

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 97-12320
Chapter 13

KENNETH EDWARD DAVIS

Debtor

MEMORANDUM

Appearances: Howard B. Barnwell, Jr., Chattanooga, Tennessee, Attorney for Debtors

Allison A. Cardwell, Chambliss, Bahner & Stophel, Chattanooga, Tennessee, Attorney for Trula Rogers French

**HONORABLE R. THOMAS STINNETT,
UNITED STATES BANKRUPTCY JUDGE**

The question before the court is whether to sustain or deny objections to confirmation of Mr. Davis's proposed chapter 13 plan. The chapter 13 trustee and an unsecured creditor, Trula Rogers French, filed the objections. Both objections assert that the plan does not satisfy the confirmation requirement set out in Bankruptcy Code § 1325(a)(4). 11 U.S.C. § 1325(a)(4). This requirement is generally referred to as the best interests of creditors test. Lawrence P. King, et al., 8 *Collier on Bankruptcy* ¶ 1325.05 (15th ed. 1997).

The best interests test applies with regard to non-priority unsecured claims, often referred to as general unsecured claims. *Compare* 11 U.S.C. § 1325(a)(4) *and* 11 U.S.C. §§ 1322(a)(2) & 1325(a)(1). To meet the test, the plan must provide for payment on each general unsecured claim of not less than the amount that would be paid on the claim in a chapter 7 liquidation case. 11 U.S.C. § 1325(a)(4).

The amount that would be paid on general unsecured claims in a chapter 7 liquidation depends on the value of the debtor's property over and above exemptions and unavoidable liens. *See Hardy v. Cinco Federal Credit Union (In re Hardy)*, 755 F.2d 75 (6th Cir. 1985); *see generally* Keith M. Lundin, *Chapter 13 Bankruptcy* §§ 5.29 – 5.30 (2d ed. 1994).

The objections to confirmation focus on the value of Mr. Davis's interest in a house. Mr. Davis and his wife own the house as tenants by the entirety. Only Mr. Davis has filed bankruptcy. Mrs. Davis has not. The house is subject to a mortgage. According

to Mr. Davis's brief, the Davises have some equity in the house because it is worth more than the mortgage debt.

Because only Mr. Davis is a chapter 13 debtor, Mr. and Mrs. Davis's joint interest in the house, including their equity, did not come into the bankruptcy estate. Only Mr. Davis's survivorship interest came into the bankruptcy estate. In a chapter 7 liquidation case, only Mr. Davis's survivorship interest could be sold by the bankruptcy trustee; the trustee could not sell the house in order to obtain the equity over and above the homestead exemption. 11 U.S.C. § 522(b)(2)(B); *Ray v. Dawson (In re Dawson)*, 10 B.R. 680 (Bankr. E. D. Tenn. 1981) *aff'd* 14 B.R. 822 (E. D. Tenn. 1981); *In re Dick*, 136 B.R. 1000 (Bankr. W. D. Tenn. 1992); *Waldschmidt v. Shaw (In re Shaw)*, 5 B.R. 107 (Bankr. M. D. Tenn. 1980).

Of course, the amount of equity in the house is still important to the value of Mr. Davis's survivorship interest. Several factors can affect the value of a survivorship interest, but generally the more equity in the property, the more the survivorship interest will be worth. *Hardin v. Caldwell (In re Caldwell)*, 851 F.2d 852, 856 (6th Cir. 1988).

The objections to confirmation depend on how the equity should be calculated in light of another key fact: the mortgage debt is secured by collateral other than the house. When Mr. and Mrs. Davis bought the house, the mortgage lender demanded additional collateral. Mrs. Davis provided the additional collateral by giving the lender a mortgage on a house owned solely by her.

The chapter 13 trustee and the objecting creditor argue that the effect of marshaling must be considered to determine the amount of equity in the jointly owned house. *In re Hansen*, 77 B.R. 722 (Bankr. D. N. D. 1987). They contend that under Tennessee law the mortgage holder could be required to collect first from the house that belongs solely to Mrs. Davis, thereby increasing the equity in the jointly owned house and indirectly increasing the value of Mr. Davis's survivorship interest.

