Joint Accounts, Setoff, and Distribution of Marital Property in North Carolina

Nancy Ray

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Joint Accounts, Setoff, and Distribution of Marital Property in North Carolina

I. INTRODUCTION

The legal labyrinth of divorce can challenge even the most adroit lawyer. Depending upon the property interests and amicability of the couple involved, divorce proceedings can be colored by a variety of emotions and difficulties. Not surprisingly, the North Carolina legislature has attempted to remove at least one common stumbling-block in obtaining a divorce: the distribution of marital property. The legislature addressed the problem of property division by creating a system in which marital property is distributed on an equitable basis. However, some issues relating to the division of property are not addressed by the express language of the statute. One such situation involves


2. See id.

3. See N.C. GEN. STAT. § 50-20 (1999). This statute is referred to as the Marital Property Distribution Act, and it sets forth the approved method for determining, evaluating, and distributing marital property. See id. "Upon application of a party, the court shall determine what is the marital property and shall provide for an equitable distribution of the marital property between the parties in accordance with the provisions of this section." See id. at N.C. GEN. STAT § 50-20(2). The passage of an equitable distribution act reflects the view that marriage is "a partnership, a shared enterprise to which both spouses make valuable contributions, albeit in different ways." Sally Burnett Sharp, Equitable Distribution of Property in North Carolina: A Preliminary Analysis, 61 N.C. L. REV. 247 (1983). For comment on whether this notion of partnership is better reflected in divorce than in marriage, see K. Edward Greene, A Spouse's Right to Control Assets During Marriage: Is North Carolina Living in the Dark Ages? 18 CAMPBELL L. REV. 203, 211 (1996).

marital joint accounts and a bank's right of setoff.\textsuperscript{5}

Suppose that Wendy and Harold, who are married, have a joint account at First Local Bank.\textsuperscript{6} Harold takes out a loan, independent of Wendy, to finance the hardware store that he inherited from his father. Unfortunately, Harold's Hardware does not flourish, and Harold defaults on the loan. First Local would like to use Harold and Wendy's joint account to set off some of the debt owed on the loan. The initial problem here seems to be one of setoff of a single party's debt against a joint account.

A personal situation complicates the problem. Harold and Wendy are determined to obtain a divorce, and they are preparing to distribute their property pursuant to North Carolina's Marital Property Distribution Act.\textsuperscript{7} Under North Carolina law, how will the debt incurred by Harold be allocated among the parties, and how will that allocation affect the treatment of the joint account? Essentially, will both parties share Harold's debt to the bank, or will Harold be entirely responsible?

The case of Harold and Wendy illustrates a number of complexities and unanswered questions at work in the North Carolina case and statutory law. First, the correct interpretation of setoff in the context of joint accounts is unclear: one can piece together a position using older cases, but there is no definitive recent treatment of the law in the area.\textsuperscript{8} Second, the bank's specific rights and remedies in a case similar to that of Harold and Wendy are unclear under North Carolina's current laws.\textsuperscript{9} The

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\textsuperscript{5} See infra notes 15-20 and accompanying text (defining setoff and joint accounts).

\textsuperscript{6} Savings banks are the focus of this article. Primary attention in the area of setoff is thus given to N.C. GEN. STAT. § 54C-169, the statute which deals with setoff on joint accounts and savings banks. N.C. GEN. STAT. § 54C-169 (1999). However, joint accounts are possible in other banking contexts, such as credit unions and savings and loan associations. See N.C. GEN. STAT. § 54B-129 (1999) (discusses joint accounts held at savings and loan associations); N.C. GEN. STAT. § 54-109.58 (1999) (discusses joint accounts in the context of credit unions). See also N.C. GEN. STAT. § 54B-131 (1999) (specifically discussing the right of setoff in context of savings and loan associations).

\textsuperscript{7} See N.C. GEN. STAT. § 50-20 (1999).

\textsuperscript{8} See infra notes 15-35 and accompanying text (discussing setoff and joint accounts in North Carolina).

\textsuperscript{9} See id.
purpose of this Note is to focus attention on the relationship that might arise between setoff, joint accounts, and marital property in the context of divorce and to offer a remedy for the problems created therein.

First, this Note will briefly examine the concepts of setoff and joint accounts, using both general definitions and specific examples from North Carolina statutes.\textsuperscript{10} Next, the Note will explore North Carolina’s Marital Property Distribution Act.\textsuperscript{11} Returning to the situation of Harold and Wendy, the Note will compare and contrast some recent case law from other states with North Carolina law.\textsuperscript{12} After discussing some proposed solutions offered by two researchers who have studied joint accounts and setoff,\textsuperscript{13} this Note will examine the elements that are lacking in North Carolina’s law of setoff and offer some solutions to remedy those gaps.\textsuperscript{14}

II. DEFINING THE RELEVANT TERMS: WHAT IS SETOFF, AND WHAT DIFFERENCE DOES IT MAKE IN A JOINT ACCOUNT?

Setoff can be thought of as the cancellation of cross demands, that is, the satisfaction of all or part of a debt owed by X to Y through the simultaneous discharge or forgiveness of a debt due to X from Y.\textsuperscript{15} Banks are allowed the right of setoff in North Carolina because the relationship created between the bank and the account holder is viewed as one of debtor and creditor.\textsuperscript{16}

