Tenants by the Entirety Property and the Bankruptcy Reform Act

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TENANTS BY THE ENTIRETY PROPERTY AND THE
BANKRUPTCY REFORM ACT

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This Article addresses the impact of the Bankruptcy Code of 19781 on debtors' and creditors' interests in realty held as tenants by the entirety. The 1978 Code constitutes the first major revision of the bankruptcy laws in over forty years and in many respects represents a substantial modernization of the bankruptcy process. When Congress began considering an overhaul of the bankruptcy law one commentator2 suggested that the opportunity was ripe to cure what was perceived to be the arbitrary and unfair treatment of entirety property under the Bankruptcy Act of 1898.4 Although many of the old problems may have been solved under the new Code, a number of new, more serious problems have been created. This Article will consider the joint creditor's ability to enforce his lien against entirety property when only one spouse is in bankruptcy under both the old and new bankruptcy statutes. Particular attention will be devoted to the new bankruptcy exemption scheme and the inequity this scheme creates for creditors in those states that exempt entirety property from process of creditors of an individual debtor. From the view of the joint creditor, the cure, in fact,

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2. Generally the term "tenancy by the entirety" refers only to ownership of real property. See Fetter v. United States, 269 F.2d 467, 469 (6th Cir. 1959). The term "estates by the entirety" is a broader term referring both to ownership of realty and personalty. See In re Gallagher's Estate, 352 Pa. 476, 478, 43 A.2d 132, 133 (1945). This distinction, however, is not always recognized and authorities commonly refer to tenancies by the entirety in personalty. See, e.g., 2 AMERICAN LAW OF PROPERTY § 6.6(c) (A.J. Casner ed. 1952) [hereinafter cited as AMERICAN LAW OF PROPERTY]. The 1978 Code speaks of property held as tenants by the entirety, but neither the Code nor the legislative history suggests the term applies only to real property and not to personal property as well.

701
may be worse than the disease.

THE TENANCY BY THE ENTIRETY

At common law, four forms of concurrent ownership in realty were possible: tenancy in common, joint tenancy, tenancy by the entirety, and tenancy in coparcenary. A tenancy by the entirety results from the four unities found in a joint tenancy, time, title, interest, and possession, plus the additional unity of marriage. Husband and wife are considered to be one legal entity; each spouse is deemed seised of the entire estate, not merely of an undivided fractional interest, as with a joint tenancy. Four characteristics are fundamental to tenancy by the entirety property: first, the

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5. In a tenancy in common, two or more persons hold separate and distinct shares of an undivided portion of the property. Each person is considered to take a separate and distinct share as an individual rather than as a fictitious unity in a joint tenancy. Each tenant in common may have a share that is greater or smaller than the shares of the others only if the shares are fixed in the writing creating the cotenancy; otherwise all will be considered to take in equal shares. No right of survivorship exists in a tenancy in common. See 2 AMERICAN LAW OF PROPERTY, supra note 2, § 6.5.

6. A joint tenancy exists when every joint tenant owns the undivided whole of the property rather than a fractional interest; all tenants have equal rights to share in the enjoyment of the property. The key characteristic of joint tenancy is the right of survivorship; on the death of one of the joint tenants the survivors own the entire estate and nothing passes to the heirs of the deceased tenant. See id. §§ 6.1-6.4; Hines, Real Property Joint Tenancies: Law, Fact and Fancy, 51 IOWA L. REV. 582 (1966).

7. Tenancy by the entirety is a form of joint tenancy in which the joint tenants are husband and wife; each spouse owns the whole estate, not a fractional share thereof. 2 AMERICAN LAW OF PROPERTY, supra note 2, § 6.6. Virginia abolished the right of survivorship between joint tenants unless an intent to create right of survivorship expressly appears in the instrument that establishes the tenancy. VA. CODE §§ 55-20, -21, (Repl. Vol. 1974). This statute has been interpreted as abolishing tenancies by the entirety except when the deed or will manifests an intent to create a tenancy by the entirety. Allen v. Parkey, 154 Va. 739, 745, 149 S.E. 615, 618 (1930). The importance of this form of cotenancy is illustrated by the results of an empirical study done in Iowa indicating that nine out of ten cotenancies in land were joint tenancies between husband and wife. See Hines, supra note 6, at 623.

8. The estate by coparcenary, or as it is sometimes called, paracenary, arose under the English law of primogeniture. On the death of an estate owner with no male heirs, the estate descended to the female heirs who held the property by coparcenary, the female heirs being regarded as one heir joined by unity of interest, time, title, and possession. See, e.g., Bolling v. Teel, 76 Va. 487 (1882). The estate by coparcenary is obsolete under modern statues. See C. MOYNIHAN, INTRODUCTION TO THE LAWS OF REAL PROPERTY 236 (1962).

property is not subject to partition; second, neither spouse may dispose of any part of the property without the consent of the other; third, neither spouse may subject the property to the payment of his or her individual debts; finally, upon the death of either spouse, the entire estate passes to the survivor.\(^\text{10}\)

Tenancies by the entirety currently are recognized in some form in twenty-six jurisdictions, including the District of Columbia and the Virgin Islands;\(^\text{11}\) however, the Bankruptcy Code significantly affects only those seventeen jurisdictions in which the debtor's interest in entirety property is exempt from process.\(^\text{12}\) Accordingly, the analysis set out in this Article will be limited to jurisdictions that are affected.

The estate by the entirety in personalty appears to exist in at least sixteen jurisdictions.\(^\text{13}\) An analysis of the estate by the en-

\(^{10}\) See generally 2 AMERICAN LAW OF PROPERTY, supra note 2, § 6.6(b); Bienenfeld, Creditors v. Tenancies by the Entirety, 1 WAYNE L. REV. 105 (1952); Murphy, supra note 9.

\(^{11}\) The following jurisdictions recognize tenants by the entirety property in some form: Alaska, Arkansas, Delaware, District of Columbia, Florida, Hawaii, Indiana, Kentucky, Maryland, Massachusetts, Michigan, Mississippi, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, Virgin Islands, Virginia, and Wyoming. See Craig, supra note 3, at 295; Grilliot & Yocum, supra note 9, at 354.


\(^{13}\) See Annot., 64 A.L.R.2d 8, 23 (1959). The following jurisdictions recognize the estate by the entirety in personalty: Arkansas, Delaware, District of Columbia, Florida, Hawaii, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Pennsylvania, Tennessee, Vermont, Kentucky, Virginia, and Wyoming. See generally Grilliot & Yocum, supra note 9 (recommending the abolition of tenancies by the entirety and listing jurisdictions recognizing entirety property in personalty). See also Hines, Personal Property Joint Tenancies: More Law, Fact and Fancy, 54 MINN. L. REV. 509 (1970); Townsend, Creation of Joint
entirety in personalty, such as the proceeds from the sale of realty held by the entirety, rents and profits from realty held as tenants by the entirety, and joint bank accounts, is beyond the scope of this Article, except to note that the estate by the entirety in personalty appears to create the same problems in bankruptcy as the tenancy by the entirety in realty.

