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Creditors' Rights and Security Transactions -- 1957 Tennessee Survey

Paul J. Hartman

CREDITORS' RIGHTS AND SECURITY TRANSACTIONS—1957 TENNESSEE SURVEY

PAUL J. HARTMAN*

Fraudulent Conveyances—Effect of Recordation of Fradulent Conveyance on Subsequent Creditors: In *Butler v. Holland*,[1] the Tennessee Supreme Court was faced with the question of whether the constructive notice of a recorded deed which is a fraudulent conveyance prevents a creditor, who became such after the recordation, from setting the conveyance aside. The plaintiff-creditor (Butler), in an effort to collect a debt due him from the estate of one Jesse Nolen, deceased, brought a suit in equity to have set aside, as a fraud against plaintiff, a conveyance of real estate by one Nolen to the defendant (Holland). The conveyance admittedly was a gift by Nolen to defendant. Plaintiff's claim arose after the conveyance in question was recorded. Nolen (grantor) continued to live on the land for some time after the questioned deed. He then moved off the property and went to live with defendant, who was a non-resident. While the opinion is not clear, there is considerable indication that Nolen may have been living on the land when plaintiff gave credit to Nolen.

The Supreme Court sustained defendant's demurrer on the sole ground that since the deed was on record before plaintiff's claim arose plaintiff was charged with constructive knowledge of the conveyance and it was not, therefore, fraudulent as to plaintiff.

Tennessee has adopted the Uniform Fraudulent Conveyance Act, which has a number of provisions putting subsequent creditors upon an equal basis with existing creditors with reference to their right to attack transfers that are fraudulent.[2] Likewise, one of the adopted

* Professor of Law, Vanderbilt University; member, Tennessee Bar.

1. 289 S.W.2d 701 (Tenn. 1956).

2. TENN. CODE ANN. §§ 64-313 to -315 (1956); UNIFORM FRAUDULENT CONVEYANCE ACT §§ 5-7.

"Every conveyance made without fair consideration, when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands, after the conveyance, is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business transaction without regard to his actual interest. [Sic. Intent?]" TENN. CODE ANN. § 64-313 (1956).

"Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors." TENN. CODE ANN. § 64-314 (1956).

"Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud, either present or future creditors, is fraudulent as to both present and future creditors." TENN. CODE ANN. § 64-315 (1956).

The above sections were applied in striking down a fraudulent conveyance in State *ex rel.* v. Nashville Trust Co., 28 Tenn. App. 388, 190 S.W.2d 785 (M.S.

provisions, section 4 of the Uniform Fraudulent Conveyance Act, condemns as a fraudulent conveyance the so-called voluntary or gratuitous conveyance of property, such as we have in the case at hand. Such gift will be a fraudulent conveyance irrespective of any actual intent to defraud if the gift was made by a person who is or will be thereby rendered insolvent.[3]

Unfortunately, the opinion in the case at hand does not give sufficient facts to reveal whether the conveyance would have been fraudulent under any of the relevant sections of the fraudulent conveyance statutes of Tennessee. The only question with which the Court concerned itself was whether a subsequent creditor is precluded from attacking an alleged fraudulent conveyance solely by reason of the fact that the conveyance was recorded before the creditor's claim arose. As we have already seen, the court held that such recordation was conclusive against any relief.

There is some authority to the effect that the subsequent creditor can successfully attack a fraudulent conveyance even though he had knowledge of the fraudulent conveyance before he extended credit.[4] Perhaps, however, the weight of authority is to the effect that the subsequent creditor who acted with actual knowledge that a previous conveyance was fraudulent cannot set aside the prior conveyance.[5] If the creditor actually knows, when he gives credit, that his debtor has made a fraudulent conveyance, it might be found that the creditor impliedly approved of the prior fraudulent conveyance. "But it is one thing to know of the conveyance," as Mr. McLaughlin, an authority in the field, has so aptly said, "and another to know of the fraud."[6] Continues Mr. McLaughlin, in speaking of the subsequent creditor's right to attack a fraudulent conveyance: "The law will not tolerate the concealment of assets with evil intent, even if empowering the creditor to reach such assets permits him to get satisfaction in a manner somewhat different from that which he had anticipated."[7]

1944) (This case contains a most scholarly treatment of the law of fraudulent conveyances in Tennessee by Judge Felts). Even before the adoption of the Uniform Act in 1919, a subsequent creditor was permitted successfully to attack a fraudulent conveyance under the much older fraudulent conveyance statute. TENN. CODE ANN. § 64-301 (1956); Churchill v. Wells, 47 Tenn. 364 (1870).

3. TENN. CODE ANN. § 64-312 (1956). See State *ex rel.* v. Nashville Trust Co., 28 Tenn. App. 388, 417, 190 S.W.2d 785, 796 (M.S. 1944).

