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REMEDIES IN BANKRUPTCY OF PARTNERSHIP CREDITORS ON TRANSFER OF FIRM ASSETS TO ONE PARTNER

THE retirement of any partner from the firm business works a dissolution of the partnership.[1] The remaining partner or partners, so long as the firm is solvent, then wind up the firm affairs and settle firm debts.[2] If the firm is insolvent, and is undergoing liquidation by court proceeding, the equitable rule of distribution,[3] which is codified by the Uniform Partnership Act[4] and the Bankruptcy Act,[5] provides that firm creditors shall have a prior claim to assets used in the partnership business, and that creditors of the individual partners shall have priority in those partners' separate estates. Frequently, however, the retiring partner or partners sell his or their interests in an

1. UNIFORM PARTNERSHIP ACT § 29; CRANE, PARTNERSHIP (1938) § 73.
2. UNIFORM PARTNERSHIP ACT §§ 37, 38; CRANE, PARTNERSHIP (1938) § 83.
3. Early cases applying this rule are collected in STORY, PARTNERSHIP (7th ed. 1881) §§ 263, n. 5, 363, 376, 377. See also STORY, EQUITY JURISPRUDENCE (14th ed. 1918) §§ 918, 925; Amsinck v. Bean, 22 Wall. 395 (U. S. 1874).
4. UNIFORM PARTNERSHIP ACT § 40.
5. Section 5g, 52 STAT. 845, 11 U. S. C. § 23 (Supp. 1938). This provision is virtually the same as that included in the Bankruptcy Act of 1898 § 5f, 30 STAT. 547 (1898), 11 U. S. C. § 23 (1934).

insolvent firm to a single partner, in exchange for the latter's assumption of the firm debts. On the subsequent insolvency of the purchasing partner in this situation, courts have held that the priority of firm creditors in firm assets has been destroyed.[6] They have ruled that a "bona fide" sale of the interest of all but one partner effectively converts the firm assets into the separate property of the purchasing partner, so that firm creditors are compelled to share *pro rata* with individual creditors.

Thus the priority of firm creditors assured by the rule in equity was not enforced against those claims of transferees or their creditors which had not been pursued to judgment, for the courts evidently took the view that the firm creditors' priority of access to firm assets was a rule of accounting between the separate and firm estates on distribution during actual court proceedings for liquidation. Unless the firm creditors had a judgment before the transaction of transfer took place, their equity was too weak, it was held, to survive, apparently on the ground that a greater deference to the claims of firm creditors would stand in the way of a desirable freedom in commercial affairs. The supposed equity of firm creditors became effective only upon the institution of court proceedings to wind up the firm's affairs, or, illogically enough in terms of the rule, when the creditors obtained judgment. Courts stated that the creditors' priority was dependent on the "equity" of each partner that firm assets be first applied to the payment of firm debts;[7] if in the exercise of their "bona fide" discretion, the partners converted the firm property into the several property either of one of the partners or of a third person before it was within the jurisdiction of the court, "the equities

6. Russell v. McCord, 21 Fed. Cas. 51, No. 12,157 (N. D. Mich. 1878); Reese & Heylin v. Bradford, 13 Ala. 837 (1848); Schleicher Schumm & Co. v. Walker, 28 Fla. 680, 10 So. 33 (1891) *semble;* Hanford v. Prouty, 133 Ill. 339, 24 N. E. 565 (1890); Armstrong v. Fahnestock, 19 Md. 58 (1862); Howe v. Lawrence, 9 Cush. 553 (Mass. 1852); Sanchez v. Goldfrank, 27 S. W. 204 (Tex. Civ. App. 1894); *cf.* Huiskamp v. Moline Wagon Co., 121 U. S. 310 (1887); Fitzpatrick v. Flannagan, 106 U. S. 648 (1882); Coffin v. Day, 34 Fed. 687 (N. D. Ill. 1888); Lee v. Bradley Fertilizer Co., 44 Fla. 787, 33 So. 456 (1903); First National Bank v. Brubaker, 128 Iowa 587, 105 N. W. 116 (1905); Jones v. Lusk, 2 Metc. 356 (Ky. 1859); Schmidlapp & Bros. v. Currie & Co., 55 Miss. 597 (1878); Goddard-Peck Grocery Co. v. McCune, 122 Mo. 426, 25 S. W. 904 (1894); Sigler & Richey v. Knox County Bank, 8 Ohio St. 511 (1858); Wiggins v. Blackshear, 86 Tex. 665, 26 S. W. 939 (1894). Other cases are collected in WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929) 71-78; PEPPER AND LEWIS, CASES ON LAW OF ASSOCIATION (1915) 761; Brown, *Taking Property of Insolvent Partnership* (1915) 81 CENT. L. J. 240; Crane, *The Uniform Partnership Act—A Criticism* (1915) 28 HARV. L. REV. 762, 774-5; Notes (1906) 2 L. R. A. (N.S.) 256; (1895) 43 Am. St. Rep. 364, 372.

