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Bankruptcy-Proof and Allowance of Claims-Reopening of Estate to Allow Creditors to Reach Tenancy by the Entirety

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RECENT DECISIONS

BANKRUPTCY—PROOF AND ALLOWANCE OF CLAIMS—REOPENING OF ESTATE TO ALLOW CREDITORS TO REACH TENANCY BY THE ENTIRETY—Husband (*H*) and wife (*W*) executed joint, unsecured promissory notes to each of two creditors, a realty company and a bank. *H*, in default on both notes, filed a voluntary petition in bankruptcy. The petition listed both noteholders as creditors; in addition, the schedule of assets noted that an interest in an estate by the entirety held by the bankrupt was not an asset of the bankrupt estate, since under state law it was not subject to the claims of creditors of only one spouse. After the first meeting of creditors, an order of discharge was entered without objection and *H*'s estate was closed. The United States subsequently commenced suit against *W* individually on one of the notes assigned to it by the creditor bank. Nineteen days later, more than six months after the filing of *H*'s petition, *W* initiated bankruptcy proceedings, listing the creditors on the two notes, and scheduling her interest in the same estate held by the entirety. Upon application by the United States the district court issued an *ex parte* order reopening *H*'s estate. The referee ordered consolidation of the estates of *H* and *W* and directed the trustee to sell the property held by the entirety for the benefit of the joint creditors. The district court upheld the order.[1] On appeal, *held*, affirmed. Where property held by the entirety would have been immune from administration by the trustee in successive bankruptcy proceedings by husband and wife, the court did not abuse its discretion by reopening *H*'s closed estate, consolidating it with that of *W*, and ordering sale of the property held by the entirety for the benefit of joint creditors of *H* and *W*. *Reid v. Richardson*, 304 F.2d 351 (4th Cir. 1962).

At common law, a spouse's interest in an estate by the entirety received broad protection. The estate was conceived of as a legal entity, held *per tout* and not by the moieties;[2] as a result, creditors could not reach the debtor spouse's interest in the property so held.[3] With the enactment of married women's property acts,[4] which accorded legal recognition to the

1 *In re* Reid, 198 F. Supp. 689 (W.D. Va. 1961).

2 "By the common law of England . . . a conveyance to husband and wife does not constitute them joint tenants . . . . They are, in the contemplation of the common law, but one person, and hence they take, not by moieties, but the entirety . . . . As stated by Blackstone, 'husband and wife being considered as one person in law, they cannot take the estate by moieties, but both are seized of the entirety, per tout, et non per my; the consequence of which is, that neither the husband nor the wife can dispose of any part without the assent of the other, but the whole estate must remain to the survivor.' 2 Black Com. 182." Tyler v. United States, 28 F.2d 887, 890 (D. Md. 1928).

3 See, *e.g.*, Edwards & Chamberlain Hardware Co. v. Pethick, 250 Mich. 315, 230 N.W. 186 (1930). See also Annot., 82 A.L.R. 1235 (1933).

4 See, *e.g.*, MICH. COMP. LAWS §§ 557.1-.255 (1948). The purpose of such statutes is set forth in typical fashion as follows: "An Act abrogating the common law disability of women so far as to make and render them competent to bind themselves and become liable with their husbands upon any instrument, so as to subject the real estate of the husband and wife owned by them as tenants by the entirety . . . to the payment and satisfaction of judgments and decrees of courts." MICH. COMP. LAWS § 557.11 (1948).

wife's right to manage and control her separate estate, the common-law concept of a tenancy by the entirety underwent significant change. Under such statutes, a wife may hold property in her own name,[5] may contract,[6] and may become jointly liable with her husband.[7] Moreover, in some jurisdictions a creditor of either husband or wife may subject the rights of the debtor spouse to the payment of the obligation. Upon execution against property so held, the creditor acquires such rights as the debtor had, including the right to share possession of the property as a tenant in common with the non-debtor spouse, as well as the right of survivorship should the debtor spouse survive the non-debtor.[8]

