

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MISSOURI**

In re:)	
)	
CLIFFORD EARL HERNDON,)	Case No. 03-50591-JWV
)	
Debtor.)	
)	
CLIFFORD EARL HERNDON,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 03-05015-JWV
)	
NENA HERNDON,)	
)	
Defendant.)	

MEMORANDUM OPINION AND ORDER

This adversary proceeding comes before the Court on Clifford Earl Herndon’s (“Clifford”) Complaint to Determine Dischargeability of Debt. Clifford seeks a determination by this Court that debts owing to his former spouse, Nena R. Herndon (“Nena”), denominated in a separation agreement approved by the state divorce court as “maintenance,” are not actually in the nature of alimony, maintenance, or support in the context of 11 U.S.C. § 523(a)(5), and are thus not excepted from discharge in his Chapter 7 bankruptcy. The Court held a trial in St. Joseph, Missouri, on August 21, 2003, and took the matter under advisement. The Court has reviewed the pleadings, relevant case law, and the evidence adduced at trial and is now ready to rule. For the reasons set out below, the Court finds that Clifford’s debt to Nena is excepted from discharge under § 523(a)(5).

I. BACKGROUND

On November 21, 1981, Clifford married Nena in Maryville, Missouri. Neither Clifford nor Nena pursued academics beyond high school. The couple had four children, born in 1982, 1984, 1989, and 1992. To support his family, Clifford engaged in farming operations in Nodaway County, Missouri. He owned 760 acres of farmland jointly with Nena, and he held as separate property an additional 320 acres that he had inherited. While the farming operation was initially prosperous,

flooding in 1993 consumed nearly all of the family's farming capital, and Clifford began to borrow money. Unfortunately, the farm continued to accumulate debt and Clifford declared a net farming loss of \$80,000.00 in 1998; a net loss of \$210,000.00 in 1999; a net loss of \$240,000.00 in 2000; and a net loss of \$340,000.00 in 2001. Nevertheless, in 1999 Clifford calculated his income as a farmer averaged \$3,500.00 per month, and Nena – who obtained employment as a dental assistant – had a monthly pay of \$1,467.00. The couple enjoyed a relatively comfortable material life inasmuch as they were able to maintain a “fairly nice” house and have newer automobiles.

In July 1999, Clifford and Nena obtained a divorce in the Circuit Court of Nodaway County, Missouri. Pursuant to the parties' separation agreement, dated July 12, 1999, Nena was awarded custody of the four minor children, Clifford was ordered to pay \$1,250.00 per month in child support, and Clifford was to pay maintenance to Nena as follows:

13. Maintenance: The Husband shall pay to the Wife the sum of \$348,000.00 in contractual maintenance. This maintenance will be paid as follows: \$30,000.00 within fifteen days of the granting of the Decree of Dissolution. \$15,000.00 on or before the 15th day of October, 1999. Annual payments of \$30,000.00 per year payable on the 15th of October of each year commencing in the year 2000. One final payment in the sum of \$33,000.00 payable on October 15, 2009. This award of maintenance shall be non-modifiable and non-discharge able (sic) by the Husband in bankruptcy. And is necessary for support of the wife and minor child. It is understood that these maintenance payments will be deductible for income tax purposes to the husband and taxable for income tax purposes to the wife. It is understood that this maintenance award will accrue no interest unless any payment is delinquent. It is further understood that should any payment be any more than one (1) week delinquent that the wife shall give written notice of this delinquency and if same is not corrected within a period of one (1) week of the receipt of the notice of delinquency that the entire unpaid balance of the maintenance shall become due and payable in full. Until this maintenance is payable (sic) in full the husband agrees to maintain the Wife as the primary beneficiary on the Life Insurance that he currently has upon himself.

(First Amended Separation Agreement, ¶ 13).¹

Nena testified that the \$30,000.00 yearly figure for maintenance was the product of a discussion with her attorney over how much it would take to support herself over the next ten years as a single mother. Also as part of the separation agreement, Nena executed a quit claim deed to Clifford releasing all of her ownership interest in the farm property and homestead, which enabled

¹ On May 21, 2002, the First Amended Separation Agreement was modified by the Circuit Court of Nodaway County to provide that Clifford's “maintenance” payments were to be due on November 15th of each year instead of October 15th.