7. Case v. Beauregard, 99 U. S. 119 (1878) established this doctrine on a firm basis in the United States. In England it had been settled by Lord Eldon in the leading case of *Ex parte* Ruffin, 6 Ves. 119, 31 Eng. Rep. 970 (Ch. 1801). The American cases are collected in ROWLEY, MODERN LAW OF PARTNERSHIP (1916) § 526. See Shroder, *Distribution of Assets of Bankrupt Partnerships and Partners* (1905) 18 HARV. L. REV. 495, 499; CRANE, PARTNERSHIP (1938) § 43.

of the partners are extinguished, and consequently the derivative equities of the creditors are at an end."[8]

The partners were thus permitted, provided they acted in good faith, to prefer individual to firm creditors as they wished. Moreover, the evidential standards adopted with regard to proof of bad faith in these transactions were very strict. Even knowledge of firm insolvency at the time of the transaction was sometimes held insufficient to negative good faith.[9] These strict requirements, however, were not universal. In England a transfer of assets from an insolvent firm was considered a fraudulent conveyance.[10] In New Hampshire firm creditors were considered to have a "legal right" to follow firm assets, a "right" which survived efforts of the partners to cut it off.[11] In other states courts have held such a transfer fraudulent, either because of insufficient consideration,[12] or because of the disregard of equitable priorities and the hindrance to firm creditors if firm property be converted to severalty during insolvency.[13]

8. Mr. Justice Strong, in Case v. Beauregard, 99 U. S. 119, 125 (1878). This doctrine was broadly affirmed in two subsequent decisions of the Supreme Court. Huiskamp v. Moline Wagon Co., 121 U. S. 310 (1887); Fitzpatrick v. Flannagan, 106 U. S. 648 (1882). This analysis of the partnership relationship has been used to support, as against firm creditors, the application, with consent of the partners, of the assets of an insolvent firm to payment of individual debts of a partner, Huiskamp v. Moline Wagon Co., *supra;* or to payment of a debt of all the partners not a partnership debt, Vietor v. Glover, 17 Wash. 37, 48 Pac. 788 (1897); or to support a division of firm property among the partners, Lee v. Bradley Fertilizer Co., 44 Fla. 787, 33 So. 456 (1902); or a claim of statutory exemption in firm property on dissolution, Crawford v. Sternberg, 220 Fed. 73 (C. C. A. 8th, 1915). *Contra* on last point: *In re* Turnock & Sons, 230 Fed. 985 (C. C. A. 7th, 1916); *In re* Jacobs, 21 F. (2d) 1006 (W. D. Mich. 1927), (1928) 41 HARV. L. REV. 664; *cf.* Dixon v. Koplar, 102 F. (2d) 295 (C. C. A. 8th, 1939).

9. Case v. Beauregard, 99 U. S. 119 (1878); *In re* Fackelman, 248 Fed. 565 (S. D. Cal. 1918); Crawford v. Sternberg, 220 Fed. 73 (C. C. A. 8th, 1915); *In re* McConnell & Williams, 32 Am. B. R. 589 (S. D. Cal. 1914) (referee); Lee v. Bradley Fertilizer Co., 44 Fla. 787, 33 So. 456 (1903); *cf.* Hays v. Harris, 78 F. (2d) 66, 72 (C. C. A. 8th, 1935), *cert. denied,* 296 U. S. 613 (1935); Dakota Trust & Savings Bank v. Hanson, 5 F. (2d) 915 (C. C. A. 8th, 1925); Sargent v. Blake, 160 Fed. 57 (C. C. A. 8th, 1908). Many of the reports do not make clear whether or not knowledge of insolvency was present.

10. *Ex parte* Mayou, 4 DeG. J. & S. 664, 46 Eng. Rep. 1076 (Ch. App. 1865); LINDLEY, PARTNERSHIP (10th ed. 1935) 414. Professor Warren suggests that the American courts erred in not following Ex parte *Mayou,* as well as Ex parte *Ruffin,* 6 Ves. 119, 31 Eng. Rep. 970 (Ch. 1801). WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929) 65-80.

11. Tenney v. Johnson, 43 N. H. 144 (1861); *cf.* Elliot v. Stevens, 38 N. H. 311 (1859); Ferson v. Monroe, 21 N. H. 462 (1850). See also Conroy & O'Connor v. Woods, 13 Cal. 626 (1859).

12. Caraway's Adm'rs v. Stealey, 44 W. Va. 163, 28 S. E. 793 (1897); Darby & Co. v. Gilligan, 33 W. Va. 246, 10 S. E. 400 (1889); *cf.* Keith v. Fink, 47 Ill. 272 (1868).

13. Johnston v. Straus, 26 Fed. 57 (C. C. E. D. Va. 1882); Conroy & O'Connor v. Woods, 13 Cal. 626 (1859); Roop v. Herron, 15 Neb. 73, 17 N. W. 353 (1883); Arnold v. Hagerman, 45 N. J. Eq. 186, 17 Atl. 93 (1888); Bulger v. Rosa, 119 N. Y. 459, 24 N. E. 853 (1890); *cf.* Goodbar v. Cary, 16 Fed. 316 (N. D. Miss. 1882); Pritchett v.

Bankruptcy courts under the 1898 Act[14] occasionally followed the lead of these cases,[15] but the influence of the old line of decisions persisted and the priority of firm creditors was often held lost through a prior "good faith" transfer during insolvency.[16] The serious effect of such decisions on the position of firm creditors cannot be doubted, even in the situation where the purchasing partner has assumed the firm debts so as to put firm creditors on a parity with, instead of behind, his individual creditors.[17] Since the test of firm solvency is the sufficiency of firm assets and the surplus of individual assets of the partners over their individual liabilities,[18] it is almost certain

Pollock & Co., 82 Ala. 169, 2 So. 735 (1887); Cron v. Cron's Estate, 56 Mich. 8, 22 N. W. 94 (1885); Clark-Jewell-Wells Co. v. Tolsma, 151 Mich. 561, 115 N. W. 688 (1908); Jackson Bank v. Durfey, 72 Miss. 971, 18 So. 456 (1895). Other courts say that the "derivative" right of firm creditors may not be impaired upon insolvency of the firm. Franklin Sugar Refining Co. v. Henderson, 86 Md. 452, 38 Atl. 991 (1897), (1898) 11 HARV. L. REV. 552. See generally Cowles, *The Firm as a Legal Person* (1903) 57 CENT. L. J. 343.

14. 30 STAT. 544 (1898), 11 U. S. C. §§ 1-112 (1934).