4. Pope v. Bain, 6 N.J. 351, 78 A.2d 820 (1951); Ledford v. Lee, 29 Tenn. App. 660, 200 S.W.2d 393 (E.S. 1946).

5. *In re* Campbell's Estate, 164 Misc. 632, 299 N.Y. Supp. 442 (Surr. Ct. 1937); Long v. True, 149 Tenn. 673, 261 S.W. 669 (1923); see State *ex rel.* v. Nashville Trust Co., 28 Tenn. App. 388, 418-19, 190 S.W.2d 785, 796-97 (M.S. 1944); 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 343c (1940); 24 AM. JUR., *Fraudulent Conveyances* § 145 (1939).

6. McLaughlin, *Application of the Uniform Fraudulent Conveyance Act*, 46 HARV. L. REV. 404, 430 (1932).

7. *Id.* at 431.

Consequently, a good many jurisdictions passing on the point have taken the position that the subsequent creditor is not precluded from attacking a fraudulent conveyance by anything except knowledge, or actual notice, that the conveyance was fraudulent. The subsequent creditor is thus not prejudiced in his efforts to set aside a fraudulent conveyance by the constructive notice that is afforded by recordation of the transfer.[8] This view is approved by the leading authoritative writers in the field.[9] There have been intervals when Tennessee seemed committed to this view,[10] and during other periods of time the Tennessee courts have been of the persuasion that such constructive notice is enough to prevent a subsequent creditor from upsetting a fraudulent conveyance.[11]

It might be urged with some force that, in view of the fact that the deed in question in the instant case recited that it was made for a consideration of $1.00 (which was unpaid), plaintiff was put on constructive notice that the conveyance was, in fact, fraudulent, although deed recitals as to consideration usually are not too accurate.

However, the Court in the instant case (as well as courts in other jurisdictions adopting this view) seems to predicate its holding on the idea that the subsequent creditor cannot upset a fraudulent conveyance unless he has been misled. In the writer's opinion, this is to misconceive the law of fraudulent conveyances, for the rights of creditors to attack such a conveyance do not necessarily depend upon a showing that the creditors have been specifically misled.[12] As we have already pointed out, Teunessee has statutory provisions condemning fraudulent conveyances as to those who become creditors *subsequent to* the fraudulent conveyance in question. It cannot, with reason, be said that such subsequent creditors' rights depend upon being misled by the debtor. The reason for nullifying such conveyances is that the law simply should not permit a debtor to conceal his assets with the evil intent of defrauding his subsequent creditors.

The decision in the instant case devitalizes these Tennessee statutory provisions empowering subsequent creditors to set aside fraudulent conveyances, in so far as recordable transactions are concerned, by

8. McCanless v. Smith, 51 N.J. Eq. 505, 25 Atl. 211 (Ch. 1892); Marshall v. Roll, 139 Pa. 399, 20 Atl. 999 (1891); see Davis v. Cassels, 220 Fed. 958, 966 (N.D. Ala. 1915). In Bailey v. Way, 266 Mass. 437, 165 N.E. 388 (1929), a subsequent mortgagee was not prevented from upsetting a prior fraudulent mortgage by reason of its record, although complainant's mortgage recited that it was subject to all mortgages of record.

9. See 1 GLENN, *op. cit. supra* note 5, § 343c; McLaughlin, *supra* note 6, at 430-31.

10. See Churchill v. Wells, 47 Tenn. 364, 372-73 (1870); Hartnett v. Doyle, 16 Tenn. App. 302, 311-12, 64 S.W.2d 227, 232-33 (M.S. 1932).

11. Nelson v. Vanden, 99 Tenn. 224, 42 S.W. 5 (1897). To the same effect, see First Nat'l Bank v. Holbrook, 309 Ky. 326, 217 S.W.2d 787 (1949); Perry v. Brown, 76 S.W.2d 230 (Tex. 1934).

12. See McLaughlin, *supra* note 6, at 431.

opening up an avenue whereby a scheming debtor can make his fraudulent conveyance fool-proof as to future creditors by making a prompt recordation of his fraudulent transactions.

Also, Nolen, the grantor, continued in possession of the property for some time after the questioned conveyance was recorded, perhaps until plaintiff had extended the credit. Thus, the apparent ownership of the land remained in Nolen. This is a circumstance which would, of course, tend to mislead prospective creditors into giving credit, believing that Nolen still owned the land, and could serve as a basis for calling the deed a fraudulent conveyance.[13]

Moreover, in the writer's opinion, courts that refuse to permit a subsequent creditor to set aside a fraudulent conveyance because of constructive notice of the recorded deed misapply the recording statutes. The purpose of such statute is to *make void,* as to certain purchasers and creditors, transactions because they are not recorded. It is difficult for the writer to believe that one of the purposes of the recording statutes is to serve as a balm of Gilead to cleanse the mephitic stench from a fraudulent conveyance.

