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The Compelling Federal Interests of § 67d of The Bankruptcy Act as Invalidating the Tenancy by the Entirety

THE COMPELLING FEDERAL INTERESTS OF § 67d OF THE BANKRUPTCY ACT AS INVALIDATING THE TENANCY BY THE ENTIRETY

A conveyance of income-producing real property which hinders and delays the rights of creditors will normally be deemed fraudulent and be set aside.[1] The availability of this relief cannot be predicted with uniformity, however, when the realty is owned by husband and wife as tenants by the entirety.[2] In the majority of states which permit real property to be held by the entirety, a judgment creditor of one spouse is not permitted to levy upon the fee interest[3] because, according to the common law theory, both spouses possess the entire property through the marital union.[4] Most of these states have also extended the protection from levy by individual creditors to include rents and profits of entirety realty, thereby abrogating the common law estate to the extent that rents and profits,[5] instead of being attributable exclusively to the husband,[6] are

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[1]*See* First Security Bank of Utah v. Vrontikis Bros., Inc., 26 Utah 2d 422, 490 P.2d 1301 (1971); McHenry F.S., Inc. v. Clauser, 491 P.2d 592 (Col. App. 1971); Montgomery Ward & Co. v. Simmons, 261 N.E.2d 555 (Ill. App. 1970).

[2]The theory of this concurrent estate is that neither spouse individually owns any divisible part of property held by the entirety; both husband and wife own the entire property through the marital union. The estate is a creature of the common law and is derived from the legal fiction that the husband and wife were one person before the law. *See* 4A R. POWELL, REAL PROPERTY ¶ 623 (1972) [hereinafter POWELL]; *see also* 4 G. THOMPSON, REAL PROPERTY § 1784 at 52-53 (1961) [hereinafter THOMPSON].

[3]It is difficult to generalize when speaking of the characteristics of the tenancy by the entirety, but the following states protect the realty itself from levy by individual creditors: Delaware, Florida, Indiana, Maryland, Massachusetts, Michigan, Missouri, North Carolina, Pennsylvania, Rhode Island, Vermont, Virginia, Wisconsin, Wyoming and the District of Columbia. Four states, Arkansas, New Jersey, New York and Oregon, recognize the estate but allow creditors of either spouse to levy upon the realty and force a sale of both the one half income and possessory interests and the contingent right of survivorship in the fee. Kentucky and Tennessee allow only the contingent fee interest to be levied upon by individual creditors. *See* 4A POWELL ¶ 621, ¶ 623 (1972).

[4]The common law described the method of ownership as *per tout et non per my*, which means that the husband and wife do not hold by moieties, but both are seised of the entirety. *See* 4 THOMPSON § 1784 at 48 (1961).

[5]Rents and profits become personal property when earned, *i.e.*, when crops are matured, when timber is severed, and when rents are paid. *See, e.g.*, Lewis v. Pate, 212 N.C. 253, 193 S.E. 20 (1937).

[6]This situation had existed because of the dominance of the English feudal male and the legal incapacity of married women. *See* 4 THOMPSON § 1784 at 52 (1961). The incapacity of the wife was eliminated in most states by the passage of Married Women's Property Acts. However, in those states which recognized the tenancy by the entirety in both real and personal property, it merely immunized from levy by individual creditors not only the fee interest but also the rents and profits produced by the property. *See* 4A POWELL ¶ 623 at 697 (1972); *see also* Note, *Effect of Married Women's Property Acts on Rights of Creditors of Tenants by the Entireties*, 57 DICK. L. REV. 76 (1952). For a state-by-state

personal property held by the entirety. Thus, in states which permit both the fee interest and the income produced to be held by the entirety, an individual creditor of one spouse cannot complain that a gratuitous transfer of the property is fraudulent.[7]

The state of North Carolina, however, while recognizing the tenancy by the entirety as it existed at common law, does not permit personal property to be held by the entirety.[8] This creates the anomalous situation whereby individual creditors of either spouse cannot levy upon the fee interest, but creditors of the husband can levy upon income produced by entirety realty.[9] When a transfer[10] of income-producing entirety realty is made without fair consideration,[11] the question arises whether the transfer may be deemed fraudulent as to the husband's creditors because it has the practical effect of denying them access to either future rents and profits or one half the fair sale proceeds.[12] This question was considered in the bankruptcy context by the Fourth Circuit Court of Appeals in the recent case of *Stubbs v. Hardee*.[13]

Stubbs, a trustee in bankruptcy, brought suit in the district court against defendants-transferees to set aside, for insufficient consideration, a conveyance of a dairy farm formerly owned by the bankrupt and his wife as tenants by the entirety. The understanding among the parties was that the bankrupt and his wife would continue to live on the property and operate the farm in the defendants' name, with the net profits being

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comparison of the types of property which may be held by the entirety, see Phipps, *Tenancy by the Entireties*, 25 TEMP. L.Q. 24 (1951).