**Tenants by the Entirety**

**Under the Bankruptcy Act of 1898**

To appreciate the changes brought about by the 1978 Bankruptcy Code an understanding of the treatment of entirety property under the Bankruptcy Act of 1898 is necessary. Two fundamental concepts apply in bankruptcy proceedings. First, all the bankrupt's nonexempt property should be brought within the jurisdiction of the bankruptcy court and liquidated in order to pay the bankrupt's creditors as much as possible. Second, the bankrupt is discharged from all of his individual debts, as well as his joint and several obligations on joint debts, so that he may have a fresh start. Generally, judicial interpretation fairly balances these principles so that the bankrupt receives his fresh start without unduly

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18. The Supreme Court in Lines v. Frederick stated the following:

The most important consideration limiting the breadth of the definition of "property" lies in the basic purpose of the Bankruptcy Act to give the debtor a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. The various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act."

400 U.S. 18, 19 (1970)(quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244-45 (1934)).
prejudicing the rights of his creditors.

The courts' treatment of entirety property is a good example of this balancing act. The Bankruptcy Act of 1898 provided that the trustee in bankruptcy took title to "property, including any rights of action, which prior to the filing of the petition [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process."\(^\text{19}\) State law determined which interests were transferable or leviable.\(^\text{20}\) In jurisdictions that recognized an estate by the entirety was not subject to process by individual creditors of a spouse or subject to conveyance by one spouse without the consent of the other, the estate by the entirety did not pass to the trustee when only one spouse was in bankruptcy.\(^\text{21}\)

If, however, both spouses were in bankruptcy, then their proceedings were consolidated for purposes of administering the tenancy by the entirety property; thus, the trustee took the spouses' aggregate interest in the entirety property into the joint estate.\(^\text{22}\)

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\(^{20}\) In re Wetteroff, 453 F.2d 544, 546 (8th Cir.), cert. denied sub nom. Wetteroff v. Grand, 409 U.S. 934 (1972); Hayes v. Schaefer, 399 F.2d 300, 301 (6th Cir. 1968) (bankrupt was owner of entirety property with husband who died subsequent to filing of bankruptcy petition but before proceedings were terminated; held under state law bankrupt not entitled to one-half of the proceeds from sale of property); Reid v. Richardson, 304 F.2d 351, 353 (4th Cir. 1962) (reopening husband's bankruptcy estate to consolidate it with wife's later filed estate in bankruptcy and making entireties property liable for joint obligations of both bankrupts); see 4A COLLIER ON BANKRUPTCY ¶ 70.17(7) (14th ed. 1978).

\(^{21}\) Reid v. Richardson, 304 F.2d 351, 353 (4th Cir. 1962); Bledgett v. United States, 161 F.2d 47, 50 (8th Cir. 1947) (criminal suit for concealing entirety property in bankruptcy); Phillips v. Krakower, 46 F.2d 764, 765 (4th Cir. 1931); In re Hallenbeck, 209 F. Supp. 263, 264 (W.D. Va. 1962) (husband, who owned realty with wife subject to deed of trust, filed bankruptcy; held, equity in property was not an asset of bankruptcy estate). See generally 4A COLLIER ON BANKRUPTCY ¶ 70.17(7), [8] (14th ed. 1978); Annot., 75 A.L.R.2d 1172, 1190 (1961). Section 70a of the Bankruptcy Act of 1898 provides that property "in which the bankrupt has at the date of bankruptcy an estate or interest by entirety which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt . . . ." 11 U.S.C. § 110(a) (1970) (repealed 1978). Thus, when a termination of the tenancy by the entirety occurs within the six month period, the trustee takes title to the interest passing to the bankrupt.

\(^{22}\) In re Wetteroff, 453 F.2d 544, 546 (8th Cir.), cert. denied sub nom. Wetteroff v. Grand, 409 U.S. 934 (1972) (dictum) (husband filed bankruptcy petition but wife did not); Roberts v. Henry V. Dick & Co., 275 F.2d 943, 944 (4th Cir. 1960); In re Hallenbeck, 211 F. Supp. 604, 605 (W.D. Va. 1962), rev'd on other grounds sub nom. Hallenbeck v. Penn Mutal Life Ins. Co., 323 F.2d 566 (4th Cir. 1963); In re Pennell, 15 F. Supp. 743, 744 (W.D. Pa. 1935); In re Utz, 7 F. Supp. 612, 613 (D. Md. 1934); see 4A COLLIER ON BANKRUPTCY ¶ 70.17
In such a consolidated case, three estates were created: the husband's, the wife's, and the joint estate. The trustee then would sell the entirety property and the proceeds from the sale would be placed into the joint estate to pay the joint creditors.\(^{23}\)

Under the 1898 Act, the joint creditor was forced to act promptly to avoid being prejudiced when an individual bankruptcy involved entirety property not passing to the trustee. In order for the joint creditor to reach entirety property, the joint creditor first had to obtain a joint judgment against both the bankrupt and his spouse. If one spouse successfully obtained a discharge in bankruptcy, the joint creditor later could not obtain a joint judgment because the discharge barred any such action. The joint creditor therefore was limited to an individual judgment against the nonbankrupt spouse, which could not be enforced against the entirety property.\(^{24}\) This result was considered inequitable because it permitted a bankrupt to obtain a discharge of his debts and thus barred the joint creditor from enforcing his claim against the entirety property, which was not otherwise subject to the jurisdiction of the bankruptcy court for the benefit of creditors.\(^{25}\)

To circumvent this inequity, courts permitted joint creditors relief from the automatic stay provisions and delayed the bankrupt's discharge until a joint judgment and lien could be obtained.\(^{26}\) *Phillips v. Krakower*\(^{27}\) is the prototype of the decisions under the 1898


This procedure has been followed in Virginia because the entirety would not be available to satisfy the claims of the individual spouse's creditors. Some commentators have concluded that if the bankruptcy trustee takes the entirety property and sells it, then the proceeds may be used for all unsecured creditors of both spouses individually, not just the joint creditors. See Bienenfeld, *supra* note 10, at 114; Craig, *supra* note 3, at 271.

The question remains, however, whether the remainder should be distributed to individual creditors or to the bankrupts if the joint creditors are paid in full out of the joint estate. See *In re Magee*, 176 F. Supp. 361 (M.D.N.C. 1959), vacated sub nom. Roberts v. Henry V. Dick & Co., 275 F.2d 943 (4th Cir. 1960) (dictum). Although there are no reported cases, the practice in Virginia is to distribute the excess to the husband and wife.

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\(^{26}\) Phillips v. Krakower, 46 F.2d 764 (4th Cir. 1931); Lockwood v. Exchange Bank, 190 U.S. 294 (1903).