Clifford to keep all of the farm property. At the time, the 760 acres which Nina co-owned was subject to an outstanding mortgage in the amount of \$668,531.00, but Clifford only valued the farm property at \$800.00 per acre, or \$608,000.00. Also, apart from a Chevrolet Suburban, virtually all of the personal property remained with Clifford. Excluding non-marital property, Clifford estimated that the parties had \$845,000.00 in total assets and \$932,000.00 in total indebtedness at the time they executed the separation agreement.

After the decree of dissolution was entered in July 1999, Clifford was able to make the mortgage payment on the property – due yearly on the tenth of February – and was able to pay Nena’s maintenance by selling 360 acres of land for \$840.00 per acre. Clifford testified that all but \$60,000.00 of the proceeds went to the mortgagee, and after paying Nena’s maintenance and other debts, such as crop input costs and machinery payments, nothing was left. In October 2000, Clifford was able to make Nena’s maintenance payment because the Bank allowed him to take money from the sale of his crops before the Bank was paid. In December 2000, however, Clifford was forced to sell another 209 acres, which only brought \$735.00 per acre. After paying the mortgagee, Clifford only had \$20,000.00 remaining which he turned over to other creditors. Likewise, in October 2001, Clifford sold another 190 acres at \$900.00 per acre, but no proceeds were left to pay Nena’s maintenance. In 2002, Clifford sold more property, but all proceeds went to the mortgagee. Subsequently, secured creditors began repossessing his farm equipment, and Clifford filed bankruptcy.

Regarding the parties’ treatment of the payments Clifford made to Nena, Clifford deducted the amount paid as maintenance on his federal tax returns. Nena claimed an equal amount as income. Nena also listed the maintenance payments as income when she applied for a residential loan and when her daughter filled out an application for student aid prior to enrolling in college. Furthermore, Clifford listed the obligation as “maintenance” on his bankruptcy schedules.

In October 2002, Clifford quit farming and began work at Kawasaki Motors in Maryville as a machinist earning a net monthly income of \$2,086.53. He also remarried. Nena moved to Texas where she currently works as a real estate agent and one day a week as a dental assistant.

II. DISCUSSION

Debts arising out of a maintenance obligation to a former spouse are generally excepted from discharge in a Chapter 7 bankruptcy proceeding. Specifically, the statute 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—

....

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

11 U.S.C. § 523(a)(5).

Initially, the creditor bears the burden of proof that a debt falls within the parameters of § 523(a)(5) – i.e., the creditor must show that the debt was incurred to a former spouse and was in the nature of alimony, maintenance, or support under Missouri law. *See generally Grogan v. Garner*, 498 U.S. 279, 287-88, 111 S. Ct. 654, 659-60, 112 L. Ed. 2d 755 (1991) (stating that a creditor bears the burden of proof by a preponderance of the evidence in establishing an exception to discharge). Even though a state court may denominate a payment as maintenance, "[b]ankruptcy courts are not bound by state laws that define an item as maintenance or property settlement, nor are they bound to accept a divorce decree's characterization of an award as maintenance or a property settlement." *Williams v. Williams (In re Williams)*, 703 F.2d 1055, 1057 (8th Cir. 1983). *Cf. Sorah v. Sorah (In re Sorah)*, 163 F. 3d 397, 401 (6th Cir. 1998) (stating that a bankruptcy court should give deference to a state court's label on an award when the label and structure of the award resemble alimony); *Kelly v. Jeter (In re Jeter)*, 257 B.R. 907, 910 n.2 (B.A.P. 8th Cir. 2001) (same). The crucial issue is the function that the state court award was intended to serve. *Williams*, 703 F.2d at 1057. Although statutory exceptions to discharge normally are narrowly construed, *Werner v. Hofmann*, 5 F.3d 1170, 1172 (8th Cir. 1993) (per curiam), the exception for spousal support is given a more liberal construction to effectuate the Congressional policy favoring enforcement of familial support obligations over the debtor's fresh start. *Holliday v. Kline (In re Kline)*, 65 F.3d 749, 750-51 (8th Cir. 1995); *Miller v. Gentry (In re Miller)*, 55 F.3d 1487, 1489 (10th Cir. 1995), *cert. denied* 516 U.S. 916, 116 S. Ct. 305, 133 L. Ed. 2d 210 (1995).

