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**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

In Re: )  
JOSE MARIA ESTRADA, JR. and )  
PATRICIA McCAFFREY ESTRADA, )  
Debtors. )

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CASE NO.: 96-14109-A7

**MEMORANDUM DECISION**

Patricia McCaffrey Estrada (“Debtor”) seeks (1) bifurcation of the joint case with her husband, Jose Maria Estrada, Jr.; (2) conversion of the chapter 7 case to a chapter 13; and (3) an order directing the chapter 7 trustee to (A) deliver approximately \$100,000 in life insurance proceeds to Debtor and (B) sign any documents necessary to release approximately \$200,000 in life insurance proceeds held in a blocked account. The chapter 7 trustee (“trustee”) and two groups of creditors, Williams & Gilmore and Vorachit Sengpaseuth, Siew Sengpaseuth and Manisak Khammanivong (collectively, “Partnership Creditors”), oppose these actions. The trustee contends by bifurcating the cases, the creditors of the jointly filed case, particularly the creditors of the partnership, will be left unpaid while Debtor retains

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1 life insurance proceeds of at least \$300,000.00. The Partnership Creditors contend that  
2 Debtor was involved in the day-to-day operation of the partnership and is liable for its  
3 debts. After considering the pleadings and hearing argument from counsel, this Court  
4 holds the joint case is administratively separated and the Debtor's estate is converted to  
5 a chapter 13. Additionally, the Court directs the trustee to deliver approximately  
6 \$100,000 in life insurance proceeds to Debtor and sign any documents necessary to  
7 release approximately \$190,000 in life insurance proceeds held in a blocked account.  
8 The remaining sum is to be held for any chapter 7 administrative expenses. The Court  
9 declines to consider the exempt nature of the insurance proceeds at this time.

### 10 FACTS

11 Jose Maria Estrada, Jr. and Patricia McCaffrey Estrada ("Joint Debtors") filed  
12 their joint chapter 7 case on October 16, 1996. Their schedules listed liabilities  
13 consisting of both personal consumer debts of the Estradas as well as business debts of  
14 a partnership, Club Cleaners in an amount of \$188,158.61. The case was deemed a no-  
15 asset case and was closed on February 10, 1997.

16 After Mr. Estrada's death, the trustee filed a motion to reopen the case because  
17 of the possible life insurance proceeds resulting from his death. The case was reopened  
18 on July 31, 1997. The Debtor was the beneficiary of several life insurance policies on  
19 Mr. Estrada's life totaling approximately \$550,000.00. Two of the insurance policies  
20 totaling \$300,000.00 have been paid to the Debtor and the insurance company disputes  
21 its liability under another policy for \$250,000.00. Of the \$300,000.00, the Debtor  
22 turned over \$100,000 to the trustee and the remaining \$200,000.00 was placed in a  
23 blocked account, requiring both the trustee's and the Debtor's signature for any  
24 disbursements. Her counsel then brought motions to bifurcate the joint case and  
25 convert her case to one under chapter 13.

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### 27 ISSUES

1 A. May the Court bifurcate or separately administer a jointly filed case?

2 B. If so, may the case then be converted to a different chapter?

3 **DISCUSSION**

4 **A. *Bifurcation/Separate Administration***

5 The Debtor asks this Court to bifurcate her case from that of her husband's. She  
6 argues that it is no longer feasible to jointly administer both her and her husband's  
7 bankruptcy estates. While Debtor's estate is potentially solvent, depending on her  
8 exemption amount, Mr. Estrada's estate is not. The Debtor maintains the insurance  
9 proceeds are property of her separate estate pursuant to section 541(a)(5). Also, under  
10 California law, the insurance proceeds are not community property but Debtor's  
11 separate property as the beneficiary under the policy. The Debtor contends bifurcation  
12 would avoid confusion regarding which claims are entitled to be paid from which  
13 estate. Finally, the Debtor claims a significant amount of the joint creditors represent  
14 her late husband's separate business debts for which she has no personal liability.

15 The trustee's opposition focuses on prejudice to the Partnership Creditors. The  
16 trustee argues Debtor provides no evidence for the claim that the debts against the  
17 estate arising from her deceased husband's former partnership are Mr. Estrada's  
18 separate debts for which she has no liability. The trustee contends the life insurance  
19 proceeds are property of the bankruptcy estate and, under this chapter 7, the creditors  
20 will be paid in full and Debtor will receive back a significant portion of the proceeds.  
21 However, if the cases are bifurcated, the trustee maintains all the creditors' claims  
22 relating to the partnership will remain unpaid while the Debtor retains life insurance  
23 proceeds.