15. Amundson v. Folsom, 219 Fed. 122 (C. C. A. 8th, 1914); *In re* Filmar, 177 Fed. 170 (C. C. A. 7th, 1910); *In re* Terens, 175 Fed. 495 (E. D. Wis. 1910); *cf. In re* Turrentine & Thompson, 6 F. Supp. 490 (N. D. Tex. 1934); *In re* Brewer, 289 Fed. 79 (E. D. N. C. 1923); *In re* Turnock & Sons, 230 Fed. 985 (C. C. A. 7th, 1916); *In re* Young, 223 Fed. 659 (D. Mass. 1915); *In re* Damare, 28 Am. B. R. 297 (S. D. Miss. 1912) (referee); *In re* Perlhefter, 177 Fed. 299 (S. D. N. Y. 1910); Holmes v. Baker & Hamilton, 160 Fed. 922 (C. C. A. 9th, 1908); *In re* Head, 114 Fed. 489 (W. D. Ark. 1902); *In re* Denning, 114 Fed. 219 (D. Mass. 1902); *In re* Jones, 100 Fed. 781 (E. D. Mo. 1900). See Comment (1910) 10 COL. L. REV. 467; Note (1928) 41 HARV. L. REV. 664.

16. Titus v. Maxwell, 281 Fed. 433 (C. C. A. 6th, 1922); *In re* Fackelman, 248 Fed. 565 (S. D. Cal. 1918); *In re* Zartman, 242 Fed. 595 (M. D. Pa. 1917); Stringer v. Stevenson, 240 Fed. 892 (C. C. A. 2d, 1917); *In re* Suprenant, 217 Fed. 470 (N. D. N. Y. 1914) *semble; In re* Kolber, 193 Fed. 281 (E. D. Pa. 1912); *cf.* Hays v. Harris, 78 F. (2d) 66, 72 (C. C. A. 8th, 1935); Dakota Trust & Savings Bank v. Hanson, 5 F. (2d) 915 (C. C. A. 8th, 1925); *In re* Baker & Edwards, 224 Fed. 611 (E. D. N. C. 1915); Ryan v. Cavanagh, 238 Fed. 604 (S. D. Iowa 1916); Rapple v. Dutton, 226 Fed. 430 (C. C. A. 9th, 1915), (1916) 16 COL. L. REV. 355; Crawford v. Sternberg, 220 Fed. 73 (C. C. A. 8th, 1915); Warner v. Grafton Woodworking Co., 210 Fed. 12 (C. C. A. 4th, 1913); Sargent v. Blake, 160 Fed. 57 (C. C. A. 8th, 1908); *In re* McConnell & Williams, 32 Am. B. R. 589 (S. D. Cal. 1914) (referee). See 6 REMINGTON, BANKRUPTCY (4th ed. 1937) § 2935. In Dean v. Davis, 242 U. S. 438 (1917), Mr. Justice Brandeis in a footnote cited *Sargent v. Blake*, one of the cases most frequently cited in support of this doctrine, as a case difficult to reconcile "with the great weight of authority and the decisions of this court." *Id.* at 446.

17. In the rare event that firm assets are negligible, and assets of the purchasing partner considerable, it is clear that firm creditors will have no reason to object to loss of priority in firm assets.

18. Francis v. McNeal, 228 U. S. 695 (1913); Meek v. Beezer, 28 F. (2d) 343 (C. C. A. 3d, 1928), *cert. denied*, 278 U. S. 651 (1929); Vaccaro v. Security Bank of Memphis, 103 Fed. 436 (C. C. A. 6th, 1900). A similar definition of insolvency is contained in Uniform Fraudulent Conveyance Act § 2(2); *cf.* UNIFORM PARTNERSHIP ACT § 40(a). But the Supreme Court has hinted that the method of determining firm insolvency is still open to argument. Liberty Nat. Bank v. Bear, 276 U. S. 215, 224, n. 9 (1928).

that if the firm were insolvent at the time of transfer, the purchasing partner's estate, augmented by the former firm property, will be far from adequate to pay all creditors. Therefore, to treat as an evanescent "derivative equity" the priority on which firm creditors have relied in dealing with the firm seems to those unacquainted with the mysteries of jurisprudence highly unfair.[19]

Under the Chandler Act,[20] firm creditors seem to have at last a hopeful prospect of escape from this inequity. Several preliminary steps are necessary, however, before the creditors can take advantage of the remedies provided by the Act. First, they must promptly assert their opposition to the transfer. If they assent, as they may sometimes wish to do, to the assumption of the firm debts by the purchasing partner, the novation effectively discharges the firm obligation as such.[21] If, moreover, the firm creditors are not willing to share *pro rata* with the individual creditors, they must take care not to be barred from relief by laches or by a finding of tacit acquiescence in the assumption of firm debts by the remaining partner.[22] Provided, however, that they act in time, firm creditors may file against the dissolved firm a petition under the Bankruptcy Act, if they can show the occurrence of a firm act of bankruptcy within four months prior to the petition.[23] The existence of such an act of bankruptcy will depend in

19. *Cf.* Dodd, *Dogma and Practice in the Law of Associations* (1929) 42 HARV. L. REV. 977, 998; Dodd, *American Business Association Law a Hundred Years Ago and Today* in 3 LAW—A CENTURY OF PROGRESS (1937) 254, 260.

20. 52 STAT. 840, 11 U. S. C. § 1 *et seq.* (Supp. 1938).

21. UNIFORM PARTNERSHIP ACT § 36; RESTATEMENT, CONTRACTS (1932) § 428. Dissolution of itself does not discharge the existing liability of any partner. UNIFORM PARTNERSHIP ACT § 36(1); CRANE, PARTNERSHIP (1938) § 79. Section 41(2) of the Act provides that if the remaining partner continues the business, creditors of the dissolved firm are also his creditors, whether or not he assumed the firm debts.

