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# The Rights and Liabilities of a Fraudulent Grantee

Edmond C. Alger  
*Cornell Law School*

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For the Degree of Bachelor of Laws.

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The Rights and Liabilities of a Fraudulent Grantee.

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Edmond C. Alger.

Cornell University, 1893.

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The earliest remedies of creditors in a crude legal system were always against the person and not the property of the debtor. 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 release.

Finally, the remedies against the person were taken away and a complete system for annulling fraudulent transfers and securing the debtor's estate for creditors was provided by 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 as a threat against the debtor's person to prevent fraudulent transfers; but its operation was 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: This occasioned the passage of the statute 13th. of Elizabeth and others.

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 of how to neutralize the fraudulent transfers which it has ceased to prevent.

New York has been highly conservative in her policy in this matter and one of the slowest to make advances toward the invalidation of conveyances to defraud creditors. The Statute of 13th. Elizabeth is the foundation of all the modern law of fraudulent conveyances; and New York and the other various states have passed statutes which are substantially the same as the English statute.

The provisions of the New York statute are to be found in the 8th ed. Rev. Stat. p. 2592, and are substantially as follows---

sec. 1.--Every conveyance or assignment in writing or otherwise of any estate or interest in lands, goods, or things in action.....made with intent to hinder, delay or defraud creditors or other

persons of their lawful suits, damages, forfeitures, debts or demands.....as against the persons so hindered, delayed or defrauded, shall be void.

sec. 4.-- The question of fraudulent intent shall be deemed a question of fact and not of law; nor shall any conveyance or charge be adjudged fraudulent as against creditors or purchasers solely on the ground that it was not on a valuable consideration.

sec. 5.--- These provisions 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.

The principle upon which this legislation is founded and toward which all the courts are working is 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 payment of its owner's

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.

The idea in setting aside a transfer as fraudulent is to so place the property that the creditors will in no way be damaged by the transfer: it is not that the creditors should gain by such fraudulent transfer, or on the other hand that the fraudulent grantee should be punished: In other words, the position of the creditors in regard to the debtor's property should be just as though there never had been a transfer.

As a result of sec. 5 of the statute and various decisions, we see that in the case of a voluntary conveyance it is not necessary to prove a fraudulent intent on the part of the grantee, but only to show intent to defraud or circumstances which in law amount to such intention on the part of the grantor alone: this is because the grantee is not a purchaser for value. In cases of conveyances

for value, it must be shown that the grantee participated in the intent of the grantor to hinder, delay or defraud the creditors, and acted in furtherance of such intent. The tendency of the courts of this state is to regard the debtor's property as a trust fund for the benefit of his creditors and any attempt to deplete this fund will be rendered ineffectual as far as possible without interfering with the rights of third persons not parties to the fraud.

Who may impeach the transfer?

The statute was designed solely to protect the rights of creditors, and consequently it renders a fraudulent transfer void only as against them, and makes no provision whatever in regard to its effect between the parties. A conspiracy to defraud creditors is an offence against good morals, common honesty and sound public policy; so therefore, it is a proper case for the application of the maxim "In pari delicto melior est conditio defendentis".

The principle that such a contract binds the parties to it is a principle which commends itself



no less to the moralist than to the jurist, for no dictate of duty calls on the judge to extricate the rogue from his own toils. On any other principle, a knave might gain but could not lose by a dishonest expedient, and inducements would be furnished to unfair dealing if the courts were to repair the accidents of an unsuccessful trick.

A fraudulent transfer is good as against the grantor, his heirs, executors, administrators, parties claiming under him and his vendees and grantees. In fact, the title of a fraudulent grantee is <sup>good</sup> not only as against the debtor, but it is also good against all parties except creditors and their representatives. It is voidable only at the suit of creditors and if no creditor interposes and complains, the transfer is as binding and effectual to pass the title as if made with the best of intents and for the most innocent and commendable purposes.

But not only must a person be a creditor in order to put in controversy the bona fides of a sale of goods, but the character in which the attacking party prosecutes the action and claims to overthrow the sale or conveyance must be settled and put at rest by a judgment of decree of a competent court.

The same principles of policy which require that a fraudulent transfer shall be held valid as between the parties also demand that no aid or relief shall be granted for the enforcement of any agreement arising out of a fraudulent transaction. The suppression of fraud is far more likely in general to be accomplished by leaving the parties without remedy against each other.

