Collusive Foreclosure Sales: The Forgotten Legacy of *Northern Pacific v. Boyd*

by

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In *BFP v. Resolution Trust Corp.*,[1] the Supreme Court ruled that the buyer at a foreclosure sale is never the recipient of a *constructive* fraudulent transfer[2] because whatever the buyer paid equals the value of what the buyer received.[3] An exception is made for *collusive* foreclosures.[4] These might be "actual" (not constructive) frauds on creditors.[5] But what is a collusive foreclosure sale? On this point the Supreme Court was silent.

In fact, the Supreme Court addressed this question in a classic case, *Northern Pacific Railway Corp. v. Boyd*.[6] Bankruptcy specialists will recognize *Boyd* as the birth, more or less, of the absolute priority rule in chapter 11 cases. *Boyd* is a mortgage foreclosure case, and, it turns out, chapter 11 is a lien foreclosure procedure.[7]

From *Boyd* we may induce a definition of collusive mortgage foreclosures. According to the induction, a collusive foreclosure sale requires a corporate debtor (*D Corp.*) and corporate buyer (*B Corp.*) and an

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[1] 511 U.S. 531, 546 (1994).

[2] *Id.*; 11 U.S.C. § 548(a)(1) (trustee may avoid transfer if the debtor "(B)(i) received less than a reasonably equivalent value in exchange for such transfer . . . and (ii)(I) was insolvent on the date such transfer was made . . . ").

[3] Per Justice Scalia:

> We deem, as the law has always deemed, that a fair and proper price, or a "reasonably equivalent value," for foreclosed property, is the price in fact received at the foreclosure sale, so long as the requirements of the State's foreclosure law have been complied with.

Id. at 545.

[4] *Id.* at 545-46.

[5] 11 U.S.C. § 548(a)(1)(A) (trustee may avoid transfer if the debtor "made such transfer . . . with actual intent to hinder, delay, or defraud any entity to which the debtor was . . . indebted").

[6] 228 U.S. 482 (1913), *aff'g* 177 F. 804 (9th Cir. 1910), *aff'g* 170 F. 779 (C.C.D. Wash. 1909).

[7] 11 U.S.C. § 1141(b) (confirmation vests all property of the estate in the debtor), (c) ("property dealt with by the plan is free and clear of all claims and interests of creditors . . . ").

intermediating secured party (*SP*) with a lien on the assets of *D Corp.*

What makes the foreclosure sale "collusive" is that *D Corp.* and *B Corp.* have the same shareholders (*SH*). In a collusive foreclosure sale, we have this structure:

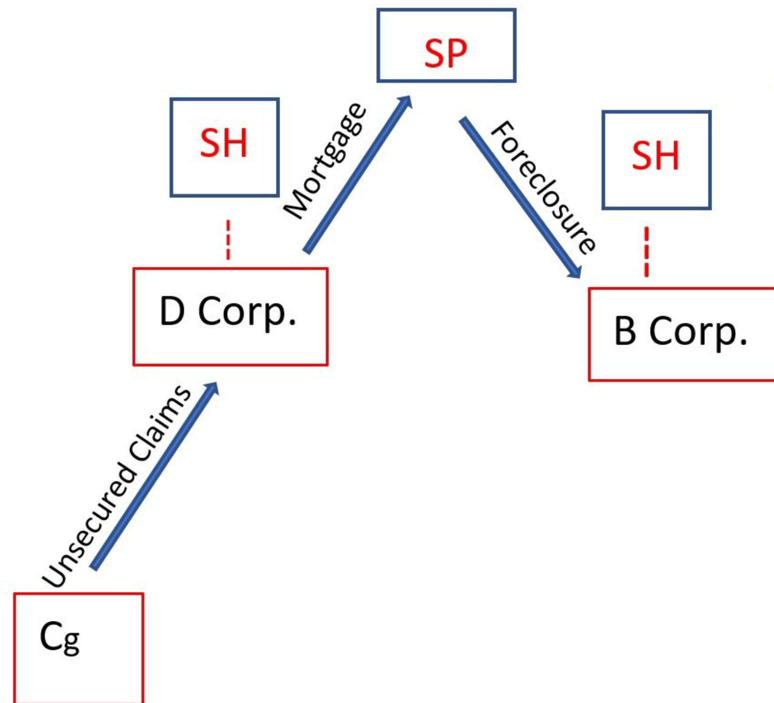

Figure One
Collusive Mortgage Foreclosure

In Figure One, *D Corp.* is insolvent and its assets are over-encumbered. In modern bankruptcy parlance, *D Corp.* is administratively insolvent. *D Corp.* has unsecured creditors (collectively, the C_g). No $\{C_1, C_2, C_3 \ldots\} \in C_g$ can realize anything from the assets of *D Corp.* *SP* takes all the proceeds of the sale. Dispatching the C_g is the point of the collusive sale. *SH* would like to get rid of these characters.[8] The idea is to launder the assets of *D Corp.* of all C_g claims and to put the assets to a new entity (*B Corp.*) which is also

[8] Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co., 174 U.S. 674, 684 (1899) (attributing this motive to a collusive foreclosure sale).

owned by *SH*. In this way *SH* can award herself a fresh start. If fortunes improve, *SH* captures all the appreciation value in the assets. The C_g, who have been foreclosed, have no access to this value.

This transaction is usually assumed to be a fraudulent transfer.[9] But it is not one, whenever *SP* is "under water"--i.e., when *SP*'s secured claim exceeds the value of the collateral.[10] Suppose, prior to the collusive foreclosure sale, C_1 emerges to levy on *D Corp*'s assets. Since every asset is over-encumbered. C_1 realizes nothing from an execution sale, because the sheriff must sell the asset subject to *SP*'s senior security interest. Since *D Corp.*'s equity is worth nothing, C_1 can get nothing. Hence, when *SP* conveys *D Corp.*'s equity to *B Corp.*, C_1 is neither hindered nor delayed nor defrauded. When *SP*'s secured claim exceeds the value of what *B Corp.* pays, C_1 is not harmed. As is said in the fraudulent transfer case law: "no harm, no foul."[11]

This point is especially clear under the Uniform Fraudulent Transfer Act (UFTA) or Uniform Voidable Transactions Act, which represent the law of fraudulent transfers in most states. Suppose *D Corp.* is under water to *SP*'s blanket lien. *SH*, who owns *D Corp.*, incorporates *B Corp.* and provokes *SP* to foreclose. *B Corp.* wins the auction by virtue of bidding the amount of *SP*'s secured claim (or less). Under UFTA § 1(2)(i), "asset" is

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[9] William O. Douglas & Jerome Frank, *Landlords' Claims in Reorganizations*, 42 YALE L.J. 1003, 1010 (1933) ("nothing more than an adaptation of the similar rule of fraudulent conveyances originally expressed in the statute of 13 Elizabeth"); *see also* 1 GARRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 224, at 389 (rev. ed. 1940); DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS 43 (Cambridge University Press 2022); Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 56 U CH. L. REV. 738, 745 (1988); Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM. BANKR. L.J. 387,400-01 (1998); Bruce A. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 74, 76-77 (1991); *but see id.* at 79 ("If issued today, the opinion would probably be analyzed as another unexceptional 'successor liability' case applying the 'mere continuation' theory of fraudulent transfer or bulk transfer liability."). *See also* Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 587 (2016) (*Boyd* "was really a kind of successor liability or fraudulent transfer case . . . ").

[10] Miller v. Forge Mench P'ship, 55 U.C.C. Rep. Serv. 2d 1022, 1024 (S.D.N.Y. 2005).

[11] Nino v. Moyer, 437 B.R. 230, 235 (W.D. Mich. 2009) (citation omitted); *see* Voest-Alpine Trading USA Corp. v. Vantage Steel Corp, 919 F.2d 206, 214 (3d Cir. 1990) ("The third requirement for finding a fraudulent conveyance is that creditors have been prejudiced by the transaction in question.").

defined to exclude "property to the extent it is encumbered by a valid lien."[12] Therefore, in the collusive foreclosure sale, *D Corp.* transfers zero assets to *B Corp.*, and so there is no transfer at all--and hence no *fraudulent* transfer.[13]

Fraudulent transfer law promises C_1 an equitable lien on whatever *D Corp.* transferred to *B Corp.*[14] So does the law applicable to the collusive foreclosures. The collusive foreclosure rule, however, is founded on a theory much different from and flatly contradictory to the theory of fraudulent transfer. Collusive foreclosure doctrine is based on piercing corporate veils. Piercing the veil is the logic of *Boyd* and therefore of bankruptcy's absolute priority rule.

According to this logic, Figure 1 automatically triggers piercing the veil between *D Corp.* and *B Corp.* Thus, *D Corp.*'s veil is pierced and *SH* and *D Corp.* are revealed to be alter egos--the same person. Likewise, the veil between *SH* and *B Corp.* is pierced. *SH* and *B Corp.* are the same person. To invoke the algebraic property of transitivity, collusive mortgage doctrine asserts *D Corp.=SH=B Corp. SH* silently drops from the equation, leaving *D Corp.=B Corp.* In effect, as the *Boyd* opinion expressly recognizes, *D Corp* buys at the foreclosure sale (because *D Corp.=B Corp.*) When *D Corp.* does so, C_1 is free to levy on the property ostensibly owned by *B Corp.*, because *B Corp.=D Corp.*[15]

In *Boyd*, C_1 was invited to get a lien on *B Corp.*'s property, but at first this would have availed C_1 nothing. This was because *B Corp.* had what superficially appeared to be a purchase money lender SP_2, who took an underwater blanket security interest on what *B Corp.* bought.

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[12] UFTA § 1(2)(i).

[13] Wells Fargo Vendor Fin, Serv., LLC v. Nationwide Learning, LLC, 429 P.3d 221, 265 (Kan. App. 2018); Board of Cnty. Comm'n v. Park Cnty. Sportsmen's Ranch, LLP, 271 P.3d 562, 571 (Colo. App. 2011).

[14] Classically, *B Corp.* was not personally liable to C_1 for receiving fraudulently transferred property. Fraudulent transfer litigation terminated with an equitable lien on whatever *B Corp.* received from *D Corp.* David Gray Carlson, *Fraudulent Transfers: Void and Voidable*, 28 AM. BANKR. INST. L. REV. 1 (2021). Since the days of *Boyd*, fraudulent transfer may have become a tort. David Gray Carlson, *Fraudulent Transfers as a Tort*, 2022 MICH. ST. L. REV. 1093 (2021).

[15] C_1, however, may not levy on *SH*'s assets because *SH* has dropped from the equation. In algebraic terms, *SH* is the imaginary number $-\sqrt{1}=i$. Thus, $(a-bi)(a+bi)=a^2-b^2$. The imaginary i has disappeared. It is a vanishing mediator, and so is *SH*.

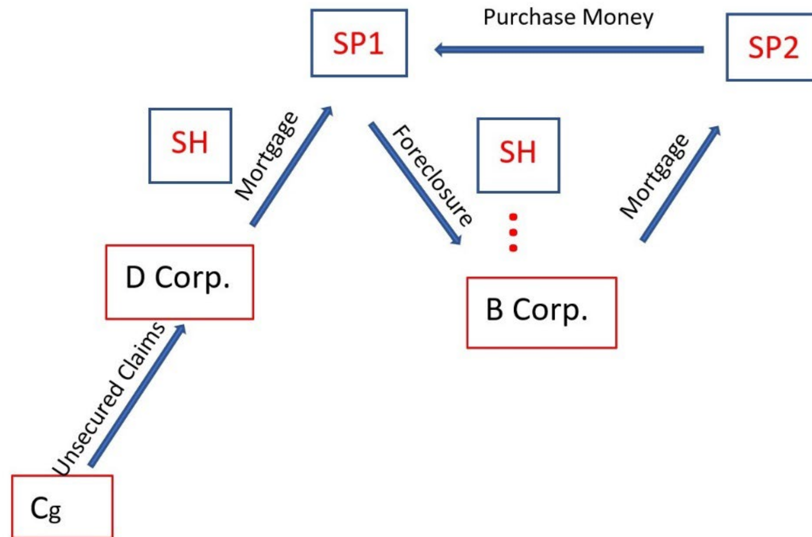

Figure Two
Purchase Money Financing

C_1 has a lien on the property of *B Corp*=*D Corp*, but because of SP_2's blanket lien, C_1 is out of the money. But C_1 can afford to wait,[16] as Joseph H. Boyd (who waited eight years) was to prove. As *B Corp*. pays down SP_2 from earnings, C_1 can ultimately expect to realize a collection, if fortune smiles on *B Corp*.