22. *Cf.* UNIFORM PARTNERSHIP ACT § 36(2); CRANE, PARTNERSHIP (1938) § 79. If a partner on retiring from a firm fails to give adequate notice of his retirement, he is considered a partner by estoppel as to subsequent creditors ignorant of the change in firm membership, and he may in certain instances bind the partnership by his acts. UNIFORM PARTNERSHIP ACT § 35; CRANE, PARTNERSHIP (1938) § 81. However, a partnership by estoppel cannot be adjudged a bankrupt, nor can an estoppel partner, despite his personal liability to estoppel creditors, be adjudged a member of a bankrupt partnership. *In re* Ganaposki, 27 F. Supp. 41 (M. D. Pa. 1939); *In re* Kuntz, 33 F. (2d) 198 (M. D. Pa. 1929); *In re* Pinson & Co., 180 Fed. 787 (N. D. Ala. 1910); 1 REMINGTON, BANKRUPTCY (4th ed. 1934) § 71; *cf.* Marquette Cloak & Suit Co. v. Netter & Meyer, 151 So. 820 (La. App. 1934); *In re* Fahey, 26 F. (2d) 382 (S. D. Tex. 1928); *In re* Kaplan, 234 Fed. 866 (C. C. A. 7th, 1916); *In re* Evans, 161 Fed. 590 (N. D. Ga. 1908); Thayer v. Humphrey, 91 Wis. 276, 64 N. W. 1007 (1895), (1896) 9 HARV. L. REV. 433. Comparable estoppel problems arise when a stranger to the firm represents himself as a partner. See UNIFORM PARTNERSHIP ACT § 16.

23. "A partnership . . . during the continuation of the partnership business or after its dissolution and before the final settlement thereof may be adjudged a bankrupt . . ." § 5a, 52 STAT. 845, 11 U. S. C. § 23 (Supp. 1938). It is settled that a partnership may be adjudicated a bankrupt as a separate entity, without regard to any adjudication of bankruptcy against the partners as individuals. Liberty Nat. Bank v. Bear, 276 U. S.

most cases[24] on a determination of whether the sale of one partner's interest in the firm to his copartner constitutes a fraudulent or preferential transfer of firm assets within the meaning of Sections 3a(1) or 3a(2) of the Bankruptcy Act.

The first question to be answered in the solution of this problem is whether the transaction amounts to a "transfer" in the sense in which that word is used in the Bankruptcy Act.[25] As a practical matter, the sale of one partner's interest in a firm of two partners should be regarded as a conveyance of partnership property to the partner purchasing the interest, at least for the purposes of Section 3a(1) and 3a(2). It may well be questioned whether such a conveyance can be *valid*;[26] but if held valid, it terminates the part-

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215 (1928). See Comments (1929) 29 COL. L. REV. 1134; (1928) 41 HARV. L. REV. 1044. §§ 5a and 5b of the present Act make statutory provision for such an adjudication. A firm may be adjudicated when the only evidence of its continued existence is its unpaid debts and the surviving assets in one partner's hands. Amundson v. Folsom, 219 Fed. 122 (C. C. A. 8th, 1914); *In re* Perlhefter, 177 Fed. 299 (S. D. N. Y. 1910); Holmes v. Baker & Hamilton, 160 Fed. 922 (C. C. A. 9th, 1908); *cf. In re* Hirsch, 97 Fed. 571 (S. D. N. Y. 1899); *In re* Levy, 95 Fed. 812 (N. D. N. Y. 1899). *But cf. In re* Pinson & Co., 180 Fed. 787 (N. D. Ala. 1910); *In re* Young, 223 Fed. 659 (D. Mass. 1915). A firm may be adjudicated bankrupt after its dissolution by the death of one of the two partners. *In re* Salladay, 22 F. (2d) 300 (E. D. Ill. 1927); *In re* Lomont, 9 F. (2d) 407 (D. Md. 1925); *In re* Wells, 298 Fed. 109 (S. D. Ohio 1924).

24. Some other act of bankruptcy, such as the appointment of an equity receiver in a state court, may be available. Again the necessity of finding any act of bankruptcy may be unnecessary under § 5i which provides that a partnership will be adjudged bankrupt, if all the general partners are in bankruptcy; thus if the selling, as well as the purchasing partner be adjudged bankrupt, automatic adjudication of the firm will follow. Another possibility for securing firm adjudication lies in the new § 5b. The transferor partner, seeing the purchasing partner on the threshold of bankruptcy, might, under § 5b, file a petition "in behalf of" the partnership, alleging firm insolvency. The vendor partner, whose liability to partnership creditors still subsists [CRANE, PARTNERSHIP (1938) § 79], might thus forestall the possibility of having to pay the full amount of firm creditors' claims, with no prospect of full remuneration from the purchasing partner. See note 26 *infra*.

25. An act of bankruptcy by a person shall consist, under § 3a(1), of his having "conveyed, *transferred*, concealed, removed, or permitted to be concealed or removed any part of his property . . . ;" under § 3a(2), of his having "*transferred* while insolvent any part of his property . . ." (Italics supplied).