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27 The Partnership Creditors claim the Debtor is liable for the partnership debts

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1 because she was significantly involved in the day-to-day operation and management of  
2 Club Cleaners. They also argue that where community assets -- the insurance proceeds  
3 -- are available for community debts, bifurcation is improper.

4 The opposing parties confuse what a *jointly* filed petition represents. Section  
5 302(a)<sup>1</sup> permits a married couple to file a joint petition. Section 302 is designed for  
6 ease of administration and to permit the payment of one filing fee. *In re Crowell*, 53  
7 B.R. 555, 557 (Bankr. M.D. Tenn. 1985). But, as the Debtor points out, the joint  
8 petition actually creates two separate bankruptcy estates. *In re Ageton*, 14 B.R. 833,  
9 835 (9th Cir. BAP 1981); *In re McAlister*, 56 B.R. 164, 166 (Bankr. D. Or. 1985).  
10 However, there is no statutory provision to **sever** a jointly filed petition pursuant to  
11 section 302. *See, In re Devers*, 759 F.2d 751, 753n.1 (9th Cir. BAP 1985).  
12 Nevertheless, section 302(b) provides that the Debtor's estate could be separately  
13 **administered** from Mr. Estrada's estate. *In re Romano*, 170 B.R. 90 (Bankr. W.D.  
14 Penn. 1994); *In re McAlister*, 56 B.R. 164.

15 Pursuant to section 302(b), the court must determine the extent, if any, to which  
16 the joint debtors' estates shall be consolidated.<sup>2</sup> Until consolidated by the court, the  
17 two estates remain separate. *In re Reider*, 31 F.3d 1102, 1111 (11th Cir. 1994). After  
18 reviewing the docket in this case, this Court finds there has been no request for  
19 substantive consolidation of these two estates. Consequently, there are two estates and  
20 not one "community estate."

21 Although there has not been a formal request for substantive consolidation, this

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23 <sup>1</sup> Unless otherwise noted, all references herein to "section" refer to section of the  
24 Bankruptcy Code, 11 U.S.C. §§101-1330.

25 <sup>2</sup> Federal Rule of Bankruptcy Procedure 1015(b) in relevant part provides:

26 If a joint petition or two or more petitions are pending in the same court by or against (1)  
27 a husband and wife . . . , the court may order a joint administration of the estates. Prior  
28 to entering an order the court shall give consideration to protecting creditors of different  
estates against potential conflicts of interest.

1 Court will consider the trustee’s and the Partnership Creditors’ opposition as such.  
2 The standard for substantive consolidation in the spousal context is whether the affairs  
3 of the husband and wife are so intermingled that their respective assets and liabilities  
4 cannot be separated. *In re Reider*, 31 F.3d at 1105; *In re Chan*, 113 B.R. 427, 428  
5 (Bankr. N.D. Ill. 1990). This standard requires the court to “weigh ‘the economic  
6 prejudice of continued debtor separateness versus the economic prejudice of  
7 consolidation.’” [Citations omitted] *In re Reider*, 31 F.3d at 1108. Ultimately, the  
8 court is to determine what equity requires. *In re Augie/Restivo Baking Co., Ltd.*, 860  
9 F.2d 515, 518 (2nd Cir. 1988).

10 On or around February 10, 1997, the trustee determined the joint case was a no-  
11 asset case and closed the case. The only events that have transpired to change this  
12 status are that Mr. Estrada passed away and the Debtor received the life insurance  
13 proceeds. Section 541(a)(5) states:

14 (a) the commencement of a case under section 301, 302, or  
15 303 of this title creates an estate. Such estate is comprised of  
all the following property, wherever located and by  
whomever held:

16 (5) Any interest in property that would have  
17 been property of the estate if such interest had  
18 been an interest of the debtor on the date of the  
filing of the petition, and that the debtor  
acquires or becomes entitled to acquire within  
180 days after such date --

19 (C) as a beneficiary of a life  
20 insurance policy or of a death  
benefit plan.

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27 No one disputes that Mr. Estrada passed away within 180 days after Joint Debtors filed

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1 their petition. Debtor received the insurance proceeds as the result of being a  
2 beneficiary and, under section 541(a)(5)(C), these proceeds became assets of her  
3 separate bankruptcy estate.<sup>3</sup> Thus, her separate estate contains the insurance proceeds  
4 and is solvent. Mr. Estrada was not a beneficiary under the life insurance so section  
5 541(a)(5)(C) is inapplicable to his estate. Thus, Mr. Estrada's estate has not changed.  
6 The Court disagrees with the Partnership Creditors that the insurance proceeds are part  
7 of the "community estate." As previously explained, in this case, there is no  
8 "community estate." The Debtor's estate is significantly different from Mr. Estrada's.

