

1950

Creditors' Bills and Actions to Set Aside Fraudulent Conveyances--Prerequisites to Suit

Arloe W. Mayne
University of Kentucky

Follow this and additional works at: <https://uknowledge.uky.edu/klj>



Part of the [Property Law and Real Estate Commons](#)

[Right click to open a feedback form in a new tab to let us know how this document benefits you.](#)

Recommended Citation

Mayne, Arloe W. (1950) "Creditors' Bills and Actions to Set Aside Fraudulent Conveyances--Prerequisites to Suit," *Kentucky Law Journal*: Vol. 39: Iss. 1, Article 14.

Available at: <https://uknowledge.uky.edu/klj/vol39/iss1/14>

This Note is brought to you for free and open access by the Law Journals at UKnowledge. It has been accepted for inclusion in *Kentucky Law Journal* by an authorized editor of UKnowledge. For more information, please contact UKnowledge@lsv.uky.edu.

CREDITORS' BILLS AND ACTIONS TO SET ASIDE FRAUDULENT
CONVEYANCES — PREREQUISITES TO SUIT

Not the least of the lawyer's problems is to obtain satisfaction of a judgment once it has been obtained. When the difficulty springs from the penury of the judgment debtor it is, of course, insurmountable, for no legal machinery can wring blood from a turnip. Very often, however, the difficulty is not so fundamental as it is procedural. The usual procedure by which a judgment is satisfied at law is by execution, levy, and sale of the debtor's assets. With the growth of commerce and new forms of property a debtor often has valuable interests which this clumsy and narrow process will not reach. To remedy this situation equity has lent the aid of its more adaptable process, through various types of suits known as creditors bills. The creditors bill may be used to reach any property of the debtor which by reason of its nature only, and not by some positive rule of law or statute exempting it from liability for debt,¹ cannot be reached by execution at law. Thus, at common law such intangible property as a patent cannot be reached by execution; it can be by a creditors bill. Nor can a debtor's contingent interests be reached generally by execution; they can be reached by means of a creditors bill.² In the absence of statute equitable interests cannot be sold under execution;³ but in general may be subjected to the payment of the debt by a creditors bill.⁴ While an individual's joint interest in notes and a mortgage is not subject to garnishment or execution, it has been held that such interest may be reached by a creditors bill.⁵ At law the relation of creditors to debtor corporations is the ordinary relation of debtor and creditor, and in the absence of statute there is no relation between the creditor and stockholders of the corporation. But creditors bills may be maintained against the stockholders of a private corporation for payment of unpaid stock subscriptions. Property which the debtor has conveyed in fraud of his creditors cannot be reached by execution because the title is no longer in the debtor. Such a conveyance can be set aside by a creditors bill.⁶ Another function of the creditors bill is to obtain a complete discovery of the debtor's assets and a disclosure of the names of his debtors.⁷

Statutes in various states have greatly enlarged the scope of execution providing an adequate legal remedy in many cases where formerly it was necessary

¹ E.g., Ky. R. S. 427.010 *et seq.* (1948).

² *Ayer v. Murray*, 15 Otto 126 (U.S. 1881).

³ *Alexander v. McPeck*, 189 Mass. 34, 75 N.E. 88 (1905). In Kentucky contingent interests in land can be taken and sold under execution. Ky. R. S. 426.190 (1948).

⁴ *Robinson v. Tischler*, 69 Fla. 77, 67 So. 565 (1915).

⁵ *St. Louis Hoop & Stave Co. v. Danforth*, 160 Mich. 226, 125 N.W. 5 (1910). (Trust resulting to the debtor from payment by him of the purchase price of property, and procuring the title to be taken in the name of another); *Kirby v. Bruns*, 45 Mo. 234, 100 Am. Dec. 376 (1870) (Improvements placed by a debtor husband on his wife's land); *Hegler et al. v. Grove*, 63 Ohio State 404, 59 N.E. 162 (1900) (Equity of redemption).

⁶ *Martin v. Carter*, 90 Ala. 96, 7 So. 510 (1890).

⁷ *Banes v. Babcock*, 95 Cal. 581, 27 Pac. 674 (1891).

⁸ *Vanderpool v. Notley*, 71 Mich. 422, 39 N.W. 574 (1888). For cases holding that a creditor may disregard a fraudulent conveyance and have the property sold at an execution sale see *Brasie v. Minneapolis Brewing Co.*, 87 Minn. 456, 92 N.W. 340 (1902), and *Runyon v. Bevins*, 218 Ky. 589, 291 S.W. 1033 (1927).