[7]The general principle advanced by courts is that the property can be conveyed free and clear of even a docketed judgment. *See, e.g.*, Vasilion v. Vasilion, 192 Va. 735, 66 S.E.2d 599 (1951); Hertz v. Mills, 166 Md. 492, 171 A. 709 (1934); Biehl v. Martin, 236 Pa. 519, 84 A. 953 (1912). The rationale is that neither spouse possessed any property before the conveyance which could have been levied upon, and thus no assets subject to creditors' claims have been removed.

[8]Bowling v. Bowling, 243 N.C. 515, 91 S.E.2d 176 (1956); Turlington v. Lucas, 186 N.C. 283, 119 S.E. 366 (1923). This represents the minority view, since most states which recognize the tenancy by the entirety allow both real and personal property to be held in this manner. *See* 4A POWELL ¶ 622 (1972).

[9]Note 5 *supra*.

[10]The conveyance described should not be confused with a transfer of separately owned property into ownership by the entirety. Such a transfer would be deemed fraudulent and be set aside under North Carolina law. *See* Sills v. Morgan, 217 N.C. 662, 9 S.E.2d 518 (1940).

[11]Fair consideration is that which fairly represents the value of the property transferred or the obligation incurred. *See* Schlecht v. Schlecht, 168 Minn. 168, 209 N.W. 883 (1926). For example, ten dollars or merely love and affection would seem to be insufficient consideration.

[12]Wilson v. Ervin, 227 N.C. 396, 42 S.E.2d 468 (1947) (proceeds held as tenants in common). As personal property, proceeds would be immediately subject to individual creditors' levy.

[13]461 F.2d 480 (4th Cir. 1972).

retained for the bankrupt's benefit. The parties further agreed "that the farm would be reconveyed to the bankrupt and his wife when the claims of the bankrupt's creditors were either settled or barred",[14] apparently by his discharge. The Fourth Circuit, in reversing the summary judgment[15] entered against the trustee's suit, accepted his allegations as true and found that the transfer of the farm, said to be worth in excess of $200,000, was the initial step in a cunning scheme[16] to frustrate the husband's creditors.

The Fourth Circuit tersely discussed North Carolina law regarding the tenancy by the entirety and properly concluded that as long as the bankrupt and his wife held the realty, neither his individual creditors nor the trustee could have levied upon the fee. Creditors could only have levied upon all accrued[17] or accruing[18] rents and profits. Finding that the bankrupt had the right to limit the claims of his creditors to either accruing profits or, if he chose to convey, one half the proceeds of a fair sale, the court held that a conveyance which defeated both these possible claims would violate § 67d(2) of the Bankruptcy Act.[19] The appropriateness of particular relief was not considered, however, as the case was remanded to the district court for a full factual determination; but the court did suggest that

> [i]f the land is found to have been conveyed for less than fair consideration, the District Judge will consider whether the transferees should be held accountable to the Trustee for one half of

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[14] *Id.* at 482.

[15] According to the unreported memorandum opinion of the district court, the bankrupt had transferred exempt property to the defendants. Brief for Appellant at 33-34 (appendix), Stubbs v. Hardee, 461 F.2d 480 (4th Cir. 1972). Text accompanying notes 31-36 *infra*.

[16] According to the amended complaint of the trustee, the bankrupt and the defendants were planning to rebuild his business together, with a $15,000 loan obtained by defendants and some new customer contracts which both had negotiated prior to the conveyance. The key to their success was apparently a quick adjudication in bankruptcy followed by discharge. Brief for Appellant at 22-25 (appendix), Stubbs v. Hardee, 461 F.2d 480 (4th Cir. 1972).

[17] *Cf.* note 5 *supra*.

[18] The court was apparently referring to the right to appointment of a receiver. Text accompanying notes 26-29 *infra*.

[19] Bankruptcy Act § 67d(2), 11 U.S.C. § 107d(2) (1970), provides:

> Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; . . . or (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors.

the fair value of the land, in lieu of reconveyance, and for all interim profits.[20]

Before discussing the propriety of this relief, it is necessary to briefly review North Carolina's view of income-producing entirety realty.[21] The position of the bankrupt vis-à-vis his creditors prior to the conveyance is pertinent both to an understanding of the motive behind this agreement with the defendants and to an analysis of the Fourth Circuit's suggestion of relief which was unattainable under state law.

In North Carolina only joint judgment creditors may obtain a lien upon entirety realty while both spouses are living.[22] Consequently, the bankrupt's individual creditors could not have obtained a lien upon the realty itself; nor could they have obtained a lien upon future rents and profits.[23] The fee interest is non-leviable because neither spouse possesses a divisible interest[24] in the property itself; and levy upon the income interest is not permitted until income is actually earned, in the sense that rents are paid or crops are matured.[25] Thus, if land and buildings held by the entirety comprise the bankrupt's assets, his creditors could anticipate payment of judgments only from future profits as earned.

