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Robert Schoenecker

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WHEN MAY CREDITOR ATTACH DEBTOR'S INTEREST IN PLEDGE PROPERTY?

Courts often are confronted with the plight of a creditor who finds his investment in his debtor totally unsecured, and the debtor's property pledged to secure debts contracted with other creditors. However, where such a pledge has been made, the value of the pledged goods may exceed the amount of the debtor's indebtedness to the pledgee and thus give the debtor an interest in the pledge to the extent of this excess. The question then arises: What are the rights of the unsecured creditor with respect to the interest of his debtor in the pledged property? May a pledgor's interest in pledged property be attached by a creditor of the pledgor, and if so how may the attachment be made?

Attachments as we know them today are the creatures of statute.¹ An attachment was recognized by the common law, however, as a part of the service of process in a civil suit and was a species of distress in which the chattels attached were pledges. If the defendant did not appear in response to a summons, an attachment issued, and his chattels were seized by the sheriff to compel his appearance, but when he appeared, he was entitled to the return of his property. If he did not appear, the chattels were forfeited.² Although the common law attachment was merely a form of distress, statutes developed attachments and garnishments so that they became a security for or even a method of recovering a debt due to a creditor. In any particular case, therefore, whether a pledgor's interest may or may not be attached will depend upon the statute in that jurisdiction and the courts interpretation of the statute.

Some of the early American courts did not recognize the right of attaching a pledgor's interest. In an Alabama case where a debtor had shipped cotton to be sold by the consignee who had made advances to the shipper, the creditor of the shipper was not allowed to attach the cotton in the hands of the consignee even to the extent of the debtor's interest above the advances he had already received from the consignee. The Alabama court reasoned that since garnishment was a legal and not an equitable proceeding, the fund to be attached must also be a legal right and one which the defendant could have enforced by attachment and seizure at common law. Since at the time of the attempted attachment the cotton had not been sold and the consignee owed the defendant no surplus, the debtor had no legal right but merely an equitable right in the cotton. The court held that legislation was required for the creation of a right in the creditor to reach the pledgor's interest.³

¹ *Clark v. Wells*, 203 U.S. 164, 27 Sup. Ct. 43, 51 L.Ed. 138 (1906).

² *Bond v. Ward*, 7 Mass. 123 (1810).

³ *Roby v. Labuzan*, 21 Ala. 60, 56 Am. Dec. 237 (1852).

In the state of Maine a debtor had pledged a horse as security for a loan. After the pledge a statute was passed which allowed a pledgor's interest to be attached. The plaintiff, a creditor of the pledgor, complied with the statute and sought to attach the horse. The Maine court arrived at the same conclusion as the Alabama court, but for a different reason. The Maine court would not allow attachment since the cause of action arose prior to the statute granting such right, and, before the passage of the statute, a pledgor's interest was looked upon as being too doubtful and uncertain to be enforced in law.⁴

However, at the time that the Maine and Alabama decisions were made there were jurisdictions which would allow the type of attachment under consideration if certain statutory requirements were strictly complied with. One of the earliest statutes allowing attachment of a pledgor's interest is the statute upon which the Maryland case of *Deacon v. Oliver*⁵ is based. Here the pledgor had pledged an interest in a certain company as security for a debt. The plaintiff in seeking to attach this interest in the hands of the pledgee asked if the pledgee had in his possession any funds, stock, or evidences of indebtedness belonging to the pledgor which might be the subject of attachment. The defendant pledgee replied that he had not. Years later the plaintiff claimed this was fraudulent. The court held: "If the pledgee had title to the pledgor's claim, he held it merely as security for the sum advanced by him; the equitable assignments taken as such security was his own; it was but an instrument to obtain satisfaction for his debt; it conferred nothing but a right in equity. Whether it was valid or invalid, absolute or defeasible, it did not constitute him a debtor of the pledgor, or put him in possession of any of his credits or effects, so as to subject him to attachment as the pledgor's garnishee." The statute in question was passed in 1770 and gave a judgment creditor the right to sue out an attachment against the chattels and credits of the defendant in his own hands or the hands of another. The court further said: "The proper person to be made garnishee in an attachment, would have been the debtor, not the equitable claimant of the debt. He has but an equity or a base right, but whatever it is, it is his own, and his claim is hostile to both plaintiff and defendant." If the pledgor had been made the defendant, the court could have condemned the pledgor's interest, but since the proper party was not made the defendant, the attachment could not be allowed.

