

RENDERED: JULY 18, 2003; 2:00 P.M.

ORDERED NOT PUBLISHED BY THE KENTUCKY SUPREME COURT:
 APRIL 15, 2004 (2003-SC-0603-D)

Commonwealth Of Kentucky

Court of Appeals

NO. 2001-CA-001662-MR

BANK ONE, KENTUCKY, NA

APPELLANT

APPEAL FROM FAYETTE CIRCUIT COURT
v. HONORABLE MARY C. NOBLE, JUDGE
ACTION NO. 99-CI-04354

DANIELLE C. VAUGHT, N/K/A
DANIELLE COLDIRON; ARVIN G. VAUGHT;
AND PRINCIPAL WHOLESALE MORTGAGE, INC.

APPELLEES

OPINION
AFFIRMING

* * * * *

BEFORE: BUCKINGHAM AND JOHNSON, JUDGES; AND HUDDLESTON, SENIOR JUDGE.¹

JOHNSON, JUDGE: Bank One, Kentucky, NA has appealed from the summary judgment and order entered by the Fayette Circuit Court on July 6, 2001, in a mortgage foreclosure action that ordered the distribution of certain proceeds held in escrow following the sale of real estate jointly owned by appellees, Arvin G.

¹ Senior Judge Joseph R. Huddleston, sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

Vaught and Danielle C. Vaught (n/k/a Danielle Coldiron). Having concluded that the trial court correctly applied the law in distributing the proceeds from the sale, we affirm.

On June 5, 1991, the Vaughts purchased a house and lot located in Lexington, Fayette County, Kentucky, for their marital residence. The couple held title to the property as tenants by the entirety and the deed was duly recorded on June 5, 1991, in the Fayette County Court Clerk's Office. On February 1, 1994, the Vaughts borrowed \$73,600.00 from Cumberland Federal Savings Bank and gave Cumberland a first mortgage on their marital residence.²

On May 17, 1997, Danielle filed a petition for dissolution of marriage in the Fayette Circuit Court. While the Vaughts' divorce action was still pending, on February 16, 1998, Arvin entered into a Revolving Credit Line Real Estate Mortgage with Bank One, providing him with a line of credit of \$36,000.00.³ Arvin secured the line of credit with Bank One by executing a mortgage on the Vaughts' marital residence. While the mortgage to Bank One also included a signature line for Danielle as a mortgagor and while the mortgage referenced the title source for the mortgaged property as being the marital

² Cumberland later assigned the note and mortgage to Principal Wholesale Mortgage, Inc.

³ Arvin subsequently made draws in excess of \$33,000.00 on the account.

residence that had been conveyed to Arvin and Danielle as husband and wife, Danielle never signed or agreed to the mortgage.

On February 4, 1999, the Fayette Circuit Court entered a decree dissolving the Vaughns' marriage; and it ordered, inter alia, that the marital residence "be listed and sold[.]"⁴ In the decree Danielle was "awarded \$25,000.00 of the net proceeds, with any remaining proceeds equally divided between the parties." No appeal was filed in the divorce action.

In December 1999 Bank One discovered that its mortgage from Arvin securing the revolving credit line account had not been recorded and that the original copy of the mortgage had been lost. On December 9, 1999, Bank One recorded a copy of the mortgage in the Fayette County Court Clerk's Office.⁵

On December 17, 1999, Principal filed a lawsuit in the Fayette Circuit Court seeking to foreclose on its first mortgage on the Vaught residence. Danielle filed an answer and a cross-claim asserting her interest in the property. Bank One filed an answer, counterclaim and a cross-claim asserting its interest in the property based on the mortgage signed by Arvin. On June 7,

⁴ The decree did not provide any specifics concerning the sale of the real estate other than the requirement that "[e]ach party shall execute all documents necessary to comply with the Court's Findings of Fact, Conclusions of Law and Decree."

⁵ An Affidavit in Aid of Title was also filed as an explanation as to why a copy was being filed.

2000, the trial court entered a judgment and order of sale in favor of Principal, and on July 24, 2000, the residence sold for \$107,000.00. After the payment of costs and Principal's first mortgage, the net proceeds from the sale of \$39,914.99 were held in escrow by the master commissioner.

After considering various motions by the parties, the trial court on September 8, 2000, ordered that one-half of the net sale proceeds be distributed to Danielle with the remaining one-half staying on deposit with the master commissioner.⁶ After considering further motions by the parties, the trial court entered an opinion and order on June 12, 2001, providing that Danielle should receive a total of \$32,457.50 from the net sale proceeds of \$39,914.99. This amount was based on the previous award in the divorce decree of \$25,000.00, plus one-half of the remainder, or \$7,457.50.⁷ Bank One was awarded \$7,457.49.⁸ The opinion and order of June 12 was adopted by the trial court in a summary judgment and order entered on July 6, 2001, which ordered the distribution of the remaining funds. This appeal followed.

⁶ Danielle received \$19,957.50 at that time.

⁷ The net sale proceeds were \$39,914.99. Danielle received a total of \$32,457.50, which consisted of the sum of \$25,000.00 and \$7,457.50 (\$39,914.99 minus \$25,000.00, divided by 2). Bank One received the other one-half of the balance, or \$7,457.49.