The appropriate procedure for obtaining court supervision of these future profits is by application for appointment of a receiver under North Carolina statutes.[26] The availability of such a court order, even after a

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[20]461 F.2d at 482. Even though the bankrupt's wife was a party to neither the trustee's suit nor the bankruptcy proceedings, the court linked her participation in the scheme to the suggested relief of reconveyance and sale. If only constructive fraud was found under § 67d(2)(a), the proceeds of sale were appropriated one half to creditors, and one half to the wife; if she was a participant with actual fraudulent intent under § 67d(2)(d), all proceeds were available for payment of creditors. *Id.* at 482. A reconveyance and sale is unlikely. *See* note 47 *infra*. Thus, the effect of this relief upon the wife will not be discussed in depth nor will the issues of the type of fraud involved. However, if this relief could be achieved, there seems to be no legal theory which could adequately sustain payment of the husband's creditors with the property of the wife, absent some agreement of guarantee or surety on her part.

[21]For a very extensive exposition of the estate, see Lee, *Tenancy by the Enitrety in North Carolina*, 41 N.C.L. REV. 67 (1962). A less exhaustive but updated discussion is found in J. WEBSTER, JR., REAL ESTATE LAW IN NORTH CAROLINA § 115 (1971).

[22]Martin v. Lewis, 187 N.C. 473, 122 S.E. 180 (1924). The creditors may then force a judicial sale of the property and apply the proceeds against their judgments.

[23]*See* Johnson v. Leavitt, 188 N.C. 682, 125 S.E. 490 (1924); Bruce v. Nicholson, 109 N.C. 202, 13 S.E. 790 (1891). These cases state that the husband has no interest subject to levy and sale, nor does his contingent right of survivorship constitute any present interest, or a remainder, either vested or contingent.

[24]*See* Grabenhofer v. Garrett, 260 N.C. 118, 131 S.E.2d 675 (1963); Edwards v. Arnold, 250 N.C. 500, 109 S.E.2d 205 (1959).

[25]Lewis v. Pate, 212 N.C. 253, 193 S.E. 20 (1937).

[26]N.C. GEN. STAT. § 1-363 (Repl. vol. 1969) provides in part:

conveyance, was implied by the North Carolina Supreme Court in *L & M Gas Co. v. Leggett*,[27] which involved a transfer of income-producing entirety realty to the wife for no consideration. The court found the fraudulent conveyance allegation of a judgment creditor insufficient to state a cause of action[28] and refused to set aside the conveyance. The opinion implied, however, that a complaint alleging the existence of accrued or accruing rents or profits might have stated a claim upon which relief would be granted. It would be speculative at best to predict what relief the court might have suggested, but it appears very unlikely that relief would have exceeded appointment of a receiver by more than nominal damages.[29]

The importance of *Leggett*, decided about one year before the conveyance in *Stubbs*, is that it should have put potential bankrupts on notice that less than arm's-length dealings with entirety realty would be closely scrutinized by the state courts. The bankrupt in *Stubbs* was probably aware that a conveyance for full consideration would have immediately made his share of the proceeds available for levy; the alternative—that of retaining the property—would have probably triggered receivership, a prospect frustrating both his hopes of financial recovery and his plans for immediate expansion. Apparently confident that the tenancy by the entirety would protect him, the bankrupt and the defendants conceived a scheme not only designed to cut off his creditors' claims to accruing rents and profits, but also to extinguish these claims through adjudication and discharge in bankruptcy.[30]

> The court . . . may . . . appoint a receiver in proceedings under this article of the property of the judgment debtor, whether subject or not to be sold under execution, except the homestead and personal property exemptions.

The appointment of a receiver of income-producing entirety realty tends to accelerate the process of levy only in the sense that the procedure prevents misappropriation of funds and removal of production from the realty before the personal property can be applied in payment of judgments. Even a receiver obtains no title to the fee interest and obtains title to the income only when earned. *Cf.* note 29 *infra*.

[27]273 N.C. 547, 161 S.E.2d 23 (1968).

[28]*Id.* at 28. The majority opinion concluded:

> Moreover, to avoid husband's deed would be an exercise in futility. Husband and wife could by joint voluntary conveyance transfer the property to anyone of their choice, free of lien or claim of husband's creditors.

[29]The North Carolina Supreme Court gave tacit approval to appointment of a receiver for rentals from entirety realty in Hodge v. Hodge, 12 N.C. App. 574, 183 S.E.2d 800, *cert. denied*, 279 N.C. 726, 184 S.E.2d 884 (1971). The case was decided after *Leggett* and no conveyance was involved, but the court made no suggestion that the husband had any leviable property prior to receipt of monthly rents.