⁹ *Bay State Iron Co. v. Goodall*, 39 N. H. 223, 75 Am. Dec. 219 (1859).

to resort to the equitable remedy.²⁰ But these statutes have by no means displaced the creditors bill, and it still has an important role. Since the creditors bill was developed by equity to aid the creditor in collecting his debt when the legal remedies were ineffectual it would seem that the creditors bill would be available only when the legal remedies have been exhausted, and it is the general rule that the creditor must obtain a valid judgment and take certain steps toward enforcing it before he can bring a creditors bill in equity. However, there are exceptions to the general rule requiring a judgment.²¹ When none of these exceptions apply to a particular case the further difficulty arises in determining how far the creditor must proceed after he has obtained his judgment before equity will aid him.

It is the purpose of this article to determine when, under Kentucky law, a creditor has exhausted his legal remedies to the extent necessary to obtain the aid of equity when he comes within an exception enabling him to obtain relief in equity without first resorting to his legal remedy and with regard to fraudulent conveyance actions to note and discuss certain peculiarities in regard to the exception to the general rule requiring a judgment.

When a creditor does not come within any exception to the general rule there is little difficulty in determining how far he must proceed after he has obtained a judgment before he can bring a creditors suit in equity. The Kentucky Code of Civil Practice²² requires that a personal judgment has been recovered against the debtor, that execution has been issued on the judgment, that the execution has been placed in the hands of the proper officer, and that it has been returned by the officer endorsed "no property found."²³ New York and some other jurisdictions agree that execution returned unsatisfied is a prerequisite to the suit.²⁴ Another view on this subject, expressed by the United States Supreme Court, is that while it must be shown that execution has been issued, it is not necessary to show a return of execution unsatisfied.²⁵ It is submitted that this is the better view. The creditor after he has established the validity of his claim by a judgment should not be required to search among a defaulting debtor's assets, or to realize first on any particular piece of property.²⁶ What is more important to the debtor from a practical point of view is that the delay caused by waiting for a return of *nulla bona* may endanger the chances of subjecting the debtor's execution-proof assets to the satisfaction of the creditor's judgment, in that the debtor may dispose of such assets in such a manner as to prevent the creditor from ever reaching them. This unjust result would be avoided by allowing the creditor to file a creditors bill immediately after judgment, since the petition, if it describes the property

²⁰ Ky. R. S. 426.190 (1948); CONN. GEN. STAT. Sec. 5807 (1930).

²¹ *American Brake Shoe & Foundry Co. v. Pere Marquette R. R. Co.*, 205 Fed. 14 (1913) (judgment waived by admission of debt and insolvency); *Shuck v. Quackenbush*, 75 Colo. 592, 227 Pac. 1041 (1924) (debtor fled from the state leaving no property); *Overmire v. Haworth*, 48 Minn. 372, 51 N.W. 121 (1892) (debtor a non-resident with no property in the state); *National Tradesman's Bank v. Wetmore*, 124 N. Y. 241, 26 N.E. 548 (1891) (judgment at law impossible); 38 A.L.R. 269.

²² KY. CODES, CIV. PRAC. Sec. 439 (1948).

²³ While it is absolutely necessary that the execution be returned unsatisfied as a prerequisite to the suit, it is immaterial that the debtor actually had ample property subject to levy to satisfy the debt so long as the execution has been returned unsatisfied. *Sipple v. Catron*, 205 Ky. 81, 265 S.W. 491 (1924).

²⁴ N. Y. CIV. PRAC. ACT sec. 1189 (1939).

²⁵ See *Freedman's Savings Bank v. Earle*, 110 U. S. 710 (1884).

²⁶ GLENN, FRAUDULENT CONVEYANCES sec. 28 (Rev. ed. 1940).

to be subjected, will operate as a *lis pendens* as to purchasers and other creditors of the debtor. Also, the petition will create a lien on the specified property.¹⁷

A real exception to the rule requiring a personal judgment and execution returned unsatisfied as conditions precedent to suit lies in that form of creditors bill which seeks to set aside a fraudulent conveyance of real property. These prerequisites to the suit to set aside a fraudulent conveyance of real property have been expressly eliminated in this state by statute.¹⁸ Prior to the enactment of this statute in order to maintain a suit to set aside a conveyance of real property made in fraud of creditors, it was necessary for the creditor first to obtain a lien on the property either by attachment or by an execution against the debtor returned unsatisfied.¹⁹ In *Lochem & Co. v. Eversole*,²⁰ which was decided shortly after the enactment of the statute, a creditor sued to set aside a conveyance of land by his debtor to her children alleged to have been without consideration and with the intent to defraud her creditors. The defendant filed a special demurrer objecting to the jurisdiction of the court until after a return of *nulla bona*. The Court of Appeals held that so much of section 439 of the Civil Code as required a return of execution *nulla bona* before a creditor could institute an equitable action to set aside a fraudulent conveyance of real property was expressly repealed by this statute. In *Smith v. Curd*,²¹ the Court went further and held that the creditor could set aside a fraudulent deed to land, without first reducing his claim against the debtor to a personal judgment. It has been held that the creditor's refusal to have execution levied on the debtor's other assets of which he has knowledge is no bar to a suit to set aside a fraudulent conveyance of land.²² Thus, all that is necessary for a creditor to do in order to bring a suit to set aside a fraudulent conveyance of real property is to file a petition in equity alleging a cause of action against the debtor and facts showing that a fraudulent conveyance has been made. It is not necessary to exhaust or resort to the legal remedy.²³