Under Missouri law, a court awards a spouse maintenance only if the spouse seeking an award lacks sufficient property to provide for his or her reasonable needs, and is unable to support him/herself through appropriate employment. Mo. Rev. Stat. § 452.335. The amount of maintenance is based on all relevant factors, including:

- (1) The financial resources of the party seeking maintenance, including marital property apportioned to him, and his ability to meet his needs independently, including the extent to which a provision for support of a child living with the party includes a sum for that party as custodian;
- (2) The time necessary to acquire sufficient education or training to enable the party seeking maintenance to find appropriate employment;
- (3) The comparative earning capacity of each spouse;
- (4) The standard of living established during the marriage;
- (5) The obligations and assets, including the marital property apportioned to him and the separate property of each party;
- (6) The duration of the marriage;
- (7) The age, and the physical and emotional condition of the spouse seeking maintenance;
- (8) The ability of the spouse from whom maintenance is sought to meet his needs while meeting those of the spouse seeking maintenance;
- (9) The conduct of the parties during the marriage; and
- (10) Any other relevant factors.

Mo. Rev. Stat § 452.335.2.

Based on the statutory purpose of maintenance and the above criteria, the Court finds that Nena satisfied her initial burden of establishing that Clifford's debt under paragraph 13 of the separation agreement is in the nature of maintenance under state law. Specifically, the obligation is to a former spouse in connection with a separation agreement; paragraph 13 was entitled "Maintenance;" Nena had a lesser earning capacity than Clifford at the time of the decree of dissolution; the ten-year time period roughly corresponds to the date the youngest child would graduate from high school; Nena's standard of living decreased after the decree of dissolution; Clifford received the bulk of the marital assets; and the marriage had lasted seventeen years. Accordingly, a sufficient basis existed under Missouri State law for denominating Clifford's debt to Nena as maintenance.

In the context of federal bankruptcy law, however, the courts are required to look behind the face of the state court decree to determine the function that the state court award was intended to serve. *Williams*, 703 F.2d at 1057. In making that determination, the following nonexclusive factors are illustrative of the nature of the payments in this case:

- 1) Labels in the agreement or order.

- 2) Income and needs of the parties at the time the obligation became fixed.
- 3) Amount and outcome of the property division.
- 4) Whether the obligation terminates on the obligee's death or remarriage or on emancipation of children.
- 5) Number and frequency of payments.
- 6) Tax treatment of the obligation.

4 *Collier on Bankruptcy* ¶ 523.11[6] (Lawrence P. King et al. eds., 15th rev. ed. Matthew Bender 2003). *See also Moeder v. Moeder (In re Moeder)*, 220 B.R. 52, 55 (B.A.P. 8th Cir. 1998) (reiterating that the pertinent inquiry includes the relative financial conditions of the parties; the respective employment histories and prospects for financial support; the distribution of marital property; the periodic nature of the payments; and whether it would be difficult for the former spouse and children to subsist without the payments).

In this case, the preponderance of the evidence supports a finding that the payments required to be made by Clifford are maintenance as provided in 11 U.S.C. § 523(a)(5) and thus are nondischargeable.

