

1894

Extra-Territorial Effect of State Insolvency Laws

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EXTRA - TERRITORIAL EFFECT OF
STATE INSOLVENCY LAWS.

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THE S I S
O F
FRANCIS E. WOOD JR.

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SUBMITTED FOR THE DEGREE
O F
BACHELOR OF LAWS
A T
CORNELL UNIVERSITY,
1894.

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PREFACE.

When the subject of this thesis was suggested to me as a good one for investigation I accepted it as one furnishing much room for independent research, there being so many of the States having laws on the subject of bankruptcy. The more I continued my investigations, however, the more convinced I became that the same path marked out for me was one already well trodden by the most eminent jurists in both this country and in England; and there was little left for me to do but to collect and report the reasonings and conclusions which they had set forth.

In doing this I have quoted liberally from the opinions of the learned judges in both countries and am also much indebted to Mr. Bishop's invaluable work on Insolvent Debtors and also the work of Judge Cooley on The Conflict of Laws, knowing that, as my object was to state the law as it exists, I could in no way improve either on their language or judgment for the period covered. I have tried as best I could to ascertain and state the trend of judicial decisions subsequent to the period covered by those distinguished authors,

and if my work in this direction can add any authority to support the principles laid down by them, or can set forth in their true effect decisions which bear upon points that when they wrote were unsettled questions, I shall feel that my work has not been entirely without profit.

Ithaca, May 28, 1894.

F. E. W.

INTRODUCTION.

Every commercial country has some system of bankruptcy. From the early jurisprudence of the Roman Empire down to the present day, it has existed in some form in nearly every nation. The French and Teutonic nations engrafted it into their Codes, and in England it has prevailed for nearly two centuries.

In the United States the right to enact a uniform system of bankrupt laws was conferred upon Congress by the Constitution, though in such a way that it did not take from the states the power to pass bankruptcy laws in the absence of a national enactment on the subject.^a The failure of the congressional attempts at legislation upon this important subject is historic. In 1800 an act was passed which was simply a carefully prepared Digest of the English Statutes as they then existed, without any proper adaptation of the system to the needs of this country. It was a law for creditors only and was soon repealed. In 1841 Congress went to the other extreme and enacted a law which

a Ogden v. Saunders, 12 Wheat. 213.

resulted for the benefit of debtors only, and this also was soon rescinded. Again in 1867 Congress enacted another bankrupt law, but this too failed in effect the object of its advocates and was in turn short lived. The result has been that for the greater portion of our national existence we have been without a comprehensive uniform system of bankrupt laws and have been forced to rely on State legislation which is necessarily conflicting and unsatisfactory.

As to the need of some such law, there can be no question. Its use is two-fold: First, to secure to the honest but unfortunate business man, release from his debts when he is unable to pay them after applying all his property to that purpose, and thus permitting him to start anew; and second, to prevent the dishonest and the tricky from defrauding their creditors. As ~~to~~ the need of such provision is admitted, so the enactment of bankruptcy or insolvency laws are important; and in the present day of great business ventures, when an insolvent often has both debtors and creditors in two or more states, the question of the extra-territorial effect of the laws of each becomes of the greatest importance, for upon that effect frequently depends

the distribution of a large part of the insolvent's estate .
In the following pages we will examine such effect of the
laws and try to formulate and express the general rules as
laid down in the different jurisdictions for the disposi-
tion of such property.

DISTINCTION BETWEEN VOLUNTARY AND INVOLUNTARY

GENERAL ASSIGNMENTS.

It is not our purpose to deal with assignments in general, but in order to understand thoroughly the decisions in the various States and the ground on which they are based, a few words are necessary on the force and effect of voluntary assignments, and the characteristics which distinguish voluntary general assignments from those which are called involuntary, or assignments under and by force of insolvency laws.

