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Buchanan Vs. Smith

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Decided On : 1872

Appeal No. : 83 U.S. 277

Appellant : Buchanan

Respondent : Smith

Judgement :

Buchanan v. Smith - 83 U.S. 277 (1872)
U.S. Supreme Court Buchanan v. Smith, 83 U.S. 16 Wall. 277 277 (1872)

Buchanan v. Smith

83 U.S. (16 Wall.) 277

APPEAL FROM THE CIRCUIT COURT FOR

THE NORTHERN DISTRICT OF NEW YORK

SYLLABUS

1. A creditor has reasonable cause to believe his debtor "insolvent" in the sense of the Bankrupt Act when such a state of facts is brought to his notice respecting the affairs and pecuniary condition of his debtor, as would lead a prudent

businessman to the conclusion that he, the debtor, is unable to meet his obligations as they mature in the ordinary course of business.

2. A debtor "suffers" or "procures" his property to be seized on execution when, knowing himself to be insolvent, an admitted creditor who has brought suit against him -- and who he knows will, unless he applies for the benefit of the Bankrupt Act, secure a preference over all other creditors -- proceeds in the effort to get a judgment until one has been actually got by the perseverance of him the creditor and the default of him the debtor.

3. Such effort by the creditor to get a judgment, and such omission by the debtor to "invoke the protecting shield of the Bankrupt Act" in favor of all his creditors, is a fraud on the Bankrupt Act, and invalidates any judgments obtained.

4. The fact that the debtor, just before the judgments were recovered, may have made a general assignment which he meant for the benefit of all his creditors equally does not change the case. Such assignment is a nullity.

The Cascade Paper Manufacturing Company of Penn Yan, New York, had for a long time purchased things used in the manufacture of paper, of Buchanan & Co., merchants in the City of New York, and had habitually given notes in payment.

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Its dealings with them were considerable, and its credit so good that it was not limited as to time; that when extensions were asked they were given, and that up to March 3, 1869, its notes had never lain over or been protested for nonpayment. The notes of the company were endorsed by its officers individually, except in one instance, when accident prevented. On the 3d of March, 1869, however, the company were unable to meet a note to Buchanan & Co., which came due on that day, and telegraphed the fact to these last, adding that they had sent that day a draft for half the amount, and a new note at thirty days for the balance. Buchanan & Co. replied (apparently by telegraph on the same day), that they would protect the note; but in a letter of March 4 reciting these facts (apparently not having received the promised half remittance and new note), they say:

"We are much disappointed at not receiving anything from you today. What does it mean? We had used the note, and it was not at all convenient for us to take care of it at so short notice. We shall certainly expect to hear from you by next mail."

On the 21st of March, 1869, the company's mills were destroyed by fire. The loss was about $80,000; the insurance $45,000 or $47,000. From that time, the company did no more business; and, *as it afterwards appeared, it was from that time insolvent.* At the time of the fire, Buchanan & Co. held six notes of the company, to-wit:

One for $1,000, due March 25, 1869.

One for $2,501, due April 2, 1869.

One for $1,141, due April 6, 1869.

One for $2,293.19, due May 4, 1869.

One for $2,305.94, due June 4, 1869.

One for $2,318.69, due July 3, 1869.

Two days after the fire the company wrote to Buchanan & Co., informing them of the fact, and, apparently, of the magnitude of their loss. These last replied March 23, expressing sympathy, and "a trust that when you get things more settled, *they may not turn out as bad as you now expect.* "

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They promised in the same letter to take care of the note of the company due the 25th, and to advise in a few days about the other coming due April 2.

Just before this fire, Mr. Goodwin, one of the firm of Buchanan & Co., had set off on a tour of business, westward. He reached Penn Yan immediately after the fire, and had an interview with the officers of the company, who informed him of the amount of their loss and insurance, and spoke of the notes, and said,

"On account of our misfortune of burning, we shan't be able to meet those notes. Of course we can't get the insurance money in, and you will have to be easy with us, and wait; but will get your pay in full."

They said that all they wanted was their insurance money to pay all they owed, and as soon as they got that, they would commence to pay. They asked to have the notes renewed, which was afterwards done. They said the concern would be solvent if they got their insurance money, and expressed their expectation of getting it. No statement was made of the company's debts, and Buchanan & Co., according to their own positive testimony, had no knowledge of any particulars, or of the fact of their debts beyond supposition.

The following letters from Buchanan & Co. now were written. What replies, if any came back, did not appear.

"NEW YORK, March 29, 1869"

"THE CASCADE PAPER COMPANY"

"GENTLEMEN: In relation to renewal of notes, we shall do everything we reasonably can, though we cannot really afford to renew a single one. You must take into consideration that our Mr. Buchanan has recently met with a greater loss by fire, with less than half the amount of insurance you have, and we really need all the money we can command. We have taken care of the $1,000 note due 25th, and you will please send us now note with your individual endorsements, and at as short time as possible. Can't you possibly take care of the one due April 2d and 6th? You see our position, and we trust you will meet the matter accordingly."

"Yours truly,"

"BUCHANAN & CO."

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"NEW YORK, April 2, 1869"

"THE CASCADE PAPER COMPANY."