[30]The discharge in bankruptcy will generally bar recovery after adjudication upon any claims provable under the Bankruptcy Act, which normally requires only that the claim be

The trustee presented the particulars of this scheme to the Fourth Circuit and claimed that the bankrupt had conveyed non-exempt property consisting of the right to future rents and profits, that creditors had been actually defrauded, and that the defendants had been unjustly enriched.[31] The defendants countered with the argument that the trustee had no standing to attack the transfer under § 67d(2) because the entirety realty was exempt property under § 67d(1)(a).[32] The Fourth Circuit did not expressly reject this argument but instead introduced a collateral issue by making the irrelevant statement that "[t]he exemption, however, is qualified and conditional. . . ."[33]

The court's statement about the conditional nature of the exemption was not pertinent to the determination of whether the conveyance in *Stubbs* was fraudulent and added no support to the attack upon the transfer. Its observation was apparently made in reference to § 6 of the Bankruptcy Act[34] which stresses the authority of the trustee to deny the bankrupt his state and federal exemptions from property fraudulently conveyed and recovered for the estate. It would have been more desirable, however, if the court had explicitly repudiated the defendants' argument that the property was exempt since this contention was erroneous. Property held as tenants by the entirety is not exempt property[35] within the

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in existence at the date of bankruptcy. The trustee alleged that those he represented were of a provable nature and hence would be barred. Brief for Appellant at 20 (appendix), Stubbs v. Hardee, 461 F.2d 480 (4th Cir. 1972). The fact that the claims were asserted against entirety realty would not affect their dischargeability. *See generally*, Hartman, *The Dischargeability of Debts in Bankruptcy*, 15 VAND. L. REV. 13 (1961); Comment, *Entireties Property: The Effect of Bankruptcy on Creditors' Rights*, 28 U. PITT. L. REV. 267 (1966). In order for the creditors' claims to survive bankruptcy in *Stubbs*, they would either have to be non-provable under § 63 or non-dischargeable under § 17; the normal business and personal debts would not come under the protection of these sections. *See* 1A W. COLLIER, BANKRUPTCY ¶ 17.27, at 1718 (14th ed. 1972) [hereinafter cited as COLLIER].

[31]Brief for Appellant at 5, Stubbs v. Hardee, 461 F.2d 480 (4th Cir. 1972).

[32]Bankruptcy Act § 67d(1)(a), 11 U.S.C. § 107d(1)(a) (1970), provides:

> For the purposes of, and exclusively applicable to, this subdivision:
>
> (a) "Property" of a debtor shall include only his nonexempt property.

[33]461 F.2d at 481.

[34]Section 6 of the Bankruptcy Act was amended in 1938 to provide that no allowance for exemptions should be made from the property which a bankrupt fraudulently transfers and which is recovered by the trustee. *See* Bankruptcy Act § 6, 11 U.S.C. § 24 (1970).

[35]As Collier states:

> Even though property held by the entirety is not under state law subject to payment of the debts of either tenant, it is not to be regarded as exempt, *i.e.*, unless it otherwise falls within the scope of the state's . . . exemption law.

See 4A COLLIER ¶ 70.17[8], at 187-88. *Cf.* McMullen v. Zabawski, 283 F. 552 (E.D. Mich. 1922) (trustee failed to acquire title to property because estate is not capable of division; property is not exempt in any true legal sense, as is a homestead).

meaning of the Bankruptcy Act; to characterize it as such would be dispositive of the case since exempt property generally cannot be the subject of a fraudulent conveyance.[36] In any event, the statement probably was an allusion to the equity power of the bankruptcy court and did not substantially affect the court's decision to deem the transfer fraudulent. Rather, the Fourth Circuit's ultimate conclusion that the conveyance violated the rights of the husband's creditors seems based solely upon § 67d(2).

The conveyance by the bankrupt in *Stubbs* appears to have violated the plain meaning of § 67d(2),[37] for clearly there was a transfer of property having substantial value for inadequate consideration. This surface analysis of the transaction must be supplemented, however, by answering the additional question of what non-exempt property[38] of the debtor has been transferred. The court adequately determined, albeit through a confused analysis, that no problem of conveyance of exempt property was involved;[39] but it did not clearly indicate what non-exempt property of the bankrupt was conveyed.

The trustee advanced the theory that the bankrupt had conveyed, for insufficient consideration, non-exempt property consisting of his right to receive future rents and profits from the entirety realty. The Fourth Circuit did not discuss the merits of this allegation, but it appears that the accountability of the defendants was not based upon the income potentiality of the property. There are at least two reasons for the court's presumed rejection of the trustee's theory. First, the court undoubtedly recognized the uncertainty and speculation of valuing estimated future income.[40] Secondly, it probably was aware of the procedure whereby a federal court defers to state law the characterization of a bankrupt's property rights in determining under § 70a(5) of the Bankruptcy Act whether the bankrupt possessed any transferable or leviable interest in entirety realty.[41] The North Carolina Supreme Court has repudiated the

[36]*See* 1 G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 172 (1940); *see also* 1A COLLIER ¶ 6.11. The labels "exempt property" and "exemption" may merge together at times, but they may be distinguished by saying that exempt property is the individual items which comprise the debtor's exemptions, either under federal or state law.

[37]Note 19 *supra.*

[38]Note 32 *supra.*

[39]Notes 34-36 *supra.*

[40]*See* Dunham, *Valuing of Life Estates and Remainders*, 107 TRUSTS AND ESTATES 13 (1968); *see generally* 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN §§ 169-170 (2d ed. 1953).

