To clarify what is being decided: (1) para 9 payments ($2m/month to repay family) have been completed, and (2) are only talking about the matured but unpaid payments as of petition date that are due under para 3(c) of the MSA. §502(b)(5); 4 Collier (15th Ed. Rev. 2000) ¶507.09, at page 507-52; ¶502.03[6][a], at pages 502-38 – 502-40. Of course, the determination of the status of the matured payments should also be applicable to the unmatured payments.

Shared intent:

What is clear is that Jawort wanted to insure that the debt, including the $1500/month, not be dischargeable. She told that to Debtor and he did not disabuse her of that notion (Debtor said that he did not know what she meant by "not doing this to me" but he did not ask her for clarification – but given what seemed to be several statements

on her part about not having him eliminate her debt by bankruptcy, as he had done with his previous bankruptcy filing in Chicago to someone else (which she was very aware of), I think he knew fairly well what she meant and did not need to ask). And the attorney testified that he discussed that issue with both of them when they met together with him. I realize that Debtor's testimony differs from that somewhat, but I think that if he had a different impression or intention (and the Court is not convinced that he did have a different understanding at the time), he did not convey it to her or the attorney at that time. And this intention, or lack of conveying the opposite intention, would not be dependent on him seeing and approving the specific language of the MSA. It was also his testimony that he knew she was getting $1500/month and what she did with it was her business.

And her goal of avoiding discharge of the debt owed to her is what the attorney attempted to accomplish in the MSA. He testified that after attending a CLE with Barbara Shapiro (a family law expert in NM), he concluded that the $1500/month would be treated as a §523(a)(15) debt if the Debtor filed bankruptcy: the renewals would continue to be treated as a property settlement, but because she would be hurt very much if she did not get the $1500 and he would be relatively well off, the $1500 obligation would therefore not be dischargeable and the payments would continue to go to her. He did not treat the $1500 as 523 (a)(5) support or alimony for tax purposes, which Court will address shortly in this decision. But the attorney testified that his reasons for not labeling the $1500 a month 523 (a)(5) debt had nothing to do with whether it was support or not; that is, he intended the $1500/month to function as support but labeled it something else for tax reasons. (Claimant testified that Debtor would have to pay her more if she was going to have to pay taxes on the income received. Debtor denies that there was any such discussion.) And this was consistent with what the attorney understood his instructions were from both parties. He may have not done the best job drafting the MSA to anticipate a chapter 13 filing by the Debtor (a little knowledge is a dangerous thing), but the testimony of the parties makes clear enough that the parties had at least this shared intent that was supposed to inform the agreement: the $1500 payments to Claimant were to be nondischargeable.

In addition, Attorney testified that there was no doubt (at that time) that this was the money that she was going to live on. This is consistent with (a) the MSA language that the para 3 money was going to repay family debts (and therefore not to RJ's support), and the testimony that (b) she was going to California to go back to school to get degrees to support herself, and thus would not have a job to bring in significant funds to support herself, and (c) that the additional amounts she was receiving (about $400/month directly from Northwest Mutual, where his checks were coming from) were going for health and dental premiums only. (On the other hand, if the claimant were entitled to $1500/month as a property settlement, and the funds were available, then arguably there would not be a need for support or alimony.)

The attorney also testified unequivocally that he drafted the document the way he did in order to minimize or avoid payment of additional taxes. This statement, among others, could be construed as an admission against interest (for potential tax fraud), although testifying otherwise or testifying that he did not remember could probably have a

more damaging effect on him if he were to get sued by Jawort for malpractice. (The attorney appeared to be candid during his testimony to the Court.) The attorney also stated he specifically discussed the provisions and intent of the MSA with Debtor, including that the $1500 was actually support and not dischargeable. Debtor denies that any such conversation took place, and also denies that any discussion took place about the tax treatment and what might have been a requirement to pay a higher sum to her if the $1500 was denominated "alimony".