9 The sole aim of substantive consolidation is fairness to all creditors. *In re*  
10 *Augie/Restivo Baking Co., Ltd.*, 860 F.2d at 518. The opposing parties fail to show  
11 they will suffer prejudice from separate administration. The Court shares the Debtor's  
12 observation that separate administration of the Debtor's estate will have no effect on  
13 the substantive rights of the creditors. All creditors will have the right to file claims in  
14 her case and the Debtor may object to those claims. The validity of these claims will  
15 be determined by this Court at another time.<sup>4</sup> The Court finds persuasive Debtor's  
16 argument that no prejudice results to the creditors because all allowed claims will be  
17 paid in full in the Debtor's case. The Court finds because the Debtor's estate is  
18 significantly distinct and there is no prejudice to the creditors, substantive consolidation  
19 is not appropriate.

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## 22 **B. Conversion**

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24 <sup>3</sup> Although an old case, the opposing parties have offered no authority for this Court to  
25 question the holding in *In re Matter of Margaretha L. Dobbel, Deceased.*, 104 Cal. 432, 435  
26 (1894), that the insurance proceeds are a spouse's separate property even if purchased with  
community assets.

27 <sup>4</sup> The Court declines to consider whether the Debtor is jointly liable for the  
partnership debts as this should be done in the context of the claims objection procedure.

1 The Debtor requests that her case be converted to one under chapter 13. She  
2 argues if her case is a chapter 13 case she will be able to pay all allowed claims in full.  
3 Neither the trustee nor the Partnership Creditors separately address conversion other  
4 than to argue the nonpayment of partnership debts.

5 Section 706(a) provides that a debtor may convert a case from chapter 7 to  
6 chapter 13 at any time, provided that the case had not previously been converted to  
7 chapter 7. The intent of Congress was to give the debtor an “absolute right” to convert.  
8 *In re Street*, 55 B.R. 763, 765 (9th Cir. BAP 1985). Additionally, this section is based  
9 on the policy that debtors should be given the opportunity to repay their debts rather  
10 than go through a complete liquidation. *In re J.B. Lovell Corp.*, 876 F.2d 96, 97 (11th  
11 Cir. 1989). The Court failed to locate any cases discussing whether a joint debtor may  
12 convert under section 706(a).<sup>5</sup> Where there are two separate estates there are two  
13 separate debtors. Because section 706(a) authorizes “a debtor” to convert its case, it  
14 would stand to reason a separate debtor in a jointly filed case could also convert. The  
15 Court has found no cases denying this relief.

16 Section 105(a) provides that the bankruptcy court may issue any order, process,  
17 or judgment that is necessary, or appropriate to carry out the provisions of the  
18 Bankruptcy Code. But this equitable power is limited and can only be exercised within  
19 the confines of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers*, 108 S.Ct.  
20 963, 968 (1988). This Court finds it within its equitable powers to convert this  
21 Debtor’s chapter 7 case into a chapter 13.<sup>6</sup> To hold otherwise would be to deny the  
22 Debtor’s intention to pay all creditors and subject her to an involuntary liquidation.

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23 <sup>5</sup> The Court did find administratively consolidated cases where the court separately  
24 converted one of the cases. *In re Sibarium*, 107 B.R. 108, 109 (Bankr. N.D. Tex. 1989).

25 <sup>6</sup> The trustee’s opposition states there are approximately \$186,570.11 in partnership  
26 claims while the Court’s claims register lists unsecured claims in an approximate amount of  
27 \$133,775.57, and the schedules reflect secured claims of \$122,265.00, both amounts well within  
the confines of section 109(e)’s requirements for a chapter 13 debtor. Additionally, the filed  
schedules reflect that the Debtor has a regular monthly income of \$5,537.00.

1 Under section 1306(b), a chapter 13 debtor is considered a debtor in possession  
2 and is entitled to all property in the estate. Conversion of a case under section 706  
3 terminates the service of the chapter 7 trustee. Section 348(e). Thus, the trustee must  
4 transfer the insurance proceeds to the Debtor.

5 **CONCLUSION**

6 This Court finds that there is insufficient evidence of prejudice of the creditors to  
7 warrant substantive consolidation of the Joint Debtors' separate estates. Under the  
8 Court's equitable powers, the Debtor's separate estate and case is converted to a case  
9 under chapter 13. The Trustee's request for a set aside of \$10,000.00 for  
10 administrative expenses is granted. Debtor's counsel is directed to prepare an order in  
11 accordance with this Memorandum Decision within ten (10) days of the date of entry.

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14 DATED: December 15, 1998

15 LOUISE DeCARL ADLER, Chief Judge  
16 United States Bankruptcy Court  
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