Deeds of Trust Foreclosure—Effect of Purchase at Foreclosure Sale by Creditor Holding Debt Secured by the Trust Deed—Effect of Bidding at the Sale by Agent of the Debtor: In *Jones v. Thomas,*[14] the Tennessee Court of Appeals held that a creditor, who was secured by a deed of trust, "breached his trust relationship" toward the debtor by purchasing the property at the trustee's sale. While the result of the case may well be just under all the circumstances, nevertheless there is some very considerable doubt concerning the court's conclusion that the creditor secured by a trust deed is under any fiduciary obligation to the debtor.

Where a straight mortgage is concerned, the mortgagee having a power of sale is regarded as invested with so great an ability to do harm to the mortgagor that he is often treated as a trustee.[15] Consequently, in England under no circumstances can the mortgagee purchase at his own sale.[16] In the United States, in the absence of consent by the mortgagor, or statutory sanction, the mortgagee generally may not bid in the mortgaged premises at an out of court sale under his power of sale.[17] There is, however, something to be said for allowing him to bid, not only in his own interest, but in the interest of the

13. McCanless v. Smith, 51 N.J. Eq. 505, 25 Atl. 211 (Ch. 1892); Churchill v. Wells, 47 Tenn. 364 (1870).
14. 296 S.W.2d 646 (Tenn. App. W.S. 1955).
15. OSBORNE, MORTGAGES § 342 (1951); 1 GLENN, MORTGAGES § 108 (1943).
16. For a collection of cases, see OSBORNE, MORTGAGES § 342 (1951).
17. Jackson v. Blankenship, 213 Ala. 607, 105 So. 684 (1925); Dyer v. Shurtleff, 112 Mass. 165 (1873); Mills v. Mut. Bldg. & Loan Ass'n, 216 N.C. 664, 6 S.E.2d 549 (1940).

mortgagor as well, for it is also to the mortgagor's advantage that the property should sell for the best price which can be obtained. Moreover, the mortgage sale is advertised and is public. Nevertheless, there is but little authority of this persuasion.[18]

Nor can a trustee under a deed of trust generally purchase at the sale he is making, for he is a fiduciary and is under the same restriction as the mortgagee at his own sale.[19]

However, no such inhibitions apply to the holder of the debt secured by a deed of trust. As a general proposition, therefore, he is free to purchase at the sale, for he is not in charge of it, nor is he under a fiduciary obligation to the debtor.[20]

So, it is doubtful that the creditor holding the debt secured by the deed of trust in *Jones v. Thomas* can properly be described as having a fiduciary relationship to the debtor. Nevertheless, under the particular circumstances of that case, it may well be just to hold the creditor liable for purchasing at the trustee's sale. When Tindall, the holder of the debt secured by the deed of trust, purchased at the foreclosure sale, he knew that the debtor (Gladys Thomas) was a middle-aged colored woman of limited educational advantages and very limited financial resources. The court found also that he knew that the debtor could not possibly pay the $2,773.19 due on the note secured by his deed of trust, without borrowing the money from someone else. He also knew that the debtor was exercising every effort at her command to borrow this money. An attorney had arranged with one Nabors to buy the property at a foreclosure sale for the use and benefit of the debtor (Thomas). Tindall knew that the foreclosure had been arranged so that the debtor could save her home, the property covered by his deed of trust; and, the court concludes, Tindall's actions were such as to lead the debtor and her attorney to believe that he was interested only in the money due and owing him.

The attorney for the debtor was authorized to bid $3,000, which would have paid off Tindall's claim. At the foreclosure sale Tindall and one Jones, a loan broker (to be discussed later), ran the bids up

18. See 1 GLENN, MORTGAGES § 108 (1943). For support of this view that in Tennessee the mortgagee is allowed to buy, see Brown v. Eckhardt, 23 Tenn. App. 217, 233-34, 129 S.W.2d 1122, 1132-33 (M.S. 1939) (trust instrument authorized purchase by holder of the debt).

19. Wilson v. Hayes, 29 Tenn. App. 49, 193 S.W.2d 107 (W.S. 1945). For earlier conflicting language to the effect that Tennessee is an exception to this rule and will permit the trustee to bid at his own sale if he does so in fairness and good faith, see Brown v. Eckhardt, 23 Tenn. App. 217, 234, 129 S.W.2d 1122, 1132 (M.S. 1939). For additional cases supporting the general rule that the trustee cannot buy at his own sale, see Carter v. Thompson, 41 Ala. 375 (1867); Jodd v. Lee, 256 Mo. 536, 165 S.W. 991 (1914); Davis v. Doggett, 212 N.C. 589, 194 S.E. 288 (1937).

20. Easton v. German-American Bank, 127 U.S. 532 (1888); Spruill v. Ballard, 58 F.2d 517 (D.C. Cir. 1932); Metropolitan Life Ins. Co. v. Rasberry, 204 N.C. 787. 168 S.E. 669 (1933); see Brown v. Eckhardt, 23 Tenn. App. 217, 233-35, 129 S.W.2d 1122, 1132-33 (M.S. 1939).

to $3,475 and the property was knocked down to Tindall. Tindall later made some improvements on the property and sold it to a third party for approximately $7,000.