A similar case in which attachment would have been allowed if made properly, is the early Massachusetts case in which a pledgor turned over goods as security for a loan and another creditor of the pledgor took the goods from the pledgee without first paying to the

⁴ *Sargent v. Carr*, 12 Me. 396 (1835).

⁵ 55 U.S. (14 How.) 610, 14 L.Ed. 563 (Md. 1852).

pledgee the amount of his lien. In an action of trespass, the pledgor raised the question whether he could recover the entire goods or just the amount of his debt. The court allowed the recovery of all the goods since the pledgor is himself liable to the pledgor for the amount of the goods which is in excess of the debt. Furthermore the creditor could not rely on the attachment because it was not made according to the statute and was therefore void.⁶ Thus although there were early cases which would not allow a pledgor's interest to be attached under any circumstances, there were also other cases in which the courts allowed such attachment if made properly.

Later courts and legislatures came more generally to recognize the right of a creditor to subject his debtor's interest in pledged property to attachment. Thus, in the case of *Bank of Centerville v. Gelhaus*, where the pledgor had sold the pledged property after garnishment and had \$1,800 in excess of the debt due to him, the South Dakota court held that the equity which the pledgor had in the pledged property was property within the meaning of the statute and therefore became impressed with a lien in favor of the garnishor. As soon as the pledgor's debt was satisfied he was required to turn over any excess which he might have to the clerk of court.⁷

In like manner, the state of Alabama which at one time did not recognize the right to attach a pledgor's interest provided by statute that a garnishee at the time of garnishment, or answer, must tell whether he is indebted to the defendant or whether he will be indebted in the future by existing contract; and whether he has in his possession or control things in action or personal property belonging to the defendant. Therefore, where a garnishee answered that he held a pledge of stock as collateral security for a debt due to him, the court held that this was a contract upon which a future indebtedness could accrue to the benefit of the defendant pledgor and as a result the case would be continued until after the stock could be sold and a determination could be made as to whether there was an excess after paying the garnishee the amount of his indebtedness.⁸

Then in the state of Minnesota a case arose in which the debtor pledged certain property to the pledgor as security for a loan. The pledgor, in order to gain possession of the property, had the goods shipped to himself; but while the material was in the hands of the carrier another creditor of the pledgor garnished the goods. After this the pledgor sold the goods to the pledgor. The court ruled that any right which the garnishor might acquire would be subordinate to the rights already acquired by the pledgor. However, while the court did

⁶ *Pomeroy v. Smith*, 34 Mass. (17 Pick.) 85 (1835).

⁷ 60 S.D. 31, 242 N.W. 642 (1932).

⁸ *Security Loan Association v. Weems*, 69 Ala. 584 (1881).

not definitely establish the garnishor's rights, they did say that in spite of the sale of the pledged property to the pledgee, the added interest of the legal title might still be the subject of garnishment and the pledgee (now owner) might be liable to the garnishor for the value of the property in excess of the debt.⁹ Generally these cases indicate that in most jurisdictions a pledgor's interest may be subjected to attachment just as tangible property which the pledgor possesses may be attached.