"GENTLEMEN: Your note for $2,501 is payable today, and up to this time (2 P.M.) we hear nothing from you in regard to it. We shall be obliged to have it protested if we do not hear from you in time. You have not sent us new endorsed note for the $1,000 payable March 25. We trust in these matters you will only rely upon us, as a question of necessity, and not of convenience. Money is very tight, and we need all that is due us."

"Yours truly,"

"BUCHANAN & CO."

"NEW YORK, April 30, 1869"

"THE CASCADE PAPER COMPANY"

"GENTLEMEN: Yours of 29th instant, with enclosure, at hand. We are surprised that you should request us to extend your note due May 4, for your superintendent, Mr. Joy, gave the writer to understand most distinctly that should be paid when due. This he said to him when at your place in March. Mr. Joy then said if we would renew some notes due about that time (which we did) everything would be met promptly after that. We have been obliged to use that note due the 4th proximo, and we are not in a position to take it up. Our payments about this time are exceedingly large, much greater than usual, and we have need of every dollar we can raise to pay our own liabilities. We cannot, therefore, renew your note. You certainly can in some way, with your connections, raise the money, and, if necessary, you ought to be willing to make any sacrifice to do it. If in no other way, we should suppose you could get an advance for the amount you need on your insurance policies. At any rate, gentlemen, you must in some way contrive to pay the note, for we are not in a position to renew it for you."

"Yours truly,"

"BUCHANAN & CO."

"NEW YORK, June 5, 1869"

"MR. W. C. JOY,"

"Superintendent of the Cascade Paper Company"

DEAR SIR: We were very much surprised and very greatly incommoded by getting notice this morning of protest of your note due yesterday, 4th instant, for $2,305.94. Have telegraphed you for explanation, and up to this time, 2 1/2 o'clock, have received

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no reply. This note had been discounted, and as we had heard nothing from you to the contrary, we supposed, of course, it would be paid. You promised us when we had to take up the last one, that after that all your notes would be promptly met. Please attend to it at once, and send funds. What are we to expect in regard to your note due us next week, the 7th instant, for $4,701.42? We assure you we are not in a position to take care of that. You must provide the funds to pay that. You have no idea how short we are just at this time, and what a disappointment and trouble it has been for us today to take care of your note due yesterday. Let us hear from you at once.

"Yours truly,"

"BUCHANAN & CO."

"NEW YORK, June 9, 1869"

"MR. W. C. JOY"

"Superintendent of the Cascade Paper Company"

"DEAR SIR: Since writing you yesterday, we learn the Manhattan Insurance Company paid you some time since about $5,000. Under the circumstances, think you should have paid us something on account."

"As we understand the matter, there is, beside the Buffalo company, unpaid as follows:"

Home, N.H. $10,000

Columbia, N.Y. 3,000

Market, N.Y. 3,000

Atlantic. 3,000

"On which there is due about $18,500."

"We do not know how serious the difficulties in the way of collecting from these companies may be, but from such information as we have been able to obtain, fear you may underrate them. Under the circumstances we think you should assign your claims against these companies to us, or at least enough of them to cover our claim, which, in round figures, is about $12,000."

"The chances of collection in our hands will be quite as good as in yours, and probably a good deal better. If you are correct in assuming that their refusal to pay is the result of Woodruff's interference and management, the assignment to us would be the very best means you can adopt to avoid litigation and loss. We suppose you have a board of trustees, and that in case

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you make the assignment it will be proper to have a meeting and authorize some officers of the company to execute the assignment. Please let us hear from you by first mail."

"Yours truly,"

"BUCHANAN & CO."

"NEW YORK, June 12, 1869"

"G. R. YOUNG, ESQ.,"

"President of the Cascade Paper Company"

"DEAR SIR: We hold the following notes of the Cascade Paper Company, payable to the order of yourself and Mr. W. C. Joy, and endorsed by you both, *viz.:* "

One due May 4 at Metropolitan Bank, N.Y. . . $ 2,293.19

" June 4 " " " " . . 2,305.94

" " 7 " " " " . . 4,701.42

" July 4 " " " " . . 2,318.69

$11,619.24

"For the note due May 4, we hold as collateral another note of the company for $2,318.70, due July 1st, endorsed same as the others. All the above notes excepting the one due July 4 have been protested for nonpayment. We have from time to time renewed all these notes at the request of Mr. Joy and Mr. Raplee, treasurer of your company, for reasons given by them at the time. The last excuse given us was that they were waiting for their insurance money. Now as the company have, to our knowledge, collected a large portion of their insurance money, some $20,000 or more, we think we are entitled to our money and that we are, under all the circumstances, very unfairly treated. We have this day written Mr. Joy, as superintendent of the company, requesting him to remit us by return mail at least one-half of the amount of our account, and at the same time informing him if it was not done, we should at once instruct our lawyers to commence suits against yourself and Mr. Joy as endorsers. We thought it best to inform you how this matter stood as you might not be fully informed in regard to it."

"Yours truly,"

"BUCHANAN & CO."

"In the month of June or July," as was testified by the superintendent of the company, "it became apparent to its officers that the company could not meet its engagements."

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On the 19th of the June thus spoken of by the superintendent -- that is to say June, 1869 -- Buchanan & Co. brought suit in the supreme court of New York against the company and the individual endorsers, Joy and Young, the former superintendent and the latter president of the company, upon the two notes which had fallen due June 4 and June 7, respectively, and immediately after the two notes due July 1 and July 3 fell due, a suit was brought upon those notes also.

