

1889

Fraudulent Conveyances

Sanford Willard Smith
Cornell Law School

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THESIS,

Cornell University School of Law,

Fraudulent Conveyances.

Sanford Willard Smith,

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Conveyances of Land in Defraud of Creditors
in New York State.

By way of introduction to the treatment of this subject I cannot, I think, do better than to make a brief quotation from a paper by Mr. John Reynolds of Brooklyn, read before the New York State Bar Association, at its Third Annual Meeting, held in the city of Albany, on the 18th day of November, 1879.

Mr. Reynolds says: "The law governing fraudulent conveyances is as yet unsettled, and at the present day in a formulative state. There is no rational ground for surprise that this branch of the law should at this late day still be unformed; on the contrary, it might be inferred, A PRIORI, that such must be the case. The theory on which it rests is a subtle one, and of late development in any legal system. This is well illustrated by the Roman Law.

The earliest remedies of creditors in a crude legal system were always against the person and not the property of the debtor. A striking example of this is the 'IN PARTES SECARE' of the Roman Law. At Rome in certain cases, the debtor might be taken and sold into slavery if he could not make the necessary arrangements with his creditors for his re-

lease. Finally, the remedies against the person were taken away, and a complete system for annulling fraudulent transfers, and securing the debtors estate for creditors, was provided, in LIBER 42 of the Digest of Justinian. The Law of England in early times, by allowing imprisonment for debt in all cases, at the option of the creditor, effectually operated IN TERRORUM against the debtors person, to prevent fraudulent transfers; but its operation was temporarily neutralized to some extent, at an early stage of legal development, by the protection against the arrest of debtors in "Sanctuaries". Hence, arose a spasmodic and premature crop of fraudulent conveyances in England, far in advance of the time for their normal, natural development. This occasioned the passage of the statute 13th of Elizabeth, and others, and the adjudication of the *Twyne*^{case} and others similar.

By the recent abolishment of imprisonment for debt, the law no longer prevents fraudulent conveyances. They have sprung up around us in frightful numbers beyond all previous experience. Modern law, accordingly, has presented to it what the early law never had, the pressing problem how to neutralize the fraudulent transfers which it has ceased to prevent.

The greatest advances in the branch of the law which governs conveyances, have been made in modern cases, since the abolishment of imprisonment for debt.. The advances already made by modern courts of Equity in neutralizing debtors transfers as fraudulent, are but stepping stones to further advances yet to come. This progress and tendency is clearly marked and is universal. In England and in all of the states of this country, this policy is well recognized by the courts. Of all the states, perhaps, New Jersey and Alabama are at present the most advanced, but they simply head the universal march of the states in this direction.

The policy of New York State in this matter has been highly conservative . She has been one of the slowest to respond to this universal tendency. This may be illustrated by New York's repudiation of the great decision of Chancellor Kent in *Reade vs. Livingston*. In New York there has been a constant struggle against this conservative favoritism towards debtors; indeed, there was actually an open quarrel between the Supreme Court and the Court of Errors on this matter. But since the New York Court of Appeals has succeeded to the Court of Errors, much stronger ground has been taken. New York has rapidly caught up with most of

the other states, and has recently made marked advances, as is shown by some of the leading cases lately decided:

Carpenter vs. Roe; (10 N.Y., 227)
 Savage vs. Murphy, (34 N.Y., 508;)
 Case vs. Phelps, (39 N.Y., 164;)
 Cole vs. Malcolm, (33 N.Y., 333;)"

I have made the above quotation (with one or two interpolations), somewhat at length, because it gives in an abbreviated manner, a sketch of the development of the general doctrine, and of the position New York has taken in the premises, a great deal better than I could have hoped to have done it.

New York State was, as is suggested by the writer of the above quotation, slow to lay down stringent rules tending toward the invalidation of conveyances in defraud of creditors. Chancellor Kent (in 2 Johns. Ch., 35) endeavored to lay down a strict rule. In this case he said, "If the deed is admitted to be fraudulent on the part of the grantor, there would be difficulty in allowing it to stand, even if the grantee were innocent of the fraud."