\(^{27}\) 46 F.2d 764 (4th Cir. 1931).
Act involving the right of joint creditors to reach tenants by the entirety property when one spouse had filed bankruptcy. In that case, Phillips was adjudged a bankrupt on January 9, 1930. At the time of his adjudication, he and his wife owned property as tenants by the entirety. Mrs. Krakower held a note against them for $5,500 and, in order to reduce her claim to judgment, asked the bankruptcy court to defer Phillips' discharge to enable her to secure a judgment on the note against the bankrupt and his wife and subject the entirety property to its satisfaction. The Court of Appeals for the Fourth Circuit, in upholding the decision of the bankruptcy court permitting Mrs. Krakower to proceed, stated as follows:

The discharge of Phillips in bankruptcy not only will prevent judgment being obtained against him on the note, but will prevent also, during his lifetime, the property held by entireties being subjected to the satisfaction of any judgment which may be obtained against his wife. And so, although the bankruptcy proceeding has brought no interest in the estate by the entireties into court for the benefit of the creditors of Phillips, his discharge in bankruptcy will remove that entire property beyond the reach of creditors entitled to subject it to their claims. The question presented is whether, without giving these creditors an opportunity to proceed, the court should grant the discharge knowing that it will result in a legal fraud, i.e. the effectual withdrawing of the property from the reach of those entitled to subject it to their claims, for the beneficial ownership and possession of those who created the claims against it. We cannot conceive that any court would lend its aid to the accomplishment of a result so shocking to the conscience.

The purpose of the bankruptcy act was to equitably distribute the assets of distressed debtors among their creditors and to discharge them from further liability after this had been done. It was never contemplated that it should be used to perpetrate fraud or to shield assets from creditors.28

28. Id. at 765. This language was quoted with approval by the Fourth Circuit in In re Seats, 537 F.2d 1176 (4th Cir. 1976); Davison v. Virginia Nat'l Bank, 493 F.2d 1220 (4th Cir. 1974); Reid v. Richardson, 304 F.2d 351 (4th Cir. 1962). A case in the Eighth Circuit also adopted this position. See In re Magee, 415 F. Supp. 521, 525 (W.D. Mo. 1976). Other courts have preferred to let the bankruptcy court delay granting the bankrupt a discharge to enable a creditor to proceed under state law against property that cannot be reached in bankruptcy, but is subject to creditor claims under state law. See Lockwood v. Exchange Bank,
The joint creditor under the 1898 Act, on timely application to the bankruptcy court, could have obtained relief from the stay to reduce his claim to judgment against the bankrupt and the nonbankrupt spouse in order to obtain a lien against the entirety property. The relief granted by the bankruptcy court in *Krakower* and its progeny, however, was not a license to the joint creditor to obtain an in personam judgment against the bankrupt. The judgment as to the bankrupt was in rem only, enforceable solely against the interest in the entirety property; the bankrupt’s in personam liability to the joint creditor was discharged by his bankruptcy.  

The joint creditor’s right to proceed against the bankrupt’s entirety property was not necessarily a right to pursue entirety property acquired after discharge. Under the 1898 Act, Michigan was the only state in which there appeared to be a basis for permitting a joint creditor to reach entirety property acquired after discharge. The legal fraud addressed by the court in *Krakower* was the use of bankruptcy to shield from creditors assets that existed as of the date of bankruptcy. Although a judgment may attach to after-acquired property in a bankruptcy context, to have allowed

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190 U.S. 294, 301 (1903); Duff v. Tegeler, 19 F.2d 305, 308 (8th Cir. 1927); B.F. Roden Grocery Co. v. Bacon, 133 F. 515, 517 (5th Cir. 1904); In re Wells, 105 F. 762, 766 (W.D. Ark. 1900). Cf. In re Harold, 15 COLLIER BANKR. CAS. 507, 516 (1977) (holding that because common law protecting bankrupt wife’s interest in tenancy by the entirety property is discriminatory, trustee can reach her interest).


30. See Schram v. Werback, 39 F. Supp. 616, 617 (E.D. Mich. 1941) (permitting a joint creditor, after the husband and wife individually were discharged, to obtain a judgment against the spouses jointly for a prebankruptcy debt and execute upon entirety property acquired after bankruptcy). In view of Harris v. Manufacturers Nat’l Bank, 457 F.2d 631, 635 (6th Cir. 1977), cert. denied, 409 U.S. 885 (1972) which invalidated Michigan law permitting joint creditors to proceed against entirety property after discharge, that Schram is still good law is doubtful.


31. VA. CODE § 8.01-458 (Repl. Vol. 1977) provides the following:

Every judgment for money rendered in this Commonwealth by any state or federal court or by confession of judgment, as provided by law, shall be a lien on all the real estate of or to which the defendant in the judgment is or becomes possessed or entitled, from the time such judgment is recorded on the judgment lien docket of the clerk’s office of the county or city where such land
a joint judgment obtained in a *Krakower* situation to attach to entirety property acquired after discharge would have undermined one of the primary purposes of bankruptcy law: to permit the debtor a fresh start.\textsuperscript{32}

A more difficult, and perhaps more typical, problem under the 1898 Act involved the joint creditor in the *Krakower* situation who reduced his claim to judgment after bankruptcy but before discharge and then recorded the judgment to obtain a lien on the entirety property existing as of the date of bankruptcy. Because the equity\textsuperscript{33} in the property was insufficient to satisfy the judgment, such a joint creditor would have taken no action to satisfy his lien out of the entirety property, in the hope that the value of the debtor's equity in the property would increase with time. In the case of *In re Saunders*,\textsuperscript{34} however, the district court recognized the right of the joint creditor to proceed to obtain a joint judgment in accordance with *Krakower*, but limited the lien against the entirety property to the equity in the property as of the date of bankruptcy.

In *Saunders*, the United Virginia Bank was a holder of obligations under which the bankrupt, Fred Saunders, and his wife were jointly liable. Saunders and his wife owned as tenants by the entirety a parcel of real property that was subject to two liens. The owner's equity in the property at the time of bankruptcy was approximately $521.\textsuperscript{35} The referee suspended discharge to allow the bank to seek a state court judgment but concluded that the judgment would have to be in rem and limited to the bankrupt's equity of redemption at the date the petition was filed, $260, and not the

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\textsuperscript{32} The fresh start policy is intended to encourage the debtor's rehabilitation after bankruptcy by providing him with a chance to start over with certain property and free from debt. Property exemptions and discharge are the two means in bankruptcy for implementing this policy. See note 18 supra. See generally 1A COLLIER ON BANKRUPTCY ¶ 14.01[6] (14th ed. 1978).

\textsuperscript{33} "Equity" in this context means the fair market value of the property in excess of the prebankruptcy liens against it.