Since the right of attachment is derived from statute, the natural assumption may be, in the case of a pledgor's interest, that certain jurisdictions place various limitations upon the type of "interest" which may be attached. For example, the Civil Code of Georgia, § 5296, provides that: "collateral securities in the hands of a creditor shall not be the subject of garnishment at the instance of other creditors." As a result where the principal defendant gave his note to the garnishee in return for a loan and secured his note by a pledge of other notes, the court held that such a garnishment, unaided by any equitable pleadings, was ineffectual to reach the surplus coming to the common debtor after the creditor holding the pledge had received payments of the amount due to him.¹⁰ Similar limitations are to be found also in the courts' interpretation of the statutes of Maine and Massachusetts.

The Massachusetts statutes provide that: "a debtor's personal property, which is subject to a pledge or lien and of which the debtor has a right of redemption, may be attached and held as if unincumbered, if the attaching creditor pays or tenders to the pledgee the amount for which he is liable within ten days after demand."¹¹ But, the Massachusetts courts have held that this section is only applicable to the attachment of goods by the actual seizure thereof, and does not apply to the attachment of corporate shares. Consequently, in one case where the debtor had transferred certain stocks to his creditor as security for a loan, another creditor who sought to attach the debtor's interest in the pledged stock was not allowed to do so.¹²

The supreme court of Maine, arrived at the same conclusion in a 1939 case. The plaintiff sought to recover a huge rent debt due to him by the defendant. In doing so the plaintiff attached certain shares in the American and Foreign Power Co. which had been pledged by the defendant as security for a loan received from third persons in England. These shares were hypothecated shares and the question arose as to whether the defendant's equity of redemption may be attached. The court decided that: "Although the Maine statute authorized the

⁹ *Cooley v. Minn. Transfer Ry. Co.*, 53 Minn. 327, 55 N.W. 141 (1893).

¹⁰ *Macon Note Bank v. Smith*, 170 Ga. 332, 153 S.E. 4 (1930).

¹¹ *Mass. Rev. Laws (1902) C. 167, Par. 69.*

¹² *Athol Savings Bank v. Beimes*, 203 Mass. 480, 89 N.E. 632 (1909).

attachment of a 'share' or 'interest' of any person in an incorporated company, the statute referred only to the attachment of a fractional ownership in the company and the equity of redemption was not deemed to be such an 'interest' and could not be attached in absence of express provision." The statute also gave the right to attach pledged or mortgaged personal property to the extent of the pledgor's interest. However, personal property was construed by the court to mean only tangible property and not intangible property like stocks.¹³ In this manner a number of courts and legislatures have limited the attachment of a pledgor's interests to only a certain type of interests and have excluded other interests.

The judicial and legislative bodies have prescribed, in numerous instances, definite rules by which the attachment or garnishment of a pledgor's interest must be carried out. In a California case a debtor pledged goods to the plaintiff as security for a loan. The debtor went bankrupt and other creditors obtained a writ of attachment and seized the goods in the hands of the plaintiff. California statute provided for the attachment of a debtor's interest and further stipulated that when the interests were not capable of delivery and were in the hands of another person, notice of garnishment would have to be served on such person and the court could order delivery to the garnishor subject to any liens existing on the property. The court in carrying out the requirements of the statute said that while a pledgor's interest may be reached under execution, it can only be done by serving a garnishment on the pledgee and not by actual seizure of the property. The court could then after due examination disturb the pledgee in the possession of the property, but only after providing for the pledgee's lien.¹⁴

A reported New York case illustrates another way of making a valid attachment. A New York bank having a claim against a Pennsylvania bank, attached certain promissory notes and bills of exchange which the latter had pledged to another New York bank as security for a loan. The case depended on the effectiveness of the levy made under the warrant, that is to say, whether the sheriff should have taken the property into custody or whether it was sufficient to serve a certified copy of the warrant with a notice of the property to be attached upon the pledgee. The court reasoned that a pledgee was entitled to the possession of the pledged property as against the sheriff. While the debt remains undischarged the pledge belongs to the pledgee, but the residuary interest of the pledgor is property which may become the subject of attachment. Therefore, merely serving notice of the prop-

¹³ Penn. Co. for Insurance on Lives and Granting Annuities v. United Railways of Havana and Regla, Warehouses Ltd., 26 F. Supp. 379 (D.C. Me. 1939).

