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REACHING FRAUDULENT CONVEYANCES AND EQUITABLE INTERESTS OF DEBTORS*

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The equitable rights and remedies of creditors which will be dealt with in this paper relate to two different types of property interests of the debtor: (1) property which has been fraudulently [1] conveyed by debtors, and (2) equitable interests which debtors may have in property.

The existence of a creditor's interest in the first class is established by a section of the Colorado statutes [2] which provides that every conveyance of real estate, goods, things in action, rents, profits, etc., made with intent to hinder, delay or defraud creditors or other persons, as against the person hindered, delayed or defrauded, "shall be void". The conveyances referred to in the statute are, obviously, those made by debtors. It should be noted that the statute in terms applies to personal property as well as real estate.[3] However, while much that is said in the cases applies with equal force to conveyances of real and personal property, this brief article will be confined to real estate. It may be pointed out in passing that while there is no difference in principle between cases involving personal and real property, the duration of a statutory lien on personal property is much shorter than that on real property, and the statute relating to *lis pendens* does not apply to personal property.

In the second class of cases in which creditors seek to realize their claims out of equitable interests of the debtors, the statute relating to fraudulent conveyances is not involved. To illustrate the nature of the equitable interests involved in this class of cases, we may suppose that a debtor buys property, furnishing the consideration himself, and to conceal the property from his creditors, he directs the grantor to convey to the debtor's wife or some other person. Another type of case which comes under this second class arises when the property is conveyed by the debtor himself to the third party at a time when he was not involved financially and when he could not have had any fraudulent intent. At any rate, in such a case, the valid legal title is in a third person, and the debtor

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[1] The words, fraud, fraudulent, fraudulently, are used herein to refer to cases including those where possibly no actual fraud was intended, but where the intent, however well-meant, was to hinder and delay.

[2] COLO. STAT. ANN., c. 71, § 17 (1935).

[3] This is a modification of the English statute against fraudulent conveyances, 13 Eliz. c. 5, which, by the decision of Sir Edward Coke in Twyne's Case, 3 Coke, 80 b, 5 Eng. Rul. Cas. 2, was judicially determined to include conveyances of personal property.

has only the equitable title. Such title may be based on the intent of the parties, or the trust may be a constructive one imposed by law.

NECESSARY PRELIMINARY STEPS

What steps are or have been necessary to reach the two classes of property? Without an understanding of the sound *ratio decidendi,* lawyers are left in hopeless confusion after reading the cases in which the courts themselves obviously have been confused. Despite this apparent confusion in these recent cases, the results seem to be proper.

The rule in both classes of cases has been that the general creditor must have a judgment against the debtor before he can secure relief against the latter in equity. While the reason for the rule consistently has been stated to be "that resort cannot be had to equity where there is an adequate remedy at law", underlying the rule and stated reason therefor is the zealously guarded right of trial by jury. It has been correctly stated that "the real basis of the rule that a judgment at law is a condition precedent to affirmative equitable relief on behalf of a creditor is, therefore, that the debtor has the right to have the issue of indebtedness determined by jury." [4]

The rule requiring judgment before granting negative relief, which is the tying-up of the debtor's property before judgment has been obtained against him, is based upon consideration for the debtor. The courts concluded that it was better to leave the debtor free to deal with his property, although he may put it out of reach of his creditors before they obtain a judgment against him, than possibly to permit some unscrupulous creditor to keep the struggling debtor from honestly attempting to meet his obligations.

The great confusion has arisen in considering what further steps, if any, must be taken in the two classes of cases before resorting to equity. Under the original English statute against fraudulent conveyances and similar statutes of the states, property fraudulently conveyed by the debtor is subject to execution. Property to which the debtor had only equitable title was not at common law or under early statutes subject to execution. The theory under which relief is granted against property subject to execution is entirely different from the theory under which aid is extended to reach property not subject to execution. It is obvious from the decisions that the confusion of ideas is caused primarily by overlooking the basis on which jurisdiction rests, and by the presumption that the necessary steps, which are conditions precedent to relief in all instances where the creditor is attempting to obtain property not subject to execution, are also necessary where he is pursuing property which *is* subject to execution.

[4] See Note, 23 L.R.A. (N.S.) 11.

WHERE THE PROPERTY IS SUBJECT TO EXECUTION

As to property subject to execution, the judgment creditor was required to take steps to secure a lien upon the property fraudulently conveyed. The lien attaches to real estate in Colorado upon the filing with the recorder of a certified transcript of the judgment docket entry.[5] Thereupon the judgment creditor went into equity and stated that the transfer was fraudulent and that his lien was clouded and obstructed by the fraudulent transfer. He alleged that his lien was to no avail under the present circumstances and asked that the court clear-up the title, so as to enable him to enforce the holding of the court of law and allow him to make an advantageous sale of the property in question.