This case was distinguished and an entirely different rule laid down in the case of Waterbury vs. Sturdevant, 13th of Wend., 363, by Senator Edwards. In delivering the opinion of the court, he says: "To render the conveyance fraudulent and void, there should be fraudulent intent on the part of

the grantee, as well as the grantor." This latter holding though obviously too broad and too general in its statement, will I think, illustrate the caution with which the New York courts dealt with this problem.

The New York Statutes though not differing essentially from the English statute, has some peculiarities. So I have thought best to set out at length such parts of the statute as pertain to the subject under consideration.

The provisions of this statute are found in sections 1, 4 and 5 of Chapter VII, Title III, of the Revised Statutes, and are as follows:

Section 1. Every conveyance of assignment, in writing or otherwise, of any estate of interest in lands, made with intent to hinder, delay or defraud creditors, or other persons of their lawful suits, damages, forfeitures, debts, or demands, shall be void.

Section 4. The question of fraudulent intent, in all cases arising under the provisions of this Chapter, shall be deemed a question of fact and not of law: nor shall any conveyance or charge be deemed fraudulent, as against creditors or purchasers, solely on the ground that it was not founded on a valuable consideration.

Section 5. The provisions of this Chapter shall not be

construed in any manner to affect or impair the title of a purchaser for a valuable consideration, unless it shall appear that such purchaser had previous notice of the fraudulent intent of his immediate grantor, or of the fraud rendering void the title of such grantor.

Here to, we may notice the reluctance of New York State to lay down rules whereby to interfere with titles already vested; section 5 of the statute was evidently enacted to emphasize the rule, already existing, that bona fide purchases for value were not to be meddled with, and, it has been claimed to make more plain the difference between voluntary conveyances and those for value in the application of this doctrine.

The principle upon which this legislation is founded, and towards which all courts are working, is, to quote from Mr. Reynolds, "that the entire property of which the debtor is the real or beneficial owner, constitutes a fund which is primarily applicable to the fullest extent of its entire value, to the payments of its owners debts; and that value will not be allowed to be withdrawn from such primary application, if any legal or equitable ground can be found, on which to prevent such withdrawal."

With this principle in view, I shall endeavor to find how the doctrine has been applied in this state, and to note

whether the courts have applied this principle to its fullest extent in their adjudications.

Subject Matter of the Conveyance.

In order that a conveyance may be set aside as fraudulent, the subject matter of the transfer must be of such a kind that it might have been applied by the creditor to the payment of his charge. The old English law held that a voluntary settlement of stocks, choses in action, of copy holds, or of any other property not liable to levy and sale on execution, was not within the Statute of Elizabeth. These have been included by a later statute however, and the only exception that I know of in this country, in the way of land, is the Homestead estate. It has been held that inasmuch as this estate is not liable to levy and sale under an execution, that a transfer of it cannot be set aside as in fraud of creditors. This appears to be correct on principle, for, if the creditors, are not allowed to satisfy their claims out of this property while in the debtor's hands, no injustice is done then by the transfer.

What Creditors may take advantage

of a Fraudulent Conveyance.

The benefits to be derived from the statute are not

confined to creditors existing at the time of the transfer, but may extend to subsequent creditors, whose debts had not been contracted at the time of the conveyance. But the principle will not operate in favor of subsequent creditors, unless it can be shown, that either the grantor made the conveyance, with actual intent to hinder, delay or defraud persons who might become creditors, (Case vs. Phelps, 39 N. Y., 134), or, that after the conveyance was made, the grantor had not sufficient means to pay his then existing debts, nor reasonable expectations that he would have, in which case the law implies that the conveyance was made with intent to defraud creditors, or, that there are debts unsatisfied which were due at the time of the conveyance.

Savage vs. Murphy, 8 Bosw., 75;

If, at the time of bringing the action, no debt due when the conveyance was made remains unpaid, and there is no evidence to show that the conveyance was made with actual intent to hinder, delay or defraud subsequent creditors, the conveyance must stand as against them.

If a conveyance is set aside as fraudulent against creditors existing at the time, subsequent creditors are entitled to participate in the application of the proceeds; but

if antecedent creditors cannot make out a case, subsequent creditors cannot impeach it on account of the former prior indebtedness. (Kerr on Fraud.)

