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Fraudulent Conveyance--Unclean Hands Held Inapplicable Where There Has Been a Reconveyance (Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d 282 (1963))

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FRAUDULENT CONVEYANCE — UNCLEAN HANDS HELD INAPPLICABLE WHERE THERE HAS BEEN A RECONVEYANCE.—Landau, the alter ego of the plaintiff corporation, had conveyed real property to his son without consideration for the purpose of concealing the property from his creditors. Seventeen years later his son conveyed the land to the defendant, Landau's son-in-law, who simultaneously promised to convey it to the plaintiff. The defendant did reconvey but the plaintiff failed to record the deed which was subsequently lost. The defendant has refused to execute another deed. In the ensuing action brought to remove the cloud on title, the Court of Appeals, in reversing the Appellate Division, *held* that the plaintiff is entitled to the relief requested since the doctrine of unclean hands is not applicable to a situation in which the defendant-grantee has previously reconveyed the land. *Seagirt Realty Corp. v. Chazanof*, 13 N.Y.2d 282, 196 N.E.2d 254, 246 N.Y.S.2d 613 (1963).

A conveyance which on its face is legally enforceable, but has as its underlying objective the defrauding of the grantor's creditors, has been deemed to be an illegal bargain.[1] The Anglo-American concept that such an act is a fraudulent conveyance has as its basis the Statute of Fraudulent Conveyances, enacted in 1571.[2] The present New York statute,[3] which is an exact replica of the Uniform Fraudulent Conveyance Act,[4] provides in part that a "conveyance made . . . with actual intent . . . to hinder, delay, or defraud . . . creditors, is fraudulent as to . . . creditors." [5]

A creditor can attack a fraudulent conveyance as being violative of his rights, but as a matter of public policy the debtor-transferor cannot.[6] In some situations where a fraudulent conveyance is made, the agreement may provide for a reconveyance by the grantee to the debtor-transferor. When this occurs and the grantee refuses to reconvey, the courts deny relief to the debtor-transferor on the ground that he has unclean hands,[7] a defense predicated on

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[1] 6A CORBIN, CONTRACTS § 1458 (1962); 1 MOORE, FRAUDULENT CONVEYANCES 26 (1908).

[2] See 1 MOORE, *op. cit. supra* note 1, at 11-13; 1 GLENN, FRAUDULENT CONVEYANCES § 58 (rev. ed. 1940).

[3] N.Y. DEBT. & CRED. LAW §§ 270-81. New York had a similar statute against fraudulent conveyances as early as 1787. N.Y. Sess. Laws 1787, ch. 44.

[4] 9B UNIFORM LAWS.

[5] N.Y. DEBT. & CRED. LAW § 276.

[6] Hall v. Stryker, 27 N.Y. 596, 600 (1863); Weinhart v. Weinhart, 193 Misc. 424, 84 N.Y.S.2d 375 (1948), *aff'd*, 275 App. Div. 994, 90 N.Y.S.2d 918 (4th Dep't 1949); Davis v. Graves, 29 Barb. 480 (N.Y. 1859); RESTATEMENT, CONTRACTS §§ 598-601 (1932).

[7] Pattison v. Pattison, 301 N.Y. 65, 73-74, 92 N.E.2d 890, 895 (1950); Pierce v. Pierce, 253 App. Div. 445, 447, 2 N.Y.S.2d 641, 642 (2d Dep't 1938), *aff'd*, 280 N.Y. 562, 20 N.E.2d 15 (1939); Moore v. Livingston, 14 How. Pr. 1 (N.Y. 1857).

the wrongful conduct of the plaintiff.[8] However, it has been generally stated that in order for such a defense to be applicable the wrongful act of a plaintiff must occur in the particular transaction which he is litigating.[9] In other words, if a plaintiff can prove his cause of action without relying on the illegal bargain, he will prevail.