¹⁴ Treadwell v. Davis, 34 Cal. 601, 94 Am. dec. 770 (1868).

erty to be attached was sufficient attachment in view of the fact that the pledgee's indebtedness had not been discharged.¹⁵

Sometimes the question will be presented to the attaching creditor as to who is the real owner of the chattels which he wishes to attach, the pledgor or pledgee? In a situation such as this the Massachusetts court ruled that personal property which has been pledged, where the general property is in the pledgor, may be attached by a creditor of the latter, but such creditor cannot maintain a bill in equity to determine the ownership but must make an election against whom he is going to proceed at law.¹⁶

The garnishee may become liable to the creditor if he does not comply with the statute or the garnishor may lose his rights under the statute if he does not observe its requirements. For instance, where a principal debtor pledged stock with a bank as security and the bank sold such stock after being garnished for much less than the stock was worth, the garnishee bank was held liable to the garnishor for the difference between the sale price and what the stock was worth. The garnishee had failed to comply with the statute which necessitated that when goods were garnished in the hands of a pledgee, such pledgee should turn the goods over to the court in order that the court might pay the pledgee's incumbrance and give the surplus to the garnishor. The garnishor also had the right to pay the pledgor's debt and then take the goods out of pledgee's possession.¹⁷ In like manner, a Minnesota case held that where a garnishor failed to obey the statute by paying to the garnishee the amount of the indebtedness due to him from the pledgor, the garnishor lost his right to obtain the benefit of the pledge for himself and the garnishee had the right to sell the pledge in order to pay the debt due to him.¹⁸

An interesting problem, also, presents itself concerning the rights of the respective parties when the amount of collateral pledged by the debtor is only sufficient to cover the loan he has received. In Missouri the question was presented to the court in a case involving two defendants, who were held in jail for having stolen \$5,000. A surety signed a bail-bond for the defendants, and they, in turn, deposited \$5,000 with the surety in case he should become liable on the bail-bond. The issue was whether a garnishor can garnishee this pledge in the hands of the surety, for a debt due to him by the defendants. The court held that a contingent liability on a contract afforded no basis for garnish-

¹⁵ Warner v. 4th Nat'l. Bank, 115 N.Y. 251, 22 N.E. 172 (1889).

¹⁶ Weil v. Raymond, 142 Mass. 206, 7 N.E. 860 (1886).

¹⁷ Kyte v. Mac Ivor, 266 Mich. 258, 153 N.W. 289 (1934).

¹⁸ Twin City Fire Ins. Co. v. Midland Nat'l. Bank of Minn., 166 Minn. 379, 208 N.W. 22 (1926).

ment so long as it was uncertain whether the surety would become liable. The surety cannot be charged because the garnishor can have no greater rights against the garnishee than the principal debtor himself has.¹⁹

In Wisconsin the same question arose, but in a different fact situation. Here the garnishee had signed as surety a note made by the principal defendant. Later the garnishee bought land from the principal defendant but kept the amount of the note out of the purchase price as indemnity against paying the note. Another creditor of the principal defendant attempted to attach this amount in the garnishee's possession. The court would not allow the attachment since a garnishee is liable to the garnishor to the same extent that he was liable to the principal defendant before the attachment proceedings. There can be no recovery against the garnishee unless the principal defendant had a cause of action against him and in this case the principal defendant had no cause of action against the garnishee because it was not known yet whether the garnishee would become liable as surety on the note or not.²⁰ The Wisconsin court applies the same reasoning to a similar situation in the mortgagor, mortgagee, and third party creditor relationships.²¹

