

2003 WL 2006846

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United States Bankruptcy Court,
M.D. North Carolina.

In re: Orbie Robert SURLES, Jr. and Ruby Holt Surles, Debtors.

No. 01-13070C-7G.

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May 1, 2003.

ORDER

STOCKS, Bankruptcy J.

*1 This case came before the court on April 1, 2003, for hearing upon the Trustee's objection to claims. In the objection the Trustee objected to all claims in this case other than claims which are based upon indebtedness for which the Debtors are jointly liable. The basis for the objection is that the proceeds held by the Trustee resulted from the sale of real property that was owned by the Debtors as tenants by the entirety when this case was filed and that the proceeds therefore may be utilized only for the payment of joint obligations of the Debtors. The relevant facts are not disputed.

FACTS

When this case was filed on October 29, 2001, the Debtors, a married couple, owned a residence in Graham, North Carolina, as tenants by the entirety ("Residence"). The Debtors listed the Residence as having a value of \$149,056.00 and showed the Residence as being subject to two deeds of trust. In their Claims for Property Exemptions each of the Debtors claimed a \$10,000.00 homestead exemption in the Residence pursuant to N.C. Gen.Stat. § 1C-1601(a)(1). However, the Debtors did not claim the Residence as being exempt tenancy by the entirety property pursuant to § 522(b)(2)(B).

Pursuant to a motion filed under § 363, the Trustee obtained authority to sell the Residence. After paying the indebtedness secured by the two deeds of trust that encumbered the property, the ad valorem taxes and costs of sale and the two \$10,000.00 exemptions claimed by the Debtors, the Trustee was left with net proceeds of \$25,467.47.

Although the record does not reflect the date of death, it is undisputed that the female Debtor died while this case was still open and the proceeds still in the hands of the Trustee.

The claims that have been filed consists of seven claims for which only the male Debtor is liable which total \$89,294.51, two claims for which only the female Debtor was responsible which total \$13,919.84 and three claims which represent joint debt totaling \$18,183.64.

ANALYSIS

This case was filed as a joint case as permitted by § 302(a) of the Bankruptcy Code. While the joint filing resulted in joint administration of the case, it did not result in substantive consolidation which occurs only if specifically ordered by the court pursuant to § 302(b). See *In re Bunker*, 312 F.3d 145, 153 (4th Cir.2002) ("Joint administration does not affect the substantive

rights of either the debtor or his or her creditors.”). Absent substantive consolidation in a joint case filed pursuant to § 302, there is a separate estate for each of the spouses consisting of the § 541 property interests of that spouse and the separate property interests of that spouse may be applied to that spouse's separate debts and to joint debts for which both spouses are liable, but not to debts for which only the other spouse is liable. See *In re Reider*, 31 F.3d 1102 (11th Cir.1994).

Under § 541 of the Bankruptcy Code, the bankruptcy estate for each spouse includes all legal or equitable property interests of that spouse as of the commencement of the case. The property interests encompassed by § 541 include a debtor's interest in property that is owned as a tenancy by the entirety. See *In re Cordova*, 73 F.3d 38, 40 (4th Cir.1996) and *In re Ballard*, 65 F.3d 367, 371 (4th Cir.1995). The filing of a bankruptcy case by debtors who own property as tenants by the entirety does not destroy or terminate the tenancy by the entirety. See *In re Ballard*, 65 F.3d at 373 (“We agree with the Trustee's contention that the commencement of a joint bankruptcy case does not disrupt a debtor's co-ownership of property as a tenant by the entireties.”); *Greenblatt v. Ford*, 638 F.2d 14 (4th Cir.1981) and *In re DeMarco*, 114 B.R. 121, 123 (Bankr.N.D.W.Va.1990). Thus, when this case was filed, the estate of each of the Debtors included that Debtor's entireties interest in the Residence. The issue presented by the Trustee's objection is the extent to which the proceeds from such property is limited to the claims of joint creditors.¹

*2 The Trustee argues that since the Residence was entireties property prior to his sale of the property, the proceeds from the sale of the Residence retained the characteristics of a tenancy by the entirety (i.e., the sale of the entireties property did not terminate the tenancy by the entirety) and that following the sale such proceeds therefore were available only to joint creditors under applicable North Carolina law which permits only joint creditors to have access to tenancy by the entirety property.