The argument raises the question of whether the Tennessee courts would require the mortgage holder to collect first from Mrs. Davis's property in order to preserve the jointly owned property for the benefit Mr. Davis's creditors.

Marshaling generally requires at least two properties belonging to the common debtor. Mr. Davis is the common debtor. The two properties in question are the jointly owned house and the house owned solely by Mrs. Davis. Both properties do not belong to the common debtor, Mr. Davis. Both properties are not available for the payment of the common creditors, the mortgage lender and the bankruptcy trustee, since the trustee has no claim to the house owned solely by Mrs. Davis. Thus, marshaling does not apply. *House v. Thompson*, 40 Tenn. 512 (1859); *Mercantile Bank v. Oransky (In re Oransky)*, 75 B.R. 541 (Bankr. E. D. Mo. 1987); 53 *Am. Jur. 2d*, Marshaling Assets §§ 10-13 (1996).

Marshaling apparently can not apply in this situation because it would prejudice a third party, Mrs. Davis, and it might prejudice her creditors. When all the property that might be marshalled belongs to the common debtor, the court can usually determine the effect of marshaling on all the parties involved and on the debtor's general

creditors. This is not true, however, with regard to property belonging to a third party, such as Mrs. Davis. The court can not predict the effect of marshalling of Mrs. Davis's separate property, and it would be a venture into the unknown.

The courts reach the same result when the wife pledges her property, or property jointly owned with her husband, to secure her husband's debts. The courts require the creditor to collect first from the collateral belonging to the husband in order to preserve the wife's property or her interest in jointly owned property. *Swift & Co. v. Kortrecht*, 112 Fed. 709, 715 (6th Cir. 1902); *American Trust Co. v. Waddle*, 162 Tenn. 412, 36 S.W.2d 894, 895-96 (1931). The courts do not base this result entirely on the rule that the property subject to marshalling must belong to the common debtor. There is an added reason for requiring creditors to take the husband's property first. Since the wife is acting as a surety on the husband's debt, she is only secondarily liable for the debt. Creditors must rely first on the property of the debtor, who is primarily liable for the debt.

Of course, Mrs. Davis was not acting as a surety or guarantor. She joined in the note and mortgage as a joint purchaser. Nevertheless, the result of the surety cases supports the court's conclusion. The rule as to sureties overlaps with the rule that marshalling does not apply to property belonging to someone other than the common debtor. See, e.g., *In re Childers*, 44 B.R. 23 (Bankr. N. D. Ala. 1987); *Central Trust Co. v. Burchett (In re Willson Dairy Co.)*, 30 B.R. 67 (Bankr. S. D. Ohio 1983); *Whirlpool Corp. v. Plad, Inc. (In re Plad, Inc.)*, 24 B.R. 676 (Bankr. M. D. Tenn. 1982). Because marshalling does not apply, the objections under the best interests test must be denied.

The trustee and the creditor also objected on the ground that the plan was not proposed in good faith. 11 U.S.C. § 1325(a)(3). This objection, however, was apparently tied to the objection under the best interests test — the theory being that the plan was not proposed in good faith because it did not meet the best interests test. The trustee and the objecting creditor have not submitted any other evidence or made any other argument related to good faith. Therefore, the bad faith objection must fall with the objection under the best interests test.

The court will enter an order denying the objections and confirming the plan.

This Memorandum constitutes findings of fact and conclusions of law as required by Fed. R. Bankr. P. 7052.

At Chattanooga, Tennessee.

BY THE COURT

entered 8/1/1997

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 97-12320
Chapter 13

KENNETH EDWARD DAVIS

Debtor

ORDER

In accordance with the court's Memorandum entered this date,

It is ORDERED that the objections to confirmation are overruled and the plan shall be confirmed.

ENTER:

BY THE COURT

entered 8/1/1997

R. THOMAS STINNETT
U.S. BANKRUPTCY JUDGE