Debt in Divorce

Jake: Today we're going to talk about the issue of debt and how debt is handled by the court in a divorce. And as a reminder, in the divorce the judge is going to be the one dividing up the property in the liabilities of the estate.

A lot of questions that we have from clients is when they come to us with debt, be it something that's secure like a mortgage or unsecure like a credit card or a loan or a family member or something like that, is “how's that going to be handled in the divorce?”

I think what we try to remind our clients when we talk to them about divorces overall, is that when you're dealing with property you’re really just attempting to develop a spreadsheet with all the assets and liabilities in there so that the courts can use that spreadsheet to divide up the estate.

First of all we’re trying to determine the “character” of things. Is it community or is it separate property? Then the value of things. After that, we're just moving columns on a spreadsheet to make it the right division of property.

So I guess Brian, talking about this from your perspective, whenever you have clients come in and let's say, they're coming to you and they're saying we've got credit card debt, and it's in my husband's name. It's not in their name or they’ve got a student loan and it's in my name, but it's taken out during the marriage.

What is the first thing that you tell clients when dealing with a divorce that even if the estate itself has an upside down within it, they have lots of liabilities to deal with. What are you saying?

Brian: A couple things. It kind of depends on, you know, their specific situation, but for most Americans a divorce is a financial disaster. Most Americans live paycheck to paycheck and have a decent amount, or a lot, of credit card debt. And now they're getting ready to go their separate ways and nobody wants the debt. That's the first thing I try to address, which is sort of what you mentioned, which is just to get kind of a general sense of what that property spreadsheet looks like and in my head.

And, of course that's always the preferred outcome for your client is that they get all the liquidity and cash and the other side gets stuck with all the debt, but it's more to it than that. It's you know, whose name is on the debt? Who's responsible? If we assign the debt to the other spouse, how can we be sure that it's actually paid and it doesn't bounce back and come back to haunt you after you think you've got rid of that.

So it's actually a common, common issue for discussion, as it should be.

Jake: Yeah. And I think on that end, you know, it's an important thing to consider whose name is on the debt. I mean, if it's ongoing in the marriage, it's going to be something that's going to be put on the spreadsheet.

But I still care about whose name it's in. You know, sometimes you'll have this misperception and l that's his credit card debt or her credit card debt. Right. That's our credit card debt. It actually doesn't matter whose name it's in. If it's ongoing in the marriage, it's most likely going to go on the spreadsheet, but we need to know whose name it is because you don't want a situation like you were alluding to Brian where I've got a credit card debt and it goes on my wife's side of the spreadsheet.

Well, what if she doesn't pay it? The family code is very clear that a divorce decree doesn't affect third party creditors. And what that means is my credit cards, let's say American express. American express doesn't care if my divorce decree says the debt is no longer in my name.

And so American express could care less. Yes, even if my wife's ordered to pay it in the divorce decree, if the debt isn't paid they're going to go after me to pay it. And so it's important when to buy it, the debts as much as possible that we try to have debts go into column or the individual whose name is it actually is in, if it's joint credit card, then we've talked about closing the credit cards, you know, stuff like that, just so we make sure that there's not, like Brian was saying, "surprises" down the road because somebody doesn't pay a credit card debt that they were ordered to pay.

What's important when you're thinking about that too, Brian sort of alluded to this and talking about surprises is, you know, a divorce decree, even if we order something to pay it, you know, go back to my first scenario where it's credit card debt.

Let's say some of it goes in my wife's column. It's in my name, the divorce decree can say my wife was ordered to pay that debt. Okay. But then if she doesn't pay it, family code is very clear that the only enforcement remedy on that is that I can go sue her and get a judgment against her. Most divorce decrees have what's called indemnification language.

That means that she'd have to identify me if American express comes after me. But it's just a judgment. It's an IOU. You can't hold somebody in contempt for not paying a debt like a credit card debt in the divorce decree, a debt that's not child support or chapter eight spousal maintenance. And she can't hold some in contempt for not paying it.

So people forget that step sometimes when they're doing their divorce, particularly when they're doing the divorce on their own, they think "Okay. Well, if I order somebody to pay it, they have to pay it. Right. Well, they're liable for it." But that doesn't mean that a whole lot. It really actually happens to them when they don't pay it.

