South Carolina Law Review

Volume 6 | Issue 1 Article 7

Fall 9-1-1953

Remedies of a Creditor for Setting Aside a Fraudulent Conveyance with Recommendations for Changes

Robert DuPre

NOTES

REMEDIES OF A CREDITOR FOR SETTING ASIDE A FRAUDULENT CONVEYANCE WITH RECOMMENDATIONS FOR CHANGES

Introduction

Alienations in fraud of creditors are a prolific source of contention in our courts and have been the subject of frequent legislative supervision. In introducing the subject of what remedies are available to a creditor in his attempt to reach these secreted assets, it is well to first trace the development of the legislative action and court decisions concerning these remedies.

The tendency of legislation has been to prevent unfeeling creditors from oppressing or punishing a debtor for his poverty,[1] but a strong purpose is manifested in the more recent statutes and decisions of the courts to enlarge and strengthen the creditor's remedies against the property of his debtor.[2]

Fraudulent alienations of property were of a very early origin. A provision in the Magna Charta is sometimes spoken of as one of the original sources of written law against fraudulent transfers. The article provided that no freeman should give or sell away his lands so that no residue would remain to the lord of the fee, out of which the service pertaining to the fee might be enforced.[3] Then came the statutes of Richard II, Edward III, and Henry VII, all containing provisions aimed at fraudulent debtors. The most famous and important statutes against fraudulent conveyances is that of 13 Elizabeth,[4] largely re-enacted by 29 Elizabeth.[5] These statutes in express language declared void all conveyances intended to defraud creditors. The import of the statutes is that the conveyances would be valid in respect to all other parties. In the United States, the statute of Elizabeth has in practically all the states been either recognized as a part of the common law or expressly enacted in more or less similar terms.

By far the leading case on fraudulent conveyances coming down after the Statute of Elizabeth, and around which have sprung up some of the most conspicuous principles governing modern fraudu-

1. Stevens v. Merrill, 41 N. H. 309, 315 (1860).
2. Meredith v. Thompson, 4 Alaska 360, 370 (1906).
3. MAGNA CHARTA, June 19, 1215.
4. St. 13 Eliz. c. 5, 1570.
5. St. 29 Eliz. c. 5, 1587.

lent transfers, was *Twyne's Case,* decided in 1601.[6] That conveyance was set aside as fraudulent because there was a general gift where the donor continued in possession and maintained a secret trust with the donee.

The basic principles of *Twyne's Case* are still applied today, though the transfers have become more involved.

Form of Remedies

In general, the creditor has three possible courses to follow where the property has been fraudulently conveyed. These three remedies are available in South Carolina and in those other states not having the Uniform Fraudulent Conveyances Act, which will be discussed later in this article. First, the creditor may treat the property as that of the transferor and levy execution thereon, leaving the purchaser to contest the title. Secondly, he may bring an action in equity to set aside the conveyance as a cloud on his right to levy execution, and have the transfer cancelled. Then the creditor would levy in the usual way. Lastly, but probably the most frequent used, is the judgment creditor's bill which is brought to set aside the conveyance, then have the property sold by the receiver (if one exists), and the proceeds applied to the payment of the judgment.

Next, it is important to consider what the courts have required the creditor to do in order to take advantage of these remedies. The leading case in South Carolina and one which includes a comprehensive view of the situation as it stands today is the case of *Temple v. Montgomery,*[7] decided in 1930. One of the issues involved was whether a creditor must exhaust his legal remedies before applying to the court to have the conveyance set aside. More precisely, must there be a return of a *nulla bona* after an execution. It was settled in that case that in a creditor's action to set aside a debtor's deed for legal fraud, an allegation and proof that the debt was reduced to a judgment and a *nulla bona* returned on execution is essential. Conversely, in an action to set aside a deed based on actual fraud, no *nulla bona* was necessary nor a showing that the debt was reduced to a judgment. The *Temple* case defines legal fraud as constructive, unintended fraud and actual fraud as that which is positive or intended. Quoted in the *Temple* case as part of the rationale in that instance was an opinion of Mr. Justice McIver in *Jackson v. Lewis*[8]

6. Twyne's Case, 3 Coke 80 a, 76 Reprint 809, 5 ERC 2, 1 Smith's Lead. Cas. 1, 18 Amer. Law. Reg. N. S. 137 (1601).
7. Temple v. Montgomery, 157 S. C. 85, 153 S. E. 640 (1930).
8. Jackson v. Lewis, 34 S. C. 1, 12 S. E. 560 (1891).

saying: ". . . a voluntary deed [without consideration] may be set aside at the instance of a creditor upon the grounds of constructive or legal fraud even where there is not the slightest taint of actual or moral fraud in the transaction, under the principle that the law requires that one must be just before he is generous."