26. In states which have adopted the Uniform Fraudulent Conveyance Act, it is, if the firm is or will be rendered insolvent, specifically outlawed under § 8 of the Act. This section was intended to protect creditors against transfer of any asset available to the creditor. GLENN, FRAUDULENT CONVEYANCES (1931) §§ 138, 139. Hence the transfer of a partner's interest with its accompanying conversion of firm property into individual property would presumably be so substantial an interference with firm assets as to come within the scope of the section. The transaction, however, creates a valid contract between the partners. Even though the promisor is insolvent, his promise to assume firm debts is good consideration. RESTATEMENT, CONTRACTS (1932) § 455. If the vendor partner is later compelled to pay firm debts by reason of his continuing personal liability, he has a right of recovery in full under the contract of transfer, instead of the contribution due under the partnership agreement. On occasion such a transfer is made solely for a

nership tenancy, and substitutes full ownership by the individual partner. Whatever doubt may previously have existed on the point should be regarded as removed by the enlarged definition of "transfer" in Section 1(30) of the Chandler Act. The word "transfer" under that section "shall include the sale and every other and different mode, *direct or indirect,* of disposing of or of parting with property or *with an interest therein or with the possession thereof* . . ."[27] What is transferred to the purchasing partner is the vendor partner's interest, which under the Uniform Partnership Act, is his share of the profits and surplus after payment of firm debts;[28] but the effect of the transaction on firm creditors is to end the partnership tenancy as completely as if the firm property were conveyed to a third person. This change in the manner of holding firm property should be considered a sufficient indirect method of "parting" with that property to bring it within the scope of Section 1(30), at least for purposes of Sections 3a(1) and 3a(2).

It seems unlikely, however, that the succession of a partner to the firm assets, as purchaser of his partner's interest, even though it has the effect of preferring individual over firm creditors, would be held a preference within the meaning of Section 3a(2); for that result it is regarded as necessary that the conveyance under attack as a preference prefer one of the transferor's creditors over his other creditors,[29] whereas in this case the "transferee" is not a creditor, and the creditors preferred are those of the transferee. Of course, the strength of this objection depends upon how essential it is, for the purposes of Section 3a(2), that the transferee be a creditor, and upon the extent to which the court regards the firm as an entity separate from its members, despite their liability for "firm" debts. Difficulties of doctrine on both counts make it unlikely that the purchase of or succession to partners' interests by a single partner will be considered an act of bankruptcy as a preference.

monetary consideration with no assumption of debts. Hanford v. Prouty, 133 Ill. 339, 24 N. E. 565 (1890). But only slight evidence is necessary to warrant the inference that the purchasing partner also assumed the firm debts. *Cf.* Kavanagh v. Johnson, 290 Mass. 587, 195 N. E. 797 (1935).

27. The 1938 amendments are indicated by the italicized words.

28. UNIFORM PARTNERSHIP ACT § 26. The Act has, in the words of one commentator, placed title to firm property in each partner as "co-owner whose interest is *sui generis*" [Comment (1925) 39 HARV. L. REV. 247], thereby establishing what § 25 of the Act describes as a tenancy in partnership. On the Uniform Partnership Act, see generally Lewis, *The Uniform Partnership Act* (1915) 24 YALE L. J. 617; Crane, *The Uniform Partnership Act—A Criticism* (1915) 28 HARV. L. REV. 762; Lewis, *The Uniform Partnership Act* (1915) 29 HARV. L. REV. 158; Comment (1925) 39 HARV. L. REV. 247; WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929) 293-301.

29. Under §3a(2) a firm commits an act of bankruptcy if it has "transferred, while insolvent, any portion of his [the firm's] property to one or more of his [the firm's] creditors with intent to prefer such creditors over his [the firm's] other creditors." *Cf.* Donadio v. Robetsky, 4 F. (2d) 51, 52 (C. C. A. 1st, 1925); 1 REMINGTON, BANKRUPTCY (4th ed. 1934) §§ 128.50, 181.

Firm creditors will also find difficulties in the language of Section 3a(1), which requires a conveyance with "intent to hinder, delay, or defraud" creditors,[30] and is traditionally interpreted in the light of the Statute of Elizabeth.[31] Several factors, however, combine to offer the firm creditors a chance of success under this subdivision. The courts have interpreted Section 3a(1) much more broadly than Section 14c(4), which is almost identically worded, but deals with the denial of a discharge.[32] Since discharge depends mainly on the motives, and adjudication primarily on the economic situation of the bankrupt, the courts have drawn two distinctions between the two sections. A transaction must hinder, delay *and* defraud to justify the denial of a discharge;[33] it may be an act of bankruptcy if it hinders, delays, *or* defrauds creditors.[34] Further, Section 14c(4) requires strong evidence of actual intent to defraud, while under Section 3a(1) the standards are much less strict, and the circumstances surrounding the transaction, such as the absence of consideration to the transferor, are more freely accepted as evidence of the requisite intent.[35] The liberality of the evidential standards of "intent" under Section 3a(1) will be still further increased if the section is interpreted in the light of the new Section 67d(4) introduced by the Chandler Act.

30. Transfer of insolvent firm's assets to single partner was found an act of bankruptcy in *In re* Turrentine & Thompson, 6 F. Supp. 490 (N. D. Tex. 1934); and Amundson v. Folsom, 219 Fed. 122 (C. C. A. 8th, 1914). See *In re* Fackelman, 248 Fed. 565, 567 (S. D. Cal. 1918); *In re* Head, 114 Fed. 489, 490 (W. D. Ark. 1902); *In re* Gillette, 104 Fed. 769 (W. D. N. Y. 1900); Lastrapes v. Blanc, 14 Fed. Cas. 1164, No. 8,100 (C. C. D. La. 1878); *In re* Matot, 16 Fed. Cas. 1109, No. 9,282 (D. Vt. 1877). But see Donadio v. Robetsky, 4 F. (2d) 51, 52 (C. C. A. 1st, 1925) (dissolution found to be bogus, giving partner right to property transferred to him); *In re* Perlhefter, 177 Fed. 299, 304 (S. D. N. Y. 1910) (suggesting that since firm creditors can follow firm assets, no fraud is involved).

