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CREDITORS' RIGHTS AND SECURITY TRANSACTIONS—1958 TENNESSEE SURVEY

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Fraudulent Conveyances: In *Nashville Milk Producers, Inc. v. Alston*[1] a bill to set aside transfers of a herd of dairy cattle alleged that the debtor in 1953 purported to transfer the herd to his wife, and that in 1955 the wife purported to transfer the herd to their son. Both transfers were alleged to have been made for no consideration, or a consideration that was not fair and adequate. The bill also charged that the conveyances rendered the grantor insolvent, and were part of a general scheme participated in by all three defendants to hinder, delay and defraud existing and subsequent creditors. Defendants' answer consisted solely of denial of the charges of fraud and lack of consideration, and gave no explanation of the transfers. None of the defendants testified, and no evidence was introduced on their behalf. It was stipulated that bills of sale were never recorded, and defendants' counsel admitted he did not know whether the sales were evidenced by written instruments. Complainant's evidence established his claim for a feed bill incurred in 1954, that debtor was lessee of the farm on which the herd was at all times kept, and that the herd was under the control and management of the debtor after the alleged transfers.

On these facts the chancellor dismissed the bill insofar as it sought to set aside the transfers as fraudulent. He ruled that the conveyance in 1953 was not fraudulent in law as to complainant because his debt was not then in existence, that the 1955 conveyance was not fraudulent as to complainant because the grantor was not indebted to him, and because the proof did not establish insolvency.

The court of appeals modified the chancellor's decree and set aside the conveyances, holding that the failure of defendants to introduce evidence to dispel the suspicion of fraud required the relief sought. Several earlier Tennessee decisions are cited in support of this holding.

The result reached by the court seems sound and clearly sustainable under section 5 of the Uniform Fraudulent Conveyance Act, which provides that every conveyance made without fair consideration by one engaged in business for which the property remaining in his hands, after the conveyance, is an unreasonably small capital, is fraudulent as to persons who become creditors during continuation of

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1. 307 S.W.2d 66 (Tenn. App. M.S. 1957).

such business, without regard to actual intent.[2] (It should be noted that Tennessee Code Annotated section 64-313 reads ". . . during the continuance of such *business transaction* without regard to his actual *interest,*" instead of "during the continuation of such business *or* transaction without regard to his actual *intent*" as it is in the Uniform Act.) (Emphasis added.)

Unfortunately, the exact basis of the decision remains uncertain, and the opinion contains language which may cause future confusion. The opinion notes the existence of the statutory sections dealing with conveyances by persons engaged in business, and by those contemplating incurring debts beyond their ability to pay, but gives no indication of reliance upon them.[3] As the chancellor found the proof did not establish insolvency, and this finding is not set aside by the court, the decision seems to stand as one finding actual intent to hinder, delay or defraud creditors.

In reaching its decision the court apparently relies to some extent upon continued possession by the seller as constituting prima facie evidence of fraud, as the opinion cites several cases to that effect. But principal emphasis in the opinion is on the failure of the defendants to testify and explain the transactions questioned. In this connection there is stressed the fact that the answers were not sworn to, and that persons charged with fraud but not guilty thereof are eager to give an explanation that will remove suspicion. It is not clear, at least to this writer, whether the court held that the failure of defendants to testify created a presumption of fraud which was not rebutted, or whether the failure to testify was significant because as a result thereof defendants failed to discharge an evidential burden cast upon them, or both. The concluding part of the opinion indicates that it was failure to discharge an evidential burden which caused the court to hold as it did.[4] But the nature of this burden is left uncertain. The opinion first cites an earlier decision[5] to the effect that:

> Where fraud is involved and complainant introduces proof casting suspicion on the transaction, defendant charged with fraud has the burden of proceeding with the evidence to overcome the suspicion, and when this is done the burden of proof continues on complainant.[6]

The opinion then states:

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2. Although no Tennessee decision has passed upon this question, farming has been treated as a business in other states. Holcomb v. Nunes, 132 Cal. App. 2d 776, 283 P.2d 301 (1955—cattle farm); Wolfkill v. Johnson, 34 Wash. 2d 759, 209 P.2d 775 (1949—chicken farm).