The creditor's bill, though the most commonly-used remedy is not an ideal one. In using a creditor's bill a domestic judgment is necessary except where it is impossible to get jurisdiction for a domestic judgment.[9]

In a further examination of the cases we find that where there was an action to set aside an assignment for the benefit of creditors, only those creditors who had sued out on their judgment and had a *nulla bona* returned were entitled to institute the action.[10] In an action to set aside a deed from husband to wife, an allegation of a *nulla bona* return was held not necessary.[11] The strongest authority against the necessity of a *nulla bona* return is perhaps the case of *Burch v. Brantley,*[12] in which Justice Simpson lumps all fraud in one category, saying: "An allegation of *nulla bona* return is unnecessary, but for a creditor to vacate a conveyance based on fraud, he must allege and prove that fraud existed, but a return of a *nulla bona* constitutes no part of such fraud."

Where Fraudulent Grantee Has Conveyed to Innocent Purchaser

The creditor can levy an attachment only on the identical property which the grantee has received under the fraudulent conveyance.[13] The question of what remedy is available to a creditor where the debtor's fraudulent grantee has disposed of the property to an innocent purchaser is an open one in most jurisdictions. It is widely accepted that once the fraudulent grantee has done this, neither the property itself nor the proceeds of the property received in exchange nor property in which the proceeds are invested are subject to attachment, in the absence of statute.[14] Some cases have vaguely alluded to a remedy in equity, but the authorities seem to have left the creditors to whistle for their money in this event.

Uniform Fraudulent Conveyances Act

In twenty states, not including South Carolina, the Uniform Frau-

9. Penning v. Reid, 166 S. E. 139 (S. C. 1932).
10. Rytenberg v. Keels, 39 S. C. 203, 17 S. E. 441 (1893).
11. Dennis v. McKnight, 161 S. C. 209, 159 S. E. 555 (1931).
12. Burch v. Brantley, 20 S. C. 503 (1883).
13. Post v. Bird, 28 Fla. 1, 9 So. 888 (1891); Accord: Rutledge v. Evans, 11 Iowa 287; Lanning v. Streeter, 57 Barb. N. Y. 33.
14. Post v. Bird, Note 13 *supra.*

dulent Conveyances Act has been adopted. This act as it has been applied in those jurisdictions, and by its language, is considerably more advantageous to the creditor than the law in effect elsewhere.

Briefly, there is one provision of the Act which differs materially from that which is required in other jurisdictions in order to have a conveyance set aside. Section 5 of the original Act embodies the following provision: "Every conveyance made without fair consideration when the person making it is engaged *or about* to be engaged in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business without regard to his actual intent."[15]

Now the question logically presented is, does this act enhance or impair the remedies of the creditor? In Minnesota where the act is in force this question has been presented. The issues arose around two troublesome problems confronted frequently by creditors in the past. They were: (1) Could the plaintiff have assailed the transfer before he obtained a judgment, and if so, was he obliged to pursue such a course under penalty of the statute of limitations running from the time the transfer could first be impeached? (2) Does the act abolish the time-honored practice of securing judgment and having execution returned unsatisfied before bringing suit to set aside a fraudulent conveyance?[16] The court answered saying:

> The definition of creditor [under their act] is clearly broad enough to embrace a party without a judgment. Section 8484[17] grants to a creditor whose claim has not matured the right to apply to the court to set aside a fraudulent transfer by his debtor. Obviously such a proceeding could not be predicated upon a judgment. It does not seem sensible to say that a creditor whose claim has matured should be in any less advantageous position. The whole purpose of the enactment is aimed at the dishonest debtor and seeks to provide an orderly, efficient, and speedy remedy for the creditor.