Figure 2 gives an important reason why we should not view the collusive foreclosure sales as a fraudulent transfer. If it were, we would have to count SP_2 as a bad faith purchaser for value from *B Corp*, the initial transferee. As such, SP_2 takes the assets of *B Corp*. in trust for the C_g. But, as we shall see, *Boyd* indicates that SP_2's security interest is senior to any equitable lien the C_g can get on the property of *B Corp*.=*D Corp*. *B Corp*.=*D Corp*. may legitimately pledge its assets to SP_2 as collateral. We might call SP_2 a purchase money lender, except that to do so would be to admit *B Corp*. is the purchaser at the foreclosure sale, and would admit *B Corp*. and *D Corp*. are different persons. We are bound to regard *B Corp*. and *D Corp*. as the same person, and so the foreclosure sale is no sale at all. It is more consistent with veil-piercing theory to regard SP_2 as refinancing

[16] Because we are denying that a collusive mortgage foreclosure is a fraudulent transfer, we can put aside the 4-year statute of limitation in UFTA § 9.

SP_1's security interest on behalf of *B Corp.*=*D Corp.*.

Boyd, it seems, was not the case the Supreme Court took it to be. In the lower courts, it was a fraudulent leveraged buyout (LBO).[17] Because the Supreme Court failed to comprehend this, it unnecessarily created or at least expanded upon the collusive foreclosure sale doctrine, thus inspiring the absolute priority rule in chapter 11. It appears the absolute priority rule is based on a mistake by the Supreme Court as to the facts in *Boyd*.

The goal of this article, then, is to provide a very close look at the facts in *Boyd*. Before we begin this presentation, Part I sets forth four legal propositions that illuminate the *Boyd* opinion.

> (1) Fraudulent transfer contradicts the theory of piercing the corporate veil.
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> (2) With regard to non-collusive foreclosures, the mortgagor's unsecured creditors (the C_g) are not "necessary parties" in foreclosure procedure. They become so when the sale is collusive.
>
> (3) If *D Corp.* wins the auction at which *SP* forecloses on *D Corp.* assets, there is no sale. There is only a redemption of *SP*s mortgage.
>
> (4) If an LBO is a fraudulent transfer, C_1 (*D Corp*'s creditor)

[17] As noticed in passing by Professor Markell, *supra* note 9, at 79. According to the leading case:

> A leveraged buy-out is not a legal term of art. It is a shorthand expression describing a business practice wherein a company is sold to a small number of investors, typically including members of the company's management, under financial arrangements in which there is a minimum amount of equity and a maximum amount of debt. The financing typically provides for a substantial return of investment capital by means of mortgages . . . The predicate transaction here fits the popular notion of a leveraged buyout. Shareholders of ⟦D Corp.⟧ sold the corporation to a small group of investors head by ⟦*D Corp.*'s⟧ president; these investors borrowed substantially all of the purchase price at an extremely high rate of interest secured by mortgages on the assets of ⟦*D Corp.*⟧ and its subsidiaries . . .

United States v. Tabor Court Realty Corp., 803 F.2d 1288, 1292 (3d Cir. 1986).

gets an equitable lien on the mortgage of the LBO financer (SP). C_1 ends up with a lien on a lien.

With these four ideas in hand, Part II reviews two earlier Supreme Court case thought to presage *Boyd*.

Part III provides a very detailed account of *Boyd*--by far the most detailed account ever published. Part III first shows that the case involved an LBO. Had the Supreme Court realized this, it could have used fraudulent transfer law to assure C_1 an equitable lien on *B Corp.*'s property--an equitable lien that would have been senior to SP_2's security interest as diagrammed in Figure 2. C_1, it seems, was a secured creditor, not a general creditor. If the Supreme Court had understood the facts, it need never have trafficked in collusive foreclosure doctrine, and (arguably) we would never have had the absolute priority rule in chapter 11.

Part IV claims that *Boyd* lives on in the modern "mere continuation" standard for piercing the corporate veil, as applied in mortgage foreclosures. None of these cases shows awareness that *Boyd* is even a precedent for piercing the veil. A majority of the cases I have found refuse to pierce where *D Corp.* was under water at the time of the foreclosure. In that sense, these cases disagree with *Boyd*. Only in a few states is a collusive mortgage foreclosure grounds to pierce the veil, where the C_g are not prejudiced by the foreclosure sale. In state common law, *Boyd* barely survives. Only a few states have an absolute priority rule as part of state law.

I. Preliminary Topics

A. Fraudulent Transfer Theory Contradicts Veil Piercing

Classically, a fraudulent transfer is one intended by D to hinder the C_g. If a transfer so was intended by *D Corp.* $C_1 \in C_g$ was invited, via a creditor's bill in equity, to obtain an equitable lien on the property transferred for the amount of C_1's claim.[18] The theory presupposes a transferor and a transferee.

Piercing a corporate veil is a radically different theory. Suppose *D Corp.* conveys property to *SH*. If piercing the veil is appropriate, then *SH* and *D Corp.* are the same person. No transfer has occurred. Rather, *SH* already

[18] Carlson, *Void and Voidable*, *supra* note 14.

owned the thing that was supposedly transferred. A transfer requires a transferor and a transferee. But where *D Corp.* and *SH* are the same person, there can be no transfer and hence no fraudulent transfer.[19]

Suppose insolvent *D Corp.* owns a gold brick which it gives *gratis* to *SH.* If *D Corp.* and *SH* are different persons, *D Corp.* has fraudulently transferred the brick to *SH.* It is *SH*'s brick, but *SH* holds the brick in trust for the C_g of *D Corp.* C_1 can obtain an equitable lien on *SH*'s brick. If, however, *D Corp.* and *SH* are the same person, C_1 can still get a lien on the brick because *D Corp.* is *SH* and there has been no transfer. But C_1 can also get a lien on other assets of *SH* that *SH* did not acquire from *D Corp.* In classical fraudulent transfer law, C_1 is not an unsecured creditor of *SH*, in ordinary circumstances.[20] Rather, C_1 has a nonrecourse lien on what *SH* received from *D Corp.* but no recourse against *SH* personally. But where C_1 can pierce the veil between *SH* and *D Corp.*, *SH* is personally liable to C_1 because *D* is liable, and *D Corp.=SH.* All of *SH*'s property can be levied.

Confusingly, the fact that *SH* used *D Corp.* as her personal piggy bank, giving and taking back property willy nilly, is grounds to pierce the corporate veil.[21] Therefore, one very commonly sees C_1 or a bankruptcy trustee pleading fraudulent transfer and piercing the veil as alternative causes of action. They are, however, inconsistent theories. If C_1 pursues the fraudulent transfer theory against *SH* but still comes up short because C_1's claim against *D Corp.* exceeds the value of *SH*'s brick, C_1 is judicially estopped from later seeking other assets of *SH*, because C_1 has already relied on the fact that *D Corp.* and *SH* are separate persons.[22]

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[19] Jeanne L. Schroeder & David Gray Carlson, *Generalized Creditors and Particularized Creditors: Against A Unified Theory of Standing in Bankruptcy*, 96 AM. BANKR. L.J. 505, 528 (2022).

[20] For regret this proposition has been compromised, *see* Carlson, *Tort*, *supra* note 14. Classically, if C_1 brings an accounting action against *SH*, *SH* must produce the fraudulently received property. If *SH* cannot do so, an equity court will award C_1 with a money judgment. But *SH* may avoid the money judgment by producing the property. *Id.* at 1117-19.

[21] Schroeder & Carlson, *supra* note 19, at 564-71.

[22] Tronox Inc. v. Kerr-McGee Corp. (*In re* Tronox Inc.), 855 F.3d 84, 100 (2d Cir. 2017) (C_1 could not pierce a corporate veil because a bankruptcy trustee had already settled a fraudulent transfer suit).

B. Unsecured Creditors Are Not Necessary Parties to a Foreclosure

There are many kinds of liens--security interests on personal property, mortgages on real property, judicial liens or tax liens on either real or personal property. Regardless of this diversity of liens, a foreclosure sale operates on a simple basic design.

A lien is a power of a creditor to sell whatever interest the debtor could have sold in property at the time *SP* obtains a lien. There is an important temporal aspect to the definition of a lien. We do not consult what *D* could sell at the time of the foreclosure sale. By that time, *D* may have sold out to some D_2 and so *D* has nothing at all. Rather, we look back in time, past *D*'s transfer of the equity to D_2. We look at what *D* had at the moment *SP* first became a secured creditor. *SP* can sell what *D* had at *that* time, which is the fee simple of the collateral. D_2 is foreclosed because *D* granted *SP* a power to sell fee simple absolute to some buyer *B*. If. After foreclosure, *B* has fee simple absolute, D_2 has nothing.[23]

Article 9 of the Uniform Commercial Code (UCC) sets forth the familiar pattern. Article 9 governs when the lien is consensually created and when the collateral is personal property.[24] When *D* defaults on the security agreement, *SP* may dispose of the collateral by sale.[25] *SP* finds a buyer, who buys whatever *D* had at the time *SP*'s lien was created --at the time of "attachment,"[26] to use the Article 9 term. For example, suppose *D* owns the fee simple of a gold brick. *D* conveys a perfected security interest to SP_1. SP_1 can sell *B* the fee simple title, if foreclosure becomes necessary.[27] Suppose, after SP_1 perfects, *D* grants a second security interest to SP_2. SP_2 can only convey the fee simple *minus* SP_1's security interest. SP_1 and SP_2 are in an asymmetrical relation. SP_1 can foreclose SP_2[28] but SP_2 cannot foreclose SP_1.[29] This is part of what it means to say that SP_2 is "junior."

Lien foreclosures distinguish between necessary-but-not-indispensable

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[23] David Gray Carlson, *Critique of Money Judgment (Part I: Judicial Liens on New York Real Property)*, 82 ST. JOHN'S L. REV. 1291, 1300-03 (2008) (rehearsing this dynamic in the context of judgment liens).

[24] U.C.C. § 9-109(a)(1) (Article 9 applies to "a transaction, regardless of its form that creates a security interest in personal property or fixtures by contract.").

[25] U.C.C. § 9-610(a).

[26] *Id.* § 9-203(a).

[27] *Id.* § 9-617(a)(1).

[28] *Id.* § 9-617(a)(2).

[29] Under § 9-617(a)(3), SP_2 can discharge only subordinate liens.

parties and improper parties. A necessary party is anyone who is foreclosed when a mortgagee exercises her foreclosure power. According to a leading New York case:

> [P]ersons holding title to the premises or acquiring any right to or lien on the property subsequent to the mortgage should be made defendants in the foreclosure action . . . . The rationale for joinder of these interests derives from the underlying objective of foreclosure actions--to extinguish the rights of redemption of all those who have a subordinate interest in the property and to vest complete title in the purchaser at the judicial sale . . . . Notice to interested persons provides them with the opportunity to redeem prior to sale, to bid at the sale (which conceivably might increase the sale price), and to protect their interests in a possible surplus . . . . Necessary parties include persons with title to the premises . . . , tenants . . . , and those holding subordinate liens . . . , or subordinate judgments . . .[30]

To illustrate, suppose *D* owns Blackacre in fee simple absolute and sequentially grants mortgages to SP_1, SP_2, and SP_3. Each mortgage is associated with a different foreclosure power.

Suppose SP_1 forecloses. At the auction *X* is the high bidder. SP_1 can sell what *D* had at the moment SP_1's lien was created. Since *D* owned fee simple absolute at that moment, *X* gets fee simple absolute. And if *X* owns fee simple absolute, then no one else owns any interest in Blackacre. *X* has effectively bought four pieces of Blackacre and put them together to make up the fee simple: the mortgages of SP_1, SP_2 and SP_3, and *D*'s equity. SP_1 has foreclosed SP_2, SP_3, and *D*.