⁸ In its brief Bank One incorrectly claimed that Danielle received all of the net sale proceeds.

This case presents an issue of first impression in Kentucky.⁹ We must determine whether a circuit court's divorce decree which divided a couple's marital interest in real property held by them as tenants by the entirety is binding in a subsequent circuit court foreclosure action where a mortgagee, who had obtained a mortgage against the marital property solely from the husband during the marriage and while the property was held by the couple as tenants by the entirety, claimed an interest in the net sale proceeds from the foreclosure.

Bank One claims that it is not bound by the property division made by the circuit court in the Vaught divorce decree and that it is entitled to one-half of the net sale proceeds from the foreclosure. Bank One contends that a divorce decree binds only the parties thereto and their privies;¹⁰ and more specifically, that as a mortgagee it was not a privy of its mortgagor, Arvin, for res judicata purposes.

⁹ We were unable to find any case law on all fours with the case sub judice. See generally, Frank D. Wagner, J.D., Annotation, Propriety of Consideration of, and Disposition as to, Third Persons' Property Claims in Divorce Litigation, 63 A.L.R.3d 373 (1975); and J. H. Cooper, Annotation, Interest of Spouse in Estate by Entireties as Subject to Satisfaction of His or Her Individual Debt, 75 A.L.R.2d 1172 (1961). Considering the contingent interest that a creditor has in a tenancy by the entirety when only one spouse mortgages the property, it is understandable that such a mortgage would be rarely utilized and consequently this issue would be rarely litigated. See Hoffman v. Newell, 249 Ky. 270, 284-85, 60 S.W.2d 607, 613 (1932).

¹⁰ Citing Parks v. Parks, 209 Ky. 127, 132, 272 S.W. 419, 422 (1925).

Bank One cites Strong v. First Nationwide Mortgage Corp.,¹¹ for its contention that "if a party to a divorce action wherein an interest in real estate is disputed files a lis pendens notice,¹² anyone claiming an interest in the property which arises after the recording of the lis pendens takes that interest subject to the results of the divorce litigation." Bank One then argues that "the converse is equally clear-if no lis pendens is filed, then the outcome of any pending divorce litigation can have no effect on any real estate encumbrances which might have arisen during the course of that litigation."

In Strong, this Court recognized that in a dissolution action the trial court had a duty pursuant to KRS 403.190 to divide the marital property in "just proportions"; and the Court further held that the wife's filing of a lis pendens notice during the pendency of the divorce action did not give the judgment the wife obtained against the husband pursuant to the divorce a priority over a third party's judgment lien against the husband since the third party's lien was filed before the wife obtained her judgment.¹³ To the extent the wife's claim in Strong was determined to have priority over the husband's creditors' claims, the Court's holding turned on the circuit

¹¹ Ky.App., 959 S.W.2d 785 (1998).

¹² Kentucky Revised Statutes (KRS) 382.440.

¹³ Strong, 959 S.W.2d at 787.

court's authority to distribute the marital property under KRS 403.190 and not on the wife's filing of the lis pendens notice.

Bank One concludes its argument by relying on Peyton v. Young,¹⁴ where the deceased husband's mortgagees asserted their interest in property which had been held by the husband and wife as a tenancy by the entirety at the time of both of their deaths following their divorce. In Peyton, the Supreme Court of Kentucky held that the husband's undivided one-half interest in the property was subject to the mortgagees' claims and that his mortgagees were entitled to receive one-half of the net proceeds from the master commissioner's sale of the property. The Supreme Court's ruling in Peyton appears to be the result of its failure to recognize that a fundamental aspect of a tenancy by the entirety is the unity of marriage and that the dissolution of the marriage converts the tenancy by the entirety into a tenancy in common.¹⁵ Since Peyton is an aberration to the well settled law concerning tenancies by the entirety, we do not find it to be persuasive in our analysis.

In response to Bank One's arguments, Danielle correctly points out that the cases relied upon by Bank One are either distinguishable from the case sub judice or favorable to her. It is well established that a tenancy by the entirety

¹⁴ Ky., 659 S.W.2d 205 (1983).

¹⁵ Id. at 207-09 (Wintersheimer, J., dissenting).

creates an indivisible estate in the whole property in both the husband and wife; and that since a tenancy by the entirety requires the legal unity of husband and wife, upon the dissolution of the marriage the tenancy by the entirety, by operation of law, is terminated and replaced by a tenancy in common. In Nelson v. Mahurin,¹⁶ this Court stated:

"One of the distinguishing incidents of this venerable estate is that which exempts it from the ordinary processes to which all other estates are subject. A tenancy by the entirety fundamentally rests on the legal unity of the husband and wife. 'It is founded on the common-law doctrine of the unity of husband and wife as constituting in law but one person. A conveyance to a husband and wife as tenants by the entirety creates one indivisible estate in them both and in the survivor, which neither can destroy by any separate act. Both husband and wife are seised of such an estate per tout et non per my as one person, and not as joint tenants or tenants in common. Alienation by either the husband or the wife will not defeat the right of the survivor to the entire estate on the death of the other. There can be no severance of such estate by the act of either alone without the assent of the other, and no partition during their joint lives, and the survivor becomes seised as sole owner of the whole estate regardless of anything the other may have done. The tenancy by the entirety is essentially a joint tenancy modified by the common-law theory of the unity of husband and wife. They do not take by moieties but by entireties.'"¹⁷

¹⁶ Ky.App., 994 S.W.2d 10 (1998).

