IN RE FOOT ET AL.

Case No. 4,906.

[8 Ben. 228;[1] 12 N. B. R. 337; 1 N. Y. Wkly. Dig. 76.]

District Court, N. D. New York. July, 1875.

APPROPRIATION OF FUND—SUBROGATION—JOINT AND SEPARATE ESTATE.

1. F., one of the firm of F. D. & Co., endorsed paper of the firm to raise money for the firm, and pledged securities, belonging to himself, as security for its payment. The firm afterwards became bankrupt. After the adjudication in bankruptcy, the holders of the paper sold the securities then pledged, and realized on the sale $18,281, being 8104 more than the amount due on the notes. The individual estate of F. proved insufficient to pay his individual debts, and the individual creditors insisted that the amount realized from the securities thus sold should be appropriated from the fund belonging to the joint estate, to that of the separate estate: *Held,* that, where there are two classes of creditors having a common debtor, who has several funds, and one class of creditors can resort to all of them, while the other can resort to only part of them, the former shall take payment out of the fund to which they can resort exclusively, so that both classes may be protected; and if the former resort to the fund common to both classes, to the loss of the latter, the latter are entitled to be substituted in place of the former, to the extent of the deprivation to which they have been subjected.
2. Under this principle, the holders of the notes in question might have surrendered the securities and resorted to either the joint estate or the separate estate.
3. The rights of the parties were not changed, because the holders of the notes satisfied them by a sale of the securities instead of resorting to the joint estate in bankruptcy; and the separate creditors were to be substituted to the right of the holders of the notes, to enforce payment from the joint estate.
4. Payment will not be permitted in equity to operate as an extinguishment, as against those equitably entitled to substitution in place of the party receiving payment
5. The assignee, therefore, must appropriate to the separate estate of F. the $104 of surplus moneys arising on the sale of the securities, and such further sum as might arise from the dividends of the joint estate, as upon a debt proved against the joint estate of $18,177, the amount of the notes, accruing as of the date of the sale of the securities.

In bankruptcy.

W. & J. D. Keman, for petitioners.

Dennison & Everett, for assignee.

WALLACE, District Judge. For the purpose of raising money for the firm of Foot, Doud & Co., the above named bankrupts, {Norman B.} Foot, one of the firm, endorsed their paper, and pledged securities belonging to himself individually as collateral for payment of the paper. After the adjudication of bankruptcy herein, the holders of the notes sold the securities thus pledged, and realized upon the sale the sum of $18,281, being 8104 in excess of the amount due upon the notes. The separate creditors of Foot now represent that his separate estate is insufficient to pay his individual debts, and insist that the amount realized from the securities thus sold, be appropriated from the fund belonging to the joint estate to that of the separate estate of Foot They maintain, that it was the duty of the assignee in bankruptcy to have exonerated the separate estate from the lien of the pledgees out of the funds of the joint estate; and they urge that, in any event, Foot, as surety for the firm, when the notes were paid by the sale of his property, became subrogated to the claims of the holders of the notes, and entitled to prove the amount of the notes against the joint estate; and that this demand enures to the benefit of his separate estate, which should be credited by the assignee with ratable dividends on the amount.

There are technical difficulties in the way of obtaining relief upon either of these theories. The assignee would not have been justified in applying the moneys of the joint estate to discharge a lien upon the property of the separate estate, even where the lien was created for the benefit of the firm; and if Foot as surety became subrogated to the rights of the holders of the notes, and therefore entitled to prove their amount, the rule which precludes a partner from proving his individual debt in competition with the joint creditors, would defeat the separate estate from deriving any benefit through the claim of Foot. But it seems clear, that the equities of the separate creditors can be worked out upon familiar principles, and a result attained, which, in view of the condition of the two estates, is highly desirable.