It seems that the trend generally is to allow a suit to set aside a fraudulent conveyance of either real or personal property without a personal judgment against the debtor. This is the universal interpretation of the Uniform Fraudulent Conveyances Act.²⁴ The reason which has been advanced for statutes and judicial interpretations permitting a creditor to set aside a fraudulent conveyance without

¹⁷ *Clay City National Bank v. Bush*, 280 Ky. 406, 133 S.W. 2d 522 (1939); *Robertson v. Stewart & Sprng*, 41 Ky. 321 (1842).

¹⁸ Ky. R. S. 378.030 (1948). "Any person aggrieved by the fraudulent conveyance, transfer or mortgage of real property may file a petition in equity against the parties thereto or their representatives or heirs, alleging the facts showing his right of action, alleging the fraud or facts constituting it and describing the property. When this petition is filed a *lis pendens* shall be created upon the property described, and the suit shall progress and be determined as other suits in equity and as though it had been brought on a return of *nulla bona*."

¹⁹ *Meyer v. Ruff*, 13 Ky. L. Rep. 254, 16 S.W. 84 (1891); *Kyle v. O'Neil*, 88 Ky. 127, 10 S.W. 275 (1889).

²⁰ 24 Ky. L. Rep. 1031, 70 S.W. 661 (1902).

²¹ 24 Ky. L. Rep. 1960, 72 S.W. 744 (1903).

²² *Yankey v. Sweeney*, 85 Ky. 55, 2 S.W. 559 (1887).

²³ *Campbell v. First National Bank*, 234 Ky. 697, 27 S.W. 2d 975 (1930).

²⁴ Fed. Rules of Civil Procedure, Rule 18(b), 28 U.S.C.A. following Sec. 723c; Uniform Fraudulent Conveyances Act, Sec. 9, GLENN, FRAUDULENT CONVEYANCES Sec. 73 (Rev. ed. 1940); *Dubin v. Ebeling*, 30 Fed. Supp. 992 (1939); *Lind v. O. N. Johnson*, 204 Minn. 30, 282 N.W. 661 (1938); *American Surety Co. v. Connor*, 251 N.Y. 1, 166 N.E. 783 (1929); *Thomas v. Stewart*, 178 Okla. 308, 62 Pac. 2d 966 (1936).

a judgment is that otherwise there is danger that the fraudulently conveyed property may be disposed of in such a manner as will defeat the creditor's right to reach it.²⁵ This view seems to have a sound foundation in both justice and practicality. Certainly there is injustice in a rule of law which requires a creditor to come armed with a judgment before he can attack a fraudulent conveyance of the debtor's property, when the delay incident to reducing his claim to a judgment might jeopardize his opportunity to reach such property. Furthermore, if there has actually been a fraudulent transaction neither of the fraudulent parties is entitled to any consideration or protection.

It is submitted, however, that the argument for dispensing with judgment lacks force in Kentucky because in this state other remedies are provided which prevent collection of a creditor's claim from being endangered pending judgment. The framers of the present Code of Civil Practice of Kentucky, seeing the necessity for giving the creditor a remedy to protect his interest in the property of his debtor fraudulently conveyed, or about to be fraudulently conveyed, provided a remedy by attachment²⁶ which can be obtained at the beginning of the action against the very property fraudulently conveyed. Prior to the enactment of the statute permitting a suit to set aside a fraudulent conveyance without a judgment, it was held that this remedy by attachment was as ample and complete as a petition in equity to set aside the conveyance,²⁷ because the levy of attachment creates a lien on the property fraudulently conveyed²⁸ which gives the court jurisdiction of the property. Then when the creditor gets his judgment against the debtor and sustains his allegations of fraud the court will subject the property to the payment of the judgment by virtue of the attachment lien.²⁹ Thus, it clearly appears that the creditor's rights in the property are not endangered pending suit. Although to perfect an attachment lien on real property against a bona fide purchaser a lis pendens must be filed in the county court clerk's office pursuant to statute,³⁰ this filing is a simple act requiring no more than a few minutes. Since in this state the creditor can protect himself by attachment proceedings, requirement of a prior judgment is not too burdensome.