\textsuperscript{35} Id. at 1352.
bankrupt's after-acquired equity in the property. The district court found the referee's suspension of discharge and limitation on the judgment to be correct but differed on the extent of the limitation. The court held that the bank could proceed in personam against the entire equity interest in the property as of the date of bankruptcy, $521, but it could not reach the after-acquired interest in the entirety property.

Consider the court in Saunders holding in the context of the following example, assuming for the purposes of illustration that the 1898 Act is applicable. Suppose on the date of bankruptcy, the fair market value of the entirety property of the bankrupt and his spouse is $80,000, and there is a valid first mortgage lien of $70,000. A joint creditor with a claim of $50,000 is allowed to reduce his claim to judgment against the bankrupt and his spouse; however, because a judicial sale of the property would not satisfy the judgment lien, the joint creditor instead decides to postpone enforcing his lien. Five years later, the property has appreciated in value to $110,000 and the first mortgage debt has been reduced by $5,000, a net increase to the joint creditor of $45,000. The joint creditor enforces his lien and sells the entirety property. According to the court in Saunders, the joint creditor is limited to the equity as of the date of bankruptcy, $10,000, not the equity at the time of the sale, $45,000.

Suppose, in the same example, the joint creditor obtains a lien and the first mortgagee then forecloses; from the proceeds of the sale, the joint creditor receives $10,000. Following the foreclosure, the bankrupt and his spouse acquire another home. Should the joint creditor's judgment lien attach to the after-acquired property to the extent of $40,000, the unpaid balance? The rule in Michigan notwithstanding, nothing would justify allowing the joint creditor's lien to attach to entirety property acquired after discharge because one of the fundamental purposes of bankruptcy, discharge and a fresh start, would be thwarted.

A different question is whether the joint creditor should be able

36. Id. at 1353-54.
37. Id. at 1355. The court found the discharge to apply to any property or interest the bankrupt obtained after the date the bankruptcy petition was filed. Id.
38. See note 30 supra & accompanying text.
to enjoy the increased equity in the entirety property against which he obtained a lien after bankruptcy but before a discharge. In this situation, the entirety property is owned by the bankrupt and his spouse on the date of bankruptcy. Because the home is entirety property, it is not subject to the jurisdiction of the bankruptcy court for the benefit of creditors. Therefore, creditors who, but for the bankruptcy, would have a claim to the entirety property should be permitted to proceed against it. The debtors then would be forced to decide whether they both should file to bring their entirety property within the jurisdiction of the bankruptcy court, or only one should file to keep it out. If they elect the latter, then their entirety property would be subject to the claims of joint creditors outside the bankruptcy court. The only distinction between the after-acquired equity and after-acquired property situation is that the lien on the entirety property in the after-acquired equity situation is created before discharge, whereas the lien on the after-acquired entirety property does not arise until after discharge.

If the bankruptcy court stays the discharge to permit a lien to be obtained on entirety property, that lien should not be limited to the equity in the property at the time of bankruptcy because the debtors have failed to exercise their right to liquidate the entirety property in bankruptcy. Conversely, the discharge of the husband should immunize entirety property acquired after the discharge from prebankruptcy joint claims. Stated differently, entirety property owned by debtors as of the date of bankruptcy should be available to satisfy creditors' claims, subject to any homestead exemption, either through the bankruptcy proceedings or state court proceedings. Property acquired after bankruptcy should be immune from prebankruptcy claims. After-acquired equity in prebankruptcy entirety property should be subject to joint creditors' claims in state court proceedings if the debtors elect not to have the entirety property submitted to the jurisdiction of the bankruptcy court.

If the entirety property is subject to the jurisdiction of the bankruptcy court but is abandoned by the trustee for lack of equity, 39

39. Generally, the bankruptcy trustee may abandon any burdensome or worthless property of the estate. See 4A Collier on Bankruptcy ¶ 70.42 (14th ed. 1978). The Bankruptcy
then creditors with liens against that property are not limited to
the value of the property as of the date of bankruptcy. Although a
discharge would prohibit a deficiency judgment, a lien creditor has
no obligation to foreclose. He may retain his lien in the hope that
the property will increase in value to the point when the entire
debt will be satisfied. The joint creditor, permitted to obtain a lien
on entirety property, should be treated no differently.

Thus, under the Bankruptcy Act of 1898, the bankrupt and his
spouse assumed the risk that if they decided not to subject their
entirety property to the jurisdiction of the bankruptcy court, then
a joint creditor would have been allowed to obtain a lien on the
entirety property before discharge and the lien would have been
valid against the prebankruptcy entirety property until satisfied or
extinguished by sale.

**Tenancies by the Entirety Under the Bankruptcy Code**

The 1978 Bankruptcy Code contains some fundamental changes
with respect to property subject to the jurisdiction of the bank-
r upty court, including the treatment of tenants by the entirety
property. The issues raised by the 1978 Code when the debtor owns property as tenants by the entirety may best be understood
with reference to the following sections of the Code:

1. The interest of the trustee in entirety property under section 541;
2. the right of the trustee to partition or sell the entirety

Act of 1898 recognized the right to abandon executory contracts, § 70b, 11 U.S.C. § 110(b)
(1970) (repealed 1978); rights in pending applications for patents, copyrights and trade-
marks, § 70a(2), 11 U.S.C. § 110(a) (2) (1970) (repealed 1978); and property against which
nothing toward satisfaction of the claims of general creditors, such as property subject to a
valid lien, frequently were abandoned. To ensure validity of an abandonment, the trustee
could obtain a court order approving the abandonment of any property. R. BANKR. P. 608.
Compare § 554 of Bankruptcy Reform Act of 1978 which gives the trustee the right to aban-
don property of the estate that is burdensome or of inconsequential value. 11 U.S.C.A. §
554(a) (West Supp. 1979).

41. The term "bankrupt" is not used in the Bankruptcy Reform Act of 1978. Section
101(2) defines "debtor" as a "person or municipality concerning which a case under this title
42. Id. § 541.
property under section 363; \(^43\) and

(3) the right of the debtor to exempt the entirety property under section 522. \(^44\)

The Interest of the Trustee in Entirety Property Under Section 541

Section 541(a)(1) of the 1978 Code provides that the commencement of the bankruptcy case creates an estate comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." \(^45\) This simple but comprehensive statement differs substantially from the approach taken in the 1898 Act, which specifically enumerated the kinds of property that were to be included in the bankrupt's distributable estate. \(^46\) Section 541 establishes that the bankruptcy estate is comprised of the debtor's property at the time of the "commencement of the case." This is similar to section 70a of the 1898 Act, which provided that the trustee is vested with title to the bankrupt's property as of the date of the filing of the petition. \(^47\)

The primary difference between the acts is that the broad language of section 541 includes exempt property in the estate, \(^48\) whereas section 70a of the 1898 Act specifically excluded exempt property. \(^49\) In *Lockwood v. Exchange Bank*, the Supreme Court recognized the exclusion of exempt property from the bankruptcy estate. \(^50\) Section 541(a)(1) effectively overrules *Lockwood* because