Where an agreement to reconvey is unenforceable because of the grantor's unclean hands, the grantee nevertheless has a moral obligation to perform his duty under the agreement.[10] If, pursuant to this obligation, the grantee does reconvey, such act will restore full legal title to the grantor.[11]

In the present case the conveyances took the form of oral trusts of real property, which are generally unenforceable in New York because of the Statute of Frauds.[12] However, where the transferee, at the time of the conveyance, is in a confidential relationship with the transferor and the former promises to reconvey but later refuses, the New York courts will impose a constructive trust for the benefit of the grantor.[13] But where such a trust is designed to defraud creditors the trust is invalid as to such creditors[14] and the debtor-grantor, having acted wrongfully in executing the trust, is prevented from enforcing it as beneficiary.[15]

Entirely different considerations are present where the original transferee has reconveyed to the debtor-transferor and the latter has lost the deed. In such a case, the court is confronted with the problem of whether to help such plaintiff (debtor-transferor) by clearing the cloud on his title, or to deny the plaintiff relief because of unclean hands.[16] Some jurisdictions uphold the

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[8] McMullen v. Hoffman, 174 U.S. 639, 669-70 (1899); McConnell v. Commonwealth Pictures Corp., 7 N.Y.2d 465, 469, 166 N.E.2d 494, 496, 199 N.Y.S.2d 483, 485 (1960).

[9] *E.g.*, Armstrong v. American Exch. Bank, 133 U.S. 433, 469 (1899); Primeau v. Granfield, 193 Fed. 911, 916 (2d Cir. 1911).

[10] McCann v. Commissioner, 87 F.2d 275, 276 (6th Cir. 1937); Davis v. Graves, *supra* note 6, at 485; 6A CORBIN, *op. cit. supra* note 1, at § 1462; 1 MOORE, *op. cit. supra* note 1, at 653.

[11] McCann v. Commissioner, 87 F.2d 275, 276 (6th Cir. 1937); Davis v. Graves, *supra* note 6, at 484; Moore v. Livingston, *supra* note 7; Springfield Homestead Ass'n v. Roll, 137 Ill. 205, 27 N.E. 184 (1891).

[12] Pattison v. Pattison, *supra* note 7; RESTATEMENT (SECOND), TRUSTS § 44 (1959); 1 SCOTT, TRUSTS §§ 40, 44 (2d ed. 1956).

[13] *Ibid.*

[14] Pattison v. Pattison, 301 N.Y. 65, 72, 92 N.E.2d 890, 895 (1950); Foreman v. Foreman, 251 N.Y. 237, 167 N.E. 428 (1929); Sinclair v. Purdy, 235 N.Y. 245, 193 N.E. 255 (1923). See RESTATEMENT (SECOND), TRUSTS § 44 (1959); 1 SCOTT, *op. cit. supra* note 12.

[15] Pattison v. Pattison, 301 N.Y. 65, 72-73, 92 N.E.2d 890, 894 (1950).

[16] The usual situation occurs when the debtor changes the name of the holder in the record in fraud of his creditors, but retains the deed. See CHAFEE, SOME PROBLEMS OF EQUITY 20-22 (1950).

defense and clear title for the defendant [17] rather than the plaintiff, even though the defendant is in pari delicto.[18] Other jurisdictions will aid neither the grantor nor the grantee.[19] When this occurs, the land becomes completely inalienable, since the former has legal and equitable title while the latter has record title. Finally, there are still other jurisdictions which will permit the grantor in this situation to prevail, since he holds both legal and equitable title.[20]

The New York position in this area has not been clearly defined. The case of *Moore v. Livingston*,[21] decided in 1857, appears to be the only case prior to the present one where this precise issue was raised.[22] In that case, the New York Supreme Court stated that if the grantee-defendant had not reconveyed and the plaintiff was seeking to enforce the grantee's promise to do so, the plaintiff would be estopped because his original conveyance was fraudulent.[23] However, since, in fact, there had been a reconveyance, the plaintiff was the legal owner of the property and was therefore entitled to have the deed restored to him.[24]

In the principal case the property had also been reconveyed to the plaintiff, giving him both legal and equitable title.[25] Since the transactions involved had been fully performed, the circumstances surrounding them were regarded by the Court as irrelevant. The Court reiterated the principle of the *Moore* case and stated that "a voluntary reconveyance to the fraudulent grantor, even from the immediate fraudulent grantee, is effective as between the parties and is entitled to the protection of the Courts in its enjoyment." [26]

Judge Burke, writing for the majority, observed that equity is not an "avenger at large" and the defense of unclean hands would not be applicable unless the plaintiff had "dealt unjustly in the very transaction of which he complains." [27]

The contention that moral considerations regarding the conduct of the plaintiff should bar recovery was also rejected. In so

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[17] Basket v. Moss, 115 N.C. 448, 20 S.E. 733 (1894); 3 POMEROY, EQUITY § 941 (5th ed. 1941).

[18] 3 POMEROY, *op. cit. supra* note 17.