In case of a voluntary conveyance, a contemporaneous creditor may have the conveyance set aside, by simply showing that the debtor did not retain a sufficient amount of property to pay his then existing debts; a subsequent creditor, must, in connection with this fact, show that debts existing at the time of the conveyance, have not been paid, of, if they have been paid, that there was actual fraudulent intent on the part of the grantor, and probably, on the part of the grantee, although of this latter proposition, I am uncertain. It is probable, however, that, if the grantee was ignorant of the fraudulent intent of the grantor, and had put himself in such a position that it would work injustice to him to have the conveyance set aside, he would be protected, and the conveyance would be allowed to stand. The practical difference between the rights of contemporaneous and subsequent creditors, as affecting voluntary conveyances, is, that it is not necessary that the former should prove actual fraudulent intent in order to have a conveyance set aside, , while, in case of the latter, fraudulent intent

will not be presumed, but must be proven as a matter of fact

Voluntary Conveyances.

A conveyance will not be adjudged fraudulent solely because voluntary. This is in accordance with the statutory provision, "No conveyance or charge shall be deemed fraudulent, as against creditors or purchasers, solely on the ground that it was not founded on a valuable consideration." This rule is applied in the case of Dygert vs. Remerschnider 32 N.Y., 329. In this case one Remerschnider, who was about to marry, made an oral agreement with his intended wife, to settle upon her certain property after marriage. This being an oral contract, was void and inoperative, and the conveyances subsequently made in pursuance of this agreement, was a voluntary settlement. A creditor of the husband, who had become such subsequently to the agreement, but prior to the conveyance, sought to have the conveyance set aside as fraudulent. The court held that a voluntary conveyance is not PER SE fraudulent, and that on these facts only being shown, the plaintiff could not recover.

Although the absence of consideration is not conclusive evidence of fraudulent intent, it is a circumstance that has great effect in determining as to whether there was or was

not such intent. (Jackson vs. Peck 32 N.Y., 629.)

Inasmuch as the grantee in this class of cases, is not a purchaser for value, he does not come within the protection of section 5 of the statute, and hence, it is not necessary to prove a fraudulent intent on his part, in order to invalidate the transfer. If the intent to defraud or circumstances which in law amount to an intent to defraud, be proven, on the part of the grantor alone, the law will regard this as sufficient cause for declaring the conveyance void and inoperative. (Mohawk Bank vs. Atwater, 2 Paige, 59.) The learned Judge here says : "It is of no consequence, whether the grantee knows of the state of the grantor's indebtedness or not. If the grantor committed a fraud upon his creditor, by giving away his property, which should have been reserved for them, the grantee, without a valuable consideration, cannot be protected, although he was not privy to the fraud."

This may safely be said to be the law of this state today, as the case is a leading one, and has been cited with approval in all the later cases in which this principle was involved.

The reason for this rule is apparent. Persons who have

given credit to the debtor, relying on his property as a security for their debt, have a right to expect that the debtor will not dispose of it in such a way as to render it highly improbable that their debt can be collected, should he fail to pay voluntarily. The grantee in such a conveyance loses nothing by being compelled to reconvey, as he has given nothing for the property, while the rights of creditors are at the same time protected.

The facts and circumstances from which fraudulent intent will be implied, are numerous and varied. In fact, all the circumstances surrounding the transaction may be taken into consideration. The very fact that the conveyance is voluntary is strong evidence of intent to defraud, and if the transfer leaves the grantor without sufficient resources with which to pay then existing debts, the conveyance is presumed to have been fraudulent.

Carpenter vs. Roe, (10 N.Y., 227;)
Cole vs. Tyler, (35 N.Y., 73;)

Dwight, J., in delivering the opinion of the court, in the case last above cited, says: "It is not necessary that there should be an actual fraudulent intent. The requisite fraud may be inferred from the circumstances of the case. It was at one time the law that a voluntary convey-

ances by one indebted was PER SE fraudulent, as a matter of law, towards his creditors; and no evidence was allowed to rebut the presumption of fraud."

Reade vs. Livingston, (3 Johns., Ch. 431.)

Fraudulent intent will also be presumed where a voluntary conveyance is made in anticipation of debt. Thus, when a person executes a voluntary conveyance, and then pays up existing indebtedness by obtaining new credit and contracting new liabilities, the transfer will be fraudulent and void, even as to subsequent creditors, the courts holding that the prior indebtedness has not been paid but simply transferred. The case of Case vs. Phelps, (34 N.Y., 164), is in point. Here, a person~~s~~ about to engage in a new business for the purpose of securing his property for the benefit of himself and family in the event of loss, conveyed his property to his wife, voluntarily and without consideration. The conveyance was set aside as fraudulent and void, notwithstanding the fact that it was distinctly found that the conveyance was made without any intention to defraud creditors then existing.