\textsuperscript{10} See id.
\textsuperscript{11} See infra notes 36-59 and accompanying text (discussing marital property distribution in North Carolina).
\textsuperscript{12} See infra notes 60-106 and accompanying text (comparing and contrasting North Carolina law with that of other states).
\textsuperscript{13} See infra notes 107-116 and accompanying text (discusses two proposed solutions offered for setoff problems).
\textsuperscript{14} See infra notes 117-126 and accompanying text.
\textsuperscript{16} See Rosenstein v. Mechanics and Farmers Bank, 304 N.C. 541, 543, 283 S.E.2d 504, 506 (1981); Schwabenton v. Security Nat’l Bank of Greensboro, 251 N.C. 655, 656, 11 S.E.2d 856, 857 (1960). For example, a depositor in a bank is entitled to retrieve the money in her account upon demand. Mutuality of obligation may arise in a situation where the depositor borrows funds from the bank. In such a situation,
Joint accounts may be created under North Carolina law when an account is established by two or more people using a written contract. Joint accounts can be divided into three types: (1) joint accounts, which require the signature of each holder to validate account transactions; (2) joint accounts, which require the signature of only one holder to validate transactions; and (3) payable-upon-death joint accounts, which effectively transfer the right to the account to a specified party upon the death of another party who previously kept sole control of the account. In North Carolina, there is a rebuttable presumption that half of such an account belongs to each person. In addition, the right of setoff on deposit accounts is controlled by statute in North Carolina.

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17. See N.C. GEN. STAT. § 53-146.1(a) (1999). “Any two or more persons may establish a deposit account or accounts by written contract. The deposit account and any balance thereof shall be held for them as joint tenants, with or without right of survivorship, as the contract shall provide.” Id. See also McAuliffe v. Wilson, 41 N.C. App. 117, 119-120, 254 S.E.2d 547, 549 (1979) (stating that creations of joint interest are well established in North Carolina law).


19. See McAuliffe, 41 N.C. App. at 120, 254 S.E.2d at 549 (holding that defendant wrongfully withdrew funds from joint account after becoming apprehensive about future of cohabitition relationship.) It is also the rule in this jurisdiction that, nothing else appearing, money in the bank to the joint credit of two persons is presumed to belong one half to each person. However, where a controversy arises as to ownership, the intent of the parties will be controlling, and evidence may be received to prove such intent. Id. One should be careful not to assume that cohabitants enjoy the same protection as married couples under the equitable distribution statute. See McIver v. McIver, 92 N.C. App. 116, 125, 374 S.E.2d 144, 150 (1988). “Only married persons are afforded the protections of our equitable distribution statute. That statute is unambiguous: property must be acquired during marriage to be classified as marital property, and only marital property is subject to distribution.” Id.


A savings bank shall have a right of setoff, without further agreement or pledge, upon all deposit accounts owned by any member.
As a rule, four conditions must exist in order for setoff to take place: (1) the funds to be set off must be property of the debtor; (2) the funds must be deposited without restrictions; (3) the existing indebtedness must be due and owing; and 4) there must exist mutuality of obligation. These four requirements present some immediate problems in the context of joint accounts and marriage.

The first requirement, that the funds in question be property of the debtor, creates immediate conflict, since it is often difficult to determine exactly which spousal property is separate (nonmarital) and which property is marital. Under N.C. Gen. Stat. § 54-169(b), the statute controlling the right of deposit on joint accounts, the amount of any member’s or customer’s interest in a joint account or other account held in the names of more than one person is subject to the right of setoff. However, funds deposited in a joint account by married persons may be held to have merged interests and thus no longer remain separate property. Determining the extent of the married customer’s interest in the account is tricky, since his interest may be indistinguishable from that of his spouse. Difficulty with the second requirement of deposit without restriction is similar: since the property in question may be of indeterminate origin, a bank may

or customer to whom or upon whose behalf the savings bank has made as unsecured advance of money by loan. Upon default in the repayment or satisfaction thereof, the savings bank may cancel on its books any or part of the deposit accounts owned by the member or customer and apply the value of the accounts in payment of the obligation. See id. at 54C-169(a). In addition, the statute provides for 30 days’ notice to the affected customer that the right to withdraw funds will be exercised and permits the bank to freeze the account during this 30 day period. See id. at 54C-169(b).

21. See Laurino, supra note 18, at 63. Sepinuck also lists four basic requirements for setoff: the provision that the two lists have in common is that of mutuality, and the remaining factors listed by Sepinuck are maturity of debt, non-contingency of debt, and liquidity of debt. Sepinuck, supra note 15, at 67-68.

22. See infra notes 37-45 and accompanying text.

23. See supra note 20 and accompanying text.


25. See Lilly v. Lilly, 107 N.C. App. 484, 486, 420 S.E.2d 492, 493 (1992). The burden of proof in such a case is placed on the party who claims that the property is marital in nature. See id. Separate property does not become marital simply because it was deposited in a joint account. See id.

26. See id.
have trouble discovering whether each party placed restrictions on the account.\textsuperscript{27}

The most challenging problem is presented by the third requirement that the indebtedness be due and owing.\textsuperscript{28} This requirement may be technically met, but, as in the case of Harold and Wendy, only one spouse may have borrowed the money. Whether both spouses must pay is not a question that has been completely answered yet in North Carolina.\textsuperscript{29} Closely related to the requirement of existing indebtedness is mutuality, or a reciprocal relationship of debt between bank and account holder.\textsuperscript{30} Whether mutuality is required is a key question, since the addition of a third party or spouse in a joint account introduces a person who may have no reciprocal relationship with the bank.