Mortgage law deems SP_2, SP_3 and *D* as necessary parties. If *X* is to buy fee simple absolute, SP_1 must make SP_2, SP_3, and *D* parties to SP_1's foreclosure proceeding. This conclusion presupposes SP_2, and SP_3 have recorded their mortgages before SP_1 commences to foreclose, or, if they have not recorded, SP_1 knows they exist. If SP_1 does not know they exist and if they have not recorded, SP_2 and SP_3 are not necessary parties and are

[30] Polish Nat'l Alliance of Brooklyn, USA v. White Eagle Hall Co., 470 N.Y.S.2d 642, 646 (2d Dept. 1983).

foreclosable in SP_1's proceeding.[31]

SP_2, SP_3, and *D* are necessary-but-not-indispensable parties. Suppose SP_1 forgets to join SP_3 to the action. There is still a sale to *X*. But SP_3 is not foreclosed. *X* has only bought three pieces of Blackacre--the senior mortgages of SP_1 and SP_2 plus *D*'s equity. Since *X* has a senior mortgage on *X*'s equity, *X* may re-foreclose the SP_1 mortgage and get rid of SP_3.[32]

The C_g, however, are not necessary parties in any of these foreclosures. The C_g need not be joined. In fact, if the C_g move to intervene in order to assert the inequity of foreclosing, the motion would be denied.[33] An

[31] According to New York Real Property Actions and Proceedings Law 1311:

> Each of the following persons, whose interest is claimed to be subject and subordinate to the plaintiff's lien, shall be made a party defendant to the action:
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> 1. Every person having an estate or interest in possession, or otherwise, in the property as tenant in fee, for life, by the curtesy, or for years, and every person entitled to the reversion, remainder, or inheritance of the real property, or of any interest therein or undivided share thereof, after the determination of a particular estate therein . . .
>
> 3. Every person having any lien or incumbrance upon the real property which is claimed to be subject and subordinate to the lien of the plaintiff.

[32] According to *Polish Alliance*,

> Nevertheless, the fact that the White Eagle vendees were necessary parties to the foreclosure action does not make them indispensable parties whose absence mandates dismissal of the action. The absence of a necessary party in a mortgage foreclosure action simply leaves that party's rights unaffected by the judgment of foreclosure and sale . . . . While the foreclosure sale may be considered void as to an omitted party, it is nonetheless effective to vest the purchaser with the interests of the mortgagee, the named defendants and persons acquiring interests from the defendants after the notice of pendency . . . . Thus--whatever the rights of its contract vendees who are not appellants here--White Eagle cannot nullify the foreclosure action on the basis of PNA's failure to name those vendees as parties in the foreclosure suit.

470 N.Y.S.2d at 648 (citations omitted).

[33] Stout v. Lye, 103 U.S. 66, 70 (1880) (unsecured creditors cannot contest the validity of a mortgage foreclosure, but a creditor with a judicial lien may do so).

unsecured creditor of *D* has no property interest in *D*'s property.[34] The C_g are improper parties. On the other hand, suppose C_1 obtains a judgment against *D* before the foreclosure sale, and C_1 records the judgment or has it docketed in the county where the real property is located. Now C_1 has a property interest in Blackacre--a judicial lien. C_1 has become a necessary party who must be joined as a party.[35]

As we shall see, in *Boyd*, C_1 was a necessary party by virtue of having an equitable lien on the property of *D Corp.* prior to the foreclosure sale. The Supreme Court erroneously thought C_1 was an unsecured creditor of *D Corp.* The Supreme Court in effect ruled (unnecessarily) that the C_g always become necessary parties when a mortgage foreclosure sale is collusive.

C. When The Debtor Buys at the Foreclosure Sale

In *Boyd*, the Supreme Court compares *B Corp.* to a defaulting debtor that buys at its own foreclosure sale, or to a debtor who buys at a tax foreclosure. Therefore, I will say a few words about a debtor who does one of these things.

Suppose *D* has granted a mortgage to $SP_{1\text{-}3}$ in sequence. SP_1 commences a foreclosure sale. *D* shows up and wins the auction. This is properly treated as a redemption, not a foreclosure. $SP_{2\text{-}3}$ are not foreclosed. *D* has in effect paid SP_1 off. SP_2 and SP_3 win a promotion when SP_1 is paid.[36] Having been second and third respectively, they are now first and second.[37]

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[34] Pusey & Jones Co. v. Hanssen, 261 U.S. 491, 497 (1923).

[35] Polish Nat'l Alliance of Brooklyn, USA v. White Eagle Hall Co., 470 N.Y.S.2d 642, 646 (2d Dept. 1983).

[36] RESTATEMENT (THIRD) PROPERTY: MORTGAGES, § 4.9 (1997); *see* Old Republic Ins. Co. v. Currie, 665 A.2d 1153, 1155 (N.J. Super. Ch. Ct. Div. 1995) ("The mortgagor is in effect paying the first mortgage and the second mortgage moves into first position. This is what would have occurred if the mortgage had paid the first mortgage when it became due.").

[37] In *Board of County Commissions v. Park County Sportsmen's Ranch*, LLP, 271 P.3d 562, 574 (Colo. App. 2011), *D* (a partnership) owned real property, *SP* advanced funds on a mortgage from *D*. A judgment creditor (*JC*) recorded the transcript of a judgment, which gave *JC* a junior lien on the property. *SP* foreclosed. The partners of *D* created *B Corp.* to buy the property. *B Corp.* won the auction. The court viewed *B Corp.* as *D* in disguise. The court should have treated the case as through *D* itself won the auction. As a result, *JC*'s lien continued to be valid. The trial court so concluded. The appellate court,

In contrast, suppose SP_3 wins the auction. SP_3 buys fee simple absolute. SP_2 and *D* are foreclosed. SP_3 is not treated as having redeemed. SP_3 has purchased. SP_2 and *D* are gone.

Tax foreclosure sales have a similar doctrine. Municipal property taxes are typically a tax on the fee simple absolute.[38] If no one steps forward to pay the tax, the taxing authority forecloses all interests in Blackacre.

Because this is so, a tax foreclosure is an opportunity for *D* to launder the property of cotenancies and mortgages. Equity intervenes to proclaim that *D* takes title to the land in trust for the other parties, be they cotenants or mortgage lenders.[39] Cotenants, at least, are required to reimburse *D* for their share of the taxes. Mortgage lenders are not. Unlike the equity owners, mortgage lenders have no equitable duty to pay real estate taxes. Equity courts will not tolerate *D* using a tax foreclosure to launder the interests of competitors. *Boyd* is founded on a similar instinct. The collusive foreclosure was a redemption, not a sale.

D. Leveraged Buyouts

This Article is not about LBOs. But it turns out that *Boyd* is an LBO case, and so we need to know a little bit about them, if we are understand *Boyd*. Properly *Boyd* never should have been a collusive foreclosure case. The Supreme Court missed this point and so its contribution to collusive foreclosure doctrine is the product of accident.

In an LBO, the old shareholders (SH_1) want to sell their shares to a new shareholder (SH_2). Being fundamentally piratical in soul, SH_2 wants the shares but does not wish to pay for them. So she arranges for *D Corp.* to borrow the price from *SP* who forwards the money to *D Corp.* in exchange for a mortgage on *D Corp.* assets. *D Corp.* upstreams the money to SH_1 and

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however, ruled that *B Corp.* was personally liable to *JC*, but *JC*'s lien disappeared in the foreclosure. *JC* would have to get a new judgment against *B Corp.* This is inconsistent. If *B Corp.* were truly *D*, no sale occurred. Only a redemption occurred, in which case *JC* was intact. *JC* therefore would lose out if a JC_2 got a lien against the real property before *JC* could get a second judgment.

[38] *See generally* Laura B. Bartell, *Tax Foreclosures as Fraudulent Transfers--Are Auctions Really Necessary?*, 93 AM. BANK. L.J. 681 (2019).

[39] RESTATEMENT (THIRD) Property: Mortgages, § 4.9 (1997); *see* Grant S. Nelson, *The Foreclosure Purchase by the Equity of Redemption Holder or Other Junior Interests: When Should Principles of Fairness and Morality Trump Normal Priority Rules?*, 72 MO. L. REV. 1259 (2007).

SH_1 tenders shares to SH_2 who now controls *D Corp*. This is achieved without SH_2 putting up much (or any) capital.

Roughly speaking, the value of SH_1's shares in *D Corp.* is the value of *D Corp*'s assets minus the amount of debt *D Corp.* owes. For example, *D Corp.*'s assets are worth $100 and C_g's unsecured claim is for $80. For the sake of explanatory simplicity, suppose C_g=C_{1-8} each holding a claim of $10. The value of SH_1's shares is $20. In order to achieve the LBO, *D Corp.* needs to borrow $20 from *SP*. Thus, before the LBO, the C_g enjoyed a $20 cushion from the assets of *D Corp.* After the LBO, *SP* is senior for $20 as to the $100 in assets and the C_g are junior for $80. *D Corp.* is highly leveraged but not insolvent. If *D Corp.*'s net earnings suffice to maintain debt service and the costs of running the business, the C_g are all right.[40] But the C_g have lost their $20 equity cushion. If business heads south, the C_g take the loss and SH_2 walks away whistling past the graveyard. But if business heads north, the C_g recover and SH_2 makes a fortune, as her shares (previously worth $100-$80-$20=nothing) are now worth something. Because the typical LBO leaves *D Corp.* barely solvent, it is not often found to be a fraudulent transfer.

SP sometimes lends to *D Corp.* knowing that *D Corp.* cannot survive long, given its cash flow. Then the LBO resembles a "bulk sale"--the classic intentional fraud on creditors.[41] In such a case, *SP* provides the liquidity that permits SH_1 to abscond with $20. *D Corp.* has hindered the C_g by granting a mortgage to *SP*. This implies that *SP* is a bad faith purchaser for value and the recipient of a fraudulent transfer. *SP* has received a fraudulent mortgage of $20 on *D Corp.*'s assets. SH_1 (not the C_g) gets the $20 in loan proceeds, which should have been retained by *D Corp.* to pay the C_g.

Suppose after the LBO, *D Corp.*'s assets have declined to $60. C_{1-4} diligently lien the $40 in equity that is left after *SP*s claim for $20 is accounted for. C_{5-8} recovers nothing. Suppose now that C_5 serves an execution on the sheriff, but the sheriff is unable to realize anything from *D Corp.*'s assets. Classic fraudulent transfer doctrine authorizes C_5 to seek an equitable lien on what *SP* (a bad faith purchaser) has fraudulently received from *D Corp.* Since *SP* claims a mortgage, C_5's equitable lien is a lien on that

[40] *See* David Gray Carlson, *Leveraged Buyouts in Bankruptcy*, 20 GA. L. REV. 73 (1985) (describing nonfraudulent LBOs).

[41] Carlson, *Void and Voidable*, *supra* note 14, at 8.

lien. *SP* holds the mortgage in constructive trust for C_5. If *SP* forecloses her mortgage on *D Corp.*'s property, *SP* is deemed to do this for the benefit of C_5. Suppose *SP* forecloses and sells to *X*. *X* pays cash to *SP*. *SP* holds this cash in trust for C_5. If, in breach of fiduciary duty, *SP* fails to tender any of this cash to C_5 and instead buys some object, C_5 can trace the funds into the object and therefore has an equitable lien on that object. But if the funds have disappeared and cannot be traced into other objects, *SP* has committed the tort of conversion--wrongful interference with the property of C_5. In that case, C_5 can bring an equitable accounting action against *SP*, where *SP* must produce the trust property. If *SP* fails to produce it, a court of equity, as a last resort, issues a money judgment in favor of C_5 against *SP*.