31. 13 Eliz., c. 5 (1571). See Johnson, Baillie Shoe Co. v. Bardsley, Elmer & Nichols, 237 Fed. 763 (C. C. A. 8th, 1916); *In re* McLoon, 162 Fed. 575 (D. Me. 1908); Lansing Boiler Works v. Ryerson, 128 Fed. 701 (C. C. A. 6th, 1904); Githens v. Shiffler, 112 Fed. 505 (M. D. Pa. 1902); Gilbert's Collier on Bankruptcy (4th ed. 1937) §§ 117, 123.

32. Under § 14c(4) the court shall grant a discharge unless, within twelve months before filing of the petition in bankruptcy, the bankrupt has transferred, or permitted to be transferred, any of his property "with intent to hinder, delay, or defraud his creditors."

33. The policy of refusing discharge only in case of personal fault requires this strict interpretation. *In re* Sandler, 26 F. Supp. 841 (D. Md. 1939); *In re* Rice & Reuben, 43 F. (2d) 378 (D. Me. 1930); Feder v. Goetz, 264 Fed. 619 (C. C. A. 2d, 1920); Gilbert's Collier on Bankruptcy (4th ed. 1937) §§ 495, 496.

34. *In re* Lampros, Inc., 18 F. (2d) 633 (D. Mass. 1927); *In re* Condon, 198 Fed. 947 (S. D. N. Y. 1912); *In re* Hughes, 183 Fed. 872 (S. D. N. Y. 1910); Gilbert's Collier on Bankruptcy (4th ed. 1937) § 125.

35. *Cf. In re* Goumas, 51 F. (2d) 126 (W. D. N. Y. 1931); Mente & Co., Inc. v. Old River Co., 17 F. (2d) 350 (C. C. A. 5th, 1927); Bean Chamberlain Mfg. Co. v. Standard Spoke & Nipple Co., 131 Fed. 215 (C. C. A. 6th, 1904); Gilbert's Collier on Bankruptcy (4th. ed. 1937) §§ 121, 123, 125.

Section 67d(4) deals with the power of the trustee of an adjudicated firm to set aside fraudulent conveyances of firm property. Under this section, which embodies with a few minor changes Section 8 of the Uniform Fraudulent Conveyance Act,[36] intent is specifically ruled out as a factor in determining whether a transfer is fraudulent. Every transfer of partnership property, when the partnership is, or will be thereby rendered insolvent, is "fraudulent as to partnership creditors . . . without regard to actual intent" if the conveyance is made "(a) to a partner, whether with or without a promise by him to pay partnership debts, or (b) to a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners."[37] Thus a transfer by one partner of his interest in an insolvent firm in exchange for the purchasing partner's assumption of firm debts, assuming that it constitutes a "transfer" of firm property, can be set aside by the firm trustee, under subdivision (a). The drafters of the section felt that "it is improper for partners to assign the partnership property to one of their number when they are insolvent."[38] They recognized that such a transfer may involve as real a diminution of the assets available for firm creditors as does a conveyance of firm assets to a third party without consideration to the firm. That this is so is made clear by the fact that in Section 67d(1) the traditional test of partnership solvency is codified,[39] as it is in the Uniform Fraudulent Conveyance Act[40] and the Uniform Partnership Act.[41] Since under this test it is ordinarily "impossible that a

36. Except for the provision "without regard to actual intent" and the time limitation of one year prior to bankruptcy, this section is substantially identical with § 8 of the Uniform Act. See McLaughlin, *Aspects of the Chandler Bill* (1937) 4 U. OF CHI. L. REV. 369, 384-388.

37. A solvent firm may or may not be rendered insolvent by transfer of firm assets to a partner. The surplus of the partners' assets are included in any determination of partnership solvency, but a relatively large deficit on an individual partner's separate account may absorb any surplus on firm account, thus making payment in full of firm assets impossible if the transfer is upheld.

38. Notes to § 22, Draft D, of the Uniform Partnership Act, which embodied provisions similar to those of § 67d(4). The entire section on fraudulent conveyances was later omitted from the Partnership Act in order that the field of fraudulent conveyances might be completely covered by the Uniform Act on that subject. The corresponding section of the seventh draft of the Partnership Act is quoted in Crane, *The Uniform Partnership Act—A Criticism* (1915) 28 HARV. L. REV. 762, 776. The notes to § 7 [present § 8] of the second draft of the Uniform Fraudulent Conveyance Act observe that "the existing case law on the subject of this section is in such confusion that it is impossible to state whether the section as drafted represents the weight of authority." (1917) 27 PROC. OF NAT. CONF. OF COMM'RS ON UNIFORM STATE LAWS 250, 256. The fact this section is specifically designed to cover a conveyance of this sort lends further strength to the argument that transfer of a partner's interest is a "transfer" of partnership property within the statutory definition. See also pp. 691-692 *supra.*

39. See p. 689 *supra.*

40. UNIFORM FRAUDULENT CONVEYANCE ACT § 2(2).

41. UNIFORM PARTNERSHIP ACT § 40(a).

firm should be insolvent while the members of it remained able to pay its debts with money available for that end,"[42] loss of priority in one of the available funds may lead to a material loss to firm creditors. Even in the rare event that no loss results, firm creditors should have the right to set the transaction aside.[43]

It seems unlikely, on the other hand, that the trustee of an adjudicated firm could attack the transfer of firm property to a single partner as a voidable preference under Section 60b.[44] Again there is the same difficulty which arose under Section 3a(2);[45] the statute says that the preferential transfer must enable the transferee creditor to obtain a greater percentage of his debt than some other creditor of the same class. However, the transfer in question is not to a creditor, nor does it benefit creditors of the transferor, which is the firm; nor is the preference created one between creditors of the same class. An alternative attack with a greater likelihood of success is found in Section 5h, under which the court is to marshal the assets of the partnership and individual estates "so as to prevent preferences and secure the equitable distribution of the property of the several estates."[46] Preferences within the meaning of this section have, in judicial usage, not been limited to the definition of Section 60;[47] rather it appears that the term means preferences as between different classes of creditors — those of the firm and those of the individual partners. This conclusion is supported both by the statutory language and by the interpretation given it by the courts. Section 5h is intended to "secure the equitable distribution of the property of the several estates." The courts have ruled that 5h does not limit, but rather strengthens and executes the distribution provisions of 5g, under which