A voluntary assignment has been well defined as a transfer by the debtor, without legal compulsion and without consideration, of all his property to an assignee for the payment of his debts.^b It is obvious that no Statute is necessary to give validity and effect to a voluntary general assignment, and this is of great importance because we have so many statutes upon the subject, and their bearing is frequently misunderstood. The assignor can do with his property what he pleases; he may give it away or make any other distribution of it, provided he does not controvert

b. Mills v. Parkhurst, 126 N. Y., 89.

the Statute of trusts on the one hand or the statute of frauds on the other. The fact that statutes regulating assignments have been passed in almost every State does not deprive him of those rights or take from ~~those~~ assignments the quality of being voluntary. They merely regulate a conceded power; they do not compel the debtor to make an assignment. The assignment is a trust deriving its validity from the debtor's voluntary act and the terms of the instrument which he has executed. It is obvious that a conveyance of this sort, in trust, in the absence of Statutes, while all right if fairly made yet it may be made the instrument of the grossest frauds; the assignee may be irresponsible; information as to the extent of the assets and liabilities may be ascertained with great difficulty; there will be a lack of summary measures to bring the assignee before a Court of justice and see that he administers his trust in a way to protect creditors; to meet and remedy these commonly recognized evils the Statutes have been passed. These Statutes vary greatly in the different states. Questions as to how far preferences will be allowed and what shall be done by the assignee in the administration of the estate, in some, are regulated with great nicety, while in

others they are left almost as a common law; but it must not be forgotten that however regulated, the assignment takes effect from the voluntary act of the debtor. ^c Just how far a law must go, to remove assignments made under it from the classification of voluntary, is not entirely clear. It is well settled that any law which provides for the entire distribution of the debtor's property among his creditors, on his committing an act of bankruptcy or appealing to its provisions for relief from his debts, would be a bankrupt law. ^d This is, of course, an instance of a bankrupt law in the generic sense. It is held, also that any law which required a creditor to relinquish any of his rights against the insolvent debtor, as a condition precedent to sharing in the distribution of such debtor's estate under the assignment, would be considered a bankrupt law within the provisions of the rule. ^e It is probable from the trend of decisions that any law which does not act against the insolvent debtor, in invitum, or does not restrict in any way the rights of creditors, would be considered as a mere regulating statute, and not an insolvent law.

^c Lectures of Prof. Hughes.

^d In re Wait 99 N. Y. 433.

^e Barth v. Backus 140 N. Y. 230.

REAL PROPERTY.

Unlike personalty , there can never be any doubt as to the jurisdiction over real estate. Every State and every nation has provided laws which govern its transfer, and many of them have adopted forms to be used in making a voluntary transferal. They have provided for the recording or filing of the deeds, and have thrown every safeguard around the title. It is the one article of property which requires a close adherence to fixed rules of law in the transferal of title to make it binding and secure. This being the case, it is evident that a rule of comity cannot operate to effect a transferal of real property unless all the requirements of law of the the situs are complied with. It is a general rule, both in this country and in England, that the title and disposition of real estate are exclusively subject to the laws of the country in which it is situated, which alone can prescribe the mode by which title to it can pass.^f A deed or mortgage can have no effect of itself except by virtue of the law of the State in which the land is situated,^g and it is well settled that a general assignment by an insolvent debtor, under and by force of an insolvent law of his domicile, cannot pass

^f Osborn v. Adams 18 Pick. 245, 247

^g Dundas v. Bowler 3 McLean 399.

real estate situated in another State.^a The same principle applies as well to voluntary as to bankrupt assignments.^b

a Hutchison v. Peshine, 1 Greene 167;
Rogers v. Allen, 3 Ham. 1. (O.) 488;
Osborn v. Adams, 18 Pick. 247.

b Burrill on Assignment 462;
2 Kent's Com. 489 note.

CHAPTER IV.

PERSONALTY.

In the consideration of the questions arising from the application of foreign laws to domestic personal property, we encounter the great difficulties of this subject, and scarcely any two jurisdictions agree as to all the details of the law and their application. In general, however, there are two separate and distinct lines of decisions: One originating with the English Courts, and so called the English doctrine; and the other called the American doctrine.

THE ENGLISH DOCTRINE.