"At the time the suits were commenced," testified the superintendent *in May, 1870,* when he was examined, "I should say, *from my present* standpoint, the company was insolvent." There was no proof in the present proceeding that, when these suits were brought, any debts of the company had matured, except those of Buchanan & Co., and $229 due one Jones.

Each member of the firm of Buchanan & Co., which consisted of four persons, was examined as a witness, and they all testified that their information and belief was, that the company was perfectly solvent, and intended to pay everybody in full; that they commenced the suit because they thought that the company's delay had been unreasonable and unnecessary; that the officers of the company were keeping the insurance money, which ought to be paid to *them,* and speculating with it, and because the company had promised to pay as soon as they got the insurance money, and had collected nearly $30,000 of it without paying anything; that the suits were not brought nor anything done subsequently, under any understanding, request, or suggestion of the company; but, on the contrary, that the company requested them to wait longer, and begged them not to think of bringing a suit; that they brought the suit for the purpose of getting their pay by any legal means; that they did not consider the question whether other parties would get their pay or not, for that they did not know that the company owed anybody

else.

It appeared in the evidence that the company pleaded in the suits on the notes a misnomer in abatement, and that

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Buchanan & Co. made a motion to correct the misnomer, and to strike out the answer as "sham," and for judgment on it as "frivolous." The motion to amend was granted. The company's counsel then insisted that the plaintiffs must reserve their complaint as amended, and the company have the usual time to answer. In a discussion before the court upon this point, the plaintiff's counsel (according to his statement as given in the present suit) insisted as a matter of argument that where delay was the only object sought by a defendant which did not deny its obligation, delay might work injury to the plaintiffs by enabling other parties to gain a priority *in case of insolvency.* And he suggested insolvency as a possible inference, from the application for delay, for the court to consider upon such a motion. He did not assert it as a fact, and as he testified he had no knowledge or information on the subject and no decided belief on the subject of their solvency or insolvency. The company's counsel emphatically denied the suggestion of insolvency, and objected to any such inference's being drawn. The judge said there was no proof on the subject, and gave the company ten days to answer. The company's counsel testified that the statement of insolvency was positively made by the counsel of Buchanan & Co., but admitted that there was nothing in the papers one way or the other upon the subject; that it became a matter of argument upon the assertions of counsel made in court, the plaintiff's counsel saying that the company was insolvent and the company's counsel saying that he did not believe it was insolvent, and he admitted that he did, in fact, believe they were solvent, and did say that he so believed in the argument. This argument was made on the 19th or 20th of July.

On the 19th of July, a judgment against the company for $229 was recovered by one Jones, which was subsequently satisfied on execution. But Buchanan & Co. testified that they had no knowledge or information of these facts.

On the 21st of July, 1869, the company made a general assignment of all their property and effects to one Benjamin Hoyt in trust to pay their creditors. This assignment was

made under advice of reputable counsel, who advised the company that they might lawfully make it, and that it would be valid. "The company supposed," according to the testimony of their superintendent,

"that the title to all their property would pass to Hoyt, and they intended to have it so pass by the assignment. They intended it should so pass before Buchanan & Co. could get their judgments and issue executions. They knew when the assignment was executed that this firm would shortly be entitled to enter judgments, and it was the intention on the part of the company in making the assignment to Hoyt to prevent them from gaining a preference by means of their judgments. They expected and intended that no property would be left on which they could get any lien. They did not expect or intend that Buchanan & Co. should get a preference over their other creditors; but intended by the assignment to secure an equal distribution of their property to their creditors, and to prevent any creditor from getting a preference. The officers of the company consulted together in reference to the assignment. There was not any difference of view."

The members of the firm of Buchanan & Co. testified that no information of this assignment was given to them, and that they had no knowledge of it until after their liens had attached as hereinafter mentioned.

On the 3d of August, no defenses having been entered in any of the suits, Buchanan & Co. recovered judgments against the company in them by default, and against Joy & Young, endorsers on the notes. On the same day, their attorneys sent transcripts of the judgments to the clerk of Yates County, in which the company's real estate was situated, to be docketed by him, and the same were docketed by him on the 4th day of August.

On the same 3d day of August, the attorneys of Buchanan & Co. also issued executions on the two judgments to the Sheriff of Yates County, wherein personal property of the company was situated, which executions were received by the sheriff on the 4th of August, and were sufficient in form to become liens on that day under the statutes of the State

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of New York, upon all the personal property of the defendants within that county. On the 4th of August, Buchanan & Co. commenced, under the said judgments, certain proceedings supplementary to execution (which are the substitute under the New York code for a creditor's bill), and thereby obtained an equitable lien upon all the choses in action of the company, which proceedings subsequently resulted in the appointment of B. Buchanan (a member of the firm) as receiver.