The classic example of a fraudulent transfer remedy in an LBO is *United States v. Tabor Court Realty Corp.*[42] The scene opens with the SH_1 wishing to sell their shares in *D Corp.* to SH_2, but SH_2 has no money to pay SH_1 \$20.[43]

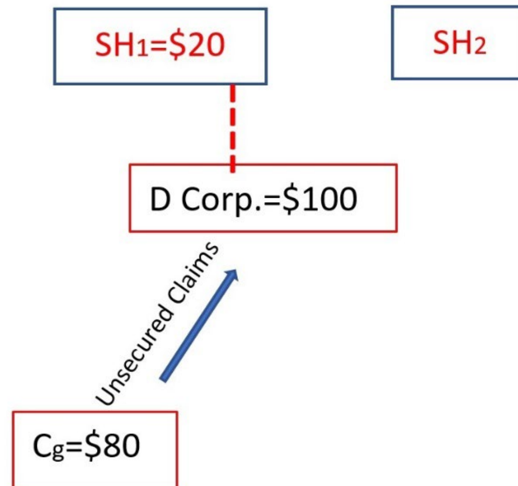

Figure Three
Before the LBO

[42] 803 F.2d 1288 (3d Cir. 1986).

[43] In *Tabor*, D Corp. was the Raymond Group. Raymond owned (directly and indirectly) anthracite coal mines. SH_1 was the Gillens and the Clevelands. Raymond Colliery owned a subsidiary, Blue Coal, which Raymond Group had acquired in an earlier LBO. Other subsidiaries were Raymond Colliery, Glen Nan and Olyphant Associates. SH_2 was Great American, a corporation owned mostly by James Durkin, president of Raymond. *Id.* at 1291-92.

The parties arrange for D Corp. to borrow $20 from $SP_{1(A)}$[44] in exchange for mortgages on all assets.[45] *D Corp.* receives the loan proceeds and lends them to SH_2. SH_2 tenders the $20 to SH_1.[46] SH_2 is now the sole shareholder of *D Corp.*

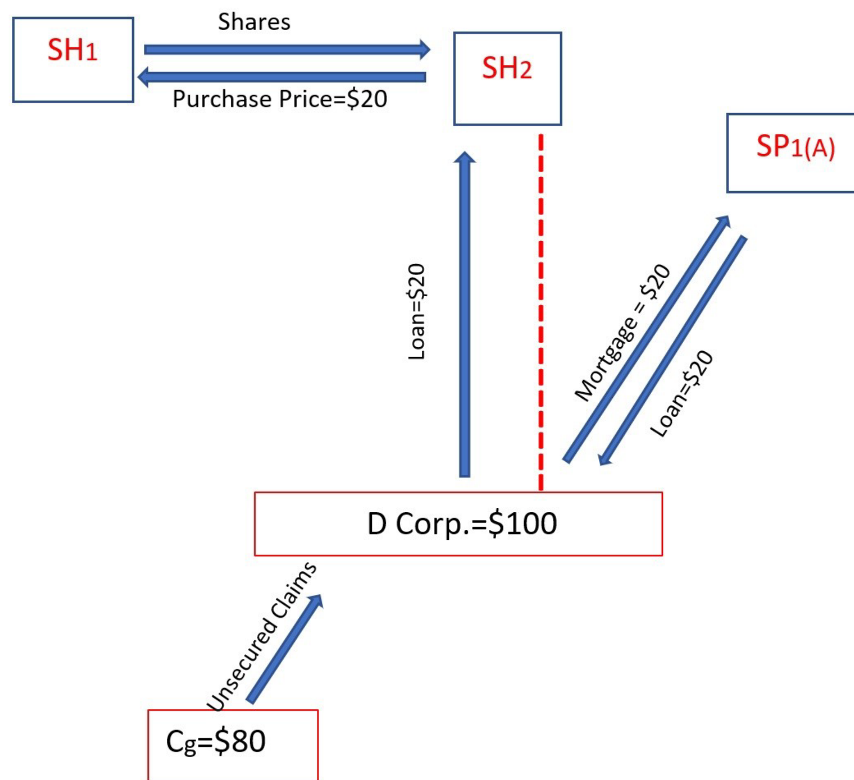

Figure Four
LBO Financing

[44] $SP_{1(A)}$ was Institutional Investors Trust.

[45] These mortgages included those granted by Raymond's subsidiaries as upstream guarantors of the loan to Raymond. *Id.* at 1293.

[46] SH1 received somewhat more than $20. The excess received was contributed by Great American, which raised funds from its shareholders (including Durkin).

Later, $SP_{1(A)}$ assigns the mortgage to $SP_{1(B)}$[47] who forecloses[48] by selling to B Corp.[49] Skipping some complexity, B Corp.'s shareholder was SH_2.

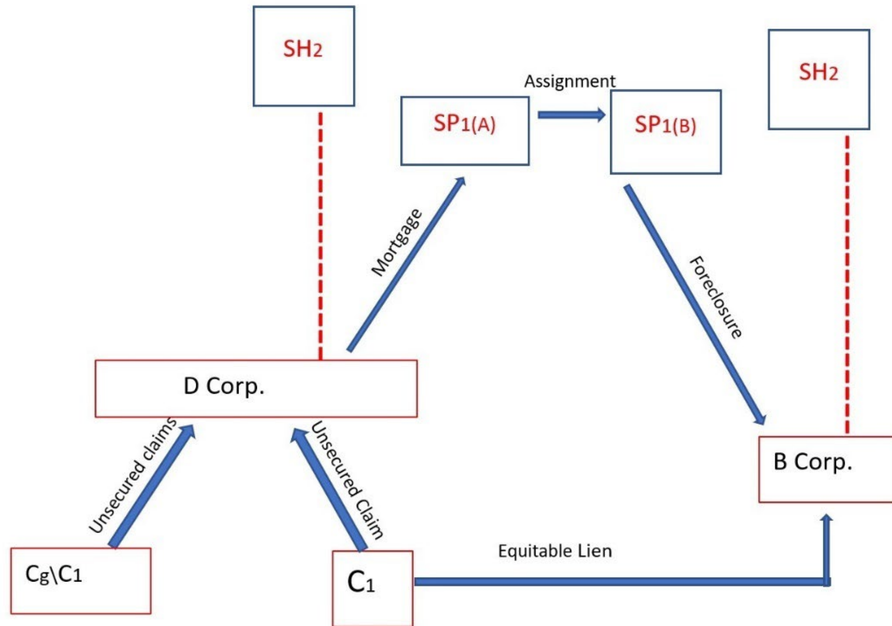

Figure Five
Fraudulent Transfer Remedy

In *Tabor*, all purchasers were in bad faith. Thus, $SP_{1(A)}$'s mortgage was encumbered by C_1's equitable lien.[50] $SP_{1(B)}$ took an assignment of $SP_{1(A)}$'s

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[47] $SP_{1(B)}$ was Pagnotti Enterprises, a competing coal mining firm. Pagnotti would further assign the mortgage to McCllellan Realty, a subsidiary. United States v. Tabor Court Realty Corp., 803 F.2d 1288, 1294 (3d Cir. 1986).

[48] D Corp. survived the LBO by only two months. *Id.*

[49] B Corp. was Loree Associates. *Id.*

[50] C_1 is the Internal Revenue Service. Ordinarily, the IRS obtains a tax lien on all the property of a delinquent taxpayer. 26 U.S.C. § 6321. But since $SP_{1(A)}$'s mortgage fully encumbered all assets of D Corp., the IRS had to resort to an action under Pennsylvania's version of the Uniform Fraudulent Conveyance Act. *Tabor*, 803 F.2d at 1294-95.

In the text, I have interpreted the legal consequence of "avoidance" to be the fixing of an equitable lien on $SP_{1(A)}$'s mortgage. Here is how Judge Aldisert described it:

mortgage in bad faith. Hence, C_1 had a lien on $SP_{1(B)}$'s mortgage. C_1 was effectively senior to $SP_{1(B)}$ and so $SP_{1(B)}$ could not foreclose C_1, where B Corp. was a bad faith purchaser. The case ends with C_1's equitable lien on B Corp.'s fee simple absolute interest.[51]

Tabor closely resembles the facts in *Boyd*, as we shall see.

II. Forerunners

Before we examine *Boyd*, we visit two cases traditionally thought to have presaged *Boyd*,[52] like prologues to the omens coming on and harbingers preceding still the fates.

Railroad Co. v. Howard[53] is not properly a collusive foreclosure sale, but its spirit is thought to be consistent with the notion. In *Howard*, insolvent *D Corp.*'s assets were entirely encumbered by *SP*s mortgage. *D Corp.* defaulted on the mortgage and *SP* foreclosed. In the negotiations, *SP* agreed with *SH* that *SP* would send a pourboire to *SH* for not throwing a

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> The government sought to assert the priority of its tax liens and to foreclose against the property that ⟦D Corp.⟧ had owned at the time of the ⟦tax⟧ assessments . . . The United States argued that the ⟦$SP_{1(A)}$⟧ mortgages . . . should be set aside under the Uniform Fraudulent Conveyance Act and further that the purported assignment of these mortgages to ⟦$SP_{1(B)}$⟧ should be voided because at the inception ⟦$SP_{1(B)}$ had purchased the mortgage s with knowledge that they had been fraudulently conveyed.

Id. at 1295.

[51] Figure 3 skips over the fact that D Corp. failed to pay property tax on lands owned by its subsidiaries. $SP_{1(B)}$ created companies to buy these coal mines at the tax foreclosure sales. One of these new buyers was Tabor Court Realty. The foreclosure sales were later invalidated, and the Raymond subsidiaries continued to own these properties. Two of the subsidiaries were the subject of involuntary bankruptcy proceedings. *Id.* at 1294.

Figure 2 also skips the fact that SH_2 had guaranteed D Corp.'s obligation to $SP_{1(A)}$ and had pledged its shares in D Corp. $SP_{1(B)}$ inherited this security interest and foreclosed, selling for $1 these shares to a nominee of $SP_{1(B)}$.

[52] *See* Kansas City Terminal Ry. v. Cent. Union Trust Co., 271 U.S. 445, 453 (1926); John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 972 (1989).

[53] 74 U.S. 392 (1868).

hissy-fit to block the sale.[54] C_1 obtained a judgment against *D Corp.* and, after getting the inevitable execution *nulla bona*, brought a creditor's bill in equity against *SP* to require *SP* to pay to C_1 what *SH* was to receive from *SP*. *SH* defended on the ground that *D Corp.* never had any interest in the pourboire--it was gifted directly by *SP* to *SH*.

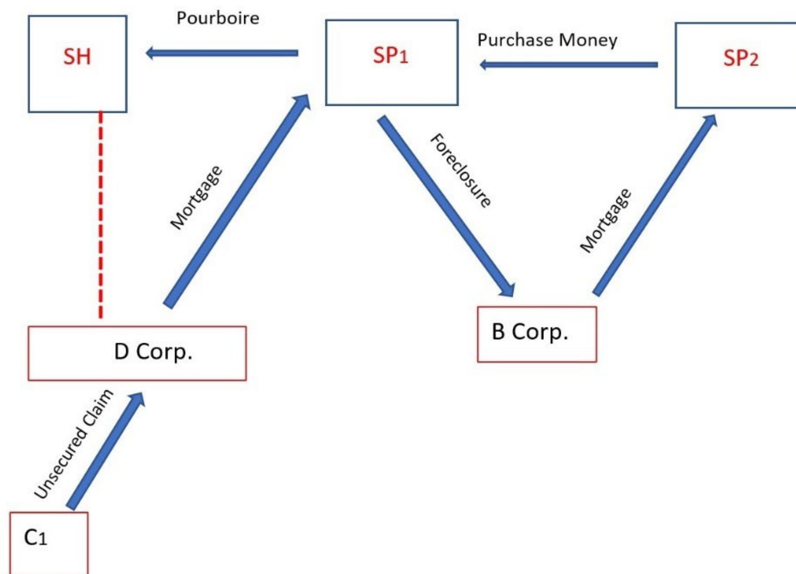

Figure Six[55]
Railroad Co. v. Howard

[54] *Id.* at 404 (brief of appellants) (SH received "a private fund not received as a dividend, not as a matter of legal right, but as a gratuity from the [[secured]] bind holders.").

[55] Some explanation is in order. SP_1 was an indenture trustee authorized to foreclose mortgages on the property of D. SP_1 sold to B. B paid by causing SP_2 (another indenture trustee) to issue bonds secured by a purchase money mortgage. B paid SP_1 by tendering bonds issued by SP_2. SP_1 paid its bondholders by tendering to them SP_2 bonds. Some of the SP_2 bonds were allocated to SH. It was these bonds that C_1 was levying. *See* Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 598 (1921) (paying SP_1 with SP_2 securities is just as good as paying with cash, where SP_2 securities have a ready market).