When Jones, the loan broker, sued the debtor (Thomas) to recover an amount allegedly due him for services in connection with his unsuccessful attempts to procure a loan for her, she (the debtor) cross-complained against Jones and Tindall to set the foreclosure sale aside.

In affirming the chancellor's decision awarding damages to the debtor (Thomas), the court of appeals held that Tindall and Jones each had breached his trust relationship toward the debtor. The court felt that under the circumstances it was inequitable and unconscionable for Tindall to appear at the sale and bid more than an amount sufficient to guarantee to him the full payment of his indebtedness and costs of foreclosure. Tindall had made some repairs on the property after he bought it at the sale, which the court thought would make it difficult for the debtor to finance, and had sold it to a third party. So the court thought it best to award the debtor (Thomas) a judgment against Tindall for the value of her equity in the land, which was the difference between the indebtedness to Tindall, costs of foreclosure, etc., and the $5,000 actual value of the property at the time of the foreclosure.

While it was not made a point in this case, the unauthorized purchase by the creditor at a foreclosure sale renders the sale voidable, not void, and a subsequent sale to a bona fide purchaser without notice will cut off the debtor's right to get the property back.[21]

Although Tennessee will permit the holder of a debt secured by a deed of trust to bid at the foreclosure sale, nevertheless, as Judge Carney's opinion in the case at hand demonstrates, the deed of trust creditor is held to a considerably higher standard of conduct than the morals of the arm's length dealings of the ordinary market place.[22]

In *Jones v. Thomas* the court of appeals also entered judgment against the loan broker, Ben Block Jones, but held him secondarily liable to Tindall. The debtor (Thomas) had executed a bearer note for $5,000 to Jones, secured the note by a deed of trust on the property in question and appointed Jones her agent to market the note. He was unable to sell the note, yet he placed the deed of trust securing it on record and sued the debtor (Thomas) for his services. As we have

21. See OSBORNE, MORTGAGES § 342 (1951); 1 GLENN, MORTGAGES § 108 (1943).

22. See Bill Jones Auto Co. v. H. E. Carr & Co., 4 Tenn. App. 443, 446 (M.S. 1926). There the court said, in part: "It has been held in Tennessee that a mortgagee, or creditor, or trustee in a deed of trust, may purchase at the trust sale, and his title will be good, but his relations to the mortgagor or debtor impose upon him the observance of fairness and good faith. . . ." To the same effect are Hawkins v. Spicer, 20 Tenn. App. 528, 531, 101 S.W.2d 151, 152-53 (M.S. 1936); Brown v. Eckhardt, 23 Tenn. App. 217, 235, 129 S.W.2d 1122, 1133 (M.S. 1939).

already seen, it was in this suit by Jones that the debtor cross-complained for the alleged breach of trust by Jones and Tindall. Jones, like Tindall, knew of the purpose of the foreclosure sale and knew that it was a part of a program to refinance the debtor. Nevertheless, he attended the sale and ran the bidding on the property up to $3,474. Tindall, as we have already seen, bought the property for $3,475.

The court held that Jones occupied a position of trust in relation to his client (the debtor), who had retained him to assist her in refinancing the indebtedness on her home. He was held to have violated his trust by further incumbering the title of his client by placing on record the deed of trust securing the $5,000 note, although the debtor did not owe the note and Jones was never able to market it. The court concluded that Jones recorded the deed of trust to complicate the legal title to the property and to make it easier to collect the money he claimed the debtor owed him, if she should later be successful in refinancing the indebtedness on her property.[23] Also, Jones was held to have violated his trust when he appeared at the trustee's sale and bid on the property. The fact that the agency contract between Jones and the debtor had been terminated prior to the foreclosure did not operate to insulate Jones from his breach of the fiduciary duty.[24]

Under the circumstances, agent Jones no doubt breached his fiduciary duty to the debtor, who was his principal. The writer has some doubt, however, that the fact that Jones bid on the property after his agency was terminated would, in and of itself, constitute a breach of his fiduciary duty.[25]

Conditional Sale—Liability of Vendor Who Repossesses Article When Vendee Defaults in Purchase Price: A Tennessee statute provides that when property sold under a conditional sales contract is repossessed by the vendor because the purchaser has defaulted in making his payments, then the vendor, within ten days after such repossession, must advertise the property for sale and sell it to the highest bidder.[26] There is a further pertinent statutory provision to the effect that if the vendor does not advertise the property for sale within the ten days, the defaulting purchaser may recover from the vendor that part of the purchase price paid by the purchaser.[27]

23. *Cf.* Keenan v. Scott, 64 W. Va. 137, 61 S.E. 806 (1908) (an attorney's taking of property involved in a litigation as compensation held voidable at election of client irrespective of fairness or unfairness).