In discussing the question as to what amounts the fraudulent grantee is entitled to upon a conveyance being set aside as fraudulent, we shall, for the sake of convenience, consider the subject, dividing it into the following classes, which although we have nowhere seen the division so made, yet we think will be consistent with all of the decisions upon the subject. We will consider

1st.- Where the fraudulent grantee is asking for the active interference of some court for his protection, or for his reimbursement for improvements, or for moneys paid in pursuance of the fraudulent arrangement, or to discharge incumbrances; and

2d.- Where the fraudulent grantee is upon the defensive in an action against him by the creditors of the grantor for the rents, profits etc.

This class will be properly subdivided hereafter.

As to the first class of cases, the rule of law is well established by the courts that a grantee of real or personal estate, when it is shown that the purchase was made with intent to defraud, or hinder and delay the creditors of the grantor, has no equity as against such creditors to be protected for the amount he actually paid on such purchase.

The theory upon which the courts base their decisions in this class of cases is the application of that fundamental maxim in equity that "He who comes into equity must come with clean hands", or as sometimes stated "He that has committed iniquity shall not have equity".

The law will not allow the transfer to stand as security for the amount paid to the grantor(a):

or for sums subsequently paid to creditors(b):  
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(a) Sands v Codwise 4 John. 536.

Allen v Berry 50 Mo. 90.

Fullerton v Viall 42How. Pr.294.

Davis v Leopold 87 N.Y. 620.

(b) Wood v Hunt 38 Barb. 302.

Union Nat'l B'nk. v Warner 12 Hun 306.

Even though he thereby pays off a mortgage(a):

The reason and justice of this rule is well stated in Ferguson v Hillman(b) "If the fraudulent grantee could be protected for the amount actually paid by him at the time of the fraudulent transfer, then a person could make a sale of his property with intent to avoid the payment of his debts, take the money and leave the country and the purchaser have knowledge that he intended to do so and yet be protected for money so paid; A rule which would lead to such results cannot be tolerated by the courts".

Chancellor Kent in an early case very well stated the rule "A fraudulent conveyance is no conveyance as against the interest to be defrauded: this is the plain language and intelligent sense of the common law: it is impossible that the deeds can be permitted to stand as security if they are to be adjudged void ab initio: if they have no legal existence,

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(a) R.R. Co. v Soutter 13 Wall. 51..

Thompson v Bickford 19 Minn. 17.

(b) Ferguson v Hillman 55 Wis. 190.

it would be inconsistent and absurd to recognize them for any lawful purpose: There is no instance to be met with of any reimbursement or indemnity afforded by a court of chancery to a particeps criminis in a case of actual fraud."

Fullerton v Viall 42 How. Pr. 294, was a case of this kind. The def't. had taken a conveyance of realty upon which there was a mortgage of \$800, agreeing to pay in addition \$1000, \$500 being a debt due from the grantor to the grantee and \$500 was paid in cash. In an action to set aside the conveyance, the recovery was not limited to the amount received by the fraudulent grantee on the sale, but his liability was held to extend to the value of the property received by him and which he had put beyond the reach of the creditors of his fraudulent grantor, subject only to prior valid incumbrances. He was neither allowed credit for his own debt of \$500 which constituted a part of the consideration he gave for the same, nor for the \$500 he paid to his grantor in cash.

At first thought, this rule might seem to work harshness and injustice to the grantee, but if the rule were otherwise, it would foster such transactions and encourage parties to enter into them. A fraudulent grantee would have everything to gain and nothing to lose; because if the transaction was impeached, he would be in no worse a position than he was before, while if its validity was unquestioned he would be in a much better position than otherwise. If the grantee in such a case suffers hardship, it is but justly; for although the refusal of the law to allow such grantee credit for moneys paid is not based on the right of a court of equity to punish the party for his wrongdoing, nevertheless if the party does by the decision of the court suffer punishment, it is but just; and it is not the province of the court to interfere.

In every such case, the party bargaining with the debtor with such an intent does it at the peril of having that which he receives taken away from him by the creditors of the debtor whom he is attempting to defraud, without having any remedy to recover what he parts with in carrying out the bargain. The law will leave him in the snare of his own devises.

In *R. R. Co. v Soutter*, 13 Wall. 517, a railroad belonging to an incorporated company and then under a 1st and 2d. mortgage was sold on execution and bought in by certain bond holders whom the 2d or junior mortgage was given to secure. These purchasers organized themselves into a new corporation and worked the road themselves. After a certain time, the mortgagees under the first or senior mortgage pressed their debt to a degree of foreclosure; and then to prevent a sale of the road, the new corporation paid the mortgage debt. Subsequently to this, and on a creditors bill, the sale made to the creditors under the 2d. mortgage was set aside as fraudulent and void as against other creditors of the original corporation. Held in an opinion by J. Bradley, with three Judges dissenting, that no bill in equity would lie for a recovery of the amount so paid in satisfying such 1st. mortgage. By satisfying the creditors, they could have kept the property and their title would have been good as against the whole world. "The payment was not made under a mistake of fact, for if it was made under any mistake at all

it was clearly a mistake of law: They mistook the legal effect of transactions of which they were chargeable with notice: they had full and actual notice of all the transactions and all the evidence on which the decree was ultimately founded.