Yet, in those few states where the common-law view of an estate by the entirety as a separate legal entity persists, a creditor with a joint judgment may perfect a lien upon property held by the entirety only where the husband and wife are joint obligors.[9] The estate by the entirety still cannot be reached by one who stands in the relation of creditor to only one of the parties, whether husband or wife.[10] Therefore, in separate bankruptcy proceedings involving only one spouse, his or her interest in the tenancy by the entirety does not vest in the trustee in bankruptcy.[11] Moreover, once a debtor's spouse has been discharged in bankruptcy, the joint creditor will generally be prevented from obtaining a joint judgment and levy upon the estate held by the entirety.[12]

5 MICH. COMP. LAWS § 557.1 (1948).

6 MICH. COMP. LAWS § 557.51 (1948).

7 MICH. COMP. LAWS § 557.52 (1948).

8 BURBY, REAL PROPERTY § 193, at 335 n.51 (2d ed. 1954), cites cases from New Jersey and New York. 4 POWELL, REAL PROPERTY § 623, at 667 nn.69-70 (1954 ed.), lists Arkansas, New Jersey, New York and Oregon as states which follow this doctrine. In Kentucky and Tennessee, the creditor may not reach the debtor spouse's right to possession, but he may acquire a contingent right of survivorship. *Id.* at 666. In contrast, although Michigan has adopted married women's property acts, the common-law view is retained. Therefore, individual creditors of either spouse may not have their claims satisfied out of the entirety estate. Dutcher v. Van Duine, 242 Mich. 477, 219 N.W. 651 (1928). See Bienenfeld, *Creditors v. Tenancies by the Entirety*, 1 WAYNE L. REV. 105 (1955).

9 See, *e.g.*, MICH. COMP. LAWS § 557.53(3) (1948), which provides: "Hereafter the real estate of the husband and wife owned by them as tenants by the entirety . . . shall be liable to seizure and sale on execution . . . in satisfaction of any judgment which has been recovered against the persons who were at the time of execution of such written instrument husband and wife jointly or the survivor upon any instrument signed by both."

10 *E.g.*, Dioguardi v. Curran, 35 F.2d 431 (4th Cir. 1929). See also Annot., 166 A.L.R. 969 (1947).

11 Bankruptcy Act of 1898, § 70a(5), 30 Stat. 565, as amended, 52 Stat. 879 (1938), 11 U.S.C. § 110(a)(5) (1958), provides that the trustee shall be vested with title to property "which prior to the filing of the petition he [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him . . . ." Since the entirety property cannot be conveyed or assigned by one spouse without the consent of the other spouse [McMullen v. Zabawski, 283 Fed. 552 (E.D. Mich. 1922)], and the interest of one spouse in the estate cannot be levied upon and sold under judicial process against one of such tenants by the entirety [*In re* Berry, 247 Fed. 700 (E.D. Mich. 1917)], the bankrupt's interest in the entirety estate does not vest in the trustee.

12 See, *e.g.*, Ades v. Caplan, 132 Md. 66, 103 Atl. 94 (1918). See 43 HARV. L. REV. 312 (1929).

Courts have experimented with various procedural devices to extend the reach of creditor process against property held by the entirety. Commonly, where the husband has filed a petition for bankruptcy, but has not yet obtained a discharge, the joint creditor may petition the bankruptcy court for a stay of proceedings, during which period he may obtain, in a state court, a joint judgment and lien against the property held by the entirety.[13] However, where one spouse has already been discharged in bankruptcy, there is much diversity of opinion as to whether any recourse is still available to a creditor of one of the spouses. Some courts have held that a joint creditor cannot proceed against the entirety estate after one spouse has been individually discharged in bankruptcy.[14] Other jurisdictions have been more flexible. Michigan, for example, authorizes the creditor to bring a quasi in rem action against the entirety estate itself[15] on the theory that bankruptcy discharges only personal liability and does not destroy the debt itself. The Indiana Supreme Court has held that a note executed by a husband and wife establishes not only a joint and several liability as to each of them, but also an obligation of the "distinct legal unity" to which the marital relationship gives rise. Under this view, the obligation so created constitutes a separate debt which, together with the entirety estate, remains outside the jurisdiction of the bankruptcy court.[16] Another recent decision allowed creditors to reach property held by the entirety on the theory that the function of a proceeding in bankruptcy was a very limited one, that of providing the bankrupt with merely an affirmative defense to a liability which, itself, remains intact.[17] Since the defense of discharge could be raised only with respect to such assets as were available for distribution in the prior bankruptcy proceeding, it could not be asserted as to entirety property which had there been excluded from the court's control.