The different members of the firm testified that at the time of commencing the suits and at the time of recovering and docketing the judgments, issuing the executions and commencing the supplementary proceedings, they did not actually believe that the company was insolvent or in contemplation of insolvency, and so far as they were aware, neither of them had any reasonable cause so to believe, but, on the contrary, their belief in fact was, and as they supposed their information warranted the belief, that the company was perfectly solvent. They each further testified that so far as they were aware, they had no cause to believe that the company had any intention, view, or desire of giving a preference to their firm or making any disposition of property in its favor or in fraud of the Bankruptcy Act; but, on the contrary, they in fact believed that the company was resisting their proceedings with the purpose of delaying, and so far as possible preventing their obtaining payment of their claims; that their information and belief was that the company did all it could to prevent the judgments, executions, and receiverships; that they thought it a part of the company's plan not to give them a preference or allow them to get any if it could help it; that it was doing all it could to prevent their getting any preference; and that they had no facts nor any cause to believe that it was showing or permitting them any favor.

The Sheriff of Yates County, on receiving the executions, August 4, called upon the officers of the company, and they all said that an execution could not touch the property; that they had made an assignment, and that it was in Hoyt's

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hands, and they supposed that that would exempt the property from levy. They objected to the levy. The sheriff also called on Hoyt, who said there was a general assignment of the company made to him, that he had possession of all the property, and that he thought the sheriff had no right to make a levy. So the sheriff did not levy at that time.

When the attorneys of Buchanan & Co. sent the transcripts of judgments to the Clerk of Yates County on the 3d of August, they wrote him a letter in which they requested him to docket the judgments and also to inform them whether there were any other judgments against any of the defendants or any assignment or transfer of property by any of them, and if so for a memorandum thereof. The clerk sent back the letter with a memorandum of a judgment recovered by Jones against the company for $229, July 19, and also of "general assignment, dated July 21, 1869, B. L. Hoyt, assignee." This letter was received by Buchanan & Co.'s attorneys August 5. This was the first information, as they testified, which they or their attorneys, so far as they knew, had ever received of the existence of the assignment or of any judgment against the company other than their own. The attorneys sent for a copy of the assignment and received it on the 7th of August. Mr. Goodwin, one of the firm, went at once to Penn Yan to investigate the circumstances. He arrived there on the 9th and remained there till the 13th. On arriving at Penn Yan, he saw the sheriff, who informed him that the company had made an assignment and there was not anything to levy on. He also saw Mr. Hoyt, who asserted that the property had vested in him as assignee. He also saw the officers of the company, who said that they had made an assignment of the property which the company formerly owned, and that the assignment was good and valid. Under advice of counsel, Goodwin directed the sheriff to levy, and gave him the bond of indemnity required by him. The sheriff levied on the personal property of the company August 13.

By orders of the supreme court made in the supplementary proceedings August 13 and 16, Buchanan was appointed

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receiver of the unpaid policies of insurance held by said company, and on the 20th, 21st, and 23d of August commenced suits on them against the insurers, to recover the losses due the company, which suits were still pending.

On the 9th of September, a petition in bankruptcy was filed against the company, on which, September 24, it was adjudicated bankrupt, and one Smith appointed its assignee.

The inventory of the assets and liabilities of the firm filed July 21, 1869, showed:

Liabilities $74,775.00

Assets. 41,435.00

Deficit $33,340.00

Among the assets were:

Cash in hands of Treasurer $6,554.70

Claims against insurance

companies for loss by fire . . . 14,545.30

Hereupon Smith filed a bill in the court below against Buchanan & Co., which, after setting forth the appointment of the complainant as assignee, alleged that the judgments in favor of Buchanan & Co. against the company were suffered and procured by the company with intent to give that firm a preference over the other creditors of the company, and with intent to hinder, delay, and impair the operation of the Bankrupt Act, and that that firm, when they entered their judgments and

issued their executions, had reasonable cause to believe that the company was insolvent, and that a fraud on the act was intended.

The bill also alleged the illegality of the appointment of the defendant, Buchanan, as receiver of the insurance claims.

The answer set forth the recovery of the judgments, the issuing of the executions, the levies thereunder, and the appointment of the receiver, and put in issue all the allegations of fraud in the recovery of the judgment, and any knowledge on the defendants' part of the insolvency of the company.

The court below gave judgment for the complainant,

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granting the relief asked in the bill, and setting aside the judgments under which the defendants claimed their lien.

From that decree this appeal was taken.

It was admitted on both sides in the argument that by the terms of the Bankrupt Act it was necessary that three things should concur to entitle the complainant, as assignee, to the decree prayed in the bill:

1st. That the company, within four months before the filing of the petition against them in bankruptcy, did " *procure* or *suffer* " their property, or some part thereof, to be attached, sequestered, or seized on execution by Buchanan & Co., with a view to give them a preference.

2d. That the company was insolvent at that time, or in contemplated insolvency.

3d. That Buchanan & Co., at the time the company "procured or suffered" such attachment, sequestration, or seizure of their property (if they did so "procure or suffer" it) had reasonable cause to believe that the company was insolvent, and that they procured or suffered such attachment, sequestration, or seizure of their property to be made to secure such preference and in fraud of the provisions of

the act.

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MR. JUSTICE CLIFFORD delivered the opinion of the Court.