The reasoning of the English Courts is, to a great extent, the same as the American. They declare that all personal property is subject to the law which governs the domicile of the owner. It is undisputed that the owner can, by a voluntary act on his part, transfer to another, all his property without regard to where situated, and an assignment under the bankruptcy law of his domicile is as valid and effectual a transfer of his property as if made personally by him. If the transfer is valid and binding under the law of his domicile, it makes no difference what

means were used to effect it.^a In short it is held that an assignment under the English bankruptcy act, transfers all the bankrupt's right and title to the assigned ~~of the~~ property wherever situated as completely as the bankrupt himself could do by a voluntary transfer.^b It was even held that any property of the bankrupt, brought into England by any person who obtained it subsequent to the assignment, might be recovered from him by the assignees for the benefit of creditors; and that an attachment by creditors in a foreign country, is void as against the assignee.^c

Mr. Story in his work on the Conflict of Laws states the propositions established in England as follows: "First, that an assignment under the bankrupt law of a foreign country, passes all the personal property of the bankrupt locally situate, and debts owing in England; secondly, that an attachment of such property by an English creditor after such bankruptcy, with or without notice to him, is invalid to over-reach the assignment; thirdly, that in England the same doctrine holds, under assignments by her own bankruptcy laws, as to personal property and debts of the bankrupt in foreign countries; fourthly, that upon principle, a Sill v. Warwick 1 H. Bl. . 690; b Sill v. Warwick 1 H. Bl. . 691 note; Solomon v. Ross 1 H. Bl. . 131; Ex Parte Blakes 1 Cox Cases in Eq. 398.
c Sill v. Warwick supra.

all attachments made by foreign creditors after such assignment, in a foreign country ought to be held invalid; fifthly, that at all events, a British creditor will not be permitted to hold the property acquired by a judgment under any attachments made in a foreign country after such assignment; and sixthly, that a foreign creditor, not subjected to British laws, will be permitted to retain any such property, acquired under any such judgment, if the local laws (however incorrectly upon principle) confer on him an absolute title!"^a

It is argued in support of the English rule, that it is the only one which can be effectual and give due recognition to comity. Any different system, which prefers an attaching domestic creditor to a foreign assignee, or to foreign creditors, can scarcely fail to bring on a retaliatory system of preferences in every other nation injured thereby.

The early cases in New York followed the English rule, Chancellor Kent deciding in three New York cases, that "It is a principle of practice among nations to admit and give effect to the title of foreign assignees. This is done on the ground that a conveyance under the bankruptcy laws of the country where the owner is domicile is equivalent to a

^a Story Conflict of Laws 572.

voluntary conveyance by the bankrupt."^a

In one of these¹ the learned Chancellor, after an exhaustive review of all the English cases on the subject, and commenting on the fact that in the case at bar the assignor, in addition to the assignment brought about by the bankruptcy act, had executed a voluntary assignment of all personal property "not being, arising, or growing in England, with the evident intention of precluding any question as to the foreign effect of the assignments, says: "This would seem to have removed every obstacle in the case. But I do not place much reliance on the distinction, and it does not appear to me to make any difference in the application of the principle whether he made the transfer himself or the law of his domicile for him. It is in either case, in the contemplation of the law, his act."

a Bird v. Caritat 2 John. 342
Ramond v Johnson 11 John. 488

1 Holmes v. Ransom 4 John. Ch. 460.

THE AMERICAN DOCTRINE.

As was set forth in the last Chapter, the general course of American authority in the early cases followed the law as laid down by the English Courts; but when the case of *Holmes v. Rensem*^a came before the N. Y. Court on a second appeal, a different rule was adopted, and Justice Platt in a very able arguments, dissented from the views of Chancellor Kent and laid down a new rule in the following words: "The assignees of the bankrupt are in the same and no better situation than the bankrupt himself in regard to foreign debts. They take subject to every equity and subject to the remedies provided by the laws of the foreign country where the debt is due, and when permitted to sue in a foreign country, it is not as assignees having an interest, but as representatives of the bankrupt. The law of the domicile having sequestered the bankrupt's estate so as to divest him of the control over it and appointed them to administer it, they stand here on the footing of administrators merely with the right of suing in common with other creditors; but our law will not regard a chose in action as exclusively appropriated to their use and the preference

a *Holmes v. Rensem* 20 John. 229.

can only be gained by pursuing the remedies which our laws afford".