So when sort of tracking that spreadsheet, you want to take that in consideration. That's why we drill down and try to figure out whose name the debt is actually in, then who's actually gonna pay it. Brian, can you talk about how we deal with the debt of a mortgage? So if somebody gets the house, but a lot of times you see the mortgage is in both spouses name.

How's that addressed a divorce?

Brian: Ideally you'd have, whoever's going to keep the house. If that's going to happen, you'd have that person refinance the mortgage in their name only to get the other spouse off of that mortgage, but that's often impractical. Typical Americans households have two incomes and they both probably were required to get that mortgage.

They probably qualified for the largest mortgage their two incomes could get. So now you take one of those away and they're not going to be able to qualify to refinance it. And so, in that case, if it's not sold, then, the person who doesn't have the house is going to still have their name on the mortgage.

That's a really uncomfortable situation. If you don't take your name off the mortgage that's okay, but you're always going to be in fear that your ex spouse is going to not pay their mortgage. As Jake alluded to, you just because the decree says your ex-husband's supposed to pay the mortgage doesn't mean that the mortgage company isn’t going to come after both of you, or maybe even just you.

The solution to that is not a perfect one. It’s typically what's called a deed of trust, a secure assumption. It's a legal document, a deed that says essentially if my ex spouse doesn't incident in both of you, that you and your ex spouse would sign it. And it says, if my ex spouse doesn't make the mortgage payments on time and in the right amount basically I have the right to come in and force a foreclosure of it and force the sale of the home.

Now, that is really not something you want to be involved in. That's not pleasant. It's complex. It's difficult. And, I've even seen courts at times really pushed back against that. Especially if kids from the marriage were still in that home and they don't really want to have the kids kind of thrown out of their home.

Luckily it rarely happens that people don't pay their mortgage, especially if there's equity in the home. There's usually a pretty easy solution if there is. So, that's the option, not great. More of a theoretical problem than an actual problem at times, unless you don't have that secure assumption in that case, you're just crossing your fingers every month.

And that's not a good feeling.

Jake: Yeah. I think sometimes the way I handle it is because it's protecting your credit. Your ex-spouse doesn't pay the mortgage but it's also, it's not as bad as it used to be doing the housing crisis back in 2008, although who knows what the COVID economy is gonna do.

But it's also the fact that even if your ex has the house mortgage and your ex is paying the mortgage, it’s still going to show up on your credit as having this huge liability on there. My practical experience is that if you go out and buy a new house, most lenders understand that you're divorced and that's why it showed up on your credit.

But there was a time, and we may get back to this more and more, where stricter rules are out there. And companies aren't willing to offer as much credit as they used to. And they'll be looking at that, that liability on there. And so that's something to consider as well. Something that's kind of a hybrid of what we've been talking about is what you can do is say, well, no, I want the other spouse to refinance.

Then give them a certain amount of time, six months, a year. And that's something that you negotiate in a day in a mediation and say, get the parents to co-sign or something like that.

You say, look, you've got a year, you've got six months or a year to, to refinance. And then if you don't refinance in that time, and then the house is going to be sold, just to protect the spouse who isn't getting the house, protect his or her credit.

I guess sort of the last thing to talk about a common debt topic in addition to credit cards and mortgages and stuff like that is a tardy CS debt, people, borrowing from family or borrowing from friends, putting attorney's fees on credit card, how's that addressed in the divorce, Brian?

Brian: It could be something similar to what we talked about. You could say all my “Oh, my ex spouse is going to pay my lawyer, the amount that I owe them.” but it's sort of the same thing. If they decide not to, it may not happen. And, it's very difficult to make someone pay if they really don't want to, and they're willing to have it on their credit and don't have assets that you can get. And so again, you can be thinking, “Oh, I've I've taken care of my lawyer” and, and you haven't.

So that can be an unpleasant surprise as is true with a lot of these. A lot of these, at one point we used to assign at least some of these attorney fees as child support, depending on certain circumstances, which made it really easy to collect, but that's become very difficult or impossible these days.

So it's one of those things that can jump up and bite you if you're not careful.

Jake: Yeah. I think that's something I try to have a discussion with clients about. Cause it sounds self-interested, but you actually don't want to be going into trial with a big attorney's fees. Say if you go into trial and you owe your divorce lawyer, $20,000, that's a marital liability.

It should go on the spreadsheet. It's amazing to me, how many times I've had the discussion with the judge? Because the judge has the ability in a divorce to award attorney's fees, but that's attorney's fees. And this could be a whole different podcast about how attorney's fees are dealt with in the divorce.