24. See Coffee v. Ruffin, 44 Tenn. 487, 515 (1867).

25. See 2 AM. JUR., *Agency* § 258 (1936): "The rule that an agent employed to sell property cannot himself become the purchaser at his own sale, either directly or indirectly, or by collusion with others, does not apply where the agent acquires an interest in the property after the termination of the agency by a bona fide sale, for he then has the same right as any other person to deal in the property, and may purchase it if he desires to do so." *Ibid.*

26. TENN. CODE ANN. § 47-1302 (1956).

27. TENN. CODE ANN. § 47-1306 (1956).

When does the ten day period begin to run? The statute would appear on its face to leave little room for controversy on that point. Nevertheless, considerable controversy may arise, as is shown in *Judd v. Fruehauf Trailer Co.*[28] There the purchaser sued the conditional vendor to recover the amount paid by plaintiff on the purchase price of a refrigerated truck trailer under a conditional sales contract, on the ground that defendant failed to advertise the trailer for sale, as required by the statute, within ten days after the vendor's regaining possession because of plaintiff's default in payments.

After plaintiff had defaulted in his payment on two trailers bought from defendant, considerable negotiations went on between the plaintiff and defendant concerning plaintiff's efforts to refinance the purchases. Defendant requested that plaintiff bring the trailers to be parked on defendant's premises in order that they might be protected while the plaintiff was attempting to refinance the trailers. Since plaintiff did not have a lot of his own on which to park the trailers and was not using them much at the time, defendant's request was complied with; and on January 15th the trailer in question was placed on defendant's lot. On January 21st, at defendant's request, plaintiff also surrendered possession of his personal trailer, on which plaintiff was also in default. On January 27th the personal trailer was refinanced and it was returned to plaintiff. The personal trailer was not involved in plaintiff's claim in the case at hand.

Plaintiff claimed that all negotiations relative to financing of the trailer in question ceased at that time or certainly not later than the middle of February at which time the parties quit conferring about the trailer. The trailer was advertised on May 24th and was sold on June 6th. Plaintiff claimed that the statute requiring advertisement for purposes of resale within ten days after the vendor took possession was not complied with. On May 18th plaintiff commenced his suit to recover the amount of the purchase price paid by him.

The lower court dismissed plaintiff's suit; the court of appeals affirmed, reasoning that the negotiations between the parties did not cease on January 27th, as plaintiff claimed. The parties continued to confer regarding the trailer in question until February 15th. On April 27th plaintiff wrote defendant insisting that defendant had not complied with the statute requiring notice of sale within ten days and demanded the money paid to defendant under the sales contract. Defendant replied that it was holding the trailer for safekeeping and that unless defendant heard from plaintiff by May 16th the trailer would be treated as repossessed. As has been pointed out, advertisement of the sale began on May 24th.

Although all active negotiations for refinancing ended about the

28. 293 S.W.2d 591 (Tenn. App. M.S. 1956).

middle of February, the court nevertheless thought that defendant was indulging plaintiff with the hope that plaintiff could catch up the delinquent installments or refinance the trailer and save the amount put into it. It seems that on at least two or three prior occasions plaintiff had become delinquent on the sales contracts of both trailers, and on each occasion satisfactory financial arrangements were made. It also seems that on one or more of those prior defaults by plaintiff the trailers had been parked on defendant's premises while plaintiff was attempting to make financial arrangements. Under all the circumstances the court felt that defendant was simply trying to cooperate in an effort to save the trailers for plaintiff and should not be penalized for extending the time for advertising the trailer for sale.

A literal reading of the applicable statutory provisions in the case at hand might suggest that defendant did not comply with the statutory mandate in that defendant did not advertise for sale "within ten days after regaining said possession" of the trailer "because of the consideration remaining unpaid at maturity."[29] Nevertheless, the Tennessee courts have taken the position that, in order to start the ten day statutory period running, the repossession by the vendor must be for the purpose of enforcement of the claim for the balance of the purchase price—not for safekeeping, storage or any purpose other than that of enforcement of the rights of the seller arising out of a default under the conditional sales contract.[30] Although the defendant did not advertise the trailer for approximately ninety days after the parties had broken off negotiations, the court was satisfied that there was a commingling of purposes in defendant's holding of possession of the trailer and that possession was not being held for the sole purpose of enforcing the rights of the defendant-seller arising out of a default under the sales contract.

Garnishment—Liability of Garnishee to Creditor Where Garnishee Pays Debtor after Service of Garnishment on Garnishee: The Tennessee Court of Appeals recently had an occasion to deal with the problem of the liability of a garnishee-employer who pays funds belonging to an employee (the principal debtor) to the debtor-employee after the garnishee has been served with the garnishment. The occasion is the case of *Stonecipher v. Knoxville Sav. & Loan Ass'n.*[31]

The facts are relatively simple. Plaintiff, Knoxville Savings and Loan Association, obtained a judgment against its debtor, one Stonecipher, who was employed by the garnishee. The judgment being un-

29. TENN. CODE ANN. § 47-1302 (1956).
30. See BAC Corp. v. Francis, 176 Tenn. 648, 653-54, 144 S.W.2d 1098 (1940); *cf.* Brooks v. Range Motor Co., 16 Tenn. App. 209, 64 S.W.2d 42 (E.S. 1933).
31. 298 S.W.2d 785 (Tenn. App. E.S. 1956).

satisfied, an execution was issued and garnishment was served upon the debtor's employer, Broadway Metal & Roofing Company, where the debtor was employed as a salesman. The employer filed an answer denying that it owed the debtor anything. A subpoena duces tecum was issued requiring the garnishee-employer to produce all pertinent records pertaining to the employee-debtor.