This principle is extended to the case of assignments, and in a case where an assignment was set aside as fraudulent(a), the assignee being a party to the fraud, the assignee was not allowed upon accounting for any disbursements made by him, and was charged with the costs and expenses of accounting. In that case, the assignee had paid over \$4000 to a creditor in pursuance of a preference in the assignment for that amount: the assignment, being void ab initio, could afford no protection whatever to the assignee who under color of its authority interfered with the property and assets of the assignor: It was the same for all legal purposes as if it had never been executed.

Now, since the fraudulent grantee in possession of the property cannot be protected for the

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(a) Smith v. White 27 N.Y.S.R. 227.



money or other consideration he may have given for the transfer as against the creditors of such debtor, it would seem to follow as a necessary consequence that such grantee cannot be protected in the possession of the proceeds of such property received by him on a sale thereof. The property in the hands of a fraudulent purchaser is held by him in trust for the creditors of his fraudulent vendor, and so when the property is converted into money, the money is impressed with the same trust. The original conveyance being void as to creditors, no title as to them ever passed to the grantee; and if he sells it and receives the money, he must hold the money for the benefit of the creditors. In equity, such money in the hands of the fraudulent grantee is held for the benefit of creditors.

Coming to the next class of cases, we find a distinctly different class. Instead of asking the active interference of a court, the grantee is upon the defensive in an action against him asking the setting aside of a conveyance as fraudulent.

And first let us consider the case where the grantee is only guilty of constructive fraud, and does not participate in the actual fraudulent intent of the grantor. The cases hold that where a deed is sought to be set aside as fraudulent against creditors, and there is not sufficient evidence of fraud to induce the court to avoid it absolutely, but suspicious circumstances as to the adequacy of the consideration and fairness of the transaction, the court will not set aside the conveyance altogether, but permit it to stand as security for the sum actually advanced(a). Chancellor Kent in *Boyd v Dunlap* (a) says "There is a marked difference between an interference actively to compel a party to reconvey or surrender a deed, and a refusal to aid a party who seeks a specific performance of a contract.

If actual fraud be not clearly and satisfactorily made out, the court may refuse its aid, but will

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(a) Boyd v Dunlap 1 John. Ch. 478.

Bigelow v Ayrault 46 Barb. 143.

not take so decisive a step as setting aside in toto the assumed title". In the case cited, the inadequacy of the price was quite considerable, and the Chancellor said that to allow the deed to stand as security only for the true sum due would be doing justice to the parties and granting a relief which could not be afforded by a court of law.

The next class of cases is where the grantee has paid out moneys for taxes, necessary repairs and improvements subsequent to the fraudulent transaction and not as a part of the transaction, but independent and distinct from it.

In such cases, the courts have held that where a conveyance is set aside as fraudulent as to the grantor's creditors, the grantee on accounting for the rents and profits, is entitled for credit for taxes paid by him, and repairs made which were necessary for the preservation of the property and to keep it tenantable, and for interest paid on mortgages which were valid liens on the property though he was a guilty participant in the fraud

VanHorn v Fonda 5 John. Ch. 388.

King v Wilcox 11 Paige Ch. 589.

Loos v Wilkinson 113 N. Y. 485.

Hamilton Nat'l B'nk. v Halstead 134 N. Y.

In King v Wilson, the owner of some property subject to two mortgages conveyed it to his brother-in-law for the purpose of defrauding his creditors: the grantee took possession, received rents and profits, and made some improvements thereon, and subsequently paid and took an assignment of the mortgages: It was held that in setting aside the conveyance as fraudulent, and in taking an account of the rents and profits received by the fraudulent grantee, he was to be credited with the amount upon the mortgages and the value of the improvements made by him upon the premises.

This seems to us to be a very just and equitable rule. It is the general rule, even in actions to recover damages for pure torts that the plaintiff shall recover compensation for such damage only as he has suffered, and such is the invariable rule in such cases except where, by the settled rule of law, punitive damages may be awarded, and in such cases, the courts are constantly striving to come nearer to the rule of compensation, leaving the wrong-doer to the criminal courts for punishment. And why is

this not right and just? A court of equity does not sit for the punishment of criminals. If a fraudulent grantee has violated the criminal law, he may be prosecuted and punished in the criminal **courts**.