The court can do attorney's fees above and beyond the property division. A judge can divide the property and say “well, and I think, I think the husband's side was being reasonable. So above and beyond the property, I'm going to make the husband pay $20 hours and attorney's fees, $50,000 in attorney's fees”, but that's an above of the offer beyond the property division, going into a divorce owing attorney's fees.

Oh, in your law firm attorneys fees are different than that. That's sort of a tag post property division. It's a marital liability. If I go into a final trial, I owe my lawyer $20,000. That's a lot of liability for the marital estate, but it's amazing how many times I've had that discussion with the judge saying that needs to go on the spreadsheet.

They owe their attorneys attorney's fees and it needs to be on the spreadsheet. It's a line item on the spreadsheet. It's a debt owed and then having trial judges push back and go, “well, no. That's different. I'm not going to award attorney's fees in this case”. And he said, “well, I'm not asking you to award attorney's fees.

I'm asking you to recognize that marital liability, which is how it should be.” It's interesting how many times I've had that discussion with trial courts and usually been able to explain to them how it should be treated on the spreadsheet, but it's, it's a conversation you don't want to be having.

It makes no logical sense, but walking into it, if you pay your lawyer with a credit card or borrow money from your family, and you're walking into the divorce with a $20,000] visa debt. Even though it was paid for, your lawyers and the judge are more likely to put down the spreadsheet than if you just owe attorney's fees to the law firm that's representing you.

It doesn't make any logical sense. It's just that you see that more in counties where they don't have dedicated family law judges that see this day in and day out, cause it can be confusing. So, I always try to advise my clients, even though it seems self interested, don't go into court with a big attorney fee debt wherever you go.

And the final trial I advise both sides of it because it just adds a layer of confusion that you don't need to have. A lot of times people do have to incur debt to be able to litigate because they're estate may not be liquid or, you know, there's, there's not enough in the estate to compensate for a fight that may be happening or for kids or something like that.

And then the last thing I'll say is that I always do advise people that if you're going to borrow from family members, for whatever reason, judges are going to be more likely to recognize the debt, if you get it in writing. So if you're borrowing $20,000 from your parents to pay for your divorce, and sometimes we do see people have to do that.

Get something in writing from your parents that says “I'm borrowing this amount of money” rather than it just be a check deposit in your account from your parents. Again, it doesn't necessarily make logical sense, but it's just one less item of discussion.

It's just, I think it's just more of a psychological step that the judges are more likely to recognize a debt if it's in writing. Has that been your experience, Brian, as far as, you know, attorney's fees, debts, and barns and family and everything to pay for paper litigating?

Brian: Yeah, it is. And it's a problem because, you know, I think that there are people who borrow from their families to pay attorney fees, debts, or even living expenses. And they really intend, and their families intend for them to pay it back.

And I'm not sure judges always see it that way. I mean, it's kind of a little bit of a mind reading and there's other people who do the opposite, who never, you know, treat it like a debt and it's probably never going to pay it back and it can be, it can be confusing.

It's best not to go down that path, but a lot of times you don't have a choice. Like I said, funding divorces a financial disaster for most Americans. Usually one party for sure. And often both. You have to rely on friends and family sometimes. Yeah. So there you go. It's there, you're stuck sometimes.

Jake: Yeah. Not a fun topic to talk about, but you know unfortunately sometimes people are coming to us and, you know, you're damage controlling. It's just like you were saying, Brian, it's just rare to financially benefit from a divorce, from either side.

So that's just part of that discussion and you really are just trying to make a bad situation as good as you can.

A lot of common errors that we see people do when they're Pro Se representing themselves are frankly the same that some lawyers do. I mean, I don't know how many times Brian you've seen, but people come with a divorce decree and you're looking at and thinking “was anybody thinking about the future when they drafted this app or negotiated this?”

So it's just one of those things that pops up and a divorce. And if you're not thinking about it or if you don't have a lawyer, then Who's thinking about that type of stuff? It really can jump up and bite you five, 10 years down the road. It really can have a significant impact on your financial makeup after the divorce.

So not anybody's favorite topic, but something that's important for us to talk about. So I think that was good for this episode. And maybe we'll talk about a cheerier subject next time.

Brian: There's so many of those in divorce law. So we'll scratch our head and try to find one.

Jake: All right.

Brian: Thanks a lot, Jake. We'll talk soon.

Jake: Alright. Bye.