The decision of Justice Platt was so well reasoned and its argument so sound that it has been followed in N. Y. and many of the other States and has come to be recognized as the American doctrine. The cases in this State have ever since uniformly sustained the rights of domestic attaching creditors against a title under a prior statutory assignment in another State or country, the several states of the union being treated for this purpose as foreign to each other^a. The departure in this country from the English rule with respect to the universal operation of assignments under foreign bankrupt laws upon all personal property, was mainly attributable to considerations effecting domestic creditors. Our own attaching creditors were to be preferred to any foreign assignees; so our local laws were to be defended and sustained as against those of any foreign state.

In defence of the American doctrine, it is admitted that the general rule is that personal property, including debts, has no locality but follows as to its disposition and transfer the law of the domicile of the owner. But this does not preclude any country from regulating as it pleases

^a Willets v. Wait, 25 N.Y. 577; Johnson v. Hunt, 23 Wend. 87; Kelly v. Crapo, 45 N. Y. 87.

the disposition of personal property found within it, and it may prefer its own attaching creditors to any foreign assignee. Then there is a marked distinction between a voluntary conveyance made by the assignor, and a conveyance by operation of law in cases of bankruptcy in invitum. The law does not force the assignor to make a conveyance; it does not coerce his will; it simply exerts its right to protect his creditors by stripping him of all the property within its reach and applying it to the payment of his debts. The law of any state or country applies only to persons or property within its jurisdiction, and can have no effect on what is without. By his own voluntary act he can divest himself of all his property without regard to place; the law can only take what it can reach having the strictest regard to place.^a

The American doctrine as laid down in *Holmes v. Rensem* has however been subject to much variation in the different states. It is apparent that the reason for the rule does not include foreign creditors domiciled in the state wherein the assignment originated, or even any creditors who are not domiciled in the state wherein the assignment is sought to be

^a *Holmes v. Rensem* 20 Johns. 229, 258, 259.

enforced. There would appear to be good reason why comity should recognize the title of a foreign assignee, as against foreign attaching creditors. This is held to be the law in several states and in the United States Courts. The latter courts have held that in a case where an assignment with preferences had been made in N. Y. by a resident of that State, a firm doing business in N. Y., one member of which was a resident of New Jersey, obtained an attachment in New Jersey against a debt due to the assignors. In an action brought by the assignors, for the benefit of the assignee to collect this debt, it was held that the attachment was no defence, the assignment being good as against any but New Jersey creditors, and the fact that a member of the New York firm was a resident of New Jersey did not bring the firm within the exception.^a So the Illinois Courts have held that an assignment with preferences executed in New York between citizens of that State, would be deemed a valid transfer of property in Illinois as against an attachment sued out by a resident of Massachusetts.^b

Some of the States while refusing to recognize the title

^a Halstead v. Strauss 32 Fed. 279

^b May v. First National Bank 11 West. 638.

of a foreign assignee, even in case of a voluntary assignment where it comes into conflict with the claims of domestic creditors,^a make a distinction where the domicile of the foreign assignee and the creditor are the same, and hold that in such case the latter will be bound by the title of the former, good by the law of the common domicile.^b The principle of comity in these states is held to apply so as to subject non-residents to the operation of the foreign law, but not so as to prevent domestic creditors from pursuing a remedy in defiance of the foreign assignment.^c

This would seem to be the most rational doctrine. The state, by providing that the rights of its citizens in relation to property within its jurisdiction, shall in no case be jeopardized by the laws of a foreign state, has fully protected their interests. Especially ought the courts of a state to deny access to attacking creditors from the state where the assignment was made. In England, a British creditor who thus seeks to defeat the operation of the law of

a Bentley v. Whittemore, 19 N. J. Eq. 462.

b Moore v. Barnell, 2 Vroom 90;
Sanderson v. Bradford, 10 N. H. 260;
May v. Wannemacher, 111 Mass. 202.

c Faulkner v. Hymen, 146 Mass. 53.

equality is treated as a trustee, and in an action by the assignee may be compelled to refund what he secured by attachment in foreign parts, or he may be restrained by injunction from proceeding against the estate of the insolvent in a foreign jurisdiction. But the New York Courts, and probably the weight of authority in this country, is against even this limited application of the doctrine of comity. To sustain and fortify the position taken for the protection of domestic creditors, the Courts have substantially shut out foreign assignees altogether. Chief Justice Marshall declared that the bankrupt law of a foreign country is incapable of operating a legal transfer of property in the United States^a. It has even been doubted whether the assignee may sue here at all but the better opinion is that he may: Not however as an assignee having an interest, but as a representative of the bankrupt^b.