At the hearing the garnishee admitted it made payments to the employee-debtor after the service of the garnishment but took the position that it did not owe him anything when the garnishment was served. However, the payments made to the debtor admittedly came from commissions which the debtor had earned prior to the date of service of the garnishment. These payments were said to be "expense money," but this appellation was challenged by the creditor as simply an afterthought on the part of the garnishee.

Judgment was entered against the garnishee in the lower court; an appeal was taken to the court of appeals, which affirmed the judgment of the lower court. The court of appeals held that the funds which plaintiff attempted to reach in his garnishment proceedings belonged to the principal debtor and were owing the debtor at the date of the service of garnishment on the garnishee. Consequently, the garnishee had no legal right to pay these funds to the debtor after the service of the garnishment.

Garnishment is a proceeding by which a plaintiff-creditor seeks to subject to his claim property of his defendant-debtor in the hands of a third person (garnishee) or money owed by such third person to the debtor.[32] The service of the garnishment on the garnishee warns him not to deliver the debtor's property or money to the debtor but to answer plaintiff's suit.[33] The garnishee is a mere stakeholder between the plaintiff-creditor and the principal debtor and it is his duty to make a full disclosure in the garnishment proceedings.[34] After the garnishment writ is served on the garnishee, the property, effects or debts of the principal debtor in the garnishee's hands are impounded; and the garnishee may not, except at his peril, pending the garnishment proceedings, surrender the garnished property or pay the garnished debt to the principal debtor.[35] In the case at hand, if the funds paid to the principal debtor by the garnishee after service of the garnishment

32. TENN. CODE ANN. § 23-701 (1956).
33. TENN. CODE ANN. §§ 23-703 to -704 (1956); 38 C.J.S., *Garnishment* § 185 (1943).
34. See 38 C.J.S., *Garnishment* § 185 (1943).
35. First Nat'l Bank v. Garrison, 235 Ala. 687, 180 So. 690 (1938); Harris v. Harris, 201 Ark. 684, 146 S.W.2d 539 (1941); Protective Check Writer Co. v. Collins, 92 N.H. 27, 23 A.2d 770 (1942); B. F. Goodrich Rubber Co. v. Yellow Taxi Corp., 154 Misc. 440, 277 N.Y. Supp. 468 (N.Y. Munic. Ct. 1935); Cumberland Tel. & Tel. Co. v. Jenkins, 1 Tenn. Civ. App. 203 (1910); Pure Oil Co. v. Walsh-Woldert Motor Co., 36 S.W.2d 802 (Tex. Civ. App. 1931); see Newport v. Semones, 286 S.W.2d 876, 880 (Tenn. App. M.S. 1955); 5 AM. JUR., *Attachment and Garnishment* § 662 (1936); 38 C.J.S., *Garnishment* § 186 (1943).

writ belonged to the principal debtor, then the garnishee is clearly liable to the plaintiff-creditor to the extent plaintiff's claim covered the amount paid by the garnishee.

The plaintiff-creditor, of course, can occupy no higher ground than the principal debtor in asserting rights against the garnishee. The garnishment proceedings merely subrogates plaintiff-creditor to the debtor's rights against the garnishee, and the plaintiff can enforce no rights that the debtor could not enforce against the garnishee. In short, the right of the garnishing creditor to recover against the garnishee depends upon the right of the principal debtor to maintain an action against the garnishee for the amount involved in the garnishment.[36]

In the case at hand, the garnishee claimed that he did not owe the principal debtor anything when the garnishment was served on him and that the funds paid to the debtor were "expense money." Nevertheless, the garnishee admitted that the debtor had earned the commissions which the garnishee paid the debtor. Thus, even under the garnishee's version of the case it is clear that the money, although called "expense money," belonged to the principal debtor, and the court so found. Consequently, the principal debtor would have had a right to maintain an action against the garnishee for the funds in question. Plaintiff-creditor was subrogated to these rights which the debtor had against the garnishee. Under the circumstances, the garnishee had no right after service of the garnishment to pay to the principal debtor funds belonging to such debtor, which plaintiff-creditor attempted to reach by his garnishment proceedings. Thus, judgment was properly entered against the garnishee.

