

IN FOCUS

The Military Dependent

A Creditor's Blind Spot in the Servicemember's Civil Relief Act

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Creditors have become savvy to the basic protections to military servicemembers under the Servicemember's Civil Relief Act (the "SCRA"). For example, the SCRA protects a servicemember from foreclosure on



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real property secured by a deed of trust, mortgage, or similar security instrument if the servicemember's financial obligation for the property arose before the service-

member's military service. Similarly, the SCRA protects a servicemember from the repossession of personal property—such as an automobile—for which the servicemember is obligated to pay for under an installment contract that predates the servicemember's military service.

Many creditors assume—incorrectly—that these provisions of the SCRA apply to the financial obligations of *only* servicemembers. In actuality, the debtor-oriented protections of the SCRA may, under certain circumstances, extend to the separate financial obligations of a servicemember's dependents. To that

end, creditors should explore three basic considerations dealing with a debtor who is a servicemember's dependent.

Who is a "dependent" under the SCRA?

The SCRA broadly defines the term "dependent" as the servicemember's spouse, minor child, or any "individual for whom the servicemember provided more than one-half of the individual's support" for the preceding 180 days.

When did the financial obligation arise?

The SCRA applies only to those separate financial obligations of the dependent that predate the servicemember's period of active military service. Thus, if a servicemember's wife acquires separate title to real property secured by a deed of trust *after* her husband entered the military, then the SCRA does not apply. Note, however, that the spouse's separate financial obligation need not have arisen during the marriage. Interestingly, Arizona is one of the few jurisdictions that has examined this issue. *Tucson Telco Federal Credit Union v. Bowser*, 9 Ariz. App. 242, 451 P.2d 322 (1969), held that the SCRA applied to a wife's separate financial obligation for an automobile that she had purchased before her marriage to her husband, who had entered the military after they were married.

How does the servicemember's military service affect the dependent's ability to meet the separate financial obligation?

The SCRA protects a dependent if the dependent's ability to meet the financial obligation is "materially affected by reason of the servicemember's military service." While this question may not be susceptible to simple analysis, generally, creditors should examine the dependent's history of compliance following the servicemember's entry into the military. Creditors may request that dependents provide information detailing how the ability to meet their financial obligation has been "materially affected," provided that such requests comply with applicable laws governing creditor-debtor communication.

Creditors must obtain a detailed waiver or court order to proceed with any foreclosure or repossession of property protected under the SCRA. Creditors who fail to do so are subject to civil and federal criminal penalties. Given the potential sanctions for violating the SCRA, creditors should be not only acutely aware of how and when the SCRA goes

beyond protecting just servicemembers, but also prepared to work through the issues, most likely with the assistance of knowledgeable counsel.



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towards insolvency may take unreasonable gambles with corporate assets that otherwise would have gone to the creditors upon dissolution of the corporation. If fiduciary duties are owed to creditors while a corporation is operating in the "zone of insolvency," the theory is that a corporation will be less likely to gamble big. While many courts have hinted that fiduciary duties exist when a corporation enters the "zone of insolvency," the issue

remains largely undecided.

Creditors can take steps to protect themselves from the risks presented when a corporation operates in the "zone of insolvency." For example, creditors can negotiate and implement safeguards by placing limitations on corporate behavior, such as restricting the types of projects in which the firm may invest or conditioning when it may invest. Similarly, a creditor could negotiate for a share of the up-side that may be realized in

various projects, such as through convertible debt securities. In addition, corporate governance restrictions could be applied, such as limits on certain expenditures.

Just as creditors can take steps to protect themselves, corporations also can initiate steps to protect themselves. For example, a corporation can document in minutes and memoranda the corporation's good faith exercise of its business judgment in all actions designed to prolong the

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life of the corporation, increase its debt, or extend terms. Likewise, before decisions are made, officers and directors can and should become thoroughly educated on the corporation's financial condition.