While such a grantee will not be allowed for permanent improvements made upon the granted property to suit his fancy, or simply to promote his interests, when the creditors of the grantor come into a court of equity seeking to compel him to account for rents and profits, the accounting should be had upon equitable principles; and when he has been compelled to surrender the property conveyed to him and to account for all the profits he has made or ought to have made, the ends of justice have been attained.

One of the latest and most important cases of this kind is *Loos v Wilkinson*, 113 N. Y. 485.

In that case the def't. Wilkinson ~~was~~ an active participant in the fraud and in the action against him by his grantor's creditors to have the conveyance set aside, it was held that he should account for the rents received from the real estate during the time he had occupied it; but that he should be

credited with the amount paid by him during the same period for necessary repairs on the premises with the amount paid for taxes while he occupied them, with interest on the mortgages upon the premises. In reference to the repairs, it was found that they were necessary for the preservation of the property: They were not made in pursuance of, or to carry out the fraudulent scheme, or to gratify the caprice of the def't., but were necessary to preserve the property for the creditors, and make the rents for which he is accountable.

Why, then, should he not be allowed for such expenses? No harm or prejudice is caused the creditors by such allowance.

As to the taxes, they were imposed by supreme authority for the benefit of the public and were inevitable. If the creditors had taken the property at the time the def't. did, they would have been obliged to pay them: by the payment of them he did them no wrong and caused them no prejudice.

As to the payment of the interest on the mortgages, the same could be said: they were liens which had to be paid and the payment was made for the

benefit of the creditors and in their interest:  
it had no connection whatever with the fraudulent  
scheme and it is impossible to see upon what prin-  
ciples of justice or equity an allowance for such  
payment could be refused.

Allowance was also made for the expenses of col-  
lecting the rents.

The claim for money paid for insurance however  
was refused: that benefited no one; it was not  
an insurance for the benefit of creditors, but solely  
for the benefit of def't., and if the property had  
burned down, they could not have enforced it in  
their favor. It was only just that he should be  
credited with such amount.

About the latest case in this state upon  
this subject is Hamilton Nat'l. B'nk v Halstead,  
134 N.Y. 520. In that case, Wm. H. Halstead was  
the owner of certain securities which he hypothecated  
with a Trust Co. for a loan of \$65000.

Fraudulently and without actual consideration,  
he transferred them to his son, the def't., and

thereupon the son gave his check for \$85000 which was endorsed by the father and taken by the son who with it paid the amount of the loan. The son afterwards realized upon the securities \$762500.

The question was whether the son was liable for the whole amount, \$76500, or for only the surplus of \$11500. The plaintiffs urged that the judgment should be for the whole amount, that having been a party to the fraud, a court of equity should charge him with the full value of the stock, notwithstanding the larger portion of it was required to pay a valid debt, which it had been pledged to secure, prior to the transfer to a party in no wise connected with the fraud. But the court held that, as the payment of the \$85000 loan by the son was entirely independent of the fraudulent transaction, the plaintiff could not recover the amount so paid.

And it seems to us that such recovery was justly refused, for by the payment of such sum the plaintiffs were in no wise harmed: practically, the father only had an interest in the securities to an amount



equal to the difference between the value of the securities and the amount for which they were pledged, \$85000; and had the transfer never been made, the creditors of Wm. Halstead could only have reached the securities subject to this lien which they would have been obliged to pay themselves.

Parker, J. in his decision says: "It is true that cases abound where the courts, in an action to set aside fraudulent conveyances, have refused to allow the fraudulent ~~conveyances~~ grantee to be reimbursed for money actually paid as a consideration for the conveyance, and in the course of the discussion have created the refusal of the court to allow such reimbursements as a proper punishment for the fraud, <sup>but</sup> it has never been assumed, as far as we have observed, that refusal was based on the right of a court of equity to punish the party because of his wrongdoing. The effect of the decisions may have been to punish quite severely the fraudulent grantee, but the courts did not have the power to deprive him of one dollar because they deemed him deserving of punishment".

In the <sup>foregoing</sup> brief and perhaps unsatisfactory discussion, we have strove merely to discover the underlying principles governing the situation, citing cases and endeavoring to state the law as it exists at the present time in the state of New York. We have not been so assuming as to advance any original theories in respect to the matter; nor have we undertaken to criticise the decisions of the judges in the various cases: we have simply taken the law as we found it and have tried to show the tendency of the courts to place the parties in the same position, <sup>they would have occupied</sup> had no transfer been made. They aim, not to punish a fraudulent grantee for any part he may have taken in the transaction, nor, on the other hand, to allow him to reap any benefit from his own wrong.