The requirement of mutuality is present in North Carolina case law.\textsuperscript{31} The presence of mutuality suggests that in a marital situation, where only one spouse' s debt is owing, the joint account shared by both spouses is protected.\textsuperscript{32} However, a modern commentator has suggested that account contracts and state statutes may overcome the requirement of mutuality.\textsuperscript{33}

\begin{footnotesize}
\begin{enumerate}
\item See \textit{id.}.
\item See Laurino, \textit{supra} note 18, at 63.
\item Whether both spouses must pay via setoff as joint account holders has not been clearly decided. However, under current North Carolina family law, a debt incurred by one spouse during the marriage is marital property for which both parties are made responsible through equitable distribution. \textit{See Geer v. Geer} 84 N.C. App. 471, 475, 353 S.E.2d 427, 429 (1987).
\item See \textit{In re Battery King Mfg. Co.}, 240 N.C. 586, 589, 83 S.E.2d 490, 492 (1954) (holding that purchaser of accounts receivable was subject to claims filed against receiver). “Setoff operates by way of payment where there are reciprocal demands. It may be invoked only where there is mutuality of parties and of demand.” \textit{Id.}
\item See \textit{id.}
\item See \textit{id.}
\item Laurino, \textit{supra} note 18, at 64.
\end{enumerate}
\end{footnotesize}
ment of mutuality seems almost insurmountable in any case involving joint accounts, a single borrower, and setoff, since by the nature of the case, at least one of the parties that the bank is setting off against is not a debtor. However, the recent decisions of at least one state court have chosen to overlook the requirement in favor of other factors.

III. THE NORTH CAROLINA MARITAL PROPERTY DISTRIBUTION ACT

Returning to the situation of Harold and Wendy, suppose that Wendy has filed for divorce. Harold and Wendy would like to split their property, but Wendy is reluctant to take on Harold’s debt from the failed store. She is incensed when she learns that bank officials are planning to set off Harold’s debt against their joint account. What will happen when Harold and Wendy divide their property pursuant to North Carolina law?

The North Carolina Marital Property Distribution Act (hereafter referred to as the North Carolina Act) allows for the distribution by the court of marital property upon divorce. Early subsections of the North Carolina Act define what property is marital and what property is separate. Marital property is defined as “all real and personal property acquired by either spouse or both spouses during the course of the marriage and before the date of the separation of the parties, and presently owned.” Conversely, separate property consists of all real and personal property acquired by a spouse before marriage or acquired by a spouse by bequest, devise, descent or gift during the course of
the marriage.” 39 Two particular aspects of the North Carolina Act are relevant here.

First, under the North Carolina Act, equal division is generally presumed. 40 Public policy favors equal division, reflecting the idea that marriage is a partnership enterprise. 41 By stating that “[T]here shall be an equal division by using net value of marital property... unless the court determines that an equal division is not equitable,” 42 the statute provides for an equitable division in some cases rather than an equal one, using a list of twelve factors. 43

The second relevant aspect of the North Carolina Act is the presumption that property is marital. 44 The North Carolina

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39. Id. at § 50-20(b)(2).
41. See The Partnership Ideal, supra note 4, at 197-198.

In particular, the partnership concept of marriage embodied in the statute has extended long-overdue recognition to the invaluable contributions of homemaker spouses and has helped to restore considerable balance to the process of private bargaining. Most significantly, the partnership concept has been instrumental in guiding courts to a restrained interpretation of the broad separate property provision of the statute.

Id

42. N.C. GEN. STAT § 50-20(c) (1999). For a concise discussion of the distinction between equal and equitable division, see The Partnership Ideal, supra note 4, at 244-247 (1987). See also Willis v. Willis, 86 N.C. App. 546, 549, 358 S.E.2d 571, 573 (1987) (holding that “marital property is to be distributed equally, unless the court determines that equal is not equitable.”).


Factors used by the court include:

[i]the income, property, and liabilities of each party at the time the division of property is to become effective, support obligations, the duration of the marriage, the need of the custodial parent to use the family residence and its belongings, the expectation of ‘deferred compensation rights,’ equitable claim to marital property by party not on title, contribution to career of other spouse, ‘direct contribution to increase in value of separate property which occurs during the course of the marriage,’ liquidity of marital property, tax consequences, ‘the acts of either party to maintain, preserve, develop, or expand; or to waste, neglect, devalue, or convert such marital property, during the period after separation of the parties and before the time of distribution,’ and other factors found by the court to be ‘just and proper’.

Id.

44. See id. “Under our equitable distribution statute, only assets and debts are subject to classification as marital property.” Adams v. Adams, 115 N.C. App. 168,
Act "creates a presumption that all property acquired by the parties during the course of the marriage is marital property," and this presumption may be rebutted by "clear, cogent, and convincing evidence that the property comes within the separate property division." By extension, therefore, the debt acquired by the parties is presumed marital unless proven otherwise. Pursuant to this notion, the North Carolina Court of Appeals held that both parties to a marriage are liable for marital debt, with a subsequent case limiting marital debt to that incurred before the separation of the parties. The court stated that all debt of parties should be considered during division of assets. Marital debt is thus included in the three-step process set up by the court to de-


45. Loeb v. Loeb, 72 N.C. App. 205, 209-210, 324 S.E.2d 33, 37, cert. denied 313 N.C. 508, 329 S.E.2d 393 (1985) (citing Mims v. Mims, 305 N.C. 41, 57-58, 286 S.E.2d 779, 790 (1982)) (construed gift to wife from mother as gift to couple because wife did not present evidence to rebut presumption of marital property). But see Johnson v. Johnson, 317 N.C. 437, 454, 346 S.E.2d 430, 440 (1986) (held in footnote that presumption of marital property was not created by statute.) "Under our statutory scheme, without the aid of any presumption, assets, the classification of which is disputed, must simply be labeled for equitable distribution purposes either as . . . marital . . . or . . . separate depending upon the proof presented to the trial court of the nature of those assets." Id.