The restrictions against foreign assignees have been gradually tightened in New York, and in 1885 the case of *in re Wait* came before the Court and Judge Earl, writing the opinion, after an exhaustive review of all the authorities, formulated three propositions which he concludes ex-

a *Ogden v. Saunders*, 12 Wheat. 174

b *Hibernia Bank v. Mechanics' &c.*, Bank. 21 Hun 166, 174.

press the doctrine of the Courts. The facts of the case were these: Wait was a member of a firm whose principal business was conducted in London, though he was a resident of New York City and a citizen of the State. In 1881 a firm in New York made an assignment, naming Wait as assignee and preferring the claim of the firm of which Wait was a member. Early in 1882 Wait went to England and in connection with his partner instituted a proceeding for the liquidation of their debts, which resulted in the Bankruptcy Court declaring Wait a bankrupt and appointing a trustee in bankruptcy to take charge of his estate. Wait continued as assignee of the New York firm and later returned to New York and paid to himself, as a member of the English firm, the amount of the preference. On the accounting, the justice of the claim was contested by the English trustee in bankruptcy of Wait's firm, who urged that the debt should have been paid to him.

The court sustained his claim though they seem even in that case to put the decision on the ground of estoppel. They say: "It matters not that Wait is a citizen of this country domiciled here. He went to England and invoked

and submitted to the jurisdiction of the Bankruptcy Courts there, and is bound by its adjudication to the same extent as if he had been domiciled there. The adjudication estopped him just as every party is estopped by the adjudication of a court which has jurisdiction of his person and of the subject matter".

The propositions of law which Judge Earl concludes are sound are as follows:

First, a Statute of a foreign state has no effect here of its own force. Foreign assignees in bankruptcy and insolvency have no standing here by virtue of the foreign Statutes.

Second; But comity allows a certain affect to title derived under foreign insolvent laws, provided they can be recognized without injustice to our own citizens, without prejudice to creditors pursuing their remedies under our laws, and provided they are not in conflict with public policy.

Third, subject to the above conditions foreign assignees may sue in this state.^a

a In re Waite 99 N. Y. 433.

The foregoing rules apply even where the assignment is made before the lien of the creditor is obtained in our Court. It will be noticed that in the above case there were no creditors whatever seeking a remedy against the property in our Courts. It was the bankrupt himself attempting to take advantage of our laws to defraud his creditors, and this, the Court declared it would not be a party to. This is the only case, however where the Court will permit the foreign assignee to recover in our Courts. In a late case decided in November 1893 it was held that Wisconsin creditors of a bankrupt firm assigned under the laws of that State could attach property of the firm in this State and such attachment would be good as against the assignee though subsequent in point of time.^a

Such is the law of New York, and such appears to be the American doctrine. Scarcely any of our States follow the English doctrine as laid down by the English Courts but scarcely any two agree as to the extent to which the American doctrine shall be applied. Pushed to the extreme limit the New York rule might work serious injustice to debtors of the bankrupt as for instance in the case of

a Barth v. Backus 140 N. Y. 230

Douglas v. Insurance Co.^a where the Insurance Company became liable to a bankrupt residing in Massachusetts for a risk incurred in New York. Two actions were brought against the Insurance Company; one in Massachusetts by the assignee of the bankrupt; and one in New York by a creditor seeking to attach the debt. The New York Courts held that the Massachusetts action constituted no bar to the attachment, as according to our interpretation, no action of the Massachusetts law could transfer from the bankrupt the title to a chose in action situated in New York. It said: "The legal proceedings or judgments of another state are recognized here only where jurisdiction has been acquired according to the course of the common law in the foreign forum; and this although the Statutes of that state purport to give its courts jurisdiction, in disregard of the principles and rules of general jurisprudence, which this state is bound to recognize." Thus it seems that under such circumstances the debt might be collected in both jurisdictions. Just how the Courts will correct this manifest injustice, whether by modifying the rule, by equitable intervention

a Douglas v. Insurance Co., 138 N. Y., 209.

or by some other means remains to be seen.

Francis E. Wood