Preferences, as well as fraudulent conveyances, are, under certain circumstances, declared to be void if made by a debtor actually insolvent, or in contemplation of insolvency, within four months before the filing of the petition by or against him as a bankrupt. [Footnote 1]

Those circumstances, so far as that rule of decision is applicable to this case, are, if the debtor procures any part of his property within that period to be attached, sequestered, or seized on execution with a view to give a preference to any creditor or person having a claim against him, or who is under any liability for him, that such attachment, sequestration, or seizure is void, provided it also appears that the creditor making the attachment, sequestration, or seizure, or the person to be benefited thereby, had reasonable cause

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to believe that the debtor was insolvent, and that the attachment, sequestration, or seizure was procured in fraud of the provisions of the Bankrupt Act.

On the 9th of September, 1869, a creditor of the corporation respondents filed a petition in bankruptcy against the company, in the office of the clerk of the district court, and on the twenty-fourth of the same month the district court adjudged the said paper manufacturing company to be bankrupts within the true intent and meaning of the Bankrupt Act.

Pursuant to that decree the appellee, on the 10th of November following, was duly appointed assignee of the estate of the bankrupts, and the register having charge of the case, there being no opposing interest, by an instrument in writing under his hand assigned and conveyed to the said assignee all the property and estate, real and personal, of the bankrupts.

By virtue of that instrument of assignment and conveyance all the real and personal estate of the bankrupts, with all their deeds, books, and papers relating thereto, became vested in the appellee as such assignee. Such instrument of assignment and conveyance embraced the several parcels of real estate described in the bill of complaint and certain personal property at that time in the hands of an assignee appointed by the state court, or in the custody of the sheriff of the county, but which has since been in part sold by the sheriff and the proceeds have been paid into the registry of the district court. Five policies of insurance upon the property of the bankrupts, which had been destroyed by fire and for which losses the insurance companies were liable, were also included in the said instrument of assignment and conveyance.

Complaint is made by the appellee in the bill that the respondents, or the three first named, on the 3d of August, prior to the decree adjudging the corporation respondents bankrupts, recovered two several judgments against the bankrupt company, in the supreme court of the state,

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amounting in the aggregate to the sum of $11,815.65; that the said judgments, on the day following, were docketed in the office of the clerk of the county, where the judgments still remain of record, and constitute an apparent lien upon the property and estate so assigned and conveyed to the appellee as such assignee, and are a cloud upon his title.

Apart from that, he also claims that the same parties took out executions upon the said judgments and delivered the same to the sheriff of the county, and that the sheriff, on the 11th of the same month, levied the executions upon certain personal property of the bankrupt company which he held in possession when the petition in bankruptcy was filed, and he alleges that the sheriff, by order of the district court duly entered, has since sold the said personal property and paid the proceeds into the registry of the bankrupt court; that the other respondent claims that he has been appointed receiver of the several policies of insurance, and that he has commenced actions against the insurance companies to recover the losses

suffered by the burning of the property covered by the said policies, in consequence of which the insurance companies refuse to pay said losses to the complainant.

Both the allegations of the bill and the proofs show that the corporation respondents, on the said 3d of August and long prior thereto, were utterly insolvent and bankrupts, and the complainant charges that they procured and suffered the said judgments in favor of the parties named to be entered and their own property to be attached, sequestered, and seized, as alleged, with intent to give to those creditors a preference over their other creditors, and that they intended by such disposition of their property to defeat and delay the operation of the Bankrupt Act; that the said judgment creditors, throughout those proceedings, had reasonable cause to believe that the debtor company was insolvent, and that the judgments were entered, the executions issued, and the levies made in fraud of the provisions of the Bankrupt Act, and that the proceedings were commenced and prosecuted with a view to prevent the property from

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coming to the assignee in bankruptcy and from being distributed under said act.

Service was made and the said judgment creditors appeared and filed an answer, and a separate answer was filed by the respondent claiming to be the receiver of the policies of insurance. Proofs were taken and the parties were heard and the court entered a decree for the complainant, and from that decree the respondents appealed to this Court.

Most or all of the defenses which it becomes material to consider consist of denials that the charges contained in the bill of complaint are true, and in that respect the two answers are substantially alike. Briefly described, the answers deny that the corporation respondents did procure or suffer the said judgments to be entered, or their property to be taken upon legal process issued upon said judgments, with intent thereby to give to those judgment creditors a preference over their other creditors, or with intent to defeat or delay, by such disposition of

their property, the operation of the Bankrupt Act, or that they had reasonable cause to believe that the respondent company was insolvent, or that the judgments were entered or the executions issued or the levies made in fraud of the provisions of the Bankrupt Act, or that such proceedings were instituted with a view to prevent the property of the bankrupts from coming to the assignee in bankruptcy, or to prevent the same from being distributed under the said act, as charged in the bill of complaint.

Fraudulent preference is the gravamen of the charge, and the complainant, as the assignee of the estate of the bankrupts, prays that the said judgments and all the proceedings in the suits may be decreed to be void and of no effect, and that the judgments, executions, and levies may be vacated and set aside, and that it may be decreed that he, as such assignee, is entitled to have and receive all the real and personal estate of the bankrupts free and clear of any lien by virtue of the said judgments, or of any of the aforesaid proceedings, and for an injunction.

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Three things must concur to entitle the complainant, as such assignee, to the decree as prayed in the bill of complaint:

(1) That the corporation respondents, within four months before the filing of the petition against them in bankruptcy, did procure or suffer their property, or some part thereof, to be attached, sequestered, or seized on execution by the said judgment creditors, with a view to give a preference to such creditors by such attachment, sequestration or seizure, over their other creditors.