46. See Loeb, 72 N.C.App. at 210, 324 S.E.2d at 37 (announced rebuttable presumption of marital property); Geer v. Geer, 84 N.C. App. 471, 475, 353 S.E.2d 427, 429 (1987) (held that debt is divisible marital property). See also Wornom v. Wornom, 126 N.C. App. 461, 466, 485 S.E.2d 856, 859 (1997) (holding that debt distributed as marital property is subject to a finding of fault or waste).

47. See Geer, 84 N.C. App. at 474, 353 S.E.2d at 428:

We hold that G.S. 50-20(c)(1) requires the court to consider all debts of the parties, whether a debt is one for which the parties are legally, jointly liable, or one for which only one party is legally, individually liable. Regardless of who is legally obligated for the debt, for the purpose of an equal distribution, a marital debt is defined as a debt incurred during the marriage for the joint benefit of the parties.

Id. Cf Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985) (holding that a savings account could be considered marital property). In Talent, one of the marital properties in question was a savings account worth approximately $68,000, and the court held that "since the $68,000 was acquired by the parties during their marriage and was owned by them on the date of their separation, under the circumstances of this case, the court correctly determined that the full $68,000 should be considered marital property as defined in G.S. 50-20(b)(1)." Talent, 76 N.C. App. At 553, 334 S.E.2d at 262.

48. See id.
termine the distribution of property.\textsuperscript{49}

Under this analysis, set forth in \textit{Willis v. Willis}, the court must first determine what is marital property, then evaluate the net market value of the marital property at the date of separation, and finally, make an equitable distribution of the marital property.\textsuperscript{50} In the case of Harold and Wendy, the presumptions of equal division and marital property mean that: (1) unless an equal division is not equitable, their property is to be equally divided;\textsuperscript{51} (2) this division would include the debt of Harold incurred before the end of the marriage;\textsuperscript{52} (3) Wendy would thus be liable for Harold's debt in some fashion;\textsuperscript{53} and (4) even if their joint account was not accessible through setoff before divorce, Wendy might be deemed a debtor through the process of equitable distribution, thus providing the missing requirement of mutuality needed for setoff.\textsuperscript{54}

Three recent North Carolina cases have reaffirmed the state's position on division of marital properties.\textsuperscript{55} \textit{Wornom v. Wornom}, a 1997 case, deals with equitable distribution of the debt from a bank loan among spouses.\textsuperscript{56} \textit{Riggs v. Riggs}, a 1996 case,

\textsuperscript{49} See Mrozek v. Mrozek, 129 N.C. App. 43, 46, 496 S.E.2d 836, 838 (1998) (citing Miller v. Miller, 97 N.C. App. 77, 79, 387 S.E.2d 181, 183 (1990)). "In an equitable distribution action, the trial court is required to classify, value, and distribute, if marital, the debts of the parties to the marriage." \textit{Id.}

\textsuperscript{50} See Willis v. Willis, 86 N.C. App. 546, 550, 358 S.E.2d 571, 573 (1987) (citing Little v. Little, 74 N.C. App. 12, 18, 327 S.E.2d 283, 286 (1985)).

\textsuperscript{51} See supra notes 40-43 and accompanying text (describing equitable and equal distribution).

\textsuperscript{52} See supra notes 45-50 and accompanying text (describing the inclusion of debt as a marital asset).

\textsuperscript{53} See id.

\textsuperscript{54} See supra notes 31-35 and accompanying text (describing mutuality as a requirement for setoff).

\textsuperscript{55} See infra notes 56-58 and accompanying text.

\textsuperscript{56} Wornom v. Wornom, 126 N.C. App. 461, 485 S.E.2d 856 (1997) (holding that fault could be considered when former husband and wife took out large loans from banks and relatives to support business, but business failed because of wife's neglect and theft). In \textit{Wornom}, the court held that "marital fault or misconduct of the parties which is not related to the economic condition of the marriage is not germane to a division of marital property and should not be considered. However, fault, which is related to the economic condition of the marriage may be considered. Fault or misconduct which dissipates or reduces marital property for nonmarital purposes is just and proper under N.C. Gen. Stat. § 50-20(C)(12)." \textit{Id.} at 126 N.C. App. 461, 466, 485 S.E.2d 856, 859 (citing Spence v. Jones, 83 N.C. App. 8,11, 348
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deals with the classification of a certificate of deposit. Lilly v. Lilly, a 1992 case, covers insurance settlements for one spouse deposited into a joint checking account. All three cases use the rules created by the state appellate courts in the 1980s to classify and distribute marital assets.

IV. NORTH CAROLINA LAW VS. THE LAW OF OTHER STATES

In a situation like that of Harold and Wendy, where the bank would like to set off the debt of a former spouse against a joint account, North Carolina law differs from that of other states in two main regards. First, rather than emphasizing the problematic requirements of mutuality or making a choice between case

S.E.2d 819, 821 (quoting Smith v. Smith 314 N.C. 80, 87-88, 331 S.E.2d 682, 687 (1985)). Under this rule, hypothetical husband Harold might have a problem in equitable distribution: if he wasted the money loaned to him by the bank, and the bank chose to exercise the right of setoff against Harold and Wendy's joint account, Harold may have fault allocated to him in the division of property proceedings. See id.