Materialmen's Liens—Effect on Materialman's Lien Against a Particular Owner of Knowledge by Materialman that Payment by Contractor Came from Particular Owner: In Tennessee the supplier of materials has a lien on a building into which his materials have gone, even though the materials were sold to a contractor who used them in the construction of the building.[37]

Suppose a materialman furnishes material to a contractor who is doing work for both X and Y. X pays the contractor and the latter pays the materialman who knows that the payment came from X. Nevertheless, the materialman credits the general account of the contractor and undertakes to enforce his materialman's lien against

36. Siegel, Cooper & Co. v. Schueck, 167 Ill. 522, 47 N.E. 855 (1897); Farley v. Colver, 113 Md. 379, 77 Atl. 589 (1910); Gilbert v. Pioneer Nat'l Bank, 206 Minn. 213, 288 N.W. 153 (1939); Dickson v. Simpson, 172 Tenn. 680, 113 S.W.2d 1190 (1938); Gray v. Houck, 167 Tenn. 233, 68 S.W.2d 117 (1934); 5 AM. JUR., *Attachment and Garnishment* § 670 (1936).

37. TENN. CODE ANN. § 64-1115 (1956). For a more extensive comment on the mechanics' and materialmen's liens in Tennessee, see Hartman, *Creditors' Rights and Security Transactions—1954 Tennessee Survey*, 7 VAND. L. REV. 799 (1954).

the building of X for the full amount of the claim for materials that went into X's building, without crediting X with the amount of the payment. What rights does the materialman have under his lien against X?

In the Tennessee Court of Appeals case of *Bain-Nicodemus, Inc.*, v. *Bethay*,[38] the court held that, under such circumstances, the materialman was required so to credit the contractor's account as to discharge, to the extent of X's payment, the materialman's lien against X's property. The court reasoned that where a materialman, to whom the contractor owes on several accounts, has notice of the source of such fund the materialman must give credit to discharge or diminish the obligation chargeable against its source.

In the case at hand a materialman, Bain-Nicodemus, Inc., brought suit against a contractor, Bethay, to recover a judgment against Bethay and to have a mechanics and furnishers' lien enforced against the property of one Botto. Bethay was a building contractor who had built a house for Botto, and just prior thereto had done some building for one Grusin. For both jobs Bethay bought materials on credit from Bain-Nicodemus, the plaintiff. Botto made a $750 payment to the contractor, Bethay, who, in turn made a payment in that amount to the plaintiff-materialman, who credited the payment on contractor-Bethay's general account. Later plaintiff undertook to enforce its materialman's lien against the Botto property without crediting Botto with the amount of the $750 payment. Plaintiff claimed it was justified in applying the payment made by the contractor, Bethay, to the contractor's general account and was not required to apply the payment so as to reduce its materialman's lien against the property of Botto.

The court of appeals was of the opinion that the evidence failed to show that the contractor directed the $750 payment to be a credit on the Botto Job. But the court was satisfied that the plaintiff-materialman did have positive knowledge that Botto was the source of the $750 payment. Hence the court felt that in equity and good conscience the payment should be credited against Botto's account and not against contractor-Bethay's general account. Plaintiff-materialman's lien claim against the Botto property was thus reduced by the amount of the $750 credit. Plaintiff was allowed a lienable claim against the Botto property for the residue of the claim.

It is well established that where a materialman, to whom a contractor owes on more than one account, knows that a payment made by a contractor comes from a particular owner, the materialman is required so to credit the contractor's account as to discharge, to the

38. 292 S.W.2d 234 (Tenn. App. W.S. 1954).

extent of payment, the materialman's lien against the owner making the payment.[39] There is some authority which goes even further and holds that if a materialman knows that a contractor is working on more than one job, the materialman must make inquiry when the contractor makes payment, so that the payment is credited to the owner making payment.[40]

Rights of Accommodation Maker of Note Against the Party Accommodated: In the case of *In re Templeton's Estate*[41] the Supreme Court of Tennessee was called upon to decide whether a wife who signs a note as an accommodation party for her husband can recover from her deceased husband's estate, where the wife was compelled to pay the note. The court permitted her to recover.

For the purpose of securing a loan Mrs. Templeton and her husband individually, and her husband as Templeton Pontiac Company, signed a note as joint makers; but she signed for the sole purpose of lending her name to her husband who received all the proceeds of the loan. The husband died insolvent and Mrs. Templeton was compelled to pay all of the note. She then filed a claim against her husband's estate for two-thirds of the amount paid by her, taking the position that she was a surety for the debt. Through some apparent misapprehension she thought she was liable, as one of the three makers, for one-third of the note. Consequently, she filed the claim for only two-thirds of the amount she was required to pay in discharging the note. The administrator of her husband's estate took the position that the husband's estate was liable for only one-half of the amount of the note.