[41]The question whether the trustee is vested with title, under § 70a of the Bankruptcy Act, to the bankrupt's interest in entirety realty is usually determined under clause (5) of that section. Section 70a(5) uses the disjunctive test of transferability or leviability under judicial process, and is liberally construed; but if title is inseparable under state law, no

theory that the husband possesses any such interest in future rents and profits,[42] and the Fourth Circuit apparently accepted this position. However, the court did not appear to be so easily persuaded when it focused its attention upon the conveyance of the fee interest, for this transfer was both substantial and tangible.

As previously mentioned, the fee interest cannot be subjected to levy by the husband's creditors under North Carolina law.[43] If bankruptcy intervenes, this situation is unaffected,[44] absent circumstances not relevant to the *Stubbs* case.[45] The reason for this, as the Fourth Circuit and other federal courts have often stated, is that the trustee obtains no title to entirety realty under § 70a(5) because the bankrupt husband has none.[46] However, in *Stubbs* the bankrupt no longer owned the property as a tenant by the entirety; it had been conveyed in an attempt to place the rents and profits beyond the reach of his creditors. It appears that this solitary distinction, the conveyance, prompted the Fourth Circuit to disregard North Carolina real property law and treat the transaction as tantamount to a transfer of the separate, non-exempt property of the bankrupt.[47] Once this decision was made, the court suggested that relief under § 67d(2)

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interest in entirety realty generally passes to the trustee in bankruptcy. *See* 4A COLLIER ¶ 70.07[1], ¶ 70.17[7], [8]; *see also* 3 H. REMINGTON, BANKRUPTCY § 1178 (Henderson ed. 1957).

[42]The court places great emphasis upon the conversion of income-producing potentiality into actual income production, recognizing no personal property subject to levy until such conversion occurs. Notes 5 and 23 *supra*. *Cf.* Grabenhofer v. Garrett, 260 N.C. 118, 131 S.E.2d 675 (1963) (court refused to convert residence into rental property).

[43]Note 24 *supra*.

[44]Note 41 *supra*.

[45]Congress provided by amendment in 1938 that the trustee should acquire title to the bankrupt's interest in entirety property in the event the property vests solely in the bankrupt, by virtue of survivorship or divorce, within six months of filing his petition. *See* Bankruptcy Act § 70a, 11 U.S.C. 110a (1970). Both husband and wife were living at the time of the proceedings in *Stubbs*.

[46]*See, e.g.*, Reid v. Richardson, 304 F.2d 351 (4th Cir. 1962); Philips v. Krakower, 46 F.2d 764 (4th Cir. 1931); Dioguardi v. Curran, 35 F.2d 431 (4th Cir. 1929); *In re* Kearns, 8 F.2d 437 (4th Cir. 1925), *cert. denied*, Cullom v. Kearns, 269 U.S. 587 (1926); Healey Ice Machine Co. v. Green, 184 F. 515 (E.D.N.C.) *aff'd per curiam*, 191 F. 1004 (4th Cir. 1911); Wylie v. Zimmer, 98 F. Supp. 298 (E.D. Pa. 1951).

[47]Although the court suggested reconveyance and sale as an alternative relief, it appears that the court's own precedents precluded this from being a viable remedy. In *In re* Roberts, 176 F. Supp. 361 (M.D.N.C. 1959), the bankrupts had conveyed entirety realty, apparently non-income-producing, to their relatives for no consideration and were denied discharges because of this. On appeal in Roberts v. Henry V. Dick & Co., 275 F.2d 943 (4th Cir. 1960), the Fourth Circuit remanded with instructions that the trustee would be unable to sell the realty unless joint creditors were involved. This holding was reaffirmed in Reid v. Richardson, 304 F.2d 351 (4th Cir. 1962). *Cf.* Wylie v. Zimmer, 98 F. Supp. 298 (E.D. Pa. 1951)

> should be fashioned with due regard for the effective vindication of the rights of the husband's creditors, . . . and the avoidance of unjust and unconscionable enrichment of the transferees or of the bankrupt and his wife.[48]

It appears that if the trustee chooses to seek recovery from the defendants of one half the fair value of the realty conveyed, he will clearly satisfy the Fourth Circuit's standards.

The opinion in *Stubbs* contains little expressed judicial reasoning, although the ultimate result appears commendable. Thus, the various factors which probably prompted the decision to sever the tenancy by the entirety must be hypothesized and evaluated in light of the policies of the Bankruptcy Act. State law was apparently disregarded under the rationale that § 67d is a federal statute and that federal courts are free to interpret it as they deem proper. A brief examination of the development of § 67d is pertinent to an analysis of the soundness of the conclusion in *Stubbs*.

The Bankruptcy Act was amended[49] in 1938 to add § 67d, which substantially incorporated the provisions of the Uniform Fraudulent Conveyance Act.[50] Enactment of § 67d has had a twofold effect: (1) more transfers are covered by federal fraudulent conveyance law because the encompassing time period has been extended from four months to one year before bankruptcy;[51] and (2) in states, such as North Carolina, which have not adopted the Uniform Act the trustee has access to the Act's superior provisions through use of § 67d.[52]

(protection of fee interest comparable with North Carolina, revesting of title in trustee would be an exercise in futility, trustee could not obtain title to entirety realty).

[48]461 F.2d at 482-83.