57. Riggs v. Riggs, 124 N.C. App. 647, 478 S.E.2d 211 (1996) (holding that plaintiff had failed to meet burden in showing that a portion of CD funds was separate). The plaintiff contended that $9,677.67 of the funds of a CD valued at approximately $40,000 was separate, and produced a withdrawal slip to verify his assertion, but the court found that the property was marital. See Riggs, 124 N.C. App. at 648, 478 S.E.2d at 213-214.

58. Lilly v. Lilly, 107 N.C. App. 484, 420 S.E.2d 492 (1992) (holding that an insurance settlement to a wife was not marital property even after deposit into joint account). In Lilly, the court stated that "the party claiming that property is marital has the burden of proving beyond a preponderance of the evidence that the property was acquired by either spouse or both spouses, was acquired during the course of the marriage, was acquired before the date of separation of the parties, and is presently owned." Lilly, 107 N.C. App. at 485-486, 420 S.E.2d at 492-493. If a party is able to meet this burden, then the burden shifts to the party claiming that the property is separate "to show by a preponderance of evidence that the property meets the definition of separate property." Id. If in our hypothetical Harold claims that the debt is marital and can thus be satisfied by use of other marital funds and apportioned to each party, he has the burden of proving these elements. See id. If Harold meets his burden of proof, then the burden shifts to Wendy to prove that the property was separate in nature. See Caudill v. Caudill, 131 N.C. App. 854, 857, 509 S.E.2d 246, 248-249 (1998). But see McLeod v. McLeod, 74 N.C. App. 144, 147-148, 327 S.E.2d 910, 913 (1985) (stating that "[p]roperty acquired in exchange for separate property is separate property, as is income derived from separate property and increases in value of separate property"); Manes v. Harrison-Manes, 79 N.C. App. 170, 172, 338 S.E.2d 815, 817 (1986) (holding that "the deposit of [separate] funds into a joint account, standing alone, is not sufficient evidence to show a gift or an intent to convert the funds from separate property to marital property").

59. See supra notes 49-50 and accompanying text.
law approaches to the ownership of funds, some states prefer to focus on the contractual agreement between the parties. Under such an approach, North Carolina might focus on the contract between Harold and Wendy and the bank as regards the right of setoff and their joint account. Second, other states simply take the approach opposite that of North Carolina cases defining the ownership and disposition of marital funds.

Illinois courts have recently decided the question of setoff against joint accounts in a way different from the approach in North Carolina. Rather than emphasizing the setoff inquiry as part of an equitable remedy for the bank, the Illinois Supreme Court chose to examine the basis of the contract between the deposer and the bank and grounded the right of setoff in that contract. In doing so, the Court looked past the traditional notion of mutuality. Since the account contract in Fisher specifically stated that the bank could treat each depositor in the account as an absolute owner, the requirement of mutuality of obligation for setoff was unnecessary under the terms of the contract. An Illinois

60. See infra notes 63-67 and accompanying text.
61. See supra note 16 and accompanying text (describing sample joint account contracts under North Carolina statute).
62. See infra notes 87-97 and accompanying text.
63. See supra notes 15-35 and accompanying text (dealing with setoff law in North Carolina).
64. See Fisher v. State Bank of Annawan, 643 N.E.2d 811, 813-4 (Ill. 1994) (allowing setoff by defendant bank of son’s debt against certificate of deposit jointly held by parent and child). The court was careful to distinguish joint bank accounts from joint tenancies in real property; therefore, the rule of setoff in this opinion is confined to the bank-depositor context. See id.
65. See supra notes 31-34 and accompanying text.
66. See Fisher, 643 N.E.2d at 812. The specific text upon which the court based its conclusion is as follows:

If more than one depositor is named above, and unless specifically indicated therein to the contrary, this certificate and the deposit evidenced hereby, shall belong to said depositors as joint tenants with right of survivorship (and not as tenants in common); provided, however, for all purposes, including endorsement, payment of principal and interest, presentation, transfer, and any notice to or from the depositors, this institution may deem and treat as the absolute owner hereof any one depositor named above, or the survivor or survivors, and each such depositor shall be the agent of each other depositor for all the foregoing purposes.

Id.
appellate court followed this opinion in Pope v. First of America.\(^6^7\)

In contrast to the approach taken by Illinois courts, the Mississippi Supreme Court has focused on mutuality of obligation rather than the terms of the contract.\(^6^8\) The contract at issue in Wallace v. United Mississippi Bank made mention of an interest roughly equivalent to the right of setoff against either party for the debts of one.\(^6^9\) The court in that case focused on the requirement of mutuality of demand, meaning that debts were between the same parties in the same capacity.\(^7^0\) The Wallace court held that even though the debtor's interest in the joint account was equal to the balance in the account as stipulated by agreement, the requirement of mutuality still controlled.\(^7^1\) This approach is more like the one taken by North Carolina courts in older cases.\(^7^2\)

The North Carolina contract comparable to the contracts in Fisher,\(^7^3\) Pope,\(^7^4\) and Wallace\(^7^5\) can be found at N.C. Gen. Stat. §

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It is interesting to compare and contrast this contract with those provided by some banks with branches in Chapel Hill, North Carolina. See BB&T, BANK SERVICES AGREEMENT 2 (1999) (pamphlet distributed to each customer who opens an account) [BB&T]. This BB&T document contains the following language that directly provides the bank a right of setoff:

> Each joint owner also authorizes the bank to exercise setoff and enforce its security interest in the entire joint account even though only one of the joint owners is the debtor. These rights exist irrespective of who contributes funds to the joint account. The Bank is not bound by the knowledge of and has no duty to inquire as to the source of funds deposited in the joint account and each joint owner shall have an equal and undivided interest in the entire account.