42. Mr. Justice Holmes in Francis v. McNeal, 228 U. S. 695, 700 (1913).

43. See notes to § 22, Draft D, Uniform Partnership Act. But *cf.* Irving Trust Co. v. Chase Nat. Bank, 65 F. (2d) 409 (C. C. A. 2d, 1933), (1935) 29 ILL. L. REV. 799. It is always possible that a bona fide purchaser, a "non-conductor" in Mr. Justice Holmes' phrase [Donnell v. Herring-Hall-Marvin Safe Co., 208 U. S. 267, 273 (1908)] will interpose himself between the trustee and firm property and prevent recovery thereof. See GLENN, FRAUDULENT CONVEYANCES (1931) §§ 236, 237.

44. This section requires that if a preference is to be voidable, the creditor receiving it must, at the time when the transfer is made, have reasonable cause to believe that the debtor is insolvent. Campanella v. Liebowitz, 103 F. (2d) 252 (C. C. A. 3d, 1939).

45. See p. 692 *supra*. On partnership preferences, see Wartell v. Moore, 261 Fed. 762 (C. C. A. 6th, 1919); Mills v. Fisher, 159 Fed. 897 (C. C. A. 6th, 1908); Rubenstein v. Lottow, 220 Mass. 156, 107 N. E. 718 (1915), 223 Mass. 227, 111 N. E. 973 (1916); 4 REMINGTON, BANKRUPTCY (4th ed. 1935) §§ 1652, 1681, 1685, 1810; 6 *id.* at §§ 2931–2933.

46. This subsection is identical with § 5g of the 1898 Act.

47. Fort Pitt Coal & Coke Co. v. Diser, 239 Fed. 443 (C. C. A. 6th, 1917); *In re* Filmar, 177 Fed. 170 (C. C. A. 7th, 1910); *In re* Terens, 175 Fed. 495 (E. D. Wis. 1910); *In re* Denning, 114 Fed. 219 (D. Mass. 1902); *In re* Jones, 100 Fed. 781 (E. D. Mo. 1900); *cf. In re* Damare, 28 Am. B. R. 297 (S. D. Miss. 1912) (referee).

the firm creditors are given their priority.[48] Since, therefore, courts of bankruptcy, both by statute[49] and by case law,[50] have equity powers, it seems reasonable to assume that the court has authority to set aside transfers which annul the rule of Section 5g, at least when the transfer is made in contemplation of bankruptcy.[51] If this be granted, Section 5h may be invoked either by the trustee of an adjudicated firm,[52] or by firm creditors on bankruptcy of the partner to whom firm assets had been assigned. In either case the court would marshal the assets to preserve the respective priorities of firm and individual creditors. Thus if the purchasing partner, but not the firm, is in bankruptcy, firm creditors may be able to preserve their priority without the necessity for finding a basis for firm adjudication.

In states which have adopted the Uniform Fraudulent Conveyance Act[53] or passed statutes containing provisions similar to the partnership section

48. Fort Pitt Coal & Coke Co. v. Diser, 239 Fed. 443 (C. C. A. 6th, 1917); *In re* Filmar, 177 Fed. 170 (C. C. A. 7th, 1910); *In re* Terens, 175 Fed. 495 (E. D. Wis. 1910); *In re* Denning, 114 Fed. 219 (D. Mass. 1902). Present § 5g is substantially the same as old § 5f; present § 5h is identical with old § 5g. Judge Lowell, in *In re* Denning, *supra* at 221, said: "Moreover, section 5g [present § 5h] of the bankruptcy act was intended, I believe, . . . to permit the court to deal with conversions of this kind so as not only to prevent preference in the technical meaning of that word, but also so as to 'secure the equitable distribution of property of the several estates.'"

49. Section 2a of the Bankruptcy Act invests courts of bankruptcy "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act."

50. Courts of Bankruptcy "are essentially courts of equity, and their proceedings inherently proceedings in equity." Continental Ill. Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 675 (1935). *Cf.* Donald v. San Antonio Joint Stock Land Bank, 100 F. (2d) 312 (C. C. A. 5th, 1938); GILBERT'S COLLIER ON BANKRUPTCY (4th ed. 1937) § 23.

51. Professor Warren has suggested that transfers made by insolvent partners might be upset "on the ground that, if allowed to stand, they would prevent the proper distribution of the assets under the bankruptcy statute." WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929) 69. This theory finds support in common law cases which set aside such transfers on equitable principles; *cf.* cases cited in notes 11, 13 *supra.* In Howe v. Lawrence, 9 Cush. 553, 558 (Mass. 1852), the court said that the transfer of joint property to a co-partner, with knowledge of insolvency of the firm, and with intent to deprive the creditors of the "proper application to the payment of the joint debts" of the firm assets, is a fraud at law, and equity would at once set it aside.

52. The trustee of an adjudicated firm may order a partner not individually adjudicated to turn over his estate for administration in firm bankruptcy proceedings. Francis v. McNeal, 228 U. S. 695 (1913). The firm trustee may thus reach assets of either vendor or purchasing partners.