[19] Italian-American Bank v. Lepore, 79 Colo. 466, 246 Pac. 792 (1926); King v. Antrim Lumber Co., 70 Okla. 52, 172 Pac. 958 (1917).

[20] Carteledge v. McCoy, 98 Ga. 558, 25 S.E. 588 (1896); Springfield Homestead Ass'n v. Roll, *supra* note 11; Ogasapian v. Danielson, 284 Mass. 27, 187 N.E. 107 (1933).

[21] *Supra* note 7.

[22] Seagirt Realty Corp. v. Chazanoff, 18 App. Div. 2d 1080, 1081, 239 N.Y.S.2d 411, 414 (2d Dep't 1963) (dissenting opinion).

[23] Moore v. Livingston, *supra* note 7, at 11.

[24] *Ibid.*

[25] Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d 282, 286, 196 N.E.2d 254, 256, 246 N.Y.S.2d 613, 615 (1963).

[26] *Id.* at 286, 196 N.E.2d at 256, 246 N.Y.S.2d at 615-16.

[27] *Id.* at 286-87, 196 N.E.2d at 256, 246 N.Y.S.2d at 616.

holding, the Court referred to the opinion of Professor Chafee that although the plaintiff had committed misdeeds in the past, he is now the lawful owner of the property, and the records should reflect that fact.[28] The Court concluded that:

> When equitable relief is sought, not to enforce an executory obligation arising out of an illegal transaction, but to protect a status of legal ownership, wrongs done by . . . [plaintiff] to creditors in respect of the property at some time prior to the acquisition of the title now in issue may not now be raised by this defendant to defeat otherwise available relief.[29]

The majority opinion is predicated on the fact that there had been a reconveyance. Thus, the Court did not consider it necessary to discuss whether the wrongful conduct of the plaintiff in originally conveying to his son would affect the subsequent transactions.[30] In contrast, the appellate division held that the plaintiff had unclean hands and was precluded from enforcing the trust despite the reconveyance.[31] Although the appellate division did not make an affirmative statement, their conclusion would seem to imply that the defense of unclean hands was not affected by the several conveyances. Judge Scileppi, in his dissent, did consider the problem and concluded that the fraudulent design of the plaintiff tainted the transaction which was the subject of the present suit and therefore the defense was available.[32] However, Judge Scileppi did not distinguish between the defense of unclean hands in an action to impose a constructive trust and an action to remove a cloud on title, where the agreement has already been executed.

In another dissenting opinion, Chief Judge Desmond also treated the problem of several conveyances. He did so by means of a comparison between the case of *Flegenheimer v. Brogan*[33] and the principal case. In *Flegenheimer* the plaintiff's intestate transferred the stock of a brewery to a "dummy" because the federal and state liquor authorities would not issue him a permit. The "dummy" thereupon conveyed to the defendant. The plain-

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[28] CHAFEE, *op. cit. supra note* 16, at 21-22.

[29] Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d 282, 287, 196 N.E.2d 254, 256, 246 N.Y.S.2d 613, 615 (1963).

[30] *Id.* at 286, 196 N.E.2d at 256, 246 N.Y.S.2d at 615. If there had not been a reconveyance the result would have probably been different even though there were several transactions. This is so because the court would look into the motives and the circumstances surrounding the conveyance to the defendant. *Ibid.*

[31] Seagirt Realty Corp. v. Chazanof, 18 App. Div. 2d 1080, 239 N.Y.S.2d 411 (2d Dep't 1963).

[32] Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d 282, 290, 196 N.E.2d 254, 258, 246 N.Y.S.2d 613, 619 (1963).

[33] 284 N.Y. 268, 30 N.E.2d 591 (1940).

tiff contended that the defendant knew of the relationship between her intestate and the "dummy." The Court of Appeals found that the "action is one brought by an alleged secret owner to vindicate his assertion of beneficial title to property which he had parted with in order to perpetrate a fraud upon the statute which regulates and controls traffic in alcoholic beverages." [34] Based on this finding the court held that the plaintiff could not maintain the action because the "transactions were so far against the common good." [35]

Although, there were several transactions in the *Flegenheimer* case, it is distinguishable on its facts from the principal case. Furthermore, it does conform to the general rule that the illegality which gives rise to the defense of unclean hands must occur in the transaction being litigated.[36] In *Flegenheimer,* the defendant was in possession and, as a result, the plaintiff had to show title in her intestate in order to prevail. To do so it was necessary for the plaintiff to rely upon the illegal transaction between her intestate and the "dummy." In the principal case the plaintiff did not have to rely on his fraudulent conveyance since he was merely seeking to clear title to land which he legally owned.