_id_.

It is instructive to compare this provision to the standard language of N.C. Gen. Stat. § 53-146.1, which is used in other contracts. See BANK OF AMERICA, PERSONAL SIGNATURE CARD WITH SUBSTITUTE FORM W-9 (1999); FIRST UNION, DEPOSIT ACCOUNT APPLICATION (1999). See also supra note 17 and accompanying text; infra note 77 and accompanying text (discussing N.C. Gen. Stat. § 53-146.1).

\(^{67}\) See Pope v. First of Am., 699 N.E.2d 178, 179-80 (Ill. App. 1998) (allowing bank to assert setoff as affirmative defense when mother sued over denial of withdrawal right because of minor son's conversion of funds from an unrelated account).

\(^{68}\) See Wallace v. United Mississippi Bank, 726 So.2d 578, 583-584 (Miss. 1998) (holding that bank wrongfully set off loans to deceased husband alone against joint account held by husband and wife).

\(^{69}\) See id.

\(^{70}\) See supra notes 30-31 and accompanying text.

\(^{71}\) See Wallace, 726 So.2d at 582-3.

\(^{72}\) See supra notes 16 and 30-31 and accompanying text.

\(^{73}\) See supra notes 64-66 and accompanying text.

\(^{74}\) See supra note 67 and accompanying text.
53-146.1. As is shown in the minimum contract provided, no express provision giving the bank the right of setoff is made in the contract between North Carolina banks and their account holders. Thus, the Illinois approach would be difficult to apply under the current North Carolina laws. In addition to lacking an express right to setoff in the sample contract, the right of complete setoff in joint accounts is not granted in the North Carolina statute governing the right of setoff on deposit accounts. N.C. Gen. Stat. § 54C-169 limits the amount that can be set off in such an account to "the amount of any member's or customer's interest" in the account.

Determining the amount of a married customer's interest in a joint account is problematic, considering the differing presumptions relating to how and whether funds placed in a joint account become marital property. In the case of an account whose holders are attempting to obtain a divorce, the bank is aided by the court's determination of which property is marital and which property is separate. Here, the approach which the state takes to determine division of marital funds becomes key.

In Harold and Wendy's case, the court's decision that Harold and Wendy both owed the debt was relatively easy, since the debt was incurred during marriage and was thus presumed

75. See infra notes 68-71 and accompanying text.
76. See N.C. GEN. STAT. § 53-146.1 (1999).
77. See id. The sample contract simply says:

We understand that by establishing a joint account under the provisions of North Carolina General Statute 53-146.1 that: the bank (or name of institution) may pay the money in the account to, or on the order of, any person named in the account unless we have agreed with the bank that withdrawals require more than one signature.

Id. In addition, the contract includes a clause creating a right of survivorship. See id. Generally, statutes not addressing ownership or setoff are not likely to be found sufficient to impute a statutory setoff right. Laurino, supra note 18, at 72. However, banks may place their own language in the contract. See supra notes 64-67 and accompanying text.

78. See supra notes 63-67 and accompanying text (explaining how banks may place their own provisions in contracts with customers).
79. See N.C. GEN. STAT. § 54C-169(b) (1999).
80. See supra notes 36-45 and accompanying text (discussing North Carolina presumptions). See infra notes 87-97 (discussing presumptions of other states).
However, had the presumption that the debt was marital not been invoked, the court might have had to rely on a different approach to divide the debt. In North Carolina, the courts use the source of funds approach, first described in the bellwether case of *Wade v. Wade.* Briefly, the source of funds rule recognizes the dual nature of property acquired with both marital and separate assets through creating a third characterization of property: part separate and part marital. The North Carolina approach differs markedly from some other states' rules.

In particular, Tennessee is among the states whose courts have adopted the doctrines of transmutation and commingling. The court in *Wade* discussed these two ideas as one theory—"transmutation through commingling." Under this theory, "affirmative acts of augmenting separate property by commingling it with marital resources [are] viewed as indicative of an intent to transmute, or transform, the separate property to marital property." The defendant in *Wade* proposed that these rules be adopted; however, the court refused to do so, implying that such a theory rested on assumptions not made by the North Carolina legislature.

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84. See *Wade*, 72 N.C. App. at 381, 325 S.E.2d at 269. "Under this theory, when both the marital and separate estates contribute assets toward the acquisition of property, each estate is entitled to an interest in the property in the ratio its contribution bears to the total investment in the property. Thus, both the separate and marital estates receive a proportionate and fair return on its [sic] investment." *Id.*
85. See infra notes 87-97 and accompanying text.
86. See infra notes 88-102 and accompanying text (discussing transmutation through commingling and contrasting doctrine with source of funds approach used in North Carolina).
88. *Id.*
89. See *id.*

Adoption of the theory of transmutation has been based on the preconceived legislative preference for the classification of property as marital. North Carolina has not legislatively adopted a presumption that the property acquired during the marriage is marital, as has Illinois, and in fact has adopted a more expansive definition of separate property than most states...we conclude that in order to be consistent with the language and purpose of G.S. 50-20 the real
The definitions of marital and separate property used by the Tennessee courts are substantially similar to those used in the North Carolina Act. In a recent case, Sickler v. Sickler, one party opened various bank accounts in his name only and expected to maintain full control of those accounts after his divorce. However, the Tennessee appellate court upheld the lower court's ruling that "all assets claimed by either party to be marital property were marital assets subject to equitable division." The court in Sickler expressly chose to recognize the doctrines of transmutation and commingling, stating that after property has been determined to be separate pursuant to the relevant statute, "the court must decide whether that property became part of the marital estate because the parties treated it in such a manner."