The Trustee's argument regarding the effect of North Carolina tenancy by the entirety law is correct. It is well settled North Carolina law that only joint creditors of both the husband and wife may execute on entireties property. See *In re Crouch*, 33 B.R. 271, 274 (Bankr.E.D.N.C.1983) and *In re Woolard*, 13 B.R. 105, 107 (Bankr.E.D.N.C.1981). As a result, creditors with a claim against only one of the spouses cannot enforce their claims against entireties property. See *Grabenhofer v. Garrett*, 260 N.C. 118, 131 S.E.2d 675 (1963). But did the proceeds from the sale of Debtors' entireties property retain the characteristics of a tenancy by the entirety? The court believes so. The tenancy by the entirety in real property has long been recognized under North Carolina law. When real property is conveyed to a husband and wife jointly, they automatically receive a tenancy by the entirety in such real property unless a contrary intention is expressed in the conveyance. See N.C. Gen.Stat. § 39–13.6(b) and, generally, WEBSTER'S REAL ESTATE LAW IN NORTH CAROLINA, § 7–15 (4th ed.1994). However, a tenancy by the entirety may be terminated by the voluntary joint acts of the husband and wife, such as where the husband and wife voluntarily sell or convey the property, in which event the proceeds from the sale become property in common. See *Koob v. Koob*, 283 N.C. 129, 195 S.E.2d 552 (1973). On the other hand, an involuntary transfer of title does not terminate the tenancy by the entirety. For example, a condemnation or taking by eminent domain of entireties property is not treated as a voluntary conversion and the proceeds resulting from such a transfer of title remain property held as tenants by the entirety. See *Highway Commission v. Myers*, 270 N.C. 258, 262, 154 S.E.2d 87, 90 (1967) (“such involuntary transfer of title does not destroy or dissolve the estate by the entirety ... and the compensation paid by the Commission therefore has the status of real property owned by husband and wife as tenants by the entirety”). Although it is difficult to apply such nonbankruptcy law in the context of a bankruptcy case, the court concludes that the Trustee's sale of the Residence was more in the nature of an involuntary transfer from the perspective of the Debtors and therefore resulted in proceeds that retained the characteristics of a tenancy by the entirety. With an involuntary transfer, the proceeds would be subject to the claims of joint creditors of both spouses but not subject to the individual creditors of either outside of bankruptcy. The filing of a bankruptcy case does not increase the substantive rights of a creditor. See *In re Ginn*, 186 B.R. 898, 901 (Bankr.D.Md.1995). “If a creditor has no rights against a debtor under applicable nonbankruptcy law, then State law should prevail unless there is an overriding Federal policy which ought to take precedence.” *In re Cerreta*, 116 B.R. 402, 406 (Bankr.D.Vt.1990). Consistent with North Carolina law applicable outside of bankruptcy, the court concludes that following the Trustee's sale the proceeds from the entireties property was subject to the claims of joint creditors only. Although the case law is divided on the issue, the court believes that the better view is that the bankruptcy trustee's sale of entireties property does not destroy the tenancy by the entirety and adopts that view. See *In re Ginn*, 186 B.R. 898 (Bankr.D.Md.1995); see also *In re Monzon*, 214 B.R. 38 (Bankr.S.D.Fla.1997); *In re Geoghegan*, 101 B.R. 329 (Bankr.M.D. Fla.1989). *Contra In re Planas*, 199 B.R. 211 (Bankr.S.D.Fla.1996); *In re Anderson*, 132 B.R. 657 (Bankr.M.D.Fla.1991).