First, the separation agreement provides that the yearly payments by Clifford to Nena are maintenance. While this label should be given some deference, *Sorah*, 163 F.3d at 401, the Court notes that the separation agreement was drafted by the parties and is thus more prone to accommodate business, tax, and other intangible considerations. The Circuit Court of Nodaway County merely found that the terms of the separation agreement were not unconscionable, and decreed that the terms of the separation agreement be incorporated into the court's order. Had the order of maintenance been a decree of the Circuit Court of Nodaway County after a consideration of the factors enumerated in Mo. Rev. Stat. § 452.335, the Court would be inclined to give the label on the agreement greater weight. Nevertheless, the fact that the separation agreement labels Clifford's obligation as "maintenance" is some evidence regarding the true nature of the obligation.

Second, the income and needs of the parties, as well as the parties' employment histories and future prospects for support, favor a finding that the obligation is in the nature of spousal maintenance. The relevant time period for considering the parties' circumstances is at the time of the decree of dissolution and the court should not focus on subsequent events. *Kline*, 65 F.3d at 751. At the time of the decree of dissolution, Clifford stated that his income as a farmer was \$3,500.00 per month. In fact, prior to the flood of 1993, Clifford was able to maintain a successful farming operation. Also, Clifford had inherited 320 acres of crop land during the marriage which was unencumbered. By

comparison, Nena, who had only a high school education, earned less than one-half of the amount of money Clifford made as a farmer. Furthermore, the family home and land went to Clifford and Nena had to find new accommodations for herself and their four children. No evidence was presented to show that Nena had other sources of income outside the marriage. Thus, the income, needs, and prospects for future self-support at the time the parties entered into the separation agreement favor a finding that Clifford's obligation was in the nature of spousal maintenance.

Third, the amount and outcome of the property division favors a finding that Clifford's obligation is maintenance. Clifford's uncontradicted testimony was that when Nena transferred all her interest in the land to Clifford, the parties had \$845,000.00 in total marital assets and \$932,000.00 in total indebtedness. Under those facts, any property settlement would have entailed Nena taking property subject to significant liabilities; while Nena could potentially realize future equity in the property if she could timely maintain payments to the mortgagee, the Court doubts the success of such an undertaking – considering the fact that Nena only earned \$1,467.00 per month and had four children to look after. Besides, Clifford was the one engaged in farming, not Nena. Moreover, Nena did not receive a security interest in the property that she transferred to Clifford, and the maintenance award does not bear any interest as long as Clifford does not default. A security interest in the property transferred and interest on the amount to be paid over time are common characteristics of a property settlement, and neither is present here. Therefore, it is more logical to consider the obligation as maintenance, not a property settlement.

Fourth, the Court notes that paragraph 13 of the separation agreement does not terminate maintenance on death or in the event Nena remarries. These two factors favor a finding that Clifford's obligation is not for spousal maintenance. *See, e.g.*, Mo. Rev. Stat. § 452.075 (“Remarriage of former spouse ends alimony”); Mo. Rev. Stat. § 452.335 (stating that the purpose of maintenance is to provide for a spouse's reasonable needs). Likewise, the fact that the separation agreement declares the maintenance obligation is non-modifiable – while specifically allowed under Mo. Rev. Stat. § 452.326(6) – also favors a finding that the obligation is not in the nature of spousal maintenance because Mo. Rev. Stat. § 452.370 allows maintenance payments to be modified – in conformity with the purpose of maintenance – when a spouse's reasonable needs change. On the other hand, Clifford's ten-year “maintenance” ends about the same time the youngest son should graduate from high school, which, theoretically, would provide Nena support at a time when she would be hampered from

pursuing alternative methods to enhance her economic status due to her family support and custody obligations. Thus, the fact that the maintenance obligation is non-modifiable² and does not terminate on death or remarriage favors a finding that the obligation was a property settlement, and the fact that the obligation will end about the same time all the children will have graduated from high school favors a finding that the obligation is in the nature of spousal support.