The lien was all that was required. The rule as to exhaustion of the remedy at law had no application here. As a matter of fact, one could not properly have made a return *nulla bona,* for the obvious reason that the property fraudulently conveyed could be levied upon and sold, the fraudulent conveyance being void. But, even when this property is levied upon and sold, we are still unable to make an advantageous sale because no determination by a decree as to whether the conveyance was fraudulent had been made. Relief at law being inadequate in such a situation, equity took jurisdiction.

WHERE EQUITABLE TITLE IS IN THE DEBTOR

When relief was sought in the second class of cases, wherein the judgment creditor sought to reach equitable title, no levy of execution could be made until authorized by comparatively recent statutes. The creditor had no lien which he could ask equity to clear. In this class of cases, as distinguished from the class involving property fraudulently conveyed by the debtor, the creditor was required to exhaust his remedy at law by showing that the debtor had no other property which might be reached by ordinary legal remedies.[6] Thus, in cases of this type, we have the requirement of a return *nulla bona,* such a return being merely proof that there was no other property out of which the creditor's judgment could be collected.

This fundamental distinction between the two classes of cases, and the different conditions precedent for equitable relief in each class, is set forth in the opinion of our Supreme Court in the case of *Chalupa* v. *Preston,*[7] wherein the court quoted at length from the very clear and sound opinion written by Judge Sanborn in *Schofield v. Ute Coal & Coke Co.,*[8] a case appealed from the United States Circuit Court for the District of Colorado.

In our Colorado statutes we find the provision that from the time of filing the transcript, the judgment becomes a lien upon "all

[5] COLO. STAT. ANN., c. 93, § 2 (1935).
[6] Emery v. Yount, 7 Colo. 107, 1 P. 686 (1883).
[7] 65 Colo. 400, 177 P. 965 (1918).
[8] 92 F. 269 (1899).

the real property of such judgment debtor—".[9] Nothing is said as to whether the interest to which the lien attaches may be an equitable one, although a subsequent section of this same chapter provides for levy upon every interest in land, legal and equitable.[10] It has been held by our Supreme Court,[11] that a judgment, upon the filing of the transcript, becomes a lien upon an equitable interest in land. It would seem, therefore, that from the time the two statutory provisions just referred to became effective, the second class of cases involving the reaching of equitable interests in land became subject to the same rules as the first class of cases in which the legal title remained in the judgment debtor in spite of his fraudulent conveyance. As a result of this, the supreme court held that no return *nulla bona* is required as a condition precedent to reaching the equitable interests of the judgment debtor in real estate, after the judgment creditor has secured a lien by filing the transcript. In holding this to be the law, our Colorado courts have stated that the levy of an execution upon a lien could not make it more specific or more efficient. The learned justices seemed to feel that the conclusion is irresistible that the general lien upon the real estate created by entering a judgment or filing a transcript of it in the county where the lands of the debtor are situated, in accordance with the statutes which provide therefor, is a sufficient basis for the maintenance of a suit in equity to remove a fraudulent obstruction to the enforcement of that lien.[12]

Space will not permit the consideration of many other questions involved in a creditor's suit or in a suit in the nature of creditor's suit.[13] They cause no particular difficulty. I might point out that in exceptional cases it has been held unnecessary to procure a judgment against the debtor before seeking equitable relief. For instance, it was held that when the judgment debtor is a non-resident, a money judgment is not essential and that a lien might be obtained by a creditor's suit with a notice of *lis pendens*.[14]

In passing, it may be pointed out that even though a debtor conveys property to a creditor with intent to defraud or to hinder and delay one or more other creditors, the conveyance is good if the grantee did not participate in the known intent of the grantor, but took the conveyance solely to secure payment of his own claim. Knowledge on the part of the creditor receiving the property that the debtor has acted with fraudulent intention is immaterial if the creditor has not done anything except receive payment of his claim. It is obvious that a creditor of an insolvent debtor must stop at securing his debt. If he goes further than this and actively participates or assists in any way in the carrying out of the fraudulent

[9] COLO. STAT. ANN., c. 93, § 2 (1935).
[10] *Id.*, § 6.
[11] Stephens v. Parvin, 33 Colo. 60, 78 P. 688 (1904).
[12] Stephens v. Parvin, 33 Colo. 60, 78 Pac. 688 (1904).
[13] We need not dwell on the fact that a creditor's suit is one in which equitable title is sought to be reached, and that a suit for relief with respect to property fraudulently conveyed is one in the nature of a creditor's suit.
[14] Shuck v. Quackenbush, 75 Colo. 592, 227 P. 1041 (1924).

purpose, his preference so obtained will be avoided in favor of other creditors. The motives which may have influenced the debtor to prefer one creditor over the others are of no importance if the preferred creditor has done nothing improper to secure the transfer.