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43. Id. § 363.
44. Id. § 522.
47. Id.
49. Bankruptcy Act of 1898, § 70a, 11 U.S.C. § 110(a) (1970) (repealed 1978) stated that "The trustee of estate . . . shall in turn be vested with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt . . . ." Id.
50. 190 U.S. 294 (1903). *Lockwood* held that the bankruptcy court had no jurisdiction to protect or enforce the right of a creditor to whom the bankrupt had waived his exemption.
it includes all property in which the debtor has an interest in the
estate, even that necessary for a fresh start.\textsuperscript{51} Although section 541
makes no reference to the estate by the entirety as it does to com-
munity property,\textsuperscript{52} the legislative history makes clear that an es-
tate by the entirety is property of the estate under section 541 re-
gardless of whether only one spouse is in bankruptcy.\textsuperscript{53}

The Right of the Trustee to Partition or Sell the Entirety Prop-
erty Under Section 363

To overcome the problem that tenants by the entirety property
is not severable or subject to devise by one spouse alone, the 1978
Code provides in section 363(h)\textsuperscript{54} that, subject to certain condi-

\begin{itemize}
\item \textsuperscript{51} Id. at 301. Such creditor was free to proceed against the exempt property in state court.
\item \textsuperscript{52} See H.R. Rep. No. 595, supra note 48, at 367-68, reprinted in Ad. News, supra note 48, at 6324. After the property comes into the estate under the 1978 Act, the debtor is permitted to exempt it under § 522. See note 78-112 infra.
\item \textsuperscript{53} 11 U.S.C.A. § 541(a)(2) (West Supp. 1979) states as follows:
\begin{itemize}
\item All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—
\begin{itemize}
\item (A) under the sole, equal, or joint management and control of the debtor; or
\item (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
\end{itemize}
\end{itemize}
\item \textsuperscript{54} Id. (footnotes omitted).
\end{itemize}
sections, the trustee in bankruptcy may sell tenants by the entirety property that has not otherwise been exempted under section 522(b). The right of the trustee to sell entirety property clearly suggests that Congress intended entirety property to be included in the estate, even though it is not specifically mentioned in section 541. This is a major change with respect to entirety property and has important consequences, not only for the nonbankrupt spouse, but for creditors of the debtor and for joint creditors of the debtor and nonbankrupt spouse.

Four conditions must be met before the trustee may sell the entirety property. First, a partition of the property among the estate and the nonbankrupt spouse must be impractical. Obviously, if the entirety property is a residence, as in the typical case, then partition would be impractical. The entirety property may be unimproved land, however, which could be partitioned. Second, the trustee must demonstrate that a sale of the estate's undivided interest would realize significantly less for the estate than a sale of the entire property. Presumably, this would not be a difficult task; in the typical situation, the undivided interest of the nonbankrupt spouse will be valued at significantly less than the estate's interest if the entirety property is sold as a whole unit.

Third, the trustee must demonstrate that the benefit to the estate

Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, immediately before the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

Id. § 522(b); see note 79 infra.

55. Id. § 363(h)(1).

56. Id. § 363(h)(2).
outweighs the detriment to the nonbankrupt spouse.58 Finally, if the property is used in the production, transmission, or distribution for sale of electric energy or of natural or synthetic gas for heat, light, or power, then the trustee may not sell either the debtor's interest or the whole.59

Court approval is not always necessary for a sale under section 363(h), though section 363(b)60 requires that such a sale take place only “after notice and a hearing.”61 A hearing is required, however, only when a party in interest requests one.62 Thus, the nonbankrupt spouse must request a hearing; otherwise, the sale may be consummated without court approval. If a hearing is requested, section 363(e)63 provides that the court may prohibit or condition the sale as is necessary to provide the nonbankrupt spouse with adequate protection.

The concept of adequate protection is set forth in section 361 of the 1978 Code.64 Section 361 recognizes three means by which the

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58. Id. § 363(h)(3).
59. Id. § 363(h)(4). This limitation is intended to protect public utilities from losing power sources if a joint owner goes into bankruptcy. See S. Rep. No. 999, supra note 45, at 56, 60, reprinted in Ad. News, supra note 45, at 5842-43.
60. 11 U.S.C.A. § 363(b) (West Supp. 1979) provides that “[t]he trustee, after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” Id.
61. Id. § 102(1) states as follows:

“after notice and a hearing,” or a similar phrase—

(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but

(B) authorizes an act without an actual hearing if such notice is given properly and if—

(i) such a hearing is not requested timely by a party in interest; or

(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.

Id.
62. Id. § 102(1)(B)(i).
63. Id. § 363(e) provides the following:

“notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.”

Id.
64. Id. § 361 states as follows:
interests of a coowner can be protected adequately: requiring the trustee to make periodic cash payments to the coowner to the extent of any decrease in value of the coowner's interest in the property; providing the coowner with an additional or replacement lien on other property to the extent of any decrease in the coowner's interest in the property; granting other forms of adequate protection the court feels would provide the coowner with the "indubitable equivalent" of its interest in the property. The methods of adequate protection outlined in section 361, however, are not exclusive and do not appear applicable to the protection of the nonbankrupt spouse. Indeed, the House report indicates that

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

1. requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

2. providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

3. granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

The Code does not define the term "adequate protection"; rather, it specifies the means by which adequate protection may be provided. See also note 68 infra.

65. Id. § 361(1).

66. Id. § 361(2).

67. Id. § 361(3). A compromise between the House and the Senate over the question of adequate protection resulted in the deletion from the final version of § 361 of a provision which would have permitted adequately protecting a secured party by giving the party an administrative expense priority to the extent of any loss. The administrative priority protection, however, was considered too uncertain to be meaningful. See S. Rep. No. 989, supra note 45, at 54, reprinted in Ap. News, supra note 45, at 5840. Therefore, § 361(3) specifically excludes the court from granting an entity compensation in the form of an administrative expense as a means of providing adequate protection.

68. The concept of adequate protection in § 361 clearly is intended to protect a creditor with a lien on the entirety property whose interest might be affected by the sale. This would be particularly applicable if the trustee proposed to partition the entirety property. Query whether an unsecured joint creditor could request adequate protection under § 361 on the theory that he has a priority claim under state law to the entirety property and proceeds therefrom ahead of individual creditors of the debtor. Such a request is inconsistent with § 363(j), which regulates the distribution of the proceeds from the sale of the entirety property, and should be denied.
the only protection intended is that provided in section 363(i), which gives the nonbankrupt spouse the right of first refusal to purchase the entirety property, and section 363(j), which requires the trustee to pay over to the nonbankrupt spouse the value of the spouse's interest in the property if the trustee sells to someone other than the spouse. Assuming the trustee conducts the sale in a commercially reasonable manner, the nonbankrupt spouse cannot argue that his or her interest in the property is decreased because of the sale. Creative lawyers, however, will develop evidence of loss; whether the adequate protection concept in section 361 would apply to protect the nonbankrupt spouse when entirety property is sold by the trustee is unclear.