3. 307 S.W.2d at 70.

4. *Id.* at 72.

5. General Contract Purchase Corp. v. Conner, 23 Tenn. App. 1, 126 S.W.2d 347 (1938).

6. 307 S.W.2d at 71.

> Where a complainant seeking to set aside conveyances by a husband to his wife, introduced evidence casting suspicion upon the transaction and warranting a suspicion of fraud, the burden of proof shifts to the defendant.[7]

It is difficult, too, to understand what the court had in mind when it stated: "The opinion in Churchhill v. Wells, 47 Tenn. 364, expresses the rule that is particularly applicable here." The opinion then quotes from the Churchhill opinion to the effect that a conveyance made on the eve of incurring an indebtedness, from property on which creditors rely, is fraudulent, and quotes further:

> . . . such conveyance is not relieved from its fraudulent character by the fact that it has been registered, if the creditor has no actual notice, and the conveyance, without his negligence, operates as a surprise on him.[8]

The court's inclusion of this statement seems odd both because it is inconsistent with a recent decision of the Tennessee Supreme Court,[9] noted in last year's survey,[10] which held that registration of a fraudulent conveyance protected it against subsequent creditors, and because it is clear in the instant case the conveyances were never registered.[11]

The opinion does reveal facts which could raise the question of the duty of a subsequent creditor to inquire as to whether or not a conveyance had been made.[12] After first stating that the complainant did not hear of the transfers until after the extension of credit, the opinion notes that the agent of complainant knew, at the time the debt was incurred, that the milk account, as carried on the books of the Federal Milk Market Administrator, had been changed to the wife and later to the son. The agent inquired of the debtor as to the reason why the name of the account was in the name of the son, and testified that he was told "it was all right as it was still in the family and that it was done merely to keep his son out of military service." Although such knowledge by complainant's agent might well be deemed to require further inquiry than was made, the opinion makes no mention of this as a factor in the decision.

Two other cases dealing with fraudulent conveyances are more routine. *Gemignani v. Partee*[13] involved questions primarily of fact. Four pieces of property were involved. The jury found that the debtor did not "directly or through the instrumentality of other persons, transfer or convey, without adequate consideration, any

7. *Ibid.*
8. *Id.* at 72.
9. Butler v. Holland, 289 S.W.2d 701 (Tenn. 1956).
10. Hartman, *Creditors' Rights and Security Transactions,* 10 VAND. L. REV. 1058 (1957).
11. 307 S.W.2d at 69.
12. *Id.* at 68-69.
13. 302 S.W.2d 821 (Tenn. App. W.S. 1956).

assets or property owned by him."[14] The chancellor also made findings of fact, including findings that three of the four properties had not been the subject of fraudulent transfer. The court of appeals held that one of the three had been fraudulently conveyed, and modified the decree so as to subject debtor's interest therein, as a tenant by the entirety, to the creditor's judgment.

The real property found to have been fraudulently conveyed was, at the time of an auto accident which lead to suits against the debtors for a large sum, in the possession of debtor and his wife under a contract to purchase. Thereafter debtor caused the deed to be executed to his wife alone. In invalidating this transfer, the court said their conclusion did not conflict with the jury's finding because "it does not appear that the jury ever found . . . that on June 8, 1949, Ed Partee was the equitable owner of an estate by the entirety in said . . . property. . . ."[15] The jury had found, however, that no "assets" had been fraudulently conveyed.

The decision is further recognition of the Tennessee law that the interest of a tenant by the entirety may be sold in satisfaction of a judgment.[16]

In *Beaty v. Hood*[17] the chancellor's determination that no fraudulent conveyance had been made was affirmed largely because the record on appeal was so meager and incomplete the court could not tell whether there had been a compliance with statutory requirements as to recording, or even whether the alleged fraudulent grantor had ever even owned the property in question.