Where there are two classes of creditors, having a common debtor who has several funds, and one class of the creditors can resort to ail the funds, while the other can resort only to part of them, the former shall take payment out of the fund to which they can resort exclusively, so that both classes may be protected; and if the former resort to the fund common to both classes, to the loss of the latter, the latter are entitled to be substituted to the extent of the deprivation to which they have been subjected, in the place of the former. This principle has been frequently applied where specific liens exist in favor of different creditors upon property of the same debtor; and the rule is the same, where the parties are creditors of different debtors, where, as between the debtors, equity demands that one of them should discharge the debt in exoneration of the other. Dorr v. Shaw, 4 Johns. Ch. 17; Story, Eq. Jur. §§ 642, 643; Ex parte Kendall, 17 Ves. 521; Neff v. Miller,

8 Barr. {8 Pa. St.} 347; Sterling v. Brightbill, 5 Watts, 229. The doctrine applies in all cases of marshalling equitable assets; and its application to assets in bankruptcy, which are to be administered upon equitable principles, is peculiarly appropriate.

In the present case, after the adjudication of bankruptcy, the holders of the notes might have surrendered the collaterals, and resorted to either of two funds to obtain payment; as creditors of the firm, they could have proved against, and shared in, the joint estate; and as creditors of Foot, they could have proved against, and shared in, his separate estate; and, if they had surrendered, the collaterals would have enured to the benefit of the separate estate, because the firm were the primary debtors and Foot was a surety. The holders of the notes could not have been compelled to elect as to which fund they should pursue;—the rule in England, which requires creditors of both the joint and separate estate in bankruptcy to elect, not obtaining here. Ex parte Farnum {Case No. 4,674}; Meade v. National Bank of Fayetteville {Id. 9,366}; Emery v. Canal Nat. Bank {Id. 4,446}. The joint creditors, therefore, could not have been heard to complain if the holders of the notes had chosen to obtain satisfaction out of the joint estate; and no equities exist on their part, to countervail those of the separate creditors of Foot. On the other hand, if the holders of the notes had surrendered their collaterals, and resorted to. the separate estate of Foot by proving their claims in bankruptcy, the creditors of his separate estate would have been entitled to be substituted in the place of the holders of the notes, and allowed to prove the notes against the joint estate.

The rights of the parties are not changed because the holders of the notes satisfied them by a sale of the securities, instead of resorting to the joint estate in bankruptcy. By the course taken, the separate estate has been diminished to the extent that satisfaction might have been obtained from the joint estate; and to that extent the separate creditors have been deprived of a fund, in which they were entitled to equitable priority as against a class of creditors who had resort to another fund, which, as between the debtors, was the primary fund for payment. Upon the principles referred to, the separate creditors are to be substituted to the rights of the holders of the notes to enforce payment from the joint estate in bankruptcy. The technical satisfaction of the notes by the proceeds of the securities, does not stand in the way; for payment will not be permitted in equity to operate as an extinguishment as against

those equitably entitled to substitution in the place of the party receiving payment. Eddy v. Traver, 6 Paige, 521; Morris v. Oakford, 9 Barr [9 Pa. St.] 498; Richardson v. Washington Bank, 3 Metc. [Mass.] 536.

Applying these principles to the present case, a result is reached which does no injustice to either class of creditors; and which affords a signal illustration of the benign vigor of the rules of equity. The assets of the primary debtors will be appropriated to the ratable payment of all their creditors, and those of the separate partner to his creditors; while the holders of the notes, protected in the exercise of their rights, will have so enforced them as not needlessly to prejudice the rights of other creditors.

A decree is ordered that the assignee appropriate to the separate estate of Foot the surplus arising upon the sales of the securities, and such further sum as may arise from the dividends of the joint estate, as upon a debt proved against such joint estate of $18,177, accruing as of the date of the sale of the securities.

[See In re Foot, Case No. 4,907.]

[1] [Reported by Robert D. Benedict, Esq., and Benj. Lincoln Benedict, Esq., and here reprinted by permission.]

This volume of American Law was transcribed for use on the Internet

through a contribution from Google.