Moreover, others besides the debtor and creditor are affected by actions involving fraudulent conveyances. Is it equitable to permit a creditor who has not even established a valid claim against his alleged debtor to file a petition asking that a conveyance to a third party purchaser be set aside as fraudulent and thus subject the purchaser to the expense and trouble of defending the suit without even a bond to indemnify the purchaser in the event the charge is wrongfully made? It would seem that it is not, in view of the fact, as already pointed out, that the creditor will not be injured by not being allowed to bring such a suit.

The fact that the Kentucky Court of Appeals refuses to set aside a fraudulent conveyance of personal property before a judgment may be an indication that it feels there is no need for such a suit. In *Shepherd et al. v. Haymond*³¹ a creditor brought suit to have an assignment of certain notes made by his debtor declared

²⁵ For example, if the grantee conveys to a bona fide purchaser the creditor cannot then reach the property. *Greene v. Robbins*, 29 N. D. 131, 150 N.W. 561 (1914).

²⁶ KY. CODES, CIV. PRAC. sec. 194(7) (1948).

²⁷ *Martz v. Pfeifer*, 80 Ky. 600 (1863).

²⁸ KY. CODES, CIV. PRAC. sec. 212 (1948).

²⁹ *Kyle v. O'Neil*, 88 Ky. 127, 10 S.W. 275 (1889).

³⁰ KY. R. S. 382.440, 382.450.

³¹ 291 Ky. 780, 165 S.W. 2d 812 (1942).

null and void because made in fraud of creditors. The plaintiff had no attachment lien on the notes and had not recovered a personal judgment against the debtor. On appeal the Court held that the rule authorizing a creditor to set aside a fraudulent conveyance of real property without a personal judgment against the debtor had no application to a fraudulent conveyance of personal property, and that before such a conveyance could be set aside it was necessary for the creditor to obtain a lien either by an attachment or by levy of execution with a return of "no property found." It seems that the Kentucky Court is inclined to narrowly restrict the use of the statute dispensing with previous judgment. In cases of this nature the³² Court could easily have extended the statute to include fraudulent conveyances of personal property as it has held other sections of the fraudulent conveyance statute equally applicable to both real and personal property.³³ As to the Court's view on the need for the suit to set aside a fraudulent conveyance before judgment, significance might be attached to the fact that prior to the statute the Court in such suits frequently went to elaborate pains to point out that the creditor had an adequate remedy by attachment proceedings.³⁴ After the statute, in suits to set aside fraudulent conveyances of real property without a judgment the Court merely remarks that since the enactment of the statute it is no longer necessary for the creditor to have a judgment in order to bring the suit,³⁴ without attempting to justify, or show that it approves of such a proceeding.

The prerequisites to a creditors suit in Kentucky can be briefly summarized. If the suit is for discovery of the debtor's assets, or to reach his intangible property, or any purpose other than to set aside a fraudulent conveyance the creditor must have a personal judgment against the debtor on which execution has been issued and returned unsatisfied. If the suit is to set aside a fraudulent conveyance of personal property the creditor must have obtained a lien either by attachment or by a return of execution unsatisfied. If the suit is to set aside a fraudulent conveyance of real property there are no conditions precedent. The creditor simply files a petition alleging his cause of action against the debtor, and a fraudulent transaction.

Considering the problem from a practical standpoint, it is submitted that the only prerequisite to any creditors suit should be a valid personal judgment against the debtor. This rule would allow the creditor to reach his debtor's non-exempt, execution-proof assets without giving the debtor an opportunity to dispose of them pending a return of *nulla bona*, and at the same time prevent spurious suits by persons asserting some fictitious claim against an alleged debtor. The same rule should apply to a suit to set aside an alleged fraudulent conveyance in this state, as the creditor can protect his rights in property fraudulently conveyed by attachment proceedings pending suit to obtain a judgment against the debtor. This view would also protect the grantee of an alleged fraudulent transaction in situations where in fact the grantee is an innocent bona fide purchaser.

ARLOE W. MAYNE

³² Patton v. Walker's Trustees, 118 S.W. 312 (Ky. 1909).

³³ Kyle v. O'Neil, 88 Ky. 127, 10 S.W. 275 (1889); Martz v. Pfeifer, 80 Ky. 600 (1883).

³⁴ Williams v. Danvenport, 181 Ky. 496, 205 S.W. 551 (1918); Smith v. Curd, 24 Ky. L. Rep. 1960, 72 S.W. 744 (1903); Lochem & Co. v. Eversole, 24 Ky. L. Rep. 1031, 70 S.W. 661 (1902); O'Kane v. Vinnedge & Co., 21 Ky. L. Rep. 1551, 55 S.W. 711 (1900). But see Crooke v. Hume's Ex'tx, 139 Ky. 834, 109 S.W. 364 (1908).