¹⁷ Nelson, supra at 14 (quoting Hoffman, 60 S.W.2d at 609 (citing Bernatavicius, 156 N.E. at 686)).

A tenancy by the entirety is a unique estate which can only be "conveyed or encumbered [] by a joint instrument or with the consent of both tenants." Peyton v. Young, Ky., 659 S.W.2d 205, 207 (1983), Justice Wintersheimer Dissenting Opinion; Weindl v. Weindl, Ky., 359 S.W.2d 333 (1962). The estate arose when divorce was rare and "functioned as a rough equivalent of a homestead right, affording protection to the family and the nondebtor spouse." Graham and Keller, Domestic Relations Law. 4.7 (2d ed., 1997). It is axiomatic that dissolution of the tenants' marriage terminates or destroys an "essential element of the tenancy--spousal unity." C. Bratt, A Primer on Kentucky Intestacy Laws, 82 Ky.L.J. 29, 95 (1993-94). As a result, a decree of dissolution, by operation of law, terminates a tenancy by the entirety and the concomitant right of survivorship to the entire estate.

Divorce is not an act of the parties. It is an act of the law . . . That act of the law creates a new legal status, both for the husband and for the wife. It divides the common-law unity hitherto existing. It creates two individuals in place of the unity theretofore recognized by the common law as existing. It substitutes for that unity two persons who thereafter are strangers to each other in their legal status. . . . Divorce establishes a legal situation with respect to the man and woman previously husband and wife which is incompatible with the legal theory of tenancy by the entirety . . . When persons who have been tenants by the entirety cease to be husband and wife, the legal factors necessary to that tenancy have gone

out of existence. A tenancy by the entirety cannot be created by the most explicit words in a legal instrument, unless the man and woman are in truth husband and wife. It seems to us more in harmony with the principles governing such tenancies to hold that they cannot continue after the tenants have become divorced and thus have ended the legal relationship to each other, which constitutes the essence of that tenancy. The great weight of authority supports this conclusion.

Bernatavicius, supra, 156 N.E. at 686-687 (citations omitted). Thus, when a marriage has been dissolved and the former husband and wife continue to hold legal title to realty, they hold that property as tenants in common. Id.; see also Bratt, supra at 96.¹⁸

Bank One, citing Future Federal Savings & Loan Assoc. v.

Daunhauer,¹⁹ argues that since the dissolution of the Vaughts' marriage converted their estate in the subject property from a tenancy in the entirety to a tenancy in common and that since Arvin and Danielle each possessed an undivided interest in the subject property, that it was entitled to "an undivided one-half interest in said property." The flaw in this argument is that at the time Arvin mortgaged his sole interest in the subject property he held the property by a tenancy by the entirety, and as such, he could only obligate as security to Bank One that

¹⁸ Nelson, 994 S.W.2d at 14-15.

¹⁹ Ky.App., 687 S.W.2d 871, 873-74 (1985).

interest which he held. Arvin's interest in the property was not converted from a tenancy by the entirety to a tenancy in common until the circuit court dissolved the parties' marriage, at which time the circuit court simultaneously divided Arvin's and Danielle's marital interest in the property pursuant to KRS 403.190. Thus, since Bank One's secured interest in the subject property was limited to no greater an interest than Arvin had in that property, when the circuit court in the dissolution action determined Arvin's interest in the property to be only one-half of the remaining net sale proceeds after Danielle was paid \$25,000.00, Bank One's interest in the net sale proceeds was limited to that same amount. Bank One is correct that it does have an interest in Arvin's undivided interest in the tenancy in common, but that interest was determined by the circuit court in the divorce action to be an amount less than one-half of the net sale proceeds that Bank One claims.

Bank One's argument that it cannot be bound by the circuit court's ruling in the divorce action because it was not a party to that action and because Danielle did not file a lis pendens notice in that action also fails. Until their marriage was dissolved, Arvin and Danielle held the subject property as a tenancy by the entirety. As a mortgagee of only Arvin, Bank One's right to foreclose on the property during the Vaught's marriage was limited by Arvin's contingent interest in the

property. At the time Bank One foreclosed on Arvin's interest, the Vaughns were divorced, the tenancy by the entirety had been converted to a tenancy in common, and the former spouses' respective interests in the property had been adjudicated. As a contingent interest, Bank One's claim against Arvin's interest in the property was determined upon the finality of the divorce action.

Based on the foregoing reasons, the summary judgment and order of the Fayette Circuit Court is affirmed.

ALL CONCUR.

BRIEF FOR APPELLANT:

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Lexington, Kentucky

BRIEF FOR APPELLEE, DANIELLE
COLDIRON:

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