The court defined transmutation as a transformation of separate property to marital property occurring when "separate property is treated in such a way as to give evidence of an intention that it become marital property." Endorsing the doctrine of commingling, the court held that separate property becomes marital property when it is "inextricably mingled with marital property or with the separate property of the other spouse."

property concerned herein must be characterized as part separate and part marital.


90. See TENV. CODE ANN. 36-4-121 (b)(1)-(2) (1999); cf. N.C. GEN. STAT. § 50-20(b) (1999). Marital property is defined in Tennessee as: "[A]ll real and personal property, both tangible and intangible, acquired by either or both spouses during the course of the marriage up to the date of the final divorce hearing and owned by either or both spouses as of the date of filing of a complaint for divorce."

Id. Separate property includes the following:

[A]ll real and personal property owned by a spouse before marriage; property acquired in exchange for property acquired before the marriage; income from and appreciation of property owned by a spouse before marriage except when characterized as marital property; and property acquired by a spouse at any time by gift, bequest, devise, or descent.

Id.


92. See id. at *2.

93. Id. at *4.

94. Id. at *8.

95. Id. at *8.

96. Id. at *9. In the states of Mississippi and Arkansas, simply placing the
The Tennessee approach clearly has different consequences from the source of funds rule adopted in North Carolina.

For example, suppose that Harold and Wendy live in a jurisdiction in which the laws are similar to those of Tennessee. Assume that Harold treated the loan funds from First Local in such a way as to evince intent that they be marital property. In Tennessee, the funds have effectively become marital property and are part of an ownership interest that cannot be separated on a pro rata basis by tracing the source of the funds. In addition, if the funds have been commingled with marital funds, whether by deposit in the marital joint account or by other method, they also become part of an ownership interest that cannot be easily sorted out by a bank wishing to set off individual debt. A bank choosing to exercise the right of setoff in this context would probably be more likely to setoff against the account as a whole, since the pro rata interests in the account are not as determinable as those under the North Carolina account governed by the source-of-funds approach.

Thus, the Tennessee laws may not provide a measure of protection to the non-borrower spouse that the North Carolina laws may: since Tennessee courts consider funds to be marital if at all mingled in any way, both spouses must pay the debt of either if the property is deemed marital. The opposite result would be true in North Carolina: property possibly of a dual character (the third characterization under the rule in Wade) would more likely be protected, and thus payout would occur under a pro rata scheme as suggested by N.C. Gen. Stat. § 54C-169(b).

Haneline v. Haneline, a Nebraska case, makes an interest-

97. See supra notes 92-97 and accompanying text.
98. See id.
101. See supra notes 79-80 and accompanying text.
ing point regarding administrative feasibility, stating that "tracing the money [in the case in question, premarital property deposited into a joint account] is not feasible." Although the Tennessee approach may be less beneficial in some regards for bank customers, it can boast of the benefit of simplicity. Tracing account funds under the North Carolina approach could easily become quite difficult depending on the amount of money involved and financial sophistication of the spouses. Such a situation would be particularly frustrating for a bank which wants to exercise the right of setoff because of its swiftness and simplicity as a remedy.

V. SOLUTIONS PROPOSED BY LEGAL SCHOLARS: HOW WOULD THEY WORK IN NORTH CAROLINA?

Two researchers who have examined the subject of setoff in joint accounts at length have come up with varying strategies to reduce the harm to bank customers and make the bank's right of setoff more efficient. One commentator has suggested amending the signature form provided by banks upon the opening of a joint account to include a provision that would expressly give the right of setoff to banks. Banks would be expected to provide information to prospective customers about the different types of joint accounts. In exchange for this information provided by banks, a customer's signature on one account contract

104. See The Partnership Ideal, supra note 4, at 220. Application of the source of funds doctrine depends on the ability to trace the contribution of property from either a marital or separate source to an asset with a contrary classification. This will sometimes involve an attempt to trace out marital property contributions from separate property. Id. In addition, Sharp states that "the demands of tracing can vary enormously, depending largely on the nature of the contributed asset and the amount of time that has passed since the contribution." Id.
105. See Sepinuck, supra note 15, at 65 (describing setoff as attractive remedy for banks because of relative quickness).
106. See Laurino, supra note 18; Sepinuck, supra note 15.
107. See Laurino, supra note 18, at 79.
108. See id.
would be deemed sufficient for other identical accounts that might be created by the customer.\textsuperscript{109}