Motor Vehicle Title Registration Law: Manufacturers Acceptance Corporation v. Vaughn,[18] applying the Motor Vehicle Title Registration Law[19] to an involved factual situation, is especially noteworthy to auto dealers and finance companies. One Cookston traded in an auto to a dealer, Gentry, apparently without executing even a bill of sale. The certificate of title was not assigned because it was in the possession of a lien holder, General Motors Acceptance Corporation. Gentry then sold the auto to Vaughn, giving Vaughn a bill of sale and taking from him a title retention note. Gentry having paid the amount owed by Cookston to G.M.A.C., G.M.A.C. forwarded the title certificate to Cookston with a statement showing satisfaction of the lien. Vaughn obtained the certificate from Cookston's wife, and procured another

14. *Id.* at 823.
15. *Id.* at 829.
16. Hartman, *Creditors' Rights and Security Transactions,* 10 VAND. L. REV. 1058, 1071 (1957).
17. 306 S.W.2d 671 (Tenn. App. M.S. 1957).
18. 305 S.W.2d 513 (Tenn. App. M.S. 1956).
19. TENN. CODE ANN. §§ 59-101 to -608 (1956).

to forge Cookston's name assigning the title certificate to Vaughn. This forgery was in the presence of a notary public, who did not swear the forger. Vaughn then applied for a transfer of title to himself. He took a copy of the application for a title to Manufacturers Acceptance Corporation who loaned him $1000, and took his copy of the application. Gentry never registered his lien with the Motor Vehicle Division, and Manufacturers did not register until more than three weeks after making the loan. Meanwhile the Division sent to Vaughn a certificate showing no encumbrances, and on the strength of this Southern Acceptance Corporation made a loan to him. Southern promptly forwarded the certificate and their lien to Division for registration, which was accomplished before Manufacturers lien notice was received by the Division. Thereafter Vaughn returned the auto to Gentry, and was given a release of title retention note. Manufacturers then brought a replevin action against Gentry and Vaughn, and Gentry filed a cross-bill bringing in G.M.A.C., Southern, the notary public and the notary's surety. The chancellor held that Southern's lien had first priority, and that neither G.M.A.C. nor the notary was liable to Gentry or Manufacturers. This decision was affirmed on appeal.

The superiority of Southern's lien seems clear. Tennessee Code Annotated section 59-326 expressly provides that no lien or title retention shall be valid against subsequent encumbrancers without actual notice until the requirements of the registration law shall have been complied with. Section 59-327 provides that filing of notice of lien with the Motor Vehicle Division and notation upon the certificate of title shall be the exclusive method of giving constructive notice of encumbrances upon titles to autos.

Gentry and Manufacturers contended that G.M.A.C. was negligent in forwarding the title certificate to the original owner, Cookston. With respect to this claim, the court held G.M.A.C. not to be liable because of Gentry's contributory negligence, because the certificate showed Cookston as owner and the statute makes it the duty of the lien holder to return the certificate to the owner upon satisfaction of the lien, because the cross-bill was never amended to set forth the position relied on at the hearing, viz.—that Gentry had specifically requested G.M.A.C. to forward the certificate to it—and finally, that intervening independent causes made the loss possible.

As to the notary public, who admitted he did not know the forger and did not formally swear him, the court said it was unable to say he failed to exercise ordinary care in identifying the man who signed Cookston's name, and that a notary is not an insurer of the truth of the recitals. As to the omission of swearing the signer, it was stated

that this would not have ferreted out the fraud, and was therefore not the proximate cause of the loss.