The principal case sanctions a more effective and straightforward means of intervention by the court and thereby avoids the inequities resulting from immunizing the entirety property of successive bankrupts. Without resort to theoretical sleight of hand, the district court, in reopening the proceeding, made use of the broadened powers granted it by the Chandler

13 See, *e.g.*, Phillips v. Krakower, 46 F.2d 764 (4th Cir. 1931). See also Annot., 82 A.L.R. 1235 (1933).

14 See, *e.g.*, Wharton v. Citizens' Bank, 233 Mo. App. 236, 15 S.W.2d 860 (1929). "The only right that appellant [creditor bank on a joint note] ever had was to obtain a judgment against the husband and wife jointly, and thus perfect a lien upon the real estate which they owned as tenants by the entirety. . . . When the husband received his discharge in bankruptcy, appellant's right to a joint judgment against the spouses was destroyed . . . . The discharge is res adjudicata." *Id.* at 240, 15 S.W.2d at 863.

15 MICH. COMP. LAWS § 557.53 (1948). See Kolakowski v. Cyman, 285 Mich. 585, 281 N.W. 332 (1938). "[T]he statute, in effect, subjects the entireties property to a non-personal or quasi in rem liability, which is not dischargeable in bankruptcy." *Id.* at 590, 281 N.W. at 335.

16 First Nat'l Bank v. Pothuisje, 217 Ind. 1, 25 N.E.2d 436 (1940).

17 United States v. Fetter, 163 F. Supp. 10 (E.D. Mich. 1958). See 1 COLLIER, BANKRUPTCY § 1606 (14th ed. 1962).

Act.[18] The old Bankruptcy Act of 1898 had limited the court's power to reopen bankruptcy proceedings to instances in which "it appears that they were closed before being fully administered."[19] Section 2a(8) of the 1938 Chandler Act now gives the court authority to "reopen estates for cause shown." However, this grant of broader discretion to reopen estates has not been accompanied by increased procedural safeguards. Courts may continue to grant *ex parte* orders to reopen estates.[20] The moving party need only present an application which states sufficient cause to reopen;[21] notice to the discharged bankrupt is unnecessary.[22]

In addition, since the act fails to state a test for "cause shown," this determination must necessarily lie within the discretion of the court. Sufficient cause to reopen has been found to permit the inclusion of unadministered assets (perhaps the primary purpose),[23] the amendment of schedules to include creditors not listed,[24] and the recovery of excessive commissions obtained by fraud in violation of court orders.[25] No explicit period of limitation has been formulated as a bar to reopening.[26] On the other hand, applications for reopening have been denied for laches,[27] and in those instances in which few additional assets would pass to the trustee under a second administration.[28] Thus, the change introduced by the Chandler Act, allowing the court to "reopen estates for cause shown," has been interpreted as an expression of congressional intent to grant broader discretion to district courts to reopen estates.[29]

The question before the court in the principal case was whether there existed sufficient cause to justify reopening of the estate. To determine what causes are sufficient, an evaluation of the objectives of the Bank-

18 Section 2a(8), 52 Stat. 842 (1938), 11 U.S.C. § 11(a)(8) (1958), amending Bankruptcy Act of 1898, § 2a(8), 30 Stat. 545.

19 Chapter 2, § 2, 30 Stat. 545.

20 *In re* Carlucci Stone Co., 269 Fed. 795 (M.D. Pa. 1920).

21 See, *e.g.*, *In re* Snyder, 4 F.2d 627 (9th Cir. 1925). "[S]uch petition must be either in itself, or in connection with supporting affidavits, of such persuasive character as to reasonably satisfy the court of the requisite jurisdictional fact, namely, that there are some assets belonging to the bankrupt which have not been administered." *Id.* at 628. See 73 Stat. 571 (1959), 11 U.S.C. § 41(c) (Supp. III, 1961), amending Bankruptcy Act of 1898, § 18c, 30 Stat. 551.