[49]For a general discussion of the 1938 amendments, better known as the Chandler Act, see 4 COLLIER ¶ 67.02; *see also* McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 U. CHI. L. REV. 369 (1937).

[50]The Uniform Fraudulent Conveyance Act [hereinafter referred to as Uniform Act] was incorporated into the Bankruptcy Act because it was deemed to codify the better decisions of American courts applying the old English statute of Elizabeth, 13 Eliz., c.5 (1570), upon which American fraudulent conveyance law is based. For a discussion of the statute and its effect upon American bankruptcy law, see 1 G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES §§ 58-62b (1940).

[51]Under the old § 67e, prior to the 1938 amendments, only fraudulent transfers made within four months of bankruptcy were voidable; any transfers outside this period were voidable by reference to applicable state or federal nonbankruptcy law under § 70e. 4 COLLIER ¶ 67.29[2], at 480.

[52]The Uniform Fraudulent Conveyance Act has been adopted by twenty-five jurisdictions: Arizona, California, Delaware, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Utah, Virgin Islands, Washington, Wisconsin and Wyoming. 7 UNIFORM LAWS ANN. 423 (1970). It is interesting

No express language in § 67d implies that state substantive law either controls property questions or may be disregarded by the federal court.[53] However, there are several bankruptcy cases where substantive rights asserted under state law were denied or modified in the name of "general law" or "general equitable principles."[54] The constitutional authority to create a uniform federal law of fraudulent conveyances is plain[55] and was clearly exercised by the addition of § 67d. The operational paragraph, § 67d(6),[56] suggests no particular relief. Consequently, most commentators agree that a federal court is free to draw upon the general jurisprudence of fraudulent conveyance law in fashioning relief, aided, but not controlled, by state court construction of the Uniform Act.[57] In short, a

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to note that a recent article reviewing the status of North Carolina's fraudulent conveyance law concluded that the enactment of the Uniform Fraudulent Conveyance Act would substitute clear and simple statutory provisions, but not change creditors' rights and remedies, even as to the tenancy by the entirety. *See* Note, *The Law of Fraudulent Conveyances in North Carolina: An Analysis and Comparison with the U.F.C.A.*, 50 N.C.L. REV. 873, 902 (1972).

[53]There is disagreement among commentators as to the extent which Erie R.R. v. Tompkins, 304 U.S. 64 (1938), requires the application of state law in bankruptcy cases. *See* Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U.L. REV. 407, 409 (1972) (not applicable in nondiversity cases); Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013 (1953) (applicable, but state-created rights may be overriden by federal bankruptcy objectives). Collier seems to substantially adopt the latter position. *See* 4A COLLIER ¶ 70.70[2], at 777. *But see* 1 G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 62a (1940) (*Erie* made no significant impression upon the law of fraudulent conveyances under the Bankruptcy Act; it has long been settled that local law determines whether a transaction is fraudulent as to creditors).

[54]*See, e.g.*, Tobin v. Insurance Agency Co., 80 F.2d 241, 243 (8th Cir. 1935) (validity of assignments); Wilson v. Duncan, 61 F.2d 515 (5th Cir. 1932) (priority among assignments). *See also* cases collected by Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013, 1035 n.94 (1953).

[55]U.S. CONST. art. I, § 8 provides:

> The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.

[56]Bankruptcy Act § 67d(6), 11 U.S.C. 107d(6) (1970). The paragraph, which provides "[a] transfer made . . . which is fraudulent under this subdivision [d] . . . shall be null and void against the trustee," only means that where a bankruptcy court lacks possession of the property and a substantial adverse claim exists, the trustee must initiate a plenary suit to recover the property or its value. *See* 4 COLLIER ¶ 67.41[3], at 585.

[57]As originally introduced § 67d contained the following additional paragraph:

> The provisions of this subdivision shall be interpreted and construed so far as possible in uniformity with the law wherever the Uniform Fraudulent Conveyance Act is enacted.

The clause was subsequently omitted from § 67d as enacted, which the commentators conclude indicates that the federal courts are free to interpret subdivision d as they deem proper. *See* 4 COLLIER ¶ 67.29[2], at 481; 1A J. MOORE, FEDERAL PRACTICE ¶ 0.322 (2d ed. 1961). *See generally* McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 U. CHI. L. REV. 369 (1937).

federal court is given a rather free rein in determining what transfers violate § 67d.

The court in *Stubbs* apparently felt that its discretion under § 67d was unfettered enough to deny the bankrupt the protection of the tenancy by the entirety. The first factor which entered into this decision is the equitable character of bankruptcy proceedings.[58] This grant of equitable power is essentially the power to carry out bankruptcy objectives, and one of the primary objectives of the Bankruptcy Act is the prevention of fraudulent conveyances.[59] Statutes invalidating fraudulent conveyances are designed to prevent debtors from putting property which is available for the payment of their debts beyond the reach of their creditors.[60] Moreover, the law has always condemned attempts by a debtor to place his property where he can enjoy it and at the same time require his creditors to remain unsatisfied.[61] While a narrow view of the *Stubbs* situation,[62] which would have complied with North Carolina real property law, could have been taken by the court, such a view would have countenanced an attempt by the bankrupt permanently to elude his creditors by reliance upon the unrealistic subtleties of the tenancy by the entirety. The better decision was to deem the conveyance fraudulent because of the economic effects and realities of the transaction and adjust the rights of the parties accordingly.