The Supreme Court reorganized Figure Six as follows:

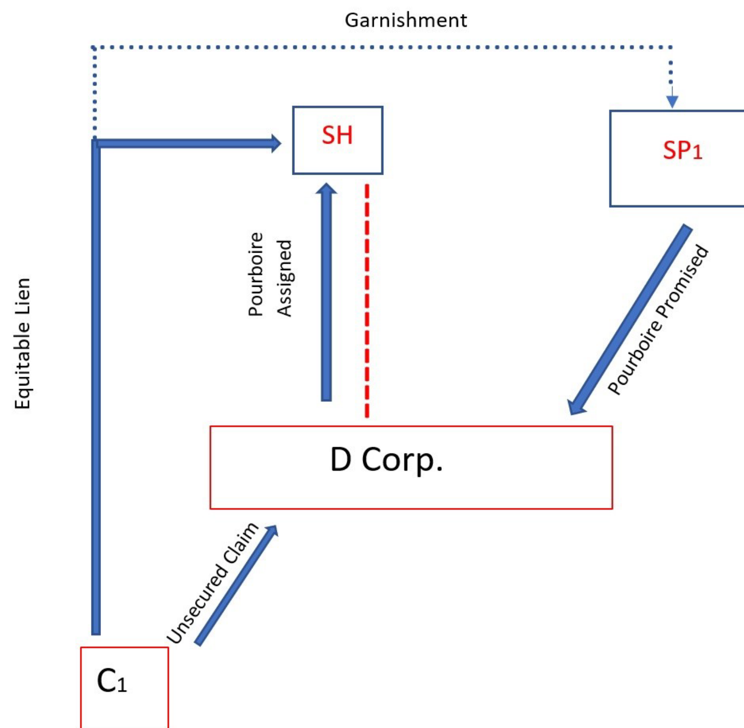

Figure Seven
Howard Reimagined

SP_1's obligation to *SH* was seen as *SP_1*'s obligation to *D Corp.*,[56] upon which *C_1* could have an equitable levy by means of the creditor's bill.[57] The

[56] *Howard*, 74 U.S. at 414 (SP "may exact the whole amount of the bonds, principal and interest; or they may, as they see fit, accept a percentage as a compromise in full discharge of their respective claims, but whenever their lien is legally discharged, the property embraced in the mortgage, or whatever remains of it, belongs to the corporation").

[57] *Id.* at 410 (*C_1* "may pursue the consideration of the sale in the hands of the respective stockholders and compel each one, to the extent of the fund, to contribute pro rata towards the payment of their debts out of the monies so received in their hands"). But none of the funds was in *SH* hands. SP had not yet paid them and was being sued in a garnishment

case was not really a collusive foreclosure because *B Corp.* had no relation to *SH*.[58] The case (as reimagined) properly sounded in fraudulent transfer. If we view *D Corp.* as the initial transferee of *SP*'s payment, which *D Corp.* had assigned to *SH*, then *D Corp.* "upstreamed" its right against *SP* in order hinder C_1.[59] The case should strike terror into the hearts of chapter 11 lawyers who rely on gifts ("carve-outs") from secured creditors to finance lawyer fees in administratively insolvent chapter 11 cases.[60]

The other forerunner to *Boyd* is *Louisville Trust Co. v. Louisville, New Albany & Chicago Railway Co.*[61] Unlike *Howard*, the case is a genuine collusive foreclosure, as I have defined it in Figure One. *D Corp.*, owned by *SH*, granted a mortgage on all assets to *SP*. *D Corp.* defaulted and *SP* commenced foreclosure proceedings. *SH* organized *B Corp.* to buy. C_1 intervened and protested the validity of the foreclosure sale. C_1's precise claim was that the sale was an impossibility: *D Corp. was B Corp*, and a seller cannot sell to itself. The lower courts overruled C_1's protest, but the

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proceeding.

[58] According to a commentator

> The court then decided that a transfer of the assets of a corporation, by agreement between its mortgage bondholders and its stockholders, which left unsecured corporate creditors unpaid while the old stockholders were given an interest in a new corporation which acquired the old corporate assets, was a so-called fraudulent conveyance which could not be sterilized by washing it through solemn foreclosure proceedings and a judicial sale.

Jerome Frank, *Some Realistic Reflections on some Aspects of Corporate Reorganization*, 19 VA. L. REV. 541, 542 (1933). Though colorful, this is wrong. The *SH* were given no equity interest in *B Corp*. Their claim was against SP_1 personally. SP_1 was to perform this obligation by tendering to *SH* bonds issued by SP_2. SP_1's obligation to tender SP_2 bonds to *SH* was treated as property of D, which was why C_1 could levy on it (after avoiding D's assignment of these bonds to SH).

[59] *Id.* at 542, 546. Dean Baird's account of this case is flawed. Baird, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS *supra* note 9, at 19. First, he has *B* paying cash to *SH* when in fact *B* paid *SP*, and *SP* paid the pourboire to *SH*. He opines that had *B* paid *SP* and *SP* paid *SH*, *SH* could have kept the money. But *B did* pay *SP* and *SP did* (agree to) pay *SH*. Nevertheless, C_1 was able to garnish *SP* for the pourboire.

[60] Carve-outs are sacred cows because they get lawyers paid via pourboires granted by *SP*. *See generally* Craig B. Cooper, *The Priority of Postpetition Retainers, Carve-Outs, and Interim Compensation under the Bankruptcy Code*, 15 CARDOZO L. REV. 2337 (1994).

[61] 174 U.S. 674 (1899).

Supreme Court reversed. C_1 was accorded veto power over the sale.

Justice David Brewer ruled that, had this been an ordinary mortgage foreclosure, C_1 would not have the right to intervene.

> It goes without saying that the proceeding in the foreclosure of an ordinary mortgage on real estate is simple and speedy. No one need be considered except the mortgagor and mortgagee, and if they concur in the disposition it is sufficient, and the court may properly enter a decree in accordance therewith. Other parties, although claiming rights in antagonism to both or either mortgagor or mortgagee, may be considered outside the scope of the foreclosure, and whatever rights they may have properly be relegated to independent suits.[62]

In effect, this says that in ordinary case the C_g are not proper parties when *SP* forecloses against *D Corp*. But, said Justice Brewer, railroads are special:

> We have held in a series of cases that the peculiar character and conditions of railroad property not only justify but compel a court entertaining foreclosure proceedings to give certain limited unsecured claims a priority over the debts secured by the mortgage. It is needless to refer to the many cases in which this doctrine has been affirmed . . . ⟦A⟧ railroad is not simply private property, but also an instrument of public service . . . ⟦T⟧he character of its business, and the public obligations which it assumes, justify a limited displacement of contract and recorded liens in behalf of temporary and unsecured creditors . . . We . . . note the fact that foreclosure proceedings of mortgages covering extensive railroad properties are not necessarily conducted with the limitations that attend the foreclosures of ordinary real estate mortgages.[63]

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[62] *Id.* at 682.

[63] *Id.* at 682-83.

Here Justice Brewer refers to the receiver's certificate, authorized by foreclosure courts to contract for necessary expenses. These charges were senior to the rights of *SP*, on the theory that these expenses maintained the value of *SP*'s collateral.[64]

Justice Brewer continued:

> We notice, again, that railroad mortgages, or trust deeds, are ordinarily so large in amount that on foreclosure thereof, only the mortgagees, or their representatives, can be considered as probable purchasers.[65]
>
> We must, therefore, recognize the fact . . . that whenever the legal rights of the parties may be, ordinarily foreclosures of railroad mortgages mean not the destruction of all interest of the mortgagor and the transfer to the mortgagee alone of the full title, but that such proceedings are carried on in the interests of all parties who have any rights in the mortgaged property, whether as mortgagee, creditor or mortgagor. We do not stop to inquire . . . whether a court is justified in permitting a foreclosure and sale which leaves any interest in the mortgagor, to wit, ⟦*D Corp.*⟧ and ⟦*SH*⟧, and ought not always to require an extinction of all the mortgagor's interest and a full transfer to the mortgagee, representing the bondholders.[66]

To be noted is the assumption of veil piercing. The mortgagor is *D Corp.* Properly, the *SH* have no interest in the collateral. The *SH* have an interest only if we pierce the *D Corp.-SH* veil.

> Assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mortgagee and mortgagor, (that is, bondholder and stockholder), we observe that no such proceedings can be

[64] Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1444 1448 (2004); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in Possession Financing*, 25 CARDOZO L. REV. 1905, 1911-12 (2004). Bankruptcy Code § 506(c) now legislates this result.

[65] *Louisville*, 174 U.S. at 683.

[66] *Id.*

> rightfully carried to consummation which recognize and preserve any interest in ⟦*SH*⟧ without also recognizing and preserving the interests, not merely of ⟦*SP*⟧, but of every creditor ⟦C_g⟧ to ⟦*D Corp.*⟧ In other words, if ⟦*SP*⟧ wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of ⟦C_g⟧ thereof. This is based upon the familiar rule that ⟦*SH*⟧'s interest in the property is subordinate to the rights of ⟦C_g⟧; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interest of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.[67]

In this passage, the court invokes corporate dissolution. When a corporation dissolves, the creditors must be paid first. The shareholders take the surplus.[68] Only in this context can we say that the creditors are better than the shareholders. Outside of this context of corporate dissolution, creditors have the ability to get money judgments, which empower liens on *D Corp.*'s property. The shareholders, however, are not creditors. *D Corp.* need not (and must not, when insolvent) pay the shareholders. The shareholders cannot get judgment liens on *D Corp.* property. Only loosely speaking are the creditors better than the shareholders. More precisely, the creditors have the right to a lien and the shareholders don't.

As for C_1's intervention into the mortgage foreclosure proceeding, Justice Brewer posed this rather tangled rhetorical question:

> Can it be that when in a court of law the right of an unsecured creditor is judicially determined and that judicial determination carries with it a right superior to that ⟦i.e., *SH*'s

[67] *Id.* at 683-84.

[68] *See generally* Rosemary Reger Schnall, *Extending Protection to Foreseeable Future Claimants Through Delaware's Innovative Corporate Dissolution Scheme--In re Rego Co.*, 19 DEL. J. CORP. L. 141 (1994).

> interest⟧ into an agreement by which through the form of equitable proceedings all the right of this unsecured creditor may be wiped out, and the interest of both the mortgage or and mortgagee in the property preserved and continued? The question carries its own answer. Nothing of the kind can be tolerated.

The point is, in a collusive foreclosure sale, *D Corp.* is *SH* and *SH* is *B Corp.* The C_g must be provided for in a way that guarantees the C_g be senior to *SH* (should *SH* determine later to dissolve *B Corp.*).

Justice Brewer suspected the goal of the mortgage foreclosure was simply to rid *D Corp.*=*B Corp.* of the C_g. The case was remanded so the foreclosure court could assure itself that there was some other motive than this disreputable one.[69] The lower court was ordered

> to set aside the confirmation of sale; to inquire whether it is true as alleged that the foreclosure proceedings were made in pursuance of an agreement between ⟦*SP*⟧ and ⟦*SH*⟧ to preserve the rights of both and destroy the interests of unsecured creditor, and that if it shall appear that such was the agreement between these parties, to refuse to permit the confirmation of sale until the interests of ⟦C_g⟧ have been preserved . . .[70]

Louisville stands for the proposition that, at least in railroad foreclosures, the unpaid C_g of *D Corp.* may intervene to prevent the foreclosure sale, where the shareholders of *D Corp.* are also the shareholders of *B Corp. Louisville*, therefore, can be identified as the case that established the illegality and impossibility of the collusive mortgage foreclosure (at least in railroad cases). It was the first to make the C_g necessary parties to the foreclosure. It is not a fraudulent transfer case.[71]

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[69] According to Justice Brewer, the trial court "ought, in discharge of its obligations to all parties interested in the property, to have made inquiry and ascertained that no such purpose as was alleged in the intervening petition ⟦*i.e.*, that *SH* simply wanted to shed its debt to the C_i⟧ was to be consummated by the foreclosure proceedings." *Louisville*, 174 U.S. at 685.