(2) That the corporation respondents were insolvent at that time, or in contemplation of insolvency.

(3.) That the judgment creditors, at the time their debtors, the corporation respondents, procured or suffered such attachment, sequestration, or seizure of the aforesaid property belonging to the said debtors, had reasonable cause to believe that the debtors whose property was so attached, sequestered, or seized,

were insolvent, and that they procured or suffered such attachment, sequestration, or seizure of such property to be made to secure such preference and in fraud of the provisions of the Bankrupt Act.

Equal distribution of the property of the bankrupt, *pro rata,* is the main purpose which the Bankrupt Act seeks to accomplish, and it is clear to a demonstration that the end and aim of those who framed the act must be defeated in this case if the proceedings of the judgment creditors are sustained, as they have perfected liens, by those proceedings, upon all or nearly all of the visible property of the bankrupts.

Until the debtor commits an act of bankruptcy, it is doubtless true that any creditor may lawfully sue out any proper process to enforce the payment of debts overdue, and may proceed to judgment, execution, seizure, and sale of his property; but it is equally true that the appointment of an assignee under a decree in bankruptcy relates back to the commencement of the bankrupt proceedings, and that the instrument required to be executed, under the hand of the judge or register, assigns and conveys to the assignee all the estate, real and personal, of the bankrupt, including

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equitable as well as legal rights, and interests and things in action as well as those in possession, which belonged to the debtor at the time the petition in bankruptcy was filed in the district court. [Footnote 2]

Conceded, as that proposition must be, it is obvious that the judgment creditors could not acquire any interest in the property of the debtor by virtue of the order of the state court extending the powers of the receiver, previously appointed to collect the several amounts due from the insurance companies, to all the other estate, real, personal, and mixed, of the bankrupts, as it is admitted in the answer that the order in question was passed subsequent to the filing of the petition in bankruptcy, which is the foundation of the decree adjudging the corporation respondents to be bankrupts. Suppose it were otherwise, still the same conclusion must follow, as the court is of the opinion that all the essential allegations of the bill

of complaint are established.

Much discussion to show that the paper company was insolvent is certainly unnecessary, as the answer admits the fact to be as alleged in the bill of complaint. They failed to meet their paper at maturity as early as the 4th of March, 1869, as conclusively appears from the letter of the principal appellants to the treasurer of the company, acknowledging the receipt of a telegram from him to the effect that the company could not pay their note falling due on that day.

It appears by the record that the bankrupt company was engaged in the manufacture of paper; that they had for a long time purchased goods for the purpose of the principal appellants on credit; that the appellants at that time held six notes against them, some of which were overdue; that the mills of the company, on the 20th of the same month, were destroyed by fire, which prevented the company from transacting any further business.

Correspondence immediately ensued between the appellants and the bankrupt company or their superintendent. Two days after the fire, the company informed the appellants

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of their misfortune, and the appellants replied on the following day, promising to take care of one of their notes and to advise them, in a few days, as to another which would fall due in a short time. Immediately one of the appellants visited the superintendent of the bankrupt company for the purpose of ascertaining the extent of their loss and whether they would be able to take care of their unpaid notes.

Application was soon after made to the appellants by the company that they should consent to renew the notes, and for an extension of the time of payment, which led to further correspondence and to some crimination, the appellants charging that the officers of the company had promised that all the notes should be promptly met, and that they had failed to make good their promise, and insisting that they must provide funds for that purpose. Urgent demands to that effect were made by the appellants, as appears by the letters given in evidence,

but the bankrupts failed to supply the necessary funds, and the appellants, though they at first refused so to do, finally consented to renew all of the notes except two, reducing the number from six to four, as appears by their own testimony.

Those four notes were as follows: (1) note dated April 2, 1869, for $4,701.42, payable in sixty-three days from date; (2) note dated May 4, 1869, for $2,318.70, payable in fifty-five days from date; (3) note dated November 6, 1868, for $2,305.94, payable June 4 next after its date; (4) note dated November 16, 1868, for $2,318.69, payable the 3d of July next after its date.

Repeated demands for payment having been ineffectual, the appellants, on the 9th of June subsequent to the fire, suggested to the superintendent of the company that the chances of collecting the insurance money would be better if the policies were placed in their hands, and urged that the company should assign their claims under the policies of insurance to them, "or at least enough of them to cover our claim, which in round numbers is about $12,000." Such a course, it was suggested in the same letter, would be the very best means they (the company) could adopt to *avoid litigation*

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and loss, which affords convincing evidence that it was the purpose and intention of the appellants to secure a preference over the other creditors of the company.

Persuasion having failed to accomplish the purpose, the appellants, in a letter dated three days later and addressed to the president of the company, presented a schedule of the notes renewed and unpaid, complaining that they had been very unfairly treated, and informed him that unless one-half of the amount due to them was remitted by return mail, they should instruct their attorneys to commence suits against him and the superintendent of the company as endorsers of the notes. Instead of yielding at that time to the threat of the appellants, the corporation bankrupts, on the 21st of July following, made, executed, and delivered to one Benjamin Hoyt an indenture of assignment wherein they pretended to convey to the said assignee all their real and personal property in trust, to convert the same

into money, and with the proceeds to pay the debts of the company.