While it might appear that certain courts, one of which is the Wisconsin court, will not allow a pledgor's interest to be attached when the value of the property pledged is only sufficient to cover the amount of the loan, yet these same courts may allow the interest of the pledgor to be attached when such interest is dependent on a contingency. To illustrate: A canning company had pledged warehouse receipts covering canned goods as security for a loan from the garnishee bank. Another creditor of the canning company garnisheed the pledgor's interest. The pledgor subsequently assigned his interest and the assignee claimed that since the value of the goods at the time the pledge was made was only sufficient to cover the bank's loan, the pledgor did not have enough interest which could be attached. The supreme court said: "A margin in collateral securing a debt, even though its market value be no greater than the amount of the debt, can be assigned by the debtor, and therefore constitutes such right or interest as can be reached by garnishment under § 267.17, and such garnishment has priority over a subsequent equitable assignment by the debtor to another creditor."²² The court thus seemed to hold that since there was a

¹⁹ *Holker v. Hennessy*, 44 S.W. 794, 64 Am. St. Rep. 642 (Mo. 1898).

²⁰ *St. Louis v. Regenfuss*, 28 Wis. 144 (1871).

²¹ *McCown v. Russell*, 84 Wis. 122, 54 N.W. 31 (1893).

²² *Wisc. Laundry and Nach. Co. v. Capital City Canning Co.*, 189 Wis. 154, 223 N.W. 446 (1929).

possibility of the value of the collateral increasing, thereby giving the debtor an interest in the pledged property, such contingent interest could be attached. The Pennsylvania case of *Seip v. Lanbach* is entirely in accord with this line of reasoning. There the debtor had pledged his interest in his father's estate as security for a loan. The security seemed to be less than the loan. Another creditor sought to attach the pledgor's equity of redemption. The Pennsylvania court said the attachment would be good because it was impossible to value the debtor's interest at the present time, since the property forming a part of the estate might increase in value so as to render the debtor's interest therein of real worth.²³ In view of these cases, therefore, it may be noted that the courts have advanced to the point where they will allow attachment of a pledgor's interest based on the fact that such pledgor, although he has no present interest, may have some interest in the property in the future.

Naturally, there may be certain situations which will arise rather infrequently and which will require special attention. One such case appeared in California where a wife in a divorce action gave \$1,500 to the husband's attorney to be held for the benefit of her husband in case he should become liable for any of her debts. A creditor of the wife attached the money and the wife claimed that trust property could not be attached. The court held that the attorney was a pledgeholder and the attachment would fasten itself to any surplus left over after the pledgeholder had performed the acts required of him under the contract.²⁴ Another problem arises in respect to property held *in custodia legis*. May such property be attached? Generally speaking, property held by the court may not be attached since it would interfere with the effective functioning of court procedure. But when the purpose for which the state is holding a debtor's property has been carried out and there is no further reason to retain possession of the property, then the court may allow a creditor to attach such goods.²⁵

If a debtor turns over a bill of lading as security, can another creditor of the debtor attach the interest of the debtor in goods covered by the bill of lading? West Virginia held such property could not be attached since a bill of lading confers upon the person in whose favor it was issued, or transferred, the complete title to the goods, even though the bill of lading was intended to be merely a security for advances of money. Title passes out of the pledgor and rests in the

²³ *Sein v. Laubach*, 333 Pa. 225, 4 A. (2nd) 149 (1939).

²⁴ *Roffo v. Laltz*, 106 Cal. App. 51, 288 P. 884 (1930).

²⁵ *Bankers Mtg. Co. of Topeka, Kan. v. McCoamb*, 60 F. (2d) 218 (C.C.A. Colo. 1932).

pledgee, thereby making attachment of the pledgor's interest impossible.²⁶

In conclusion, it may be stated that most states recognize the right of a creditor to attach the interest of his debtor in property pledged to secure other debts. However, just what type of property may be subjected to attachment and the method by which the attachment is to be made will vary according to the statutes and the construction given them by the courts.

ROBERT SCHOENECKER.

²⁶ *Mill v. Rogers Bros. Produce Co.*, 23 S.E. 702 (W.Va. 1895).