The defense of unclean hands is definitely not intended to protect an equally culpable defendant.[37] The defense has as its justification the protection of the public from dishonest transactions.[38] Therefore, an issue is raised as to whether a plaintiff who has acted wrongfully should prevail because: (1) he is suing to clear a cloud on title instead of suing for specific performance or, (2) that there have been several conveyances and to establish his cause of action he need not show the wrong he has committed. To permit a wrongdoer to prevail under such circumstances tends to frustrate the purpose underlying the defense of unclean hands.[39] However, prominent authors have questioned whether the defense should be applicable in any situation. For example, Professor Wigmore has stated that the "whole notion is radically wrong in principle and produces extreme injustice." [40]

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[34] *Id.* at 272, 30 N.E.2d at 592.

[35] *Id.* at 273, 30 N.E.2d at 593.

[36] Armstrong v. American Exch. Bank, 133 U.S. 433, 469 (1889); Primeau v. Granfield, 193 Fed. 911, 916 (2d Cir. 1911).

[37] McMullen v. Hoffman, 174 U.S. 639, 669 (1899); Stone v. Freeman, 298 N.Y. 268, 271, 82 N.E.2d 571, 572 (1948). See 5 WILLISTON, CONTRACTS § 1630 (rev. ed. 1930).

[38] McMullen v. Hoffman, 174 U.S. 639, 669-70 (1899); Primeau v. Granfield, 193 Fed. 911, 913 (2d Cir. 1911). See 5 WILLISTON, *op. cit. supra* note 37, at § 1628.

[39] McConnell v. Commonwealth Pictures Corp., 7 N.Y.2d 465, 166 N.E.2d 494, 199 N.Y.S.2d 483 (1960).

[40] WIGMORE, *A Summary of Quasi-Contracts,* 25 AM. L. REV. 695, 712 n.k (1891). See generally Wantulok v. Wantulok, 67 Wyo. 45, 223 P.2d 1030

The grounds for this criterion are that it is unjust for one guilty party, the plaintiff, to suffer while the defendant who is in pari delicto is rewarded; and that the penalty of not being able to maintain the action is utterly disproportionate to the offense.

Although Professor Wigmore's statement may appear correct it must be remembered that the public must also be protected. The question to be answered, in these cases, is whether the court is going to avail itself of every opportunity to discourage fraudulent conveyances. If the answer is in the affirmative the plaintiff should not prevail, regardless of the nature or form of the action.[41] The courts should not allow a wrongdoing plaintiff to prevail merely because his pleadings follow a seemingly correct analytical approach. Although the defense of unclean hands does have its pitfalls, its application will notify debtors that a court will not sanction the circumvention of the fraudulent conveyance laws. By limiting the applicability of this defense the Court is not promoting justice but sanctioning its circumvention. It is endorsing a method by which a debtor can invoke the judicial machinery to evade his obligation to his creditor.[42]

PROCEDURE — SERVICE OF PROCESS — DESIGNATION OF AGENT IN CONTRACT HELD NOT VIOLATIVE OF DUE PROCESS DESPITE ABSENCE OF PROVISION FOR ACTUAL NOTICE. — Plaintiff, a Delaware corporation doing business in New York, entered into a leasing contract with defendants, Michigan farmers. The contract was signed in Michigan and mailed to New York by defendants. A contract clause appointed a New York resident, the wife of one of the officers of the plaintiff corporation, as defendants' agent for service of process. There was no contractual provision for

(1950); CHAFEE, *op. cit. supra* note 16, at 21; WADE, *Restitution of Benefits Acquired Through Illegal Transactions,* 95 U. PA. L. REV. 261, 301-05 (1947).

[41] See RESTATEMENT, RESTITUTION §§ 46, 140 (1937).

[42] Predicated on the holding of the principal case, a debtor could fraudulently convey his property and have the court aid him in his act. That is, a debtor could change the name of the owner of the property on the record, while retaining the deed. After an accord with his creditor he would institute an action to clear cloud on title. The debtor might also convey to a third party. The third party would then record the deed and simultaneously reconvey to the debtor. The debtor would then hold the deed without recording until he reaches an accord with his creditors.