Highway Construction Bond: Thompson & Green Machinery Co. v. M. P. Smith Const. Co.[20] presented the question of whether rental of road-building equipment was covered by Tennessee Code Annotated section 54-519, which requires contractors with the Department of Highways to give bond for the payment "for all materials purchased and for all labor employed." It is also an illustration of the not uncommon practice of lower courts suggesting reconsideration of earlier decisions by which they are bonnd.[21] The chancellor held that earlier decisions of the supreme court required the conclusion that equipment rental was covered,[22] although he observed that if this were a question of first impression he would have no hesitancy in holding such rental payments to be not covered. The court of appeals affirmed, stating:

> We concur in the conclusion of the Chancellor that these decisions are controlling and, unless and until our Supreme Court modifies, distinguishes or reverses this line of decisions we feel bound thereby.[23]

An uncontested consequence of the decision that such claims were covered by section 54-519 was that the claims were payable out of the amounts retained by the Highway Commissioner, pursuant to section 54-521 *et seq.*

Mechanic's Lien Law: An interesting situation developed in two cases involving the Mechanics Lien Law. In *Chattanooga Lumber & Coal Corp. v. Phillips*[24] a materialman filed a bill to enforce a mechanic's lien against the contractor, owner, and trustee under a deed of trust. The bill sought sale of the property to satisfy the debt, and that "the rights, interests and priorities be fixed and declared by the court." Lienor claimed that as the first delivery of materials was prior to registration of the deed of trust, the mechanic's lien was superior thereto. The owner demurred to the bill on the ground that the lien claim, filed as an exhibit to the bill, showed on its face it was not acknowledged as required by Tennessee Code Annotated section 64-2201, and therefore was not entitled to registration. The demurrer was sustained and the bill dismissed, and this action was affirmed by the supreme court.

The materialman contended that a notice of lien did not require

20. 311 S.W.2d 614 (Tenn. App. M.S. 1957).

21. *E.g.*, Maggio v. Zeitz, 333 U.S. 56 (1948).

22. See Harris, Inc. v. Cincinnati, N.O. & Tex. P. Ry., 198 Tenn. 339, 280 S.W.2d 800 (1955); Nicks v. W. C. Baird & Co., 165 Tenn. 89, 52 S.W.2d 147 (1932).

23. 311 S.W.2d at 618.

24. 304 S.W.2d 82 (Tenn. 1957).

acknowledgment for registration, and that as against the owner registration is not required. In its opinion the court stated:

> It cannot be doubted but that the claim of lien must be *acknowledged* in compliance with the statute, otherwise it is ineffective for any purpose.[25]

At other places in the opinion, however, the court indicated that acknowledgment was required to be valid against the holder of the deed of trust.[26] This latter language seemed anomalous, however, because the contentions of the materialman, as set out in the opinion, revealed it sought recoguition of the lien against the owner, and the chancellor's action, affirmed by the supreme court, denied validity to the lien even to this extent.

Interpreted as a decision requiring acknowledgment and registration for a mechanic's lien to be effective against the owner of the property subject to the lien—and such an interpretation was seemingly required by the effect of the holding—the *Chattanooga Lumber* case was contra to several earlier decisions,[27] at least one of which was cited in the opinion. It was not surprising, therefore, that within a year thereafter this issue was again before the court. *Streuli v. Brooks*[28] presented substantially the same factual situation as in *Chattanooga Lumber,* the only material difference being that the lienor's bill acknowledged superiority of a deed of trust registered after the materialman's lien. On the authority of *Chattanooga Lumber,* the chancellor sustained the owner's demurrer to the bill on the ground that notice of the lien was not properly registered. The chancellor noted that he could not reconcile the *Chattanooga Lumber* case with earlier cases.