This approach would retain the net contribution/pro rata rule, similar to N.C. Gen. Stat. § 54C-169(b), allowing banks to exercise the setoff right over "a debtor's net contribution to the account, or in absence of evidence thereof, the debtor's pro rata share of the account."\textsuperscript{110} The approach then sets forth five essential statutory provisions, dealing with presumption of joint tenancy in cases of accounts under two or more names, ownership of deposited funds in proportion to contributions by each party, no requirement of inquiry into source of funds when determining said contribution, setoff of deposits subject to ownership designation, and validity of pledges of multi-party accounts.\textsuperscript{111} Under this approach, North Carolina law would resemble that found in \textit{Fisher}: courts would emphasize the contract signed between bank and customer rather than common law requirements of mutuality.\textsuperscript{112}

\begin{itemize}
\item[109.] See id.
\item[110.] Id. at 81.
\item[111.] See id. at 82-3. The provisions are as follows:
\begin{enumerate}
\item A deposit account opened or certificate of deposit purchased in the name of two or more depositors should be presumed to be an account or certificate held in joint tenancy with the right of survivorship, unless the parties agree otherwise.
\item Funds deposited into a multiple party account belong to each depositor in proportion to that party's net contribution.
\item A financial institution is not required to enquire into, for the purposes of establishing net contribution, either the source of the funds received or the proposed application of the funds withdrawn.
\item Deposits in multiple-party accounts shall be subject to setoff for obligations to the financial institution by persons designated in the account contract as owners of the funds to the extent of ownership at the date of setoff.
\item The pledge to any association of all or part of a multiple party account signed by any one of the tenants upon whose signature withdrawals may be made from the account, shall, unless the terms of the account provided specifically to the contrary, be a valid pledge and transfer to the association of that part or the account pledged and shall not operate to sever or terminate all or any part of the account.
\end{enumerate}
\item[112.] See supra note 66 and accompanying text.
\end{itemize}
In contrast to these provisions, which are specific to setoff and joint accounts, the Uniform Setoff Act proposed in another approach is more of an omnibus provision. The most relevant provision for the purpose of this analysis is the one requiring mutuality of debt unless otherwise agreed. Adding this provision would result in a resemblance to Wallace: the requirement of mutuality of debt would trump contractual provisions.

All of these suggestions are useful and intelligently reasoned. However, a simple provision could be enacted in order to remedy the special difficulty attached to joint accounts and setoff in North Carolina. Two choices immediately present themselves for consideration. First, an addition to N.C. Gen. Stat. § 53-146.1's model contract between banks and depositors could solve the problems in both the general context of joint accounts and the specific context of marital accounts. Ideally, the addition would explicitly authorize setoff by banks on customers' joint accounts, which would allow North Carolina courts to take the Illinois approach in emphasizing the terms of the contract between customer and bank. Such an addition might mirror the language used by BB&T in its Bank Services Agreement:

Each joint owner also authorizes the bank to exercise setoff and enforce its security interest in the entire joint account even though only one of the joint owners is the debtor. These rights exist irrespective of who contributes funds to the joint account. The bank is not bound by the knowledge of and has no duty to inquire as to the source of funds deposited into the joint account and each joint owner shall have an equal and undivided interest in the entire account.

114. See id. at 101. The relevant provision states that the right to setoff would exist under two conditions. See id. First, "[u]nless otherwise agreed, a creditor may set off only mutual debts." Id. Second, "[d]ebts are mutual if every creditor owed is a primary obligor on the other debt or has consented to the exercise of setoff." Id.
115. See supra notes 68-71 and accompanying text.
117. See Fisher v. the State Bank of Annawan, 643 N.E.2d 811, 813 (Ill. 1994) (allowing setoff by defendant bank of son's debt against certificate of deposit jointly held by parent and child).
118. See BB&T, supra note 66, at 2.
An amendment to the sample contract could give all banks the right to setoff against the full account for the debt of one holder. This choice would give banks a right of setoff similar to that in Fisher\textsuperscript{119} and Pope.\textsuperscript{120}

Should that choice prove unacceptable, the second option is to expressly provide a contractual reference to the rule in N.C. Gen. Stat. § 54C-169.\textsuperscript{121} Such a reference would state that the debtor holder's pro rata interest or share is subject to the right of setoff.\textsuperscript{122} This second option seems more suitable in the marital context, since it fits well within the context of the source of funds rule.\textsuperscript{123} However, the former option has its attractions as well. If duly included in the contract, it would give the parties more individual notice that they were liable for the consequences of acts of each party that might affect the status of the joint account.\textsuperscript{124}

Either choice would be a better solution than to have no particular rule expressly stated. Whether North Carolina chooses to resemble Illinois in emphasis on contract or Mississippi in emphasis on mutuality, it needs to create a clear path for banks and

\textsuperscript{119} See Fisher, 643 N.E.2d at 812:

If more than one depositor is named above, and unless specifically indicated therein to the contrary, this certificate and the deposit evidenced hereby, shall belong to said depositors as joint tenants with right of survivorship (and not as tenants in common): provided, however, for all purposes, including endorsement, payment of principal or interest, presentation, transfer, and any notice to or from the depositors, this institution may deem and treat as the absolute owner hereof any one depositor named above, or the survivor or survivors, and each such depositor shall be the agent of each other depositor for all the foregoing purposes.

\textit{Id.}

\textsuperscript{120} See Pope v. First of Am., 699 N.E.2d 178 (Ill. App. 1998).

\textsuperscript{121} See supra note 20 and accompanying text.

\textsuperscript{122} See \textit{id.}

\textsuperscript{123} See supra notes 84-90 and accompanying text.

\textsuperscript{124} See BB&T, supra note 66, at 2.
customers to follow.\textsuperscript{125} As long as the legislature does not provide clear legal guidelines on the questions attendant to setoff and joint accounts, the rules surrounding them will remain a patchwork of supposition and reliance on dated case law.

\textup{Nancy Ray}