Extended discussion of that transaction, however, is quite unnecessary, as both parties agree that the said assignment was made in contemplation of insolvency, contrary to the provisions of the revised statutes of the state, and to hinder, delay, and defraud creditors. Whether the instructions were given to the attorneys as threatened does not appear, but it does appear that the notes overdue were protested and that those notes, on the 19th of the same month, were put in suit against the bankrupt company, and that a second suit was commenced against the company upon the other two notes immediately after they fell due.

Enough appears both in the pleadings and proofs to show that those suits, on the 3d of August following, were pending in the state court, and that the principal appellants on that day recovered judgment in both suits against the corporation defendants. Judgment in one of the suits was rendered for the sum of $7,118.14, and in the other for the sum of $4,197.51, as appears by the record. Both judgments were entered and perfected on the same day, and on the following day transcripts thereof were duly filed and the respective

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judgments were duly docketed in the office of the clerk of the county so as to become, at least in form, a lien on all the estate, real and personal, belonging to the bankrupt corporation.

Argument to show that the purpose of the principal appellants in attaching, sequestering, and seizing the property of the bankrupt company, as charged in the bill of complaint, was to obtain a preference over the other creditors of the company is hardly necessary, as the charge is fully proved, and it is equally certain that the debtors throughout the entire period from the commencement to the close of those proceedings were hopelessly insolvent, and the acts, conduct, and declarations of the appellants, in the judgment of this Court, afford the most convincing proof that they had reasonable cause to believe, even if they did not positively know, that such was the actual pecuniary condition of their debtors.

Attempt is made to satisfy the court that the debtors themselves did not know that they were insolvent, but the theory, in view of the evidence, is not supported and must be rejected as improbable and as satisfactorily disproved.

Even suppose that is so, still it is insisted by the appellants that the decree is erroneous because it is not proved, as they contend, that the bankrupts procured or suffered their property to be attached, sequestered, or seized by the appellants, as charged in the bill of complaint, within the true intent and meaning of the Bankrupt Act. Properly viewed, they insist that their acts and conduct only show that they have used the process of the state courts, as they had a right to do, to collect their debts due from the insolvent company, and they submit the proposition that a creditor may lawfully do all he might have done before the Bankrupt Act was passed to collect his debts, provided he has no active or passive assistance from his debtor, whom he has reasonable cause to believe to be insolvent, to help him to secure such a preference over the other creditors of the debtor.

Creditors, it is conceded, are forbidden to sue out state process, within the said four months, and employ it to create

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and perfect such liens on the property of their debtor, by his active or passive assistance, but the proposition submitted is that whatever they can obtain of their insolvent debtor, in that way, under such process, by their own energy and activity, in spite of the debtor they may lawfully retain, and that such liens are not displaced or dissolved by any subsequent bankrupt proceedings.

Strong doubts are entertained whether the proposition could be sustained, even if the theory of fact which it assumes was fully proved, as the fourteenth section of the Bankrupt Act provides to the effect that the required instrument of assignment, when duly executed, shall vest in said assignee the title to all the property and estate of the bankrupt, although the same is then attached on mesne process as the property of the debtor, where the attachment was made within four months

next preceding the commencement of the bankrupt proceedings, but it is not necessary to decide that question at this time, as the evidence is full to the point that the judgment creditors in this case did have the passive assistance of the bankrupt debtors in obtaining their judgments and in perfecting their liens, under the state process and laws, upon all the property, real and personal, of their debtors.

Throughout it was plainly the purpose of the principal appellants to obtain a preference over the other creditors of the bankrupt company, either by payment or assignment, and it must be conceded that the officers of the company for a time refused or declined to comply with any such request or intimation or in any way to promote their purpose, but the facts and circumstances disclosed in the record fully warrant the conclusion of the circuit court that they ultimately acquiesced in what was done by the appellants, even if they did not actively promote the consummation of the several measures which they, the appellants, adopted to perfect liens upon all the visible property of the bankrupt company, unless it exceeded in value the amount of their judgments. [Footnote 3]

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Sufficient is shown to satisfy the court that those having charge of the affairs of the corporation respondents knew that they were insolvent, and that they also knew that it was the purpose and intent of the principal appellants to secure a preference over the other creditors of the bankrupt corporation. Insolvent as they knew the company to be, they could not, as reasonable men, expect that all the debts of the company would be paid, and they must have known that the appellants would secure a preference over all the other creditors of the company if they suffered them, without invoking the protecting shield of the Bankrupt Act, to recover judgments in the two pending suits, and to perfect the other measures which they subsequently adopted to give effect to their liens upon all the property of the corporation bankrupts. [Footnote 4]

Tested by these considerations the court is of the opinion that the findings of the circuit court were correct, and that the allegations of the bill of complaint are sustained, as follows:

(1) That the corporation respondents, within four months before the filing of the petition against them in bankruptcy, did procure or suffer their property to be attached, sequestered, or seized on execution by the principal appellants, with a view to give a preference to such creditors by such attachment, sequestration, or seizure, over their other creditors.

(2) That the corporation respondents were insolvent at that time, or in contemplation of insolvency.