The supreme court in the *Streuli* case reversed the decree sustaining the demurrer, and held that under Tennessee Code Annotated section 64-1112 registration is not necessary to the preservation of a furnisher's lien as between the owner and the materialman. With respect to the *Chattanooga Lumber* case, the court admitted that:

> Technically, the issue presented in the Chattanooga case was whether the furnisher had a furnisher's lien against the owner . . . because of the fact that he, the furnisher, had failed to register, in legal contemplation, notice of its claim. That this was the issue, technically, must be recognized by the fact that the Court was acting upon the demurrer of the owner. . . .[29]

However, the opinion states, in that case "battle was so earnestly waged" over the issue of priority as between the deed of trust and the

25. *Id.* at 85.
26. *Id.* at 86.
27. Green v. Williams, 92 Tenn. 220, 21 S.W. 520 (1893); Reeves v. Henderson, 90 Tenn. 521, 18 S.W. 242 (1891).
28. 313 S.W.2d 262 (Tenn. 1958).
29. *Id.* at 263.

furnisher's lien "as to cause this court to overlook the entire question presented. . . . Thus, by this inadvertence, the court limited its consideration to the question of priority. . . ."[30] The opinion continues:

> . . . this Court's limitation of the question actually considered and decided must be recognized, and the language used in the opinion given effect only within that limitation. Thus, it is the Chattanooga Lumber and Coal Corporation v. Phillips, supra, is not authority for the proposition that, as against the owner of the premises, registration of the furnisher's claim notice is a statutory prerequisite of the preservation of the furnisher's lien.[31]

The net result of the two decisions apparently is, therefore, that registration is not required for preservation of a mechanic's or furnisher's lien as between the lienor and the property owner. However, for such liens to be valid against subsequent purchasers or encumbrancers for valuable consideration without notice, registration is required, and valid registration includes authentication as provided in Tennessee Code Annotated section 64-2201.

Black v. Boyd[32] is an interesting decision, although it does not present a question of Tennessee law. A creditor of a bankrupt debtor filed an action in the Federal District Court for the Western District of Tennessee against the trustee in bankruptcy, alleging that the debtor had obtained $2,699,491 by fraud and under such circumstances as to make the debtor a constructive trustee. Joined as defendant was a bank to which said sum was paid in satisfaction of a pre-existing debt, the complaint alleging such knowledge by the bank as to make it also a constructive trustee. The trustee filed an answer, and also a cross-claim against the bank alleging that the payment to it constituted a recoverable preferential transfer. Both the bank and the trustee demanded jury trial of the issues raised by the complaint and cross-claim, but upon motion by the creditor the district judge struck both demands for jury trial. As the order denying jury trial was interlocutory and not immediately appealable,[33] both bank and the trustee petitioned for a writ of mandamus directing vacation of the order denying jury trial, claiming that the order was a denial of the right to a jury guaranteed by the seventh amendment.

The court of appeals issued the writ directing jury trial as to the issues raised by the cross-claim. In its opinion, the court re-affirmed the principle that mandamus was available only in exceptional and extreme situations, and that it could not be utilized simply because its denial "may require the aggrieved party to undergo a lengthy, costly

30. *Id.* at 264.
31. *Ibid.*
32. 248 F.2d 156 (6th Cir. 1957).
33. City of Morgantown v. Royal Ins. Co., 337 U.S. 254 (1949).

and inconvenient trial, which might be avoided by a review of the interlocutory order."[34] But relying on earlier supreme court decisions, principally *Ex parte Simons*,[35] it was held that denial of a right to jury trial presents such an exceptional situation as to call for the issuance of a mandamus to review the ruling.

Relief was restricted to the issues raised by the cross-claim, because the creditor's action sought rescission and the imposition of a constructive trust, and this action being equitable, jury trial is not a matter of right. But an action by a trustee in bankruptcy to recover as a voidable preference a sum of money paid by the bankrupt to a creditor before bankruptcy, is an action at law.

The court also held that the trustee did not waive a right to jury trial by filing in an equitable action his cross-claim for affirmative relief, stating that the older rule holding a waiver resulted in this situation was changed by the rules of civil procedure.[36]

34. 248 F.2d at 159.
35. 247 U.S. 231 (1918).
36. 248 F.2d at 163, citing six decisions in support of this ruling.