[70] *Id.* at 689.

[71] *See* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482 at 504-05 ("That such a sale would be

Indeed, in *Louisville*, there never was an effective transfer and so no *fraudulent* transfer. *Louisville* speaks to the right of the C_g to hold up the foreclosure. The C_g must be sufficiently paid off to dissuade them from pointing out the impossibility of a sale.[72]

III. Boyd

A. The Facts

With the preliminaries out of the way, I present a schematic account of the facts in *Northern Pacific Railway Co v. Boyd*.[73] It turns out to be a two-stage litigation. Stage One was a challenge to what we modernly call an LBO. Stage Two was a collusive mortgage foreclosure--or so the Supreme Court thought.

1. Stage One: The LBO

D_1 Corp.[74] was a regional railway in Idaho and Montana. C_1 was its unpaid supplier of goods and services.[75] The principal shareholder of D_1

void, even in the absence of fraud in the decree, appears from the reasoning in *Louisville* . . . ").

[72] Dean Baird's account of the case is flawed. First, he insinuates that the case is a fraudulent transfer case. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS, *supra* note 9, at 39 ("Once judges are called upon to oversee a receivership, they cannot be idle spectators. Courts have to ensure that the receivership is not part of a scheme to hinder delay or defraud creditors"). But since the assets were over-encumbered, it is impossible to say that the creditors were hindered. *Id.* at 40. Dean Baird overlooks piercing the corporate veil, which is the true basis of the case. Second, he views the case as one in which C_1 was invited to negotiate. In fact C_1 was given a veto power over the entire mortgage foreclosure. If C_1 declined to negotiate, C_1 would have to be paid. In *Boyd*, the Supreme Court would, in dictum, change its tune. It insinuated that an unreasonable holdout might be denied payment. *See infra* text accompanying note 9.

[73] *Boyd*, 228 U.S. 482 (1913), *aff'g* 177 F. 804 (9th Cir. 1910), *aff'g* 170 F. 779 (C.C.D. Wash.1909).

[74] The Coeur D'Alene Railway Co.

[75] C_1 was initially Spaulding, who commenced an Idaho *quantum meruit* suit against *D_1 Corp.* in 1886. The judgment was upheld by the Supreme Court of Idaho in 1897. Spaulding v. Coeur d'Alene Ry. & Nav. Co, 91 Pac. 408 (1897). The judgment was wrested away from Spaulding; and Boyd became the judgment creditor in 1901. *Boyd*, 228 U.S. at

Corp. (*SH_1*) wished to sell his shares[76] to *D_2 Corp.*, a major midwestern railroad.[77] In connection therewith, *D_1 Corp.* leased its assets to *D_2 Corp.* for 999 years.[78] *D_2 Corp.* arranged for its secured lender (*SP_1*)[79] to advance $850,000 in funds (on *$D_2$ Corp.*'s guaranty) to *D_1 Corp.* $360,000 went to retire a prior mortgage.[80] The balance ($465,000) stayed (briefly) with *D_1 Corp.*[81] *D_1 Corp.* declared a dividend of $465,000 to *$SH_1$*. In connection therewith, *SH_1* delivered his shares to *D_2 Corp.*[82]

As to the lease of real property from *D_1 Corp.* to *D_2 Corp.*,[83] rent was the debt service on *SP_1*'s mortgage plus net earnings.[84] Therefore, if *D_2 Corp.*'s business was profitable, *D_1 Corp.* had an income stream that was available to its creditors. This cash flow certainly would have been enough to pay *C_1*, if only *C_1* had been organized to get a prompt judgment against *D_1 Corp.* So far, the transaction does not seem like a fraudulent transfer.

498-99; Boyd v. N. Pac. Ry. Co., 170 F. 779, 781 (C.C.D. Wash. 1909).

[76] *SH_1* was Daniel C. Corbin, who controlled a majority of the shares. 170 F. at 784. The syllabus indicates that Corbin's 5100 shares "had been increased to $1,000,000, and all of which was unpaid." *Boyd*, 228 U.S. at 484.

[77] *D_2 Corp.* was incorporated by an Act of Congress on July 2, 1864. 13 Stat. 365.

[78] "In 1888 . . . Corbin entered into a contract with the Northern Pacific Railroad in which he agreed to sell it his stock, stated to be full paid and non-assessable; to secure for ⟦Northern Pacific⟧ a lease of the Coeur D'Alene's property for 999 years and ⟦*D_1 Corp.*'s authority to issue $825,000 of mortgage bonds." *Boyd*, 228 U.S. at 485. *D_2 Corp.* also bought personal property in *D_1 Corp.*'s possession. *Boyd*, 170 F. at 784.

[79] *SP_1* is a conglomerate of individual mortgage lenders, various indenture trustees and secured lenders claiming various parcels of real property owned by *D_2 Corp.*'s subsidiaries across the midwest. Paton v. N. Pac. R. Co., 85 F. 838 (C.C.E.D. Wis. 1896); *Boyd*, 170 F. at 786 (C.C.D. Wash. 1909)

[80] *Boyd*, 228 U.S. at 499.

[81] "The agreement was silent as to what should be done with the remaining $465,000 of bonds." *Id.* at 482 (syllabus). Presumably this meant to say *proceeds* of the bonds issued by *D_1 Corp.*

[82] This describes Corbin's 51% of the *D_1 Corp.* shares, delivered to *D_2 Corp.* *D_2 Corp.* also paid $250,000 extra to the other shareholders of *D_1 Corp.* In the end *D_2 Corp.* was the 100% shareholder of *D_1 Corp.*

[83] *D_2 Corp.* also paid *D_1 Corp.* cash for "the value of material on hand and $20,000 to cover amounts expended for surveys." *Id.* at 485.

[84] *Boyd*, 170 F. at 785. "The first twenty-one months after the lease the Coeur D'Alene's net earnings amounted to $176,000, and, as the lease provided that net earnings should be paid as rental, a dividend of 6 per cent was declared." *Boyd*, 228 U.S. at 487. Since *D_2 Corp.* was the 100% shareholder of *D_1 Corp.*, *D_1 Corp.* transferred the net earnings back to *D_2 Corp.* as a stock dividend.

2. Stage Two: The Collusive Foreclosure

Before C_1 could obtain a money judgment against D_1 *Corp.*, D_2 *Corp.*'s railroad business began to droop and drowse.[85] On August 15, 1893, a few unsecured creditors of D_2 *Corp.* (collectively, the C_{g2}) brought a creditor's bill in equity against D_2 *Corp.* in the Eastern District of Wisconsin, seeking a receivership.[86] A receiver[87] took over D_2's business. The receiver failed to pay debt service to SP_1. SP_1 therefore sued to foreclose its mortgage on D_1 *Corp.*'s reversion,[88] on D_2 *Corp.*'s leasehold and on the bulk of D_2 *Corp.*'s other assets. This foreclosure was consolidated with the equity receivership,[89] so that the receiver could foreclose mortgages for SP_1 and could also liquidate unencumbered assets for the C_{g2}.[90]

[85] Due to the Panic of 1893. Paton v. N. Pac. R. Co., 85 F. 838, 842 (C.C.E.D. Wis. 1896).

[86] *Boyd*, 170 F. at 786. "Similar actions, ancillary in character, were instituted in the various districts through which the main line of railroad ran, including the district of Washington." *Id.* It was important for these petitioning creditors to be strangers to Wisconsin in order to create diversity jurisdiction over C_{g2} v. D_2 *Corp.* DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 65 (2001).

[87] George A. Oakes, who was president of D_2 *Corp.*, was appointed receiver. 701 F. at 878. "[F]riendly creditors also asked the court to appoint an existing manager as receiver . . . " SKEEL, *supra* note 86, at 64.

[88] This was done in a separate receivership of D_1 *Corp.*, operating out of the federal court in Idaho. The foreclosure sale was consummated on January 11, 1897. *B Corp.* was the buyer. *B Corp.* had bought up bonds issued by SP_1 and bid these in. *B Corp.* had a deficit claim against D_1 *Corp.* Since D_2 *Corp.* was guarantor of SP_1, *B Corp.* became, to the extent of the deficit, an unsecured creditor of D_2 *Corp.* 170 F. at 791.

[89] *Boyd*, 170 F. at 786.

[90] Some real property was not encumbered by any mortgages. Various C_{g2} obtained judgments, but, as the real property was already *in custodia legis* of the receivership, these judgments could yield no liens. These C_{g2} were allowed to intervene in the Wisconsin receivership, where they were given equal priority as the original C_{g2} who first commenced the receivership. By virtue of buying up unsecured claims against D_2 *Corp.*, *B Corp.* was also a C_{g2} and so obtained a dividend of $108,246.98. 170 F. at 793. C_1 would claim that *B Corp.* held this dividend in trust for C_1, but this claim can be doubted. The unencumbered lands had been acquired from the United States government and had not been acquired from D_1 *Corp.* C_1 had an equitable lien on D_2 *Corp.*'s property only if such property was acquired from D_1 *Corp.* C_1 was, in the opinion of Judge Whitmore, an unsecured creditor of D_2 *Corp.* to the extent that D_2 *Corp.* dissipated property held in trust for C_1. If so, C_1 might have shared in the receivership dividend to the unsecured creditors. But C_1 never petitioned to intervene into the receivership.

After a period of hostility, SP_1 and the shareholders of *D_2 Corp.* (SH_2) reached a settlement. They agreed that a new corporation (*B Corp.*) would be formed to buy *D_2 Corp.*'s assets at the foreclosure sale.[91] *D_2 Corp.*'s assets consisted of the shares in 54 subsidiaries.[92] Today, we would recognize this foreclosure as governed by Article 9 of the UCC, since what *B Corp.* actually bought were certificated shares owned by *D_2 Corp.* Most of the assets of these subsidiaries had encumbered their real property with mortgages controlled by SP_1. The receiver was authorized to foreclose all of these real estate mortgages.

To raise the purchase price that would disencumber these lands, *B Corp.* borrowed from SP_2.[93] *B Corp.* used part of the proceeds to buy unsecured claims against the subsidiaries of *D_2 Corp. B Corp.* also used the loan proceeds from SP_2 on improvements to the rail business. The rest was used to pay SP_1.[94]

Significantly, SH_2 also participated in the compromise. SH_2 could exchange a preferred share in *D_2 Corp.* for one preferred share and one common share in *B Corp.*, but SH_2 had to pay *B Corp.* \$10 for the new shares in *B Corp.* As for SH_2's common shares, one common share in *D_2 Corp.* could be swapped for one share in *B Corp.*, but SH_2 had to pay *B Corp.* \$15 per share. In these transactions, *B Corp.* raised \$11,000,000 in new value.[95]

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[91] *B Corp.* is the Northern Pacific Railway Co. *B Corp.* pre-existed the workout agreement between *D_2 Corp.* and its creditors. It had been St. Paul & Northern Pacific Railroad Co., a Wisconsin corporation, but its name was changed. *Boyd*, 170 F. at 788.

[92] *Boyd*, 228 U.S. at 487.

[93] SP_2 was a different indenture trustee that issued bonds secured by new mortgages on the property *B Corp.* was buying.

[94] Since SP_1 and SP_2 were both indenture trustees, payment of SP_1 partly consisted of bondholders taking through SP_1 exchanging their bonds for new bonds supervised by SP_2. N. Pac. Ry. Co. v. Boyd, 177 F. 804, 815-16 (9th Cir. 1910). Partly *B Corp.* bought the SP_1 bonds on the open market and used them to bid in at SP_1's foreclosure sale.

[95] In the syllabus to the Supreme Court opinion, we learn that

> the holder of \$100 of preferred stock in the old company, upon paying \$10 per share was to receive \$50 of preferred and \$50 of common stock in the new company. For each \$100 of common stock the holder was to receive one share of common in the new corporation upon paying \$15 per share. The aggregate of these cash payments on stock was about \$11,000,000.