Section 363(e) expressly places the burden of proof on the trustee regarding the issue of adequate protection. If the nonbankrupt spouse requests a hearing on the sale of the entirety property, however, the Code is unclear as to whether the trustee has the burden of proving the four conditions set forth in section 362(b).

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70. 11 U.S.C.A. § 363(i) (West Supp. 1979) provides that
   before the consummation of a sale of property to which subsection (g) or (h) of this section applies, or of property of the estate that was community property of the debtor and the debtor's spouse immediately before the commencement of the case, the debtor's spouse, or a co-owner of such property, as the case may be, may purchase such property at the price at which such sale is to be consummated.
   Id.
71. Id. § 363(j) states the following:
   After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.
   Id.
72. Although there is no generally accepted definition of "commercially reasonable" in a bankruptcy context, an analogy to the Uniform Commercial Code may be appropriate. See, e.g., U.C.C. § 9-507(2) ("A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable . . . . ").
74. Id. § 362(b) requires a hearing, if requested by the nonbankrupt spouse, as a prerequisite to sale of the entirety property. See notes 66-72 supra.
363(h). Clearly, the inclusion of the four conditions indicates that Congress recognized in section 363(h) that a coowner's interest could be affected adversely by the trustee's sale. Viewing these conditions as minimal safeguards to the coowner and thus a form of adequate protection, the trustee should have the burden of proving their existence.

Once the sale of the entirety property has been consummated, section 363(j) provides that the trustee shall distribute the proceeds, less costs and administrative expenses, to the debtor's spouse and the estate according to their respective interests in the property. The 1978 Code, however, provides no guidance as to how the interests in the entirety property are to be computed. Presumably, the bankruptcy court may consider the source of the funds used to acquire the entirety property in order to determine the individual spouses' share or, more likely, could apply the state presumption that operates in nondeath terminations of the joint interest. For example, in Virginia, property owned as tenancy by the entirety automatically converts to a tenancy in common upon divorce, giving each spouse an equal one-half interest with no right of survivorship.

The Right of the Debtor to Exempt the Estate by the Entirety Under Section 522

As previously stated, section 541 puts all property in which the debtor has an interest, including exempt property, into the estate and then permits the debtor to elect his exemptions under section 522. Section 70 of the 1898 Act specifically excluded exempt

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75. See note 54 supra.
76. 11 U.S.C.A. 363(j) (West Supp. 1979); see note 64 supra.
78. See notes 45-51 supra & accompanying text.
79. 11 U.S.C.A. § 522(b) (West Supp. 1979) states as follows:
    Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—
    (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
    (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been
property from the bankrupt estate; therefore, before one could determine whether property was property of the estate, one first had to determine whether it was exempt under the law of the state of the bankrupt's domicile.

Sensing a need for change, one commentator suggested that section 70a of the 1898 Act be replaced with a single provision giving the trustee title to all of the debtor's property as of the date of bankruptcy. As a matter of federal bankruptcy policy, however, certain amounts or types of property had to be preserved to aid the debtor's rehabilitation. Hence, section 522 which sets out the bankruptcy exemption provisions was adopted. Subparagraph (d) incorporates a federal exemption law, although the debtor has the option of retaining his state exemptions unless the law of the state of the debtor's domicile specifically provides that he may not elect the federal bankruptcy exemption.

If the debtor does not elect the federal bankruptcy exemptions or the exemptions are not available pursuant to state law, then

located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

Id.


83. Note that 11 U.S.C.A. § 541 (West Supp. 1979) does not vest in the trustee title to the debtor's property. Rather, an estate is created.

84. The debtor must take affirmative action to exercise his option and claim his exemptions. The affirmative step need not be taken before filing for bankruptcy and presumably the procedure will be clarified by bankruptcy rules when they are promulgated.

under section 522(b)(2) he may exempt any property that would be exempt under federal nonbankruptcy law,86 and state or local law of the debtor's domicile. In addition, the debtor may exempt any interest in tenants by the entirety or joint tenant property to the extent that such interest is exempt from process under applicable nonbankruptcy law. Thus, if the debtor resides in a state in which tenants by the entirety property is recognized and his interest in such property is immune from process by his creditors, then the debtor may exempt such property. If the debtor exempts the entirety property, section 522(c) protects the exempt property from creditors' claims by providing that property exempted is not liable for any debt of the debtor that arose before the commencement of the case.87

This result produces the potential for a serious inequity in the 1978 Code that can be illustrated best by the following example. The husband files for relief under Chapter 7 of the new Code. At


87. 11 U.S.C.A. § 522(c) provides that

[u]nless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such claim had arisen, before the commencement of the case, except—

(1) a debt of a kind specified in section 523(a)(1) or section 523(a)(5) of this title;

(2) a lien that is—

(A) not avoided under section 544, 545, 547, 548, 549, or 724(a) of this title;

(B) not voided under section 506(d) of this title; or

(C)(i) a tax lien, notice of which is properly filed; and

(ii) avoided under section 545(2) of this title.

Id. The House report states that § 522(c) "insulates exempt property from prepetition claims" except tax claims, alimony, maintenance, or child support claims that are not excepted from discharge and debts secured by valid nonvoidable liens. H.R. Rep. No. 595, supra note 48, at 361, reprinted in Ad. News, supra note 48, at 6317.
the time of filing, husband and wife own a home as tenants by the entirety that has a fair market value of $100,000. There is a first mortgage lien against the property with a balance due of $60,000. The wife does not file bankruptcy. The $100,000 home becomes property of the estate under section 541(a)(1). The Husband, in order to preserve his "fresh start" after bankruptcy, has a choice; he either may elect the federal exemptions under section 522(b)(1) or the state and federal nonbankruptcy exemptions under section 522(b)(2). Under the federal exemption, only $7,500 of the $40,000 equity may be exempted. 88 On the other hand, if the state exemptions are selected, the home would be completely exempt under section 522(b)(2)(B), assuming that under applicable state law the interest of the husband in the entirety property is exempt from process. Thus, unless the debtor concludes that the remaining federal bankruptcy exemptions under section 522(d) are more attractive than the state exemptions, he will elect the state exemptions to protect his equity in the property.

Creditors of the husband are not prejudiced by his decision to exempt the tenants by the entirety property because, under state law, the property is immune from their process anyway. 89 Had the husband chosen the federal exemption, thus including the tenants by the entirety property in the bankrupt estate subject to the $7,500 federal exemption, the inclusion of $12,500 in the estate—the husband’s one-half interest in the $40,000 equity, less the $7,500 federal exemption—would be a windfall to the husband’s creditors and prejudicial to the joint creditors of the husband and wife to the extent the joint creditors must share pro rata with the husband’s individual creditors.