53. The Uniform Fraudulent Conveyance Act has been adopted by 16 states. 9 U. L. A. (Supp. 1938) 94. The Uniform Partnership Act has been adopted by 18 states. 7 U. L. A. (Supp. 1938) 5. Thirteen states have adopted both acts, among them New York, New Jersey, Pennsylvania, Massachusetts, and Michigan. On the Uniform Fraudulent Conveyance Act, see generally GLENN, FRAUDULENT CONVEYANCES (1931); McLaughlin, *Application of the Uniform Fraudulent Conveyance Act* (1933) 46 HARV. L. REV. 404; Legis. (1925) 25 COL. L. REV. 487, 489–490. On the application of § 8, see

of that Act, upon which Section 67d(4) is based, additional remedies are open to the trustee of an adjudicated firm. Under Section 70e, which provides that a conveyance fraudulent as to creditors under state law is void as against the trustee of the transferor, it may be possible to avoid the one year limitation on such action contained in Section 67d(4).[54] On the other hand, instead of seeking an adjudication under the Bankruptcy Act, firm creditors may prefer to bring appropriate action under state fraudulent conveyance laws, if such laws contain provisions applicable to partnership transfers of this sort.[55] Again, they may rely for relief on the rule that a constructive trust may be imposed on one who assists or encourages a fraudulent conveyance by the debtor to a third person, if the abettor thereof has received benefits, either directly or indirectly, from the conveyance.[56] If the individual creditors of the purchasing partner had known of firm insolvency, and had assisted or encouraged the transfer of firm assets to a single partner, they would be subject to this rule, having benefited at least indirectly by the conveyance;[57] an action for an accounting brought by the firm creditors against such of the individual creditors as were privy to the transaction would properly lie.

The most hopeful remedy for firm creditors on transfer of the property of an insolvent firm to a single partner, however, lies in the power of the trustee to set the transfer aside as fraudulent under Section 67d(4). This section seems specifically directed at this type of transfer; in permitting the trustee to set aside such transfers without reference to the partners' intent, inferred or otherwise, it places the emphasis in defining fraudulent conveyances where it should be placed — on the economic situation of the firm at the time of the transfer. If a proper basis for firm adjudication can be found, Section 67d(4) seems to furnish a conclusive answer to the cases which give the partners a right to destroy the priority of firm creditors so long as they do it in "good faith." In Section 3a(1), such a basis for firm

Liebowitz v. Arrow Roofing Co., 259 N. Y. 391, 182 N. E. 58 (1932); CRANE, PARTNERSHIP (1938) § 46; GLENN, FRAUDULENT CONVEYANCES (1931) §§ 215–219.

54. State statutes of limitation frequently allow a longer period in which actions may be brought. GILBERT'S COLLIER ON BANKRUPTCY (4th ed. 1937) § 1557. But the definition of what constitutes insolvency in a bankruptcy sense does not control in determining whether a debtor was insolvent so as to make a voluntary conveyance fraudulent under state law. Underleak v. Scott, 117 Minn. 136, 134 N. W. 731 (1912).

55. For various forms of state relief, see GLENN, FRAUDULENT CONVEYANCES (1931) §§ 63–93. Many state acts require "intent to disturb, delay, hinder or defraud." See ILL. ANN. STAT. (Smith-Hurd, 1936) c. 59, § 4; ORE. CODE ANN. (1930) §§ 63-507, 63-510; VA. CODE ANN. (Michie & Sublett, 1936) § 5184.

56. Duell v. Brewer, 92 F. (2d) 59 (C. C. A. 2d, 1937), (1938) 47 YALE L. J. 840, (1938) 24 VA. L. REV. 325.

57. There is a possibility that tort liability might be imposed on the abettor of a fraudulent conveyance, if he has benefitted thereby. *Cf.* Duell v. Brewer, 92 F. (2d) 59, 61 (C. C. A. 2d, 1937); Note (1938) 112 A. L. R. 1250. But *cf.* (1938) 24 VA. L. REV. 325.

adjudication appears to be provided. The liberal interpretation of the intent requirement makes it quite probable that the courts will adopt the policy of Section 67d(4) and consider insolvency of the firm at the time of transfer an important evidential consideration in inferring the requisite intent to hinder, delay or defraud firm creditors.[58] Nevertheless, the retention of the formal requirement of intent, together with the specific limitation of the standards of Section 67d(4) to that section,[59] leaves the possibility that firm creditors, when unable to prove "intent," or to discover any other act of bankruptcy,[60] may be abandoned to the often inadequate remedies of the state law.[61] Such a result would be unfortunate; subjective standards of intent have an appropriate place in determining whether a bankrupt shall be granted a discharge, but none in deciding whether he shall be adjudicated. It is to be hoped that, in the absence of a major legislative revision of the machinery of acts of bankruptcy, courts will follow the lead of Section 67d(4), and interpret the wording of Section 3a(1) so as to give firm creditors a remedy in bankruptcy against this kind of change in the internal organization of the firm whenever the firm is insolvent at the time of the transaction.[62]

58. While insolvency at the time the transfer became effective is not required under § 3a(1), solvency at the time the petition is filed is, under § 3c, a complete defense to any proceedings under the first act of bankruptcy. Under the old Act, Judge Learned Hand said that it would "violate the whole theory of bankruptcy" if § 3a(1) and the old § 67e were interpreted as setting up different standards. *In re* Condon, 198 Fed. 947, 951 (S. D. N. Y. 1912); see generally Hadley, *Fraudulent Conveyance as an Act of Bankruptcy* (1934) 9 NOTRE DAME LAWYER 261.

59. The definitions and standards used in § 67d are specifically "for the purposes of, and exclusively applicable to, this subdivision d."

60. The conveyance of firm assets will, in most cases, be the only firm act upon which an act of bankruptcy may be based.

61. The statutes of many states require "intent" if a fraudulent conveyance is to be set aside. See note 55 *supra*.

62. Professor Treiman has persuasively suggested that acts of bankruptcy be replaced by the sole requirement of insolvency, with appropriate indicia thereof, at the time of the petition. Treiman, *Acts of Bankruptcy, A Medieval Concept in Modern Bankruptcy Law* (1938) 52 HARV. L. REV. 189.