Some of the C_{g2} mounted a challenge to the compromise.[96] C_{g2} sought in the Wisconsin receivership to reverse the mortgage foreclosure as a fraud on unsecured creditors. The argument was that *B Corp.* had paid too little for the assets and had taken value from the C_{g2}. In short, the C_{g2} claimed *B Corp.* was the recipient of a fraudulent transfer. The court decided against C_{g2}, finding that SP_1's secured claim was under water at the time of the mortgage foreclosure. The foreclosure sale was therefore not a fraudulent transfer by D_2 *Corp.* to *B Corp.* (via SP_1). This challenge occurred and failed in 1896. In 1899, the Supreme Court in *Louisville* would rule that C_{g2} could have vetoed the foreclosure sale even if the sale was a not fraudulent transfer.

Meanwhile, D_2 *Corp.* owned real property that was not encumbered by SP_1's mortgage. The receiver obtained by C_{g2} liquidated these properties. This land was sold in 1899 to *B Corp.*[97] *B Corp.* had purchased unsecured claims against D_2 *Corp.* aggregating $14,000,000. Part of these claims consisted of the deficit claim of SP_1 against D_2 *Corp.*[98] As an unsecured creditor of D_2 *Corp*, *B Corp.* received a $120,000 dividend from C_{g2}'s receiver.[99] The Supreme Court would assume that every C_{g2} (except C_1) had been bought out by *B Corp.*[100]

3. Boyd's Judgment Against the Railroad

On April 26, 1896, C_1 obtained a bitterly contested[101] judgment for

Boyd, 228 U.S. at 488-89. This is oddly put to the modern eye. Today, "par value" of stock is meaningless. Stock is worth what the market says it is. So, we should read this passage to mean that one preferred share in D_2 *Corp.* could be swapped for one preferred share and one common share of *B Corp.* A common share in D_2 *Corp.* could be swapped for a common share in *B Corp.*

[96] Paton v. N. Pac. R. Co., 85 F. 838, 841 (C.C.E.D. Wis. 1896).

[97] Boyd v. N. Pac. Ry. Co., 170 F. 779, 790 (C.C.D. Wash. 1909).

[98] *Boyd*, 228 U.S. at 504.

[99] *Boyd*, 170 F. at 792. Two commentators inaccurately write, "No provision was made in the plan for unsecured creditors of the old company." William O. Douglas & Jerome Frank, *Landlords' Claims in Reorganizations*, 42 YALE L.J. 1003, 1010 (1933).

[100] *See infra* text accompanying notes 164-65.

[101] D_1 *Corp.* claimed that C_1 was late, over budget, and quit before the work was done. C_1 blamed obstruction from D_1 *Corp.* for these failures. Spaulding v. Coeur D'Alene Ry. & Nav. Co., 51 P. 408 (Idaho 1897).

quantum meruit against D_1 *Corp.*[102] On the very next day, SP_1 obtained the decree of foreclosure that sold the assets of D_1 *Corp.* and D_2 *Corp.* to *B Corp.*[103] C_1 was left with a money judgment against an empty shell.

Ten years would pass. In 1906, having resuscitated his dormant judgment[104] against D_1 *Corp.*, C_1 sued *B Corp.* in the superior court in the county of Spokane, Washington. The case was removed to the Eastern District of Washington. C_1 sought to impose an equitable lien on the property of *B Corp.*--presumably a lien on the certificated shares of D_1 *Corp.*'s subsidiaries sold to *B Corp.*[105] C_1's action was filed seven years after *B Corp.* bought the certificated shares from D_2 *Corp.*

C_1 had to achieve two different tasks. First, C_1 had to establish that either (i) C_1 could hold D_2 *Corp.* liable in personam for C_1's claim against D_1 *Corp.*, or (ii) C_1 had a lien on specific assets of D_2 *Corp.* that D_2 *Corp.* had fraudulently acquired from D_1 *Corp.* C_1 had to achieve one or both of these alternatives. The second task was to establish that C_1 had a lien on those assets of *B Corp.* which *B Corp.* had acquired from D_2 *Corp.* (via SP_1) in foreclosure.

As to the first task, C_1 had several distinct theories as to why D_2 *Corp.* was liable. C_1's first theory was that, in the lease agreement, D_2 *Corp.* had voluntarily assumed D_1 *Corp.*'s liability to D_1 *Corp.*'s unsecured creditors. This contractual theory, if correct, would have established D_2 *Corp.*'s in personam liability for C_1's claim against D_1 *Corp.* On this matter Judge Edward Whitson decided against C_1. He was unable to read the lease agreement as constituting an assumption contract for the benefit of C_1.[106]

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[102] Spaulding v. Coeur D'Alene Ry. & Nav. Co., 59 P. 426 (Idaho 1899).

[103] *Boyd*, 170 F. 779, 789.

[104] "A dormant judgment is one which has neither been satisfied nor extinguished by lapse of time, but which has remained so long unexecuted that execution cannot be issued without first reviving the judgment." 48 Tex. Jur. Judgments § 552.

[105] C_1 brought his case in Washington state court. The case, however, was removed to the federal court for the Eastern Division of Washington.

[106] *Boyd*, 170 F. at 793-94. Judge Whitson distinguished the case from Chicago, Milwaukee & St. Paul Railway Co. v. Third Nat'l Bank, 134 U.S. 276 (1890), where the lessee (also for 999 years) supposedly covenanted to assume all debts. The *Chicago* court was most unpersuasive on this score.

Chicago involved a 999-lease by a different D_1 *Corp.* to D_2 *Corp.* D_2 *Corp.* covenanted D_1 *Corp.* to hold D_1 *Corp.* harmless for any expenses arising from D_2 *Corp.*'s operation of the leased railroad and to return the premises in good order in the year 2880. From this duty to restore the premises, the court reasoned. "Does not this indicate that the

C_1's in personam theory against D_2 *Corp.* was a failure.

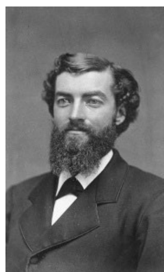

Figure Eight
Judge Edward Whitson (1852-1910)

The second claim was grounded on a so-called "trust fund" theory.[107] According to this theory, a corporation such as D_1 *Corp.* holds its assets in trust for its unsecured creditors. When D_2 *Corp.* took these assets from D_1 *Corp.* (i.e., the leasehold and incidental personal property), D_2 *Corp.* took them in trust for C_1, giving rise to C_1's equitable lien on these assets.

This "trust fund" doctrine kicked around in the 19th century, but it is misleadingly named. It contradicts a basic truth that, prior to C_1's money judgment against D_1 *Corp.*, C_1, as D_1 *Corp.*'s unsecured creditor, had no property rights in the assets of D_1 *Corp.*[108] Put another way, D_1 *Corp.* did not hold assets in trust for C_1 after all. Rather, C_1's equitable lien on the

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understanding and intent were that ⟦D_2 *Corp.*⟧ should discharge all judicial liens founded upon existing claims, whether such liens had already been perfected, or should be created in a subsequent suit?" *Id.* at 286. If so, D_2 *Corp.*'s duty to exonerate judicial liens would not arise until very late in the current millennium.

[107] "The second ground relied upon ⟦by C_1⟧ is that the transaction by which ⟦D_2 *Corp.*⟧ purchased the whole of the stock and took possession of all of the property of ⟦D_1 *Corp.*⟧ under the lease created an obligation on the part of ⟦D_2 *Corp.*⟧ to pay and discharge the debts of ⟦D_2 *Corp.*⟧ . . . ⟦C_1⟧ invoke⟦s⟧ the doctrine of equity that the assets of a corporation constitute a trust fund for the payment of its creditors. This, of course, is not disputed, but a distinction is pointed out between the personal liability of a transferee in such a case and the right of a creditor to follow the property transferred." Boyd v. N. Pac. Ry. Co., 170 F. 779, 794 (C.C.D. Wash. 1909).

[108] Pusey & Jones Co. v. Hanssen, 261 U.S. 491, 497 (1923); *see* Hollins v. Brierfield Coal & Iron Co., 150 U.S. 371, 381 (1893) (trust fund just a metaphor; unsecured creditor has no interest in *D Corp.* property).

trust fund came into existence only in 1893, when *D_1 Corp.* leased its real property for 999 years. The *lease* was the trust fund. *C_1* had no interest in the real property before the lease and only had an equitable lien in the lease after the transfer was accomplished. In effect, the so-called constructive trust doctrine was nothing but the fraudulent transfer theory in different language.[109] When the fraudulent transfer was made, *C_1* advanced from unsecured creditor of *D_1 Corp.* to a secured creditor of *D_2 Corp.* As such, *C_1* was a "necessary party" in *SP_1*'s subsequent foreclosure sale against *D_2 Corp.*

Judge Whitson held *D_2 Corp.* to be a trustee of the leasehold for the benefit of *C_1*. At first, *D_2 Corp.* had no in personam liability to *C_1*: "there is no personal liability except where property has been disposed of, misapplied or converted."[110] Nevertheless, Judge Whitson also made clear that *D_2 Corp.*, in breach of trust, had converted other assets (not the leasehold) that *D_1 Corp.* had conveyed to *D_2 Corp.* Under the equitable notion of an accounting, *D_2 Corp.* could be made to restore *C_1* to the trust property. If this property was not accounted for, an equity court was prepared (as a last resort) to issue a money judgment to *C_1* against the personhood of *D_2 Corp.*[111] This conversion of trust property made *C_1*, to some undisclosed extent, an unsecured creditor of *D_2 Corp.*[112]

How good was the theory that *D_2 Corp.* had fraudulently received property from *D_1 Corp.*? The transfer was a 999-year leasehold, granted in exchange for a rent guaranteed to permit *D_1 Corp.* to pay *SP_1*'s debt service, plus all of *D_2 Corp.*'s net earnings, which, for a few years, was a substantial amount--more than enough to pay *C_1*. This does not seem like a fraudulent transfer. If *C_1* had been more diligent, *C_1* could have collected his judgment from these net earnings.[113]

[109] Carlson, *Void and Voidable*, *supra* note 14, at 57-59.

[110] *Boyd*, 170 F. at 794.

[111] Carlson, *Tort*, *supra* note 14, at 1095.

[112] *Boyd*, 170 F. at 805-06.

[113] Whether *C_1* was barred by laches was a major issue with the Supreme Court. *C_1* had waited ten years from the time of getting judgment against *D_1 Corp.* to bring a creditor's bill against *B Corp.* Corp:

> ⟦O⟧rdinarily, such a lapse of time would prevent any creditor from asserting a claim like that here made. For along with the policy to encourage reorganizations, goes that of requiring prompt action by those who claim that their rights have been injuriously affected. The fact that

Still, there is the fact that SP_1 advanced $850,000 to D_1 *Corp.*, which D_1 *Corp.* used to retire old secured debt; the remainder ($465,000) was retained by D_1 *Corp.* but was dividended to SH_1, in exchange for which SH_1 conveyed his shares to D_2 *Corp.* Dividends by an insolvent corporation are fraudulent transfers. But D_1 *Corp.* had the right to receive as rent D_2 *Corp.*'s net earnings, which initially were substantial.[114] It is not clear in light of this income that D_1 *Corp.* was insolvent.

Assuming for the sake of argument the dividend to SH_1 rendered D_1 insolvent, how was D_2 *Corp.* responsible for this, since the LBO financing came from SP_1? Properly, we should view D_1 *Corp.* as making an intentionally fraudulent transfer (i.e., the mortgage) to SP_1, who advanced $465,000 knowing that D_1 *Corp.* would "abscond." Thus, SP_1 was a bad faith purchaser for value whose mortgage lien on D_1 *Corp.*'s assets was held in trust for C_1. This would have produced a nicer analysis, comporting with modern LBO remedies. If SP_1's mortgage was a fraudulent transfer, C_1 could

> improvements are put upon the property--that the stock and bonds of ⟦*B* Corp.⟧ almost immediately became the subject of transactions with third persons--call for special application of the rule of diligence. But the doctrine of estoppel by laches is not one which can be measured out in days and months, as though it were a statute of limitations. For what might be inexcusable delay in one case would not be inconsistent with diligence in another, and unless the non-action of the complainant operated to damage the defendant or to induce it to change its position, there is no necessary estoppel arising from the mere lapse of time.