An additional reason why the Fourth Circuit refused to respect the North Carolina view of the tenancy by the entirety was because the purpose underlying this method of ownership is no longer significant in modern society. The estate evolved at common law principally because of the incapacity of married women to own property in their own right.[63] The tenancy by the entirety was thus conceived to allow the surviving wife to obtain all realty owned during coverture free of her decedent husband's debts, a result which he could not disrupt by testamentary instrument.[64]

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[58]In Continental Bank v. Rock Island Ry., 294 U.S. 648, 675 (1935), the Court stated: "They are essentially courts of equity, and their proceedings inherently proceedings in equity. . . ."

[59]*See* Wragg v. Federal Land Bank, 317 U.S. 325 (1943); Clarke v. Rogers, 228 U.S. 534 (1913).

[60]Kuminet v. Thielen, 210 Minn. 302, 298 N.W. 245, 247 (1941).

[61]United States v. Leggett, 292 F.2d 423, 427 (6th Cir. 1961); *accord*, Katz v. Driscoll, 86 Cal. App. 2d 313, 194 P.2d 822 (1948).

[62]The Fourth Circuit could have determined that § 70a(5) controlled determinations under § 67d of what property of the debtor was transferred in violation of creditors' rights. This view, under North Carolina law, would have found that at the time of the conveyance the bankrupt owned no separate interest in the fee and removed no personal property in the form of earned income; he thus transferred none of his property under § 67d, and there was no fraudulent conveyance. Notes 41-42 *supra*.

[63]Note 6 *supra*.

[64]*See* Davis v. Bass, 188 N.C. 200, 124 S.E. 566 (1924).

With the advent of equal legal capacity of women, many states modified or even abrogated the estate.[65] North Carolina, though, has staunchly defended the common law characteristics against demands for simplification of property law and for increased access to the assets of individual debtor husbands. The Fourth Circuit apparently decided the protective incidents of the estate may be forfeited when the tenancy by the entirety is used as a device for defrauding creditors. The court therefore treated the transaction as a transfer of separate property and deemed the transfer of the husband's one half interest fraudulent.

Additionally, the court may have examined the sufficiency of mere reconveyance and denial of discharge as a remedy. If this had been the extent of suggested relief, the husband's creditors not only would be required to initiate supplementary proceedings in a state court, but also would be confronted with the outdated view of the North Carolina Supreme Court towards the tenancy by the entirety. In the state proceedings, the maximum relief available to creditors would appear to be protracted and uncertain receivership proceedings.[66] The inadequacy of this relief and its unwarranted circuity of lawsuits appears to have affected the Fourth Circuit's decision to adjust the rights of the parties while they were before the bankruptcy court.

The last and probably major factor in the decision to deny the bankrupt the protection of the tenancy by the entirety was the economic effect of the conveyance.[67] The essence of this argument by the trustee was that an arm's-length sale for full and fair consideration would have provided an equal amount of personal property subject to immediate levy by the husband's creditors; thus, the conveyance to defendants for insufficient consideration should make them accountable to the trustee in this amount. In defense of this argument, it seems plausible to describe the transaction as equivalent to a conveyance for full consideration with a pre-arranged, simultaneous return of the proceeds to the defendants. Even though no funds actually changed hands, the result under this fictional theory is the same as the actual result in the *Stubbs* situation. The bankrupt has virtually nothing and the defendants have both the property and the consideration which arm's-length dealing would have required to obtain the property.

To allow the transfer in *Stubbs* to stand unchallenged would seem to

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[65]Note 3 *supra*.

[66]Notes 26 and 29 *supra*. Moreover, there may have been creditors with claims not yet reduced to judgment, a prerequisite for participating in normal receivership proceedings under North Carolina law. *See* N.C. GEN. STAT. § 1-502 (Repl. vol. 1969).

[67]This argument was apparently presented for the first time on appeal, although it also may have been used in oral argument before the district court. Brief for Appellant at 5-8, Stubbs v. Hardee, 461 F.2d 480 (4th Cir. 1972).

exalt form over substance. The court seems to have said that because of the economic benefits accruing to the transferees, the substance of a fair sale should be superimposed over the form chosen in a sale for inadequate consideration. The Fourth Circuit was apparently persuaded by this substance-form dichotomy, for its suggested damage recovery essentially amounts to a direct attack upon the husband's share of proceeds which were never paid over by defendants.

If the proposition that North Carolina entirety realty may be fraudulently conveyed by a husband is accepted, then the relief suggested by the court in *Stubbs* is not extraordinary. In the event of a fraudulent transfer of separately owned realty, the awarding of damages equal to the value of the property conveyed is an accepted relief, though it is normally utilized only when the transferee has consumed the property himself or conveyed it to an innocent purchaser.[68] Although the defendants in *Stubbs* still hold the property, reconveyance would not provide relief.[69] Thus, it appears appropriate that the defendants be held accountable for the value of the husband's interest in the farm, since this is the amount which his creditors could have reached if the transfer had been for adequate consideration.