Suppose in the above example a bank holds an unsecured demand note of $10,000 executed by husband and wife. It is a joint

88. 11 U.S.C.A. § 522(d)(1) (West Supp. 1979) provides that the following property may be exempted:

    The debtor’s aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

Id.

89. See text accompanying note 10 supra.
and several obligation. Under the 1898 Act, the bank would be entitled to relief from the stay to reduce its claim to judgment against both husband and wife, in order to obtain a lien against the home. The bank also would be entitled to file a proof of claim in the husband’s bankruptcy to share as a creditor in his individual estate.

Whether the bank will be entitled to similar relief under the 1978 Code when the tenants by the entirety property is exempted and thus not subject to liquidation for the benefit of creditors is uncertain. If not, the prejudice to the bank is obvious. The $40,000 equity in the home is more than enough to satisfy the bank’s $10,000 claim. If the husband exempts the home under section 522(b)(2), however, section 522(c) provides that property exempted under section 522 is not liable during or after the case for any debt of the bankrupt arising before the commencement of the case. The bank’s note is a prebankruptcy debt; the home that has been exempted is not liable to satisfy the debt and the bank’s request for relief from the stay to sue the husband and wife to obtain a lien on the home thus would be denied on the basis of section 522(c). Unless the wife survives the husband, the bank’s judgment against the wife cannot be satisfied out of the entirety property. Although this result seems inevitable from a reading of section 522(c), it is irreconcilable with judicial treatment of tenants by the entirety property under the 1898 Act and inconsistent with the 1978 Code and the accompanying congressional comments.

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90. Phillips v. Kakrower, 46 F.2d 764, 766 (4th Cir. 1931); see notes 26-29 supra & accompanying text.
91. Reid v. Richardson, 304 F.2d 351, 354 (4th Cir. 1962).
93. In 11 U.S.C.A. § 363(h) (West Supp. 1979), Congress recognized that the debtor’s interest in entirety property should be available to creditors. Thus, it is inconsistent to interpret § 522(c) to immunize totally entirety property from creditors when it is unavailable in the bankruptcy proceeding.
94. H.R. REP. No. 595, supra note 48, at 175-77, reprinted in Ad. News, supra note 48, at 6136. The legislative history indicates Congress was concerned with providing a method for the estate to realize on the debtor’s interest in tenancy by the entirety property. The trustee
Assume in our example that the husband chooses the federal exemptions because he owns several unmatured life insurance contracts,\textsuperscript{95} plus an award under a crime victim’s reparation law\textsuperscript{96} the aggregate value of which exceeds his equity in his home. The home, then, is subject to the trustee’s right to sell.\textsuperscript{97} Furthermore, assume that the trustee sells the home and, after paying off the first mortgage, holds $40,000. The $40,000 would be distributed as follows: $7,500 to the husband on account of his federal exemption; $20,000 to the wife, assuming her interest is one-half; and, the balance, $12,500 to the husband’s creditors. The bank is still prejudiced, because under state law the individual creditors of the husband cannot share in the proceeds from the sale of the entirety property;\textsuperscript{98} and under the 1978 Code the individual creditors share on a pro rata basis with the joint creditors.\textsuperscript{99} The bank, however, can execute on the wife’s interest, even though the husband’s $7,500 fresh start is immune from attack.\textsuperscript{100} The example demonstrates that the joint creditor’s right to share in proceeds from the sale of tenants by the entirety property depends solely upon whether the debtor elects the federal bankruptcy exemptions or the state exemptions.

The historical purpose of exemption laws has been to protect the debtor from his creditors, to “permit him to start afresh free from the obligations and responsibilities consequent upon business misfortune,”\textsuperscript{101} and to give him a “new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.”\textsuperscript{102} Under the 1898 Act, exempt prop-

\textsuperscript{95} Unmatured life insurance contracts owned by the debtor are exempt under 11 U.S.C.A. § 522(d)(7) (West Supp. 1979).

\textsuperscript{96} An award to the debtor under a crime victim’s reparation law is exempted under id. § 522(d)(11)(A).

\textsuperscript{97} Id. § 363(h); see note 54 supra.

\textsuperscript{98} See text accompanying note 10 supra.

\textsuperscript{99} Under the 1978 Code, if the debtor elects the federal exemptions and his interest in the entirety property is sold the individual creditors are entitled to share on a pro rata basis with the joint creditors in the proceeds from the sale of the tenants by the entirety property.

\textsuperscript{100} 11 U.S.C.A. § 522(c) (West Supp. 1979).


\textsuperscript{102} Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
eity was determined by state law. In providing for federal exemptions in the new Code, Congress expressed a feeling that the state exemptions are "outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors."\textsuperscript{103}

The second purpose of the bankruptcy law, to pay the bankrupt's creditors as much as possible out of the nonexempt assets of the estate, has not been abandoned with the adoption of the Code. Congress noted with respect to tenants by the entirety property and other coownership interests that creditors would be able to realize on the value of the debtor's interest in coowned property by making it part of the estate.\textsuperscript{104} Thus, Congress apparently concluded that tenants by the entirety property over and above the $7,500 federal exemption is not necessary for a fresh start. Congress, however, felt that because of geographical differences, the federal exemption might not always be best; in such cases, the debtor has the option of electing his state exemptions, plus any applicable nonbankruptcy federal exemptions.\textsuperscript{105} The decision to grant each state the power to deny its citizens the right to elect the federal exemption scheme was a congressional compromise.\textsuperscript{106}

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\textsuperscript{103} H.R. Rep. No. 595, supra note 48, at 126, reprinted in Ad. News, supra note 48, at 6087 states as follows:

Though exemption laws have been considered within the province of state law under the current Bankruptcy Act, H.R. 8200 adopts the position that there is a Federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start. Recognizing, however, the circumstances do vary in different parts of the county, the bill permits the States to set exemption levels appropriate to the locale, and allows debtors to choose between the State exemptions and the Federal exemptions provided in the bill. Thus, the bill continues to recognize the States' interest in regulating credit within the States, but enunciates a bankruptcy policy favoring a fresh start.

\textit{Id.} (footnotes omitted).
\textsuperscript{104} Id. at 177, reprinted in Ad. News, supra note 48, at 6137-38.
\textsuperscript{105} Id. at 126, reprinted in Ad. News, supra note 48, at 6087.
\textsuperscript{106} Senator DeConcini stated:

Section 522 of the House amendment represents a compromise on the issue of exemption between the position taken in the House bill, and that taken in the Senate amendment. . . . The States may, by passing a law, determine whether the Federal exemptions will apply as an alternative to State exemptions in bankruptcy cases.