THE EFFECT OF RULE 18 (b)

The consideration shown by the courts for those alleged to be debtors, by leaving their property free from any lien or cloud until a money judgment had been obtained, was abandoned by the adoption of Rule 18 (b) of our Rules of Civil Procedure, which provides:

> (b) Joinder of Remedies; Fraudulent Conveyances. Whenever a claim is one heretofore cognizable only after another claim has been prosecuted to a conclusion, the two claims may be joined in a single action; but the court shall grant relief in that action only in accordance with the relative substantive rights of the parties. In particular, a plaintiff may state a claim for money and a claim to have set aside a conveyance fraudulent as to him, without first having obtained a judgment establishing the claim for money.

The result is that now the creditor may bring suit to recover a judgment and, in the same action, secure a decree declaring a conveyance void as being fraudulent. By filing a notice of *lis pendens*, the debtor's property is held for an appropriate equitable decree with respect thereto, if a money judgment is obtained and the conveyance is held to be fraudulent.

No case has been found under said rule, or under the identical Federal Rule 18 (b), in which a creditor has sought a money judgment and a decree respecting the debtor's *equitable* title in real estate. However, the first sentence of the rule obviously is broad enough to include such a case. The second sentence of the rule in referring to a fraudulent conveyance "in particular" must be regarded as providing an illustration or as saying that the general rule found in the first sentence includes the case set forth in the second.[15]

In a Federal case,[16] the *modus operandi* in the trial of a case brought under said rule was stated as follows:

> . . . I rule that all issues which are common to the legal causes of action (in either count) and to the equitable cause stated in the second count shall be tried together, the legal issues, of course, to the jury and the equitable issues to the court; and that all equitable issues which do not pertain to the legal causes shall be tried to the court immediately following the jury trial.
>
> This ruling will have practical application as follows: On the day of trial . . . the parties will proceed precisely as though trying to the jury both the first count and the second count viewed as charging actionable fraud, and the rulings on the evidence will be made as though no other issues were before the court. The court, however, will accept all evidence which is received in the jury trial for any proper bearing it may have upon the second count viewed

[15] Greeley Transportation Co. v. The People, 79 Colo. 307, 245 P. 720 (1926).
[16] Ford v. C. E. Wilson Co., Inc., 30 F. Supp. 163, 165-66 (1939).

> as a cause of action in equity. After the jury has been charged and has retired to deliberate, the court will proceed to hear additional evidence on the equitable cause stated in the second count. There will be neither need nor permission to reiterate evidence already received in the jury trial; but any evidence theretofore offered and excluded in the jury trial may again be offered for its bearing on the second count viewed as a cause of action in equity.

Thus it is apparent that many of the old problems arising from questions pertaining to equitable rights and the remedies of creditors have been greatly simplified by the adoption of Rule 18 (b).

Book Notices

LABOR RELATIONS LAW, *by Marcus Manoff of the Massachusetts and Pennsylvania Bars.* 1950. $2.00. 140 pages.

A series of basic texts on important subjects of the law is being published by the Committee on Continuing Legal Education of the American Law Institute collaborating with the American Bar Association. This pamphlet is another in that series.

There has long been a need to the average general practitioner, not particularly skilled in the subject, for a basic text on the subject of labor relations law. Most general practitioners who represent business clients have need for at least some knowledge of this important subject. With such knowledge, they can solve many of the problems confronting them without the necessity of turning them over to a specialist. Also, with such a basic knowledge they can gradually undertake the responsibility of the more complicated labor problems of their clients. This book fills that need. It covers the substantive aspects of labor law and combines with this insights into practical problems. It is a general orientation booklet and a guide to substantive and procedural matters constantly confronting the business client.

PRICE DISCRIMINATION AND RELATED PROBLEMS UNDER THE ROBINSON-PATMAN ACT, *by Cyrus Austin of the New York Bar.* 1950. $2.00. 163 pages.

The Robinson-Patman Act is of prime importance to every businessman whose business crosses state lines. Therefore, every lawyer representing such clients should know something about the act. Unfortunately, few do. This is no mere handbook. It is a concise but comprehensive treatise, covering in one compact volume all of the subsections of the act. Each is analyzed in turn and all important questions of construction and compliance which have arisen and which are apt to arise are treated. The Robinson-Patman Act is not of importance alone to lawyers who must advise clients engaged in selling goods as to how to conform their pricing practices to the act's requirements. This book will be found valuable for reference in determining the rights and responsibilities of buyers as well.