Although the Debtor also testified that he was making the $1500 payments to her in recognition of her hard work, and that what she did with the $1500 was no concern of his and not relevant, he also testified candidly that he knew she was going to use the money and not be putting it into an investment account. That fact would argue that the Debtor understood clearly the funds were to be used as support.

Debtor also testified that (1) what the attorney put into the MSA was what was on the yellow legal pad that Jawort handed over to the attorney, and (2) what was on the yellow legal pad was what Jawort wanted. Since it is clear from the testimony that Jawort wanted to ensure that the obligations to her were not discharged, it makes sense to read the agreement as trying to accomplish that.

Debtor testified that after he looked at the MSA, he said he could "live with it." The Debtor would not, in the Court's opinion, have known what portions of the payments, particularly the $1500 payments, could be discharged or not. What is clear to the Court is that the Debtor did not dispute, with Claimant or the attorney, that none of the debt could be discharged; indeed, he appears not to have dealt with this issue at all, even according to his own testimony.

It did turn out later that the income he anticipated having did not stay that high (he testified that the value of his renewals went down because he was suffering from depression, which the Court finds credible, particularly after a divorce), but that is irrelevant for purposes of this analysis.

The Court concludes that the debt was not to be discharged, and that the parties both understood that and shared that intent. That means in turn that this Court will treat the debt – the $1500/month – as support. This is in some ways a backward way to get to the result, sort of like arguing from the effect back to the cause, but it reflects what it was that the parties agreed on and what the consequences are of that agreement.

Substance of the agreement:

Testimony was that Jawort had worked for Debtor's agency for years, but for the last year or so, had worked as a casino dealer at Inn of the Mountain Gods, but was now going to the west coast to go to school for a prolonged period of time. She also testified that she was leaving with a total of $500 in her pocket, and was scared to death. And Ex 10, her 1996 tax return, shows an adjusted gross income of $8,881. Clearly the function of the $1500 at the time of the divorce was to serve as support; in itself this finding is sufficient to find that the $1500 should be considered as support for purposes of this hearing. Dewey at 565; Sampson v. Sampson (In re Sampson), 997 F.2d 717, 725-26 and n. 7 (10th Cir. 1993). "Had the actual effect of providing support to [Jawort] – enabling

her to have a monthly income." Dewey, page 566.

Both the parties knew that this stream of income would not be discharged – that is, it would continue regardless of a bankruptcy filing, since, as discussed above, that was her primary goal in the negotiations and he appears never to have opposed it. So it does not matter that the attorney did not treat the income stream as a property settlement to bo collateralized or secured. Treating the obligation as support accomplishes what the parties contemplated and how they treated the payments in reality. The parties did treat the $1500 as income to her upon which she was going to live. And it appears, based on her 1996 return (recall that the divorce took place in May 1996) that initially she was dependent on the $1500 to live on. As it turned out, the following two years she did not perhaps need the funds, given her income for CY 97 and 98, but the determination of the substance of the transaction – how the funds were actually used – is to be made at the time of the MSA and the parties' contemplation at that time, not in hindsight. (Her income went back down in 1999, to the point where she did not even need to file a return.)

To be clear, this determination, and the one about the "shared intent" of the parties, are made as of the date of the MSA.

Court is very concerned that the Court's finding about the $1500/month being "support" payments runs directly contrary to the language in the MSA, the parties' written agreement. The Court is keenly aware of the 10th Circuit's instructions in Sampson, 997 F.2d at 723, in which it said that a written agreement between the parties is "persuasive evidence of intent." This Court's decision in Wylie was easier, in that the findings based on oral testimony were consistent with the written agreement of the parties in that case. And more than that, the attorney in this case even attempted to use federal bankruptcy concepts in describing the parties' obligations. As this decision makes clear, the Court finds that the attorney's drafting attempt failed, at least as compared with what the Court finds were the shared intentions and behaviour of the parties. Nevertheless, I think I need to "override" the written MSA for several reasons:

The federal statute and case law permit and even require the Court to "look behind" the MSA to determine the reality of the arrangement between the parties, as stated above. That would be the case even under New Mexico state law (assuming that New Mexico state law on this subject were relevant): When a contract's terms are clear and unambiguous, courts ascertain the intent of the parties from the ordinary meaning of the language in the agreement. Continental Potash, Inc. v. Freeport-McMoran, Inc., 115 N.M. 690, 704, 858 P.2d 66, 80 (1993). "If the court decides a writing was intended as the contract, the court is bound by the parol evidence rule from hearing collateral evidence for the purpose of construing the contract in a manner that varies or contradicts the clear and unambiguous language of the contract." C.R. Anthony Company v. Loretto Mall Partners, 112 N.M. 504, 507, 817 P.2d 238, 241 (1991). If a document is intended as a complete integration of the parties' agreement, the parol evidence rule further requires exclusion of evidence that contradicts or changes the terms of the document. Taylor v. Allegretto, 112 N.M. 410, 413, 816 P.2d 479, 482 (1991). A court may, however, be called upon to

decide if the written contract is ambiguous or has mistakenly stated a term contrary to the parties intent. C.R. Anthony Company, 112 N.M. at 507, 817 P.2d at 241. Under New Mexico law a court may consider extrinsic evidence to make a preliminary finding either on the question of ambiguity, Mark V, Inc. v. Mellekas, 114 N.M. 778, 781, 845 P.2d 1232, 1235 (1993), or on the question of whether the agreement mistakenly states a term contrary to the parties' intent, C.R. Anthony Company, 112 N.M. at 507, 817 P.2d at 241.

If the instructions about looking behind the agreement are to be taken seriously, then there must inevitably be times when the Court does not enforce the MSA as written.

The testimony was quite clear (and the statement that it was "clear" includes this Court's assessment of the credibility of the witnesses) that the $1500/month was intended as support; the only reason the MSA is written differently was the attempt to save taxes. So the MSA mistakenly stated a term contrary to the parties' intent.

The alternative argument for the $1500 was that those payments were intended to represent her share of the renewals – that is, her share of the property which they both owned. And that is what the MSA in fact says. But she also made it clear that regardless of its origins, she considered the $1500 support. And when Debtor testified, he agreed that at that time (May 1996, when the MSA was filed and divorce petition filed and granted) she was asserting a right to a share of the renewals as her property, but his testimony and demeanor made it clear that he was not conceding that she was so entitled, and she said this was his attitude in May 1996 also. (Of course, to the extent that she was not entitled to any of the renewals as a property distribution, then the $1500/month would necessarily have to be support.) Sampson, 997 F.2d at 725.

Tax treatment:

The returns show that he never took a deduction for the $1500 payments, and that she never treated them as income (with the *possible* exception of the 1997 return, Ex. 11, on which one of the W-2s is unreadable). Ironically, as it turns out, an examination of the parties' tax returns, Ex 6-12, shows that Claimant had a higher income level than Debtor in 1997 and 1998. In any event both parties' tax rates were relatively low, given the overall net income they each received in the years following the divorce. So the amount of gain realized by Claimant from the tax treatment they accorded themselves is questionable.

Claimant and the attorney stated and admitted, respectively, that the treatment of the $1500/month was done that way to avoid paying (more?) taxes. This has really bothered the Court, since the Court believes firmly in the Tenth Circuit's statement in Sampson that "We...have a strong aversion to sanctioning a sham transaction which we would effectively be doing if we accepted Defendant's argument..." Id., at 724 n. 6. However, the fact is that the testimony leads inexorably to this conclusion – that support was characterized as a property distribution for tax reasons. This case is more difficult than, say, Sampson or Wylie, because in those cases the treatment of the payments as support was consistent with the tax treatment the parties used. Here, the two "policies" run

counter to each other. However, the standards for making this decision as set out above – parties' shared intent and substance of the agreement – are the determining factors. If it turns out that there has been some tax fraud, then the parties need to deal with that. It is not the function of the Court to override established standards and the facts as they disclose themselves in order to be a tax collector for the government.