In permitting Mrs. Templeton to recover the Tennessee Supreme Court quite properly, it seems, held that when Mrs. Templeton signed the note as a maker as an accommodation for her husband there was created the relation of principal and surety, as between her and her husband.[42]

Upon payment of a debt for his principal a surety has the right to be reimbursed by his principal.[43] The reasons for permitting such recovery are sound. From the principal's request that the surety enter into the contract with him there is an implied request from the principal to pay the debt at maturity if the principal himself does not pay it. From this implied request by the principal there springs the surety's

39. Webb v. Crane Co., 52 Ariz. 299, 80 P.2d 698 (1938); A. Y. McDonald Mfg. Co. v. Leverett, 203 Iowa 1215, 211 N.W. 849 (1927); Trauth v. Voss, 231 Ky. 544, 21 S.W.2d 832 (1929); Farr v. Weaver, 84 W. Va. 182, 99 S.E. 395 (1919).

40. Modesto Lumber Co. v. Wylde, 217 Cal. 421, 19 P.2d 238 (1933).

41. 300 S.W.2d 613 (Tenn. 1957).

42. See O'Neal v. Stuart, 281 Fed. 715 (6th Cir. 1922); Fox v. Kroeger, 119 Tex. 511, 35 S.W.2d 679 (1931); 4 WILLISTON, CONTRACTS § 1211 (rev. ed. 1938); RESTATEMENT, CONTRACTS § 92, comment *a* (1932); RESTATEMENT, SECURITY § 82 (1941).

43. See note 42 *supra*. See also ARANT, SURETYSHIP § 73 (1931); SIMPSON, SURETYSHIP § 48 (1950); 8 AM. JUR., *Bills and Notes* § 466 (1937).

right to repayment from his principal as soon as the surety pays the creditor. From time immemorial courts of equity have recognized the surety's right to reimbursement upon payment of his principal's debt.[44] No extensive citation of authority is needed for these simple propositions of suretyship law at this late date.

There apparently was no contention that Mrs. Templeton should be denied recovery against her husband's estate because of the marital relationship, and there would appear to be no proper basis for making any such claim under the applicable Tennessee law.[45]

Tenancy by the Entirety—Rights of Husband's Creditor and Right of Husband to Homestead: In *Waddy v. Waddy*,[46] the Tennessee Supreme Court had before it some questions concerning the sale by a judgment creditor of the interest of his judgment debtor (husband) where the land was owned by the husband and wife as tenants by the entirety. Both the husband and wife were still living.

In the judgment creditor's suit to sell the husband's interest, the husband claimed a homestead in the property, which could not be divided. In an opinion that unfortunately appears to be garbled, the Tennessee Supreme Court held that the husband's interest in the property could be sold subject to the homestead rights of the husband in the equity which the husband and wife had in the property. An underlying mortgage had the first claim against the property.

The court pointed out, however, that if the debtor-husband predeceased his wife, then the purchaser of the husband's interest would get nothing in the transaction. Where property is owned by husband and wife as tenants by the entirety and the husband predeceases his wife, under Tennessee law the husband's interest is terminated and the estate passes as from the date of the conveyance to the surviving wife.[47] During the joint lives of the husband and wife the purchaser at an execution sale made for the husband's debts cannot obtain possession of the lands.[48] If the husband survives the wife, then the purchaser at the execution sale would come into possession of the whole estate.[49]

The rationale of this decision seems in line with the Tennessee law governing a conveyance by the husband of his interest as a tenant

44. See SIMPSON, SURETYSHIP 225 (1950); 4 WILLISTON, CONTRACTS § 1274 (rev. ed. 1938); Loyd, *The Surety*, 66 U. PA. L. REV. 40 (1917).
45. See TENN. CODE ANN. § 36-601 (1956), which removes, in sweeping terms, the disabilities of coverture from married women in so far as their power to contract is concerned. For cases construing this statute as giving the wife capacity to contract with the husband, see Howell v. Davis, 196 Tenn. 334, 268 S.W.2d 85 (1954); Hull v. Hull Bros. Lumber Co., 186 Tenn. 53, 208 S.W.2d 338 (1948).
46. 291 S.W.2d 581 (Tenn. 1956).
47. Newson v. Shackleford, 163 Tenn. 358, 43 S.W.2d 384 (1931).
48. Cole Mfg. Co. v. Collier, 95 Tenn. 115, 31 S.W. 1000 (1895).
49. *Id.* at 118, 31 S.W. at 1000.

by the entirety with his wife. The husband, as such tenant, can convey, but the purchaser stands only in the shoes of the husband and gets no present right to the husband's interest.[50] If the husband survives the wife, the purchaser from the husband takes the entire estate.[51] The purchaser, however, takes no present right to possession since during the joint lives of husband and wife their respective rights are inseparable.[52]

50. Sloan v. Sloan, 182 Tenn. 162, 184 S.W.2d 391 (1944).
51. *Id.* at 165, 184 S.W.2d at 391.
52. See note 5 *supra*. For divergent views with respect to the rights of the creditor to reach property owned by tenants by the entirety, as well as the rights of the individual tenant to convey his interest, see 2 AMERICAN LAW OF PROPERTY §§ 6.6(b) and (d) (Casner ed. 1952).