*3 Even though the proceeds retained the characteristics of a tenancy by the entirety following the sale, because of the subsequent death of the female Debtor, the Fourth Circuit decision of *In re Ballard*, 65 F.3d 367 (4th Cir.1995), requires that the Trustee's objection nonetheless be overruled. In *Ballard* a husband and wife who owned residential real property filed a joint Chapter 11 case. During the Chapter 11 case, they sold the entireties property and placed the proceeds in a debtor-in-possession account. Thereafter, the female debtor died. The sale proceeds were turned over to the Chapter 7 trustee when the case subsequently was converted to one under Chapter 7. The claims in the case included a large priority tax claim against the male debtor alone and a number of claims involving joint indebtedness. The trustee filed an objection similar to the one in the present case asserting that the joint creditors should be paid to the exclusion of the priority tax claim because the proceeds retained the characteristics of a tenancy by the entirety and therefore were available only to joint creditors. The court in *Ballard* agreed with the trustee that under applicable state law, the tenancy by the entirety was not terminated by the sale of the property and hence initially the proceeds were available solely for the benefit of joint creditors. However, the court held that the situation changed upon the death of the female debtor because by operation of applicable state law the death of the female debtor “released her surviving spouse, and thus, his bankruptcy estate, from all conditions of the tenancy conceived to preserve the unity of entireties property” including rights of survivorship and restrictions on alienation. At that point, the husband became owner in fee simple and the proceeds were brought into his bankruptcy estate pursuant to § 541(a)(7) under which any interest in property that is acquired by the estate after commencement of the case becomes property of the estate. As property of the male debtor's estate, the proceeds were available for the payment of the tax claim and were not solely for the benefit of joint creditors. The court reaffirmed this reasoning in *In re Cordova*, 73 F.3d 38 (4th Cir.1996), in holding that a debtor's divorce within 180 days of the commencement date terminated a tenancy by the entirety and resulted in the entireties property that had been exempted pursuant to § 522(b)(2)(B) being brought back into the estate pursuant to § 541(a)(5). The court observed that “[l]ike the post-petition death of the debtor's spouse in *In re Ballard*, however, the divorce decree terminating co-ownership of the home released Cordova from the unique features of the tenancy by the entirety [and] Cordova's interest, like Ballard's, became available to satisfy the claims of her individual creditors in bankruptcy.” *Id.* at 41.

In the present case, the entireties property was never exempted out of the estates pursuant to § 522(b)(2)(B). As a result, immediately prior to the death of the female Debtor, the estate of the male Debtor included his entireties interest in the Residence.² Under the decision in *Ballard*, upon the death of the female Debtor, to the extent that a tenancy by the entirety existed with respect to the proceeds, the tenancy by the entirety terminated and the proceeds “devolved” to the male Debtor's sole ownership free of the unique features of the tenancy by the entirety and, pursuant to § 541(a)(5), such proceeds became property of the estate of the male Debtor. As such, the proceeds may be used to pay the claims for which only the male Debtor is liable as well as joint claims, but not for the payment of claims for which only the female Debtor is liable.

*4 IT IS SO ORDERED.

All Citations

Not Reported in B.R., 2003 WL 2006846

Footnotes

- 1 Frequently, § 522(b)(2)(B) plays a pivotal role in determining the extent to which entireties property is subject to the claims of creditors in a bankruptcy case. Pursuant to § 522(b)(2)(B), debtors may claim tenancy by the entirety property as exempt property and thereby remove such property from the bankruptcy estate. *See In re Ford*, 3 B.R. 559, 570 (Bankr.D.Md.1980) (“The trustee merely obtains and retains custody of the debtor's undivided interest consisting of the same unities, intact and unaltered, as they existed immediately prior to the filing of the petition, until such time as that

interest, still intact and unaltered, is exempted from the estate under § 522(b)(2)(B).”), *aff’d Greenblatt v. Ford*, 638 F.2d 14 (4th Cir.1981). In the Fourth Circuit, a debtor's right to exempt entireties property pursuant to § 522(b)(2)(B) is subject to the right of the bankruptcy trustee to liquidate entireties property for the benefit of joint creditors where, under applicable state law, entireties property is subject to the claims of joint creditors. *See Sumy v. Schlossberg*, 777 F.2d 921 (4th Cir.1985). However, § 522(b)(2)(B) has no role in the present case because the Debtors did not utilize § 522(b)(2)(B) to claim the Residence as exempt property.

- 2 The fact that the property was not exempted from the estate may provide a basis for distinguishing this case from *In re Birney*, 200 F.3d 225 (4th Cir.1999), which was relied upon in this case by the Trustee. Unlike the situation in the present case, in *Birney* the debtor did exempt his interest in the entireties property pursuant to § 522(b)(2)(B). When his wife thereafter died, a creditor asserted that the property should be brought back into the estate because the wife's death terminated the tenancy by the entirety. The court refused the relief because § 541(a) provided the only potentially applicable statutory basis for relief and none of the provisions of § 541(a) were applicable. Section 541(a)(5) was not applicable because the devolvement of the tenancy by the entirety to sole ownership by the debtor did not involve an acquisition by the debtor of a property interest by bequest, devise, inheritance or any of the other means included in § 541(a)(5). Section 541(a)(7), which was relied upon in *Ballard*, apparently was not applicable because the tenancy by the entirety, having been exempted, was held by the debtor and the devolvement from tenancy by the entirety to sole ownership went to the debtor and not to the bankruptcy estate and, hence could not be regarded as the estate acquiring a property interest for purposes of § 541(a)(7).