(3) That the judgment creditors, at the time their said debtors procured or suffered such attachment, sequestration, or seizure of the aforesaid property belonging to the said debtors, had reasonable cause to believe that the said debtors whose property was so attached, sequestered, or seized were insolvent, and that they procured or suffered such attachment, sequestration, or seizure of such property to be made to secure such preference, and in fraud of the provisions of the Bankrupt Act. [Footnote 5]

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Insolvency in the sense of the Bankrupt Act means that the party whose business affairs are in question is unable to pay his debts as they become due in the ordinary course of his daily transactions, and a creditor may be said to have reasonable cause to believe his debtor to be insolvent when such a state of facts is brought to his notice respecting the affairs and pecuniary condition of his debtor, in a case like the present, as would lead a prudent businessman to the conclusion that he, the debtor, is unable to meet his obligations as they mature in the ordinary course of business.

Such a party -- that is, a creditor securing a preference from his debtor over the other creditors of the debtor -- cannot be said to have had reasonable cause to

believe that his debtor was insolvent at the time unless such was the fact, but if it appears that the debtor giving the preference, whether a merchant or trading company, was actually insolvent and that the means of knowledge upon the subject were at hand, and that such facts and circumstances were known to the creditor securing the preference, as clearly ought to have put him, as a prudent man, upon inquiry, it would seem to be a just rule of law to hold that he had reasonable cause to believe that the debtor was insolvent, if it appears that he might have ascertained the fact by reasonable inquiry. Ordinary prudence is required of a creditor under such circumstances, and if he fails to investigate when put upon inquiry he is chargeable with all the knowledge it is reasonable to suppose he would have acquired if he had performed his duty. [Footnote 6] Such proceedings, therefore, must be held invalid, as they were promoted and prosecuted by the parties acting in fraud of the Bankrupt Act, and inasmuch as that conclusion affects the judgments recovered by the appellants, it will not be necessary to bestow much consideration upon the subsequent proceedings to perfect the liens or to the order for the appointment of a receiver, or to the second

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order extending his jurisdiction and enlarging his powers. Evidently the judgments must be set aside as being superseded by the proceedings in bankruptcy, and if so, it is quite clear that all the subsequent proceedings founded upon those judgments become inoperative and ineffectual to prevent the assignee in bankruptcy from exercising the same power and dominion over all the property and estate of the bankrupts, as he might have exercised if such judgments had never been rendered, or no such subsequent proceedings had ever taken place. Creditors issuing executions on judgments obtained upon demands long overdue against a bankrupt, who has been pressed in repeated instances to pay or secure the demands and has failed to do so because of his inability, must be held to have had reasonable cause to believe that his debtor was insolvent. [Footnote 7]

It was suggested at the argument that the appointment of the receiver was an independent order of the state court, and that the action of the state court must be regarded as valid until it is set aside by some direct proceeding, but it is a

sufficient answer to that objection to say that the state statute under which the appointment was made has no application whatever to corporations, and that the proceeding must be regarded as wholly unauthorized and void. [Footnote 8] Judgment creditors of a corporation, it is held, do not obtain a preference by such a proceeding, but must proceed according to the provisions of the article relative to the sequestration of the property and effects of corporations for the benefit of creditors. [Footnote 9]

Viewed in any light the court is of the opinion that neither the decree of the state court appointing the receiver nor the order enlarging his powers, nor any of his proceedings under those powers, afford any defense to the bill of complaint.

Decree affirmed.

[Footnote 1]

14 Stat. at Large 534.

[Footnote 2]

14 Stat. at Large 522.

[Footnote 3]

Hilliard on Bankruptcy, 3d ed., 322-330.

[Footnote 4]

Marshall v. Lamb, 5 Adolphus & Ellis' New Series 126.

[Footnote 5]

Shawhan v. Wherritt, 7 How. 644; *Fernald v. Gay,* 12 Cushing 596; *Scammon v. Cole,* 5 N.B.R. 257; *Same Case,* 3 *id.* 100; *Smith v. Buchanan,* 4 *id.* 133; *Same Case,* 8 Blatchford 153.

[Footnote 6]

Toof v. Martin, 13 Wall. 40; *Scammon v. Cole,* 5 N.B.R. 263.

[Footnote 7]

Wilson v. City Bank, ib., 270; *Foster v. Goulding,* 9 Gray 52.

[Footnote 8]

Code 292, 294; *Hinds v. Railroad Co.,* 10 Howard's Practice Report 487; *Sherwood v. Railroad Co.,* 12 *id.* 136.

[Footnote 9]

Sessions Acts, 1825, p. 449; 2 Revised Statutes 463; *Morgan v. Railroad,* 10 Paige's Chancery 290; *Loring v. Gutta-Percha and Packing Co.,* 36 Barb. 32.

BRADLEY, J.:

I dissent from the opinion of the Court just read. In my opinion, an adversary suit against an insolvent person may be prosecuted to judgment up to the very moment of bankruptcy. The diligent debtor cannot be deterred from such prosecution by a knowledge that his debtor is insolvent, or by any apprehensions that bankrupt proceedings may be in contemplation. He is not bound, himself, to petition against his debtor in bankruptcy, nor does the neglect of his debtor to file such a petition deprive him of his fairly gained preference, unless complicity between them can be shown, of which in my opinion there was no evidence in this case.

JUSTICES MILLER and DAVIS did not sit.

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