22 *In re* Hopkins, 11 F. Supp. 831 (W.D.N.Y. 1934).

23 *In re* Joslyn's Estate, 171 F.2d 159 (7th Cir. 1948). "It has been held that it is the duty of the bankruptcy court to re-open closed bankruptcy estates whenever prima facia proof has been made that they have not been fully administered." *Id.* at 164. Some courts have stated that existence of unadministered assets is the sole basis for reopening. See *In re* Forman, 45 F. Supp. 295 (E.D.N.Y. 1942).

24 Casey v. Cooledge, 234 Ala. 499, 175 So. 557 (1937). *But see* Milando v. Perrone, 157 F.2d 1002 (2d Cir. 1946).

25 *In re* International Match Corp., 190 F.2d 458 (2d Cir. 1951).

26 See, *e.g.*, *In re* Thomas, 204 F.2d 788 (7th Cir. 1953); Brust v. Irving Trust Co., 129 F. Supp. 462, 467 (S.D.N.Y. 1955).

27 *In re* Fair Creamery Co., 193 F.2d 5 (6th Cir. 1951) (delay of seven years).

28 *In re* M. E. Smith & Co., 52 F.2d 212 (D. Neb. 1931).

29 *In re* Cirillo, 102 F. Supp. 715 (M.D. Pa. 1952); *In re* United Brick & Tile Co., 94 F. Supp. 269 (D. Del. 1950). See also *In re* Fox W. Coast Theatres, 25 F. Supp. 250 (S.D. Cal. 1936).

ruptcy Act is required. The court indicated that the primary aims of the act were stabilization of the insolvent debtor's financial position at the time of filing of the petition, the granting of relief from his existing financial burdens, and the making available of his assets for satisfaction of his creditors.[30] These objectives will be furthered to the extent that bankruptcy proceedings are made final and certain; they will be undermined to the extent that closed estates are arbitrarily reopened. Moreover, in the principal case a further question might have been raised as to whether such relief should have been granted in the light of the parties' conduct. The creditors had willingly accepted these *unsecured* notes; *H* and *W* had violated no explicit provisions of the Bankruptcy Act; the creditors, at the time of *H*'s separate bankruptcy, could have obtained a stay of the bankruptcy proceedings while they instituted joint actions against *H* and *W* on the notes.[31] In failing to pursue the available remedies, the creditors seemingly were guilty of a lack of diligence which might be considered sufficient to preclude the relief here granted. Yet, within the limits imposed by the equitable doctrine of laches,[32] counterbalancing weight must be given to the duty of the bankruptcy court to construe the statute to serve the best interests of all the parties.[33] Thus, a court might be justified in granting relief to prevent what has been termed a "fraud on the law" in a situation where, as in the principal case, an inequitable outcome might result even though the literal requirements of the Bankruptcy Act have been satisfied. Thus, because the obvious effect of failure to reopen *H*'s closed estate would be to exclude from the reach of lawful creditors the total entirety property, and because the interval between the filing of *H*'s and *W*'s bankruptcy petitions was only six months, it cannot be said that the court's action in reopening the estate constituted an abuse of discretion.

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30 Principal case at 355.

31 See materials cited in note 13 *supra*.

32 See note 27 *supra*. See also *In re* John Viviane & Son, 132 F. Supp. 633 (S.D.N.Y. 1955).

33 Since both creditors in the principal case were in fact joint creditors, the corollary problem concerning the rights of individual creditors to share in the proceeds of the sale of the entirety property was not explicitly raised. It has been held that, although the entirety property remains immune where husband and wife file separate bankruptcy petitions, if the proceedings are consolidated and a single trustee is appointed, the entirety estate may be sold for the benefit of both joint and individual creditors. *In re* Carpenter, 5 F. Supp. 101 (M.D. Pa. 1933). As a result, the joint creditor must share the entirety property with individual creditors who, before the bankruptcy proceedings, had no chance of realizing their claims out of the entirety estate. See Bienenfeld, *supra* note 8; 34 COLUM. L. REV. 762 (1934).