Final note:

The Court is aware that the Claimant and the attorney spoke consistently in terms of nondischargeability with respect to the $1500 payments. That of course is not the same thing as, say, the use of a security agreement and/or lien to secure the obligation; e.g., the use of a garnishment order to prevent the effect of the discharge of the debt. Arguably the attorney could have done that, and in fact the Court has considered whether what really happened here was that the attorney drafted the MSA correctly but failed instead to secure the stream of payments. Such an arrangement would have avoided the need for all this litigation. But of course the attorney did not collateralize or secure the stream of payments, so we need to examine what it was that the parties intended at that time, and, as the Court has, I hope, made clear, the Claimant was speaking not so much of dischargeability as we understand it technically, but basically insisting that the Debtor not be able to cease the payments to her. By characterizing the $1500 payments as support, the Court has characterized the payments the way that the parties themselves were thinking of them, and therefore believes it is correct in the analysis and the result of this decision.

Also need to add that this was a very difficult decision. For example, what else could the Debtor have done to make the situation clear? Did he need to have hired his own attorney so he too could have an "oath helper" on his side to balance out hers? Short of there being more money available, he could not have done anything else, with one significant exception: if he disagreed that any of the debt to her was to be dischargeable, he could have insisted that there be a clear statement in the MSA to that effect. All the rest of the language in the MSA dealing with bankruptcy, implicitly (such as the equalization of income) or explicitly (such as the reference in para 3(c) to §523(a)(5)), would require some expertise to interpret and understand the implications of. But a clear statement that one part or another of the payments to her could be discharged in bankruptcy would have brought the issue she was most concerned about to the fore, and would have probably led to an explicit resolution of the issue. Ultimately it comes down to the fact that she had nothing at the time of the divorce except as would be coming from him in one form or the other and thus she would need the money to survive on, regardless of whether the payments were characterized as support or equalization of property, and she did not want to risk the loss of any of those payments, and they both knew that and understood that was what was happening.

The Court has considered this dispute from the perspective that the attorney worked out a property settlement (re the $1500) and failed to collateralize it: if that is the case, can Jawort solve her problem simply by claiming afterward that she needed the money to live on and therefore convert a property settlement into support? The answer to that is "no", but that is not what is happening here. One could certainly have a property

settlement which, after looking at all the facts, does not become support but remains a property settlement, despite a claim that the distribution of the property is claimed to be support. That frequently happens, for example, when there is another separate source of support for the spouse receiving the property; merely claiming that something is support does not make it so. Rather, to make this decision, the Court has tried to adhere closely to the standards set out by the Tenth Circuit in the above cited case law. And in doing so, the Court has concluded that, regardless of the wording of the MSA, the parties knew the $1500 would be supporting Jawort, they shared that intent, and in fact that was the function of the $1500 payments immediately following the execution of the MSA. Of course, as pointed out in the Wylie opinion, nothing about this decision precludes either party from going back to state court to change the terms of the support provisions in the MSA. Sylvester v. Sylvester, 865 F.2d 1164, 1166 (10th Cir. 1989); see 11 U.S.C. §362(b)(2)((a)(ii) (filing of petition does not operate as a stay of initiation or continuation of action to establish or modify an order for support).

Conclusion:

Jawort has met the burden of persuasion, by a preponderance of the evidence, that the parties shared an intent to treat the $1500 as support and that the obligation was, in substance, support. Sampson, at 723.

Ruling:

Claim of RJ for prepetition unpaid $1500 monthly payments is entitled to priority treatment. SM to prepare form of order.