In New York, Chief Judge Cardozo in a case very similar in its issues to the Minnesota case applies the Act in the same way. "The uniform act in its definition of a creditor seeks a rule of uniformity,

15. § 5, Uniform Fraudulent Conveyances Act. The Uniform Laws. Emphasis supplied.
16. Lind v. Johnson, 204 Minn. 30, 282 N. W. 661 (1938).
17. MSA SS 513.20-513.32, MINN. LAWS.

and in so doing levels distinctions that at times have been the refuge of the dilatory debtor."[18]

The Minnesota court proceeds and the fury seems to mount against the dilatory debtor. "After all the fraudulent grantor cannot complain, for as to him the obligation is a subsisting one until the statutory period has run against the judgment. As to his grantee, who holds only an apparent title, a mere cloak under which is hidden the hideous skeleton of deceit, the real owner being the scheming and shifty judgment debtor, what reason has he to complain when the six year statute giving repose to the remedy has not expired since the entry of judgment."[19]

There is authority to the effect that a judgment at law is a prerequisite to a proceeding in equity under the Act,[20] but *American Surety Co. v. Conner* is the leading authority to the effect that a judgment at law is unnecessary to attack under the Uniform Act,[21] and is generally followed in most jurisdictions.

Conclusion

In a field as broad as fraudulent conveyances, with the always conflicting interests of the debtor on one hand and the creditor on the other, there is to be expected a constant search by the debtor for legal and sometimes illegal means of placing his assets outside the reach of his creditor. Add to this the shift of economic tides when the class of debtors may either be subjected to harsh criticism for their attempts to emerge from a given transaction with something more than their proverbial shirts, or when they may be the beneficiary of a rush of public sympathy for their plight. Meanwhile the creditors' purpose, and logically so, is to reach these secreted assets. He must conform to the proper procedure and avoid the pitfalls that will surely be placed in his course. It has been seen that the rights or remedies available to a creditor in this jurisdiction and those others not having adopted the Uniform Fraudulent Conveyances Act are limited to three, and in each there are certain difficulties which can prevent him from accomplishing his purpose. One is that generally only existing creditors can attack a conveyance as fraudulent. Subsequent creditors may attack if they can show an actual intent to defraud them also. A creditor must examine the type of fraud employed in the transfer, as he would be required to exhaust his legal

18. American Surety Co. v. Conner, 251 N. Y. 1, 7, 166 N. E. 783, 785 (1929).
19. Lind v. Johnson, note 16 *supra*.
20. Lippman v. Manger, 185 Wis. 63, 200 N. W. 663 (1924).
21. American Surety Co. v. Conner, note 18 *supra*.

remedies and show a *nulla bona* return in the case of constructive fraud and will find it necessary if he could show actual fraud. The creditor proceeds at his peril on this point.

Only under the Uniform Fraudulent Conveyances Act is there a positive course which the creditor may follow, and from this standpoint alone it is highly desirable. The inference is that the other jurisdictions would do well to adopt this Act, but there are certain other vital considerations involved. The conclusion follows naturally that the effectiveness of the remedies available to the creditor are in jurisdictions not having the Uniform Act severely limited by unnecessary formal requirements, and on the basis of that we find the creditor in something less than an enviable position, once his debtor has made his questionable transfers.

Recommendations

Since it is by no means definite or certain what remedy it is best for a creditor to choose in setting aside a fraudulent conveyance in South Carolina and a number of other jurisdictions, some legislation establishing a well-defined course is needed. The Statute of Elizabeth goes no further than to declare certain transfers void. The Uniform Fraudulent Conveyances Act is ideal in some respects, yet contains language which in effect can make it very risky for anyone owing obligations, or about to engage in business with small capital, to convey anything, regardless of motive. That means that the motives of the debtor are impugned, and a valid gift could later be attacked, by one not a creditor at the time of the gift. Therefore, in drawing up a statute which could clarify the situation, the legitimate interests of debtors and creditors should be carefully weighed. Every effort should be made, however, to divorce the proposed act from prejudices against or sympathies for either debtors or creditors as a class. Proceeding from there, it would seem wise to draw the act along the general lines of the Uniform Act, modifying certain sections and incorporating the Statute of Elizabeth. The prime consideration should be to prescribe a course for the creditor to follow, keeping in mind the decisions of the courts and the workability of the proposed statute.

It is difficult to specifically recommend this or that change in the law as it has been laid down, since the quarrel is not with the law but with the fact that it is far from clear to the creditor what procedure he must or should follow in setting aside the conveyance. So

the recommendation is, stated simply, "Show him the way." Set out a form of procedure which he can follow, codifying the transfers made void by the Statute of Elizabeth and the remedies used in the Uniform Fraudulent Conveyances Act.

ROBERT DUPRE.