Fifth, the number and frequency of payments favors a finding that Clifford's obligation is a property settlement. Generally, maintenance payments are awarded on a monthly basis. *See generally Rombach v. Rombach*, 867 S.W.2d 500, 505 (Mo. 1993) (noting maintenance was payable on a monthly basis). Here, Clifford's obligation to pay Nena is on an annual schedule and after Clifford has the opportunity to harvest his crop. Because Nena's maintenance payments are due at nearly the same time that income from the land that she transferred to Clifford is realized, the frequency and timing of the payments favor a finding that Clifford's maintenance obligation is a disguised property settlement. At the same time, it should be recognized that the timing of the payments is tied to the timing of Clifford's income, which is a common characteristic of maintenance.

Sixth, the parties' tax treatment of the obligation favors a finding that Clifford's obligation is spousal maintenance. Under the Federal Internal Revenue Code, maintenance obligations are deductible from ordinary income by the payor and included in ordinary income by the payee. 26 U.S.C. § 71. The Internal Revenue Code and the Bankruptcy Code serve different interests, and the mere fact that payments are treated as maintenance under the Internal Revenue Code does not mandate that the payments receive the same treatment under the Bankruptcy Code. *Friedkin v. Sternberg (In re Sternberg)*, 85 F.3d 1400, 1406 (9th Cir. 1996), *overruled on other grounds, Murray v. Bammer (In re Bammer)*, 131 F.3d 788, 792 (9th Cir. 1997). In this case, Clifford claimed the maintenance payment to Nena as a deduction on his tax returns and reaped the tax benefits, whereas Nena claimed the amounts received as income and suffered the tax detriments. Thus, the parties' tax treatment of the obligation favors a finding that the payments to Nena are in the nature of spousal maintenance.

Finally, the Court notes that Nena always considered the payments to her as necessary to maintain her livelihood and she always treated the payments as maintenance. For example, Nena listed the payments as maintenance when she completed a residential loan application and when her

² Despite the fact that the separation agreement provided that the maintenance award was non-modifiable, the parties subsequently agreed to change the due date from October 15th to November 15th of each year.

daughter filled out her Federal Application for Student Aid prior to enrolling in college. Nena asserts that because she claimed the maintenance as income her daughter was not eligible for certain federal academic income-based entitlements. On the other hand, Clifford notes that Nena referred to the payments as a “settlement” in an April 2002 state court deposition. Nena testified in this Court, however, that she did not know the legal distinction between a “settlement” and “maintenance” and that she used the terms interchangeably. Nena also testified that the \$30,000.00 yearly figure was a product of a discussion with her divorce attorney on how much it would take to support herself and her children after the dissolution of marriage. Furthermore, Clifford listed the obligation as maintenance on his bankruptcy schedules.

Based on the above facts, the Court finds that the weight of the evidence favors a finding that Clifford’s debt to Nena is excepted from discharge under 11 U.S.C. § 523(a)(5) because the debt is to a former spouse, arising out of a separation agreement under the laws of Missouri, and the liability is actually in the nature of alimony, maintenance or support as evidenced by: 1) the parties’ label of the obligation designating payments as maintenance; 2) the disparate nature of the parties’ income, needs, and prospects for future self-support at the time the parties entered the separation agreement; 3) the negative value of the marital property at the time of the decree of dissolution and the fact that Nena did not retain a security interest in the property she transferred to Clifford; 4) the fact that maintenance payments will end about the same time the youngest son will have graduated from high school, which, theoretically, would provide Nena support at a time when she would be hampered from pursuing alternative methods to enhance her economic status due to her family support and custody obligations; 5) the parties’ treatment of the payments as maintenance on their federal tax returns; and 6) the fact that Nena treated the payments to her as maintenance in representations to third parties and because she believed the payments were necessary to support herself and her children.

III. ORDER

Therefore, it is

ORDERED that Clifford Earl Herndon’s Complaint to Determine the Dischargeability of Debt be and hereby is DENIED. It is

FURTHERED ORDERED that Clifford Earl Herndon’s debt to Nena Herndon is excepted from discharge under 11 U.S.C. § 523(a)(5).

SO ORDERED this 29th day of September 2003.

/s/ Jerry W. Venters
United States Bankruptcy Judge

A copy of the foregoing mailed electronically or
conventionally to:

Jere L. Loyd

John M. Warren