I shall not attempt to give all the facts from which fraudulent intent will be inferred. Suffice it to say that any and all circumstances tending to show that the grantor conveyed away his property to get it beyond the reach of his

creditors, will be evidence of fraudulent intent.

Conveyances for Value.

Having discussed somewhat at length, the law as it has been applied to conveyances voluntary in their nature, the question as to how it shall be applied to conveyances for a valuable consideration demands some attention.

Section 5 of the statute provides: "The provisions of this Chapter shall not be construed in any manner to effect or impair the title of a purchaser for a valuable consideration, unless it shall appear that such purchaser had previous notice of the fraudulent intent of his immediate grantor, or of the fraud rendering void the title of such grantor."

Thus we see that in order to be within the protection of this section, the grantee must have been a purchaser for a valuable consideration, and in good faith. It is not sufficient that the conveyance is for a valuable consideration OR in good faith; it must be both. The concurrence of both elements is essential and indispensable, (12 Johnston, 320.)

Consideration for the Conveyance.

In order that a conveyance may be considered as having been made for a valuable consideration, the question of ad-

equacy is not material. Sutherland, J., in Jackson vs. Peck, (4 Wend, 305.), says: "A voluntary conveyance is well defined to be a deed without any valuable consideration. The adequacy of the consideration does not enter into the question and only becomes material as evidence of fraudulent intent. The sole question is whether anything of value has passed between the parties to the transfer."

But the consideration must be a legal one, and one that the law will recognize, or the transfer does not come within the protection of the statute, and will therefore be considered a voluntary conveyance and will be subject to the rules governing that kind of transfers. If the consideration is a prior debt or obligation, it must, with a few exceptions, however, be of such a kind as to be enforceable at law.

(3 Barb. Ch., 344.)

The principal exception to the rule that a conveyance in pursuance of an agreement that cannot be enforced is voluntary, is where there is a moral obligation which cannot be enforced on account of the provision of some statute. The statute of limitations is a statute that may be waived, and a debt barred by it, may be a good consideration for a conveyance. This was held in the case of Hale vs. Stewart, (7 Hun, 591.) decided in 1876. The statute of frauds may al-

so be waived, and the debt may be paid by means of a conveyance of property, which will be effectual as against creditors.

The case of Livermore vs. Northrup(44 N.Y.,110), was a case where the grantor had made an oral agreement to be responsible for the debt of another person. In pursuance of this agreement, he deeded certain property over to the defendant, which conveyance was attacked as fraudulent by creditors of the grantor. The court, in delivering the opinion, said: "It is entirely within the option of the debtor whether he will set up the statute of frauds against the performance of such a promise, or not, and although the promise was verbal, honesty, as well as honor, required that it should be faithfully performed."

A debt discharged by proceedings in bankruptcy may be a good consideration, as against creditors, for a conveyance. The reason for the rule is clear. While the remedy has been taken away by law, the moral obligation to pay the debt remains; and should the debtor choose to do so other creditors cannot claim that their rights have been invaded.

A debt discharged by voluntary release is not, however, a good consideration, for, the creditor having relinquished

the debt itself, there is no moral obligation to pay it resting on the former debtor, and a conveyance in pursuance of such a debt is voluntary.

Bona Fides of the Transfer.

In order that a conveyance may stand as against creditors of the grantor, the contract must have been entered into in absolute good faith on the part of the grantee. It makes no difference what might have been the intention of the grantor, if the grantee is free from any imputation of fraud or mala fides, he will be protected.

In the early history of the doctrine, some confusion seems to have arisen from the very general way in which the courts stated the law. The distinction between voluntary conveyances and conveyances for value, in the application of this doctrine, does not seem to have been fully made, until the case of *Dart vs. Farmer's Bank* (27 Barb.) was decided. The distinction as here made, is that mutuality of intent to defraud, on the part of grantor and grantee is not necessary to render void a voluntary conveyance by a debtor, while, if the conveyance be for a valuable consideration, such mutuality is essential.