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The final result under the 1978 Code is an imbalance between the differing exemption schemes. If the federal exemptions are elected, then the debtor's interest in tenants by the entirety property, except for the $7,500 federal exemption, is available to satisfy the claims of his creditors. When the state exemptions are chosen or the federal exemptions are unavailable, tenants by the entirety property is immune from the claims of creditors.

The inequity is magnified by the fact that the $7,500 federal exemption is limited to real property used as a residence whereas no such limitation exists on the tenants by the entirety exemption in section 522(b)(2)(B). Thus, a debtor and his spouse might own as tenants by the entirety their residence and other real property all of which would be exempt under section 522(b)(2)(B).

This inequity favoring the state exemption election over the federal scheme suggests that Congress intended section 522(c) to apply to the federal exemptions set forth in section 522(d) and to the federal nonbankruptcy and state exemptions referred to in section 522(b)(2)(A), but not to entirety property. Thus, when the husband in our example elects his federal nonbankruptcy and state exemptions, the bankruptcy court should permit the bank to reduce its note to judgment so as to obtain a lien on the tenants by the entirety property. The fresh start is not jeopardized. Assuming that under state law the debtor has a $5,000 homestead exemption in real property, the bank's judgment lien against the house would be inferior to the husband’s $5,000 homestead exemption because the state homestead exemption is not liable for the bank’s judgment under section 522(c). The debtor’s fresh start as defined by state law would be safeguarded.\(^{107}\)

This result does not prejudice the nonbankrupt spouse because her interest in the house and liability to the bank is not altered by

\(^{107}\) Even if the bank’s note contains language waiving the homestead exemption, the waiver would be unenforceable. 11 U.S.C.A. § 522(e) (West Supp. 1979) states:

A waiver of exemptions executed in favor of a creditor that holds an unsecured claim against the debtor is unenforceable in a case under this title with respect to such claim against property that the debtor may exempt under subsection (b) of this section. A waiver by the debtor of a power under subsection (f) or (h) of this section to avoid a transfer, under subsection (g) or (i) of this section to exempt property, or under subsection (i) if this section to recover property or to preserve a transfer, is unenforceable in a case under this title.

*Id.*
the bankruptcy. In fact, if the house is available to satisfy the bank's claim, the nonbankrupt spouse will be benefited to the extent that her separate estate may not be called upon to satisfy the debt owed the bank. 108

If the husband and wife file a joint case under section 302(a) 109 and elect their state exemptions, and the bankruptcy court consolidates the estate under section 302(b), 110 then section 522(b)(2)(B), which removes entirety property from the estate, apparently would be inapplicable; however, if the estates are not consolidated, then the tenants by the entirety property could be exempted from the estate under section 522(b)(2)(B). 111 The House report states as follows:

Subsection (b) [of section 302] requires the court to determine the extent, if any, to which the estates of the two debtors will be consolidated; that is, assets and liabilities combined in a single pool to pay creditors. Factors that will be relevant in the court's determination include the extent of jointly held property and the amount of jointly-owned debts. The section, of course, is not

108. If the bank's only recourse is to sue the wife and she pays the bank out of her separate estate, she cannot sue the husband for contribution because the husband's contingent liability to her was discharged by his bankruptcy. See id. § 727. She could file a proof of claim and share in the distribution. See id. §§ 502, 509.

109. Id. § 302(a) states:

A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual's spouse. The commencement of a joint case under a chapter of this title constitutes an order for relief under such chapter.

Id.

110. Id. § 302(b) provides as follows: "[A]fter the commencement of a joint case, the court shall determine the extent, if any, to which the debtor's estates shall be consolidated." Id.

111. Under id. § 522(m), the wife could elect the federal exemption and the husband the state exemption. If this occurs, the trustee in the wife's case or in a consolidated case possibly could sell the entirety property under id. § 363(h). If the trustee is permitted to sell the entirety property and thereby ignore that the tenant by the entirety property is exempt in the husband's case, then the equity in the property less the wife's $7,500 exemption and the husband's state exemption would be available for distribution to creditors. This is consistent with the notion that § 522(c) is not intended to immunize entirety property, only the federal bankruptcy or state exemption. On the other hand, if the husband takes the state exemption, his interest in the entirety property arguably immune. The creditors would get paid only out of the wife's interest less her $7,500 federal exemption. Thus, the husband could remove his entire interest in the entirety property from his creditors, not just his exempt portion.
license to consolidate in order to avoid other provisions of the
title to the detriment of either the debtors or their creditors. It
is designed mainly for ease of administration.\footnote{112}

The question is whether Congress intended to completely insu-
late tenants by the entirety property from the claims of creditors.
The creditors’ answer is obviously no, because the clear purpose of
section 363(h) is to make available to creditors the debtor’s inter-
est in tenants by the entirety property that was unavailable to
creditors under the 1898 Act. The contrary argument is that Con-
gress felt that the state exemption laws were so inadequate and
antiquated for fresh start purposes that they consciously decided
that the debtor electing his state exemption should have his en-
tirety property free from the claims of both joint creditors and in-
dividual creditors. Under the prior law, individual creditors had no
right to satisfaction out of property held as tenants by the entirety.
Whether Congress intended section 522(c) to immunize entirety
property from the claims of joint creditors will have to be decided
by the courts.

\textbf{Conclusion}

The foregoing analysis suggests that Congress was unaware of
the inequity it created with respect to entirety property when it
adopted section 522(c). For the Supreme Court’s two-fold purpose
of distributing the maximum amount of nonexempt property to
the creditors while preserving the debtor’s fresh start to have con-
tinuing validity, section 522(c) should not be interpreted to immu-
nize tenants by the entirety property from the claims of joint cred-
itors. Rather, section 522(c) should be construed as inapplicable to
tenants by the entirety property not subject to the jurisdiction of
the bankruptcy court under section 522(b)(2)(B). Section 522(c)
was intended only to protect property exempt under the federal
bankruptcy exemptions enumerated in section 522(d) or exempt
under state law or federal nonbankruptcy law. Because tenants by
the entirety property is not exempt under state law from claims of
joint creditors except to the extent of the homestead exemption,

section 522(c) would not bar a joint creditor from obtaining a judgment lien against it.

A debtor should not be able to free completely his entirety property from the claims of joint creditors merely by electing the state exemption. The 1978 Bankruptcy Code was not intended to shield assets from creditors except to the extent those assets are necessary for a fresh start. If the debtor elects the state exemption for a fresh start, then the entirety property should be immune from joint creditors only to the extent that it is immune under state exemption laws.

Therefore, if the state exemption is chosen, a joint creditor of the debtor and the nonbankrupt spouse whose debt arose before the commencement of the case should be permitted to reduce the joint claim to judgment before discharge in order to obtain a lien against the tenants by the entirety property owned by the debtor on the date of bankruptcy. After-acquired equity in entirety property owned on the date of bankruptcy would be subject to the joint creditor's lien, but entirety property acquired after bankruptcy would be free of any prebankruptcy claim of the joint creditor.