It is difficult to postulate the exact implications of *Stubbs* beyond the situation presented by that case. Since North Carolina stands alone in its position towards the tenancy by the entirety, the problem in *Stubbs* may not soon be presented again to a federal court. Now that the Fourth Circuit has expressed disfavor of use of the estate as a device to defraud creditors, a North Carolina bankrupt can no longer rely on the protection against judgment creditors which local law provides for entirety realty. The *Stubbs* decision does appear, however, to have possible dangerous implications for other states which recognize the tenancy by the entirety.[70]

The decision in *Stubbs* broadly implies that a federal court is not bound by local law in dealing with a conveyance of entirety property under § 67d. This disregard of state property law should not be extended so that local law concerning the estate would be ignored even without a purported fraudulent conveyance. Until *Stubbs* the Fourth Circuit had uniformly deferred to state law when confronted with a bankrupt owning

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[68]*See* Cahill-Mooney Constr. Co. v. Ayers, 140 Mont. 464, 373 P.2d 703 (1962); Halsey v. Winant, 233 App. Div. 103, 251 N.Y.S. 81 (1931), *rev'd other grounds*, 258 N.Y. 512, 180 N.E. 253 (1932). *See generally* 4 COLLIER ¶ 67.41.

[69]Text accompanying note 66 *supra*.

[70]The potential coverage of the implications in *Stubbs* may be significant if the popularity of the tenancy by the entirety in other states is comparable with its popularity in North Carolina. *See* Lee, *Tenancy by the Entirety in North Carolina*, 41 N.C.L. REV. 67, 69 (1962) (ninety percent of husband and wives own by the entirety per discussions with real estate operators). *See* note 3 *supra* (listing the states which may be affected).

realty by the entirety, and it had always held that the property did not become part of the bankrupt's estate, absent consolidated proceedings.[71] The *Stubbs* case may indicate that the court will refuse to recognize the inseparable title concept in future proceedings dealing with only individual creditors and simply authorize the trustee to sell a one half interest in the property, thus treating the tenancy by the entirety as a tenancy in common subject to partition.[72]

This would be an undesirable judicial extension of federal equity power, since such a decision properly rests either with Congress or the state legislatures. Judicial sale of entirety property has always been a remedy reserved for joint creditors alone, absent statutory modification.[73] Without a pressing demand of prevention of fraud, as in *Stubbs*, individual creditors should not be allowed equal treatment.

The reason for preferring joint creditors is that they have maximized their expectations by anticipating the problem of insolvency beforehand and have required joint liability on debt obligations.[74] If a bankruptcy court is permitted to sell property which was not capable of being sold under state insolvency proceedings, joint creditors will not be accorded their negotiated priority. It is submitted that the tenancy by the entirety should continue to protect a debtor's realty from his individual creditors in bankruptcy proceedings to the same degree as in state courts, absent attempts to defraud creditors by a conveyance.[75] The *Stubbs* decision should not be extended to allow a federal court to sever the tenancy by the entirety where an honest debtor is seeking relief from burdensome indebtedness.[76]

The tenancy by the entirety as it exists in North Carolina represents an archaic legal fiction which seems misplaced in modern commercial

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[71]Notes 46-47 *supra*.

[72]Partition may be defined as a division, between two or more persons, of property which they own as joint tenants or tenants in common either by setting apart the interests for separate possession or by a sale of the whole and the awarding of each his share in the proceeds. In the absence of statutes to the contrary, estates held by the entirety are not subject to partition. *See* 4A POWELL ¶ 609 (1972).

[73]Note 3 *supra*.

[74]*See* J. WEBSTER, JR., REAL ESTATE LAW IN NORTH CAROLINA § 115 (1971).

[75]The only type of transfer which might be deemed fraudulent in those states recognizing the tenancy by the entirety in both the fee interest and income produced would be one in "contemplation of death" of the non-debtor spouse. If this occurred within six months of bankruptcy it should be deemed a fraudulent conveyance. *See* note 45 *supra*; *cf.* Winchester-Simmons Co. v. Cutler, 199 N.C. 709, 155 S.E. 611 (1930) (non-income-producing entirety realty conveyed to granddaughter for no consideration to avoid execution against property upon death of wife; the court refused to set aside the transfer even though the wife died four months later).

[76]*See* Perez v. Campbell, 402 U.S. 637, 648 (1971); Williams v. Fidelity & G. Co., 236 U.S. 549 (1915).

transactions. The pronouncement by the court in *Stubbs* that the estate cannot be successfully utilized as a device for defrauding creditors should be commended. If the decision places tenants by the entirety on notice that arm's-length dealing will be required in all pre-bankruptcy conveyances, it will have served a useful purpose. The case advances the doctrine of fair dealing and honest conduct; its disregard of local property law should not, however, be extended beyond ad hoc determinations which warrant its application.

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