With this principle or distinction in view,

nearly all of the apparently conflicting decisions can be harmonized.

Absolute mala fides however, need not be proved by the creditors when attempting to set aside a conveyance as fraudulent. As a general rule, it may be said, that if the purchase be made by a person having knowledge of the fraudulent intent of the grantor, or, such knowledge as ought reasonably to have put him on inquiry, and such inquiry would have disclosed the fraudulent intent of the grantor, he is not entitled to protection, even though he bought in a actual good faith, with no intent to defraud and for a valuable consideration. The hearty cooperation of every member of society, to lend his aid in discountenancing fraudulent practices, is due to the social body of which he is a member, and, if he is negligent in the exercise of this obligation, he alone must suffer by his default.

The rule as above given has perhaps one exception, that of transfers to creditors in discharge of prior indebtedness. If there is no actual fraud on the part of the creditor, the courts will uphold the transfer, even though the grantee knew of the fraudulent intent of the grantor. It has been so held, even where the debt has been barred by the statute of limitations.

The doctrine that a creditor is not charged with notice of his grantor's fraud, has been limited to cases where the debt was the sole consideration for the transfer. Where the conveyance is for the joint purpose of paying an indebtedness and of putting the grantor's property beyond the reach of other creditors, it will be void, as fraudulent, except as to the amount of the actual indebtedness.

Cohen vs. Kelly, (35 Super. Ct. Rep.)
 Palen vs. Bushnell, (1 Hun, 319)
 58 Barb., 339;
 12 Hun, 303.

With this one restriction, a creditor is always at liberty to receive property from his debtor in payment of his debt; It is not ipso facto a fraudulent act to prefer one creditor over another.

14 Hun, 172;
 4 Denio, 118;
 14 Wend., 237;

It has been held that a conveyance absolute on its face, but intended as security for a debt to a bona fide creditor is not fraudulent as to other creditors.

Rigley vs. Talmage, (17 How. Pr., 563)

The question of bona fides is a question of fact and all the circumstances of the transaction will be considered in rendering a decision. The adequacy or inadequacy of the consideration is sometimes the controlling question; if the

consideration is grossly inadequate, the conveyance will be set aside.

Burden of Proof.

If the vendor retains possession of the property, a presumption of fraud arises, and the ONUS is on the vendee to show from the circumstances of the case that there is no fraud.

2 Hill's Ch., 329.

In cases of voluntary conveyances, the burden is on the donee to show that, at the time of making the gift, the donor was solvent and retained sufficient property to pay his then existing debts.

8 Cowen, 406;
15 Wend., 588;
24 N. Y., 623;

Where the conveyance is in the form of an assignment for the benefit of creditors, the burden of proof is on the contesting creditors, to prove that the assignment was contrary to law and fraudulent, or that the assignor is solvent.

If the conveyance is founded on a valuable consideration, the ONUS is on those who seek its impeachment. An important case on this subject is the case of Newman vs. Cordell (43 Barb., 448), where it is said: "The rule is well

settled, that, to make a conveyance fraudulent, fraud, or fraudulent intent must be shown on the part of the grantee as well as the grantor. Where conveyances are attacked for fraud, and there are many facts and circumstances surrounding the case which cast a suspicion upon the transaction, the defendants should be prepared to meet the allegations of unfairness; and if they fail to do so, the plaintiff will be entitled to the benefit of all of the unfavorable inferences which may legitimately be drawn from their neglect and the general features of the case. The denial of a party charged with fraud that there was any intention to defraud the plaintiff can scarcely be considered as anything more than an expression of opinion of the party charged with fraud, as to the character of the transaction, and his own estimate of it. While the party alleging fraud is bound to prove it by sufficient evidence, it is not necessary that it should be established by direct and positive proof; resort may be had to circumstantial evidence."

The tendency of the courts of this state, as shown by the case last above cited, is toward the full realization of the principle that a debtor's property is a trust fund for the benefit of his creditors, and that any attempt to deplete this fund will be rendered ineffectual, so far as may be consistent with the rights of third persons, who have,

through no fault of their own, been made parties to the debtor's fraud. The courts of New York, though at first applying this doctrine very sparingly, and even then reluctantly, are eagerly striving for the leadership in this, the universal march against fraudulent practices in the affairs of business.