N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 509 (1913). An embarrassing gap occurred in 1890-95, where C_1,s lawyer (Willis Sweet) was elected to Congress. The suit languished and during that time SP_1 and SH_2 were negotiating a reorganization. *Boyd*, 170 F. at 783. ("during his term the cause was permitted to slumber . . . "). This slumber was not charged against C_1:

> There was a time when ⟦C_1⟧ allowed the matter to drag during Sweet's term in Congress. But this was before ⟦*B Corp.*⟧ had any connection with the property. ⟦D_2 *Corp.*⟧ was at that time contesting the right to any judgment at all against ⟦D_1 *Corp.*⟧, and but for its interposition he would have had an adjudication long before.

Id. at 808.

[114] "The first twenty-one months after the lease the Coeur D'Alene's net earnings amounted to $176,000, and, as the lease provided that net earnings should be paid as rental, a dividend of 6 per cent was declared." *Boyd,* 228 U.S. at 283.

encumber it by an equitable lien--a lien on a lien, as in *Tabor Realty*. SP_1 would have been obliged, upon collecting debt service from D_1 *Corp.*, to hold those funds in trust for C_1. Furthermore, SP_1 would have had power to convey good title to the railroad, free and clear of C_1's equitable lien, upon foreclosure to a bona fide purchaser for value. But, upon foreclosure, SP_1 sold to a bad faith purchaser (*B Corp.*) who then conveyed the assets to yet another bad faith purchaser for value (SP_2). This would have left C_1's equitable lien intact and assertable against the property of *B Corp.* and SP_2, to the extent this property could be traced back to D_1 *Corp.* If the analysis had proceeded in this fashion, there would have been no need to pierce corporate veils. Rather, we would have had a standard case of a bad faith remote transferee of an initial transferee taking property in trust for C_1.[115] It is not unfair to conclude that the modern absolute priority rule in chapter 11 is based on confused analysis in the early 20th century.

This is not how Judge Whitson proceeded. He treated D_2 *Corp.*'s assets as encumbered by C_1's equitable lien. SP_1's mortgage, however, was considered to be senior to C_1's equitable lien, as if SP_1 had advanced funds to D_1 *Corp.* in good faith. This washing away of SP_1's sin was later upheld by the Supreme Court.[116]In *Boyd*, the Ninth Circuit confirmed the

[115] Under modern Bankruptcy Code 11 U.S.C. § 550(a)(2), a bankruptcy trustee (representing all unsecured creditors) can pursue fraudulently transferred property through an infinite chain of bad faith transferees.

[116] Judge Whitson purported to follow another railroad foreclosure case, Chicago, Milwaukee & St. Paul Railway Co. v. Third Nat'l Bank, 134 U.S. 276, 286 (1890); *see supra* note 106. The case did not involve a mortgage foreclosure. More precisely, a mortgage foreclosure and an execution sale occurred, but in both instances, a post-sale redemption (permitted under Illinois law) kept the railroad out of the hands of a buyer.

In *Chicago*, D_1 *Corp.* leased a railroad to D_2 *Corp.* for 999 years. D_1 *Corp.* issued a mortgage to *SP*, who could, if necessary, foreclose upon D_1 *Corp.*'s reversion and D_2 *Corp.*'s leasehold—the same as in *Boyd.* The Supreme Court held that D_2 had received loan proceeds from SP_1. These proceeds should have gone to D_1 *Corp.* D_2 *Corp.* had diverted them (presumably with D_1 *Corp.*'s consent). Thus, D_1 *Corp.* had fraudulently transferred these loan proceeds to D_2 *Corp.* D_2 *Corp.* held these proceeds in trust for the creditors of D_1 *Corp.* Instead of remitting those funds to C_1, D_2 *Corp.* had used these fraudulently transferred funds to improve the railway. Since D_2 *Corp.* had diverted these trust funds into real property improvements, C_1 could have an equitable lien on the entire railroad (presumably limited to the value added). RESTATEMENT (THIRD) RESTITUTION AND UNJUST ENRICHMENT § 56 (2011).

According to Judge Whitson:

> Applying the principle here, in order that there may be a liability on the

judgment against *B Corp.* The court described Judge Whitson's opinion as follows:

> ⟦C_1⟧ presents several grounds on which it is asserted that ⟦D_2 *Corp.*'s⟧ liability ⟦to C_1⟧ exists. One of them is that the lease constituted a diversion and appropriation by ⟦D_2 *Corp.*⟧ to its own use of the assets of ⟦D_1 *Corp.*⟧, such as to make it liable to the creditors of ⟦D_1 *Corp.*⟧ to the extent of the assets so diverted and appropriated. It was on the ground that the court below held that ⟦D_2 *Corp.*⟧ became chargeable with the debt.[117]

This is hopelessly imprecise. D_2 *Corp.* did not appropriate to its own use the 999-year lease. D_1 *Corp.* freely granted it. And D_2 *Corp.* paid for it was a rent consisting of all its net earnings over D_1 *Corp.*'s debt service owed to SP_1. Properly, C_1's claim was against SP_1. The Ninth Circuit did not improve on Judge Whitson's elision of SP_1's liability for fraudulently receiving the LBO mortgage over to D_2 *Corp.*'s receipt of the lease.

The rest of the Ninth Circuit opinion is almost completely opaque. The appellate panel chided D_2 *Corp.* (as newly the control person of D_1 *Corp.*) for permitting the board of directors to vote SH_1 a dividend. This might by the predicate of a breach of fiduciary duty claim by D_1 *Corp.* against D_2 *Corp.*, but there is no account as to how this justified C_1's equitable lien on D_2 *Corp.*'s leasehold interest.[118]

> part of ⟦D_2⟧ to pay ⟦C_1's⟧ judgment against ⟦D_1 *Corp.*⟧, it must appear that ⟦D_2 *Corp.*⟧ came into the possession of assets which ⟦C_1⟧ could have made available to the satisfaction of his judgment, and if not now possessed of them, they have been wrongfully disposed of and in fraud of his rights.

Boyd, 170 F. at 795. This reliance on *Chicago* makes no sense. In *Chicago*, D_1 *Corp.* borrowed funds and then conveyed them (allegedly for no reasonably equivalent value) to D_2 *Corp.* There, C_1 could trace these funds into D_2 *Corp.*'s leasehold. But in *Boyd*, SP_1 funded D_1 *Corp.*, and D_1 *Corp.* dividended the balance up to SH_1. D_2 *Corp.* never received these funds and so *Chicago*, properly, did not apply. Rather, in *Boyd, D_1 Corp.* transferred only the 999-year lease to D_2 *Corp.*, and C_1's equitable lien must have attached to this real property.

[117] N. Ry. Co. v. Boyd, 177 F. 804, 810 (9th Cir. 1910).

[118] D_2 *Corp.* did attempt to assert a "give-back" defense against fraudulent transfer

The lower courts certainly struggled to analyze *D_2 Corp.*'s liability. The Supreme Court would add new confusions. According to Justice Joseph Rucker Lamar, *C_1* "thereupon brought this suit, claiming that ⟦*D_2 Corp.*⟧ was liable in equity for a diversion of $465,000 of bonds."[119] The Supreme Court assumed that $465,000 of the bonds were "issued to ⟦*SH_1*⟧ or order."[120] Justice Lamar refers to *D_1 Corp.* as receiving "bonds" from *SP_1*.[121] At first blush, this is confusing. *SP_1* issued bonds to the investing public in exchange for cash. *SP_1* thereafter conveyed this cash to *D_1 Corp.* Justice Lamar should have said that *C_1* claimed *D_2 Corp.* was liable somehow because *D_1 Corp.* dividended unencumbered cash up to *SH_1*, who successfully absconded. Nevertheless, since there was a ready market for *SP_1* bonds,[122] it seems to have been the case that, in lieu of crediting *D_1 Corp.*'s bank account, *SP_1* sent paper bonds over to *D_1 Corp.*, which then sold them in the market for ready cash.[123]

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liability. *D_2 Corp.* pointed out that it had spent its own funds to improve the railroad which could be expected to result in increased earnings payable to *D_1 Corp. Id.* at 814. The give-back defense had been rejected in Chicago, Milwaukee & St. Paul Railway Co. v. Third Nat'l Bank, 134 U.S. 276, 289-90 (1890). On further appeal, Justice Lamar's understanding of this issue was shaky:

> Being liable for this diversion of $465,000, ⟦*$D_2$ Corp.*⟧ remained so liable until the funds were restored to the true owner. The obligation was not lessened by set-offs, nor discharged in whole, because ⟦*D_2 Corp.*⟧ spent $500,000 of its own money in broadening the gauge, extending the line, equipping the road, or for other purposes which may have been thought by it advantageous to ⟦*D_1 Corp.*⟧. Such disbursement was not a restoration of what had been taken, but an expenditure by ⟦*D_2 Corp.*⟧, for its own benefits, in improving a road which it practically owned by virtue of the 999-year lease.

N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 500-01 (1913). A "give-back" defense for fraudulent transfer continues to stir controversy to this day. David Gray Carlson, *Giving Back a Fraudulent Transfer: A Defense to Liability?* 94 AM. BANKR. L.J. 639 (2020).

[119] *Boyd,* 228 U.S. at 501 ("this diversion of $465,000 of $465,000 of bonds in 1888 made ⟦*D_2 Corp.*⟧ liable, in equity, for the payment of ⟦*C_1*'s⟧ judgment for $71,278 . . . ").

[120] *Id.* at 499.

[121] *See also* N. Pac. Ry. Co. v. Boyd, 177 F. 804, 811-12 (9th Cir. 1910).

[122] *See* Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 598 (1921) (bonds were "the equivalent of money").

[123] *SH_1*, however, testified that *D_1 Corp.* received cash in some form, not *SP_1* bonds. *Id.*

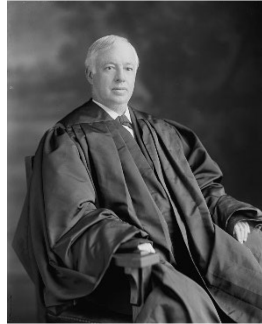

Figure Nine
Justice Joseph Rucker Lamar (1857-1916)

Justice Lamar further remarked:

> The buyer ⟦of SH_1's shares, i.e., D_2 *Corp.*⟧ would naturally have been the person to make arrangement for the payment. But ⟦*B Corp.*⟧ insists that the payment was not made in cash but that, as recited in the written contract, the stock was transferred by ⟦SH_1⟧ in consideration of ⟦D_2 *Corp.*⟧ guaranteeing the bonds ⟦i.e., guaranteeing SP_1's advance to D_1 *Corp.*⟧ and entering into the lease. But even if ⟦SH_1⟧ sold his 5100 shares for a consideration nominally moving to ⟦D_1 *Corp.*⟧, that would not change the character of the transaction if, in fact, ⟦SH_1⟧ made the transfer with the further understanding that he was to have the proceeds of the guaranteed bonds. In that event ⟦D_2 *Corp.*⟧ would be as much liable for the diversion of the $465,000 as ⟦$SH_1$⟧. The terms of the contract; ⟦SH_1's⟧ control of ⟦D_1 *Corp.*⟧; the failure to produce or account for the absence of the agent who represented ⟦D_2 *Corp.*⟧ in the purchase, together with ⟦SH_1's⟧ testimony that the stock was paid for out of the cash proceeds of the bonds, support the concurrent findings of the two courts⟦124⟧ that ⟦D_2 *Corp.*⟧ combined with ⟦SH_1⟧ to

124 That is, Judge Whitson and the Ninth Circuit.

> divert $460,000 of the assets of ⟦D_1 *Corp.*⟧. And even if, as claimed, liability for diversion of trust funds was dependent upon the insolvency of ⟦D_1 *Corp.*⟧, that insolvency was brought about in the very act of carrying the illegal contract into effect; for thereby ⟦D_1 *Corp.*⟧ was encumbered with a mortgage for twice its value and the lease for 999 years, with rental payable only from net profits, left nothing out of which debts could be made by levy and sale.[125]

This theory is very different from the ones promulgated in the courts below. Here, D_2 *Corp.* (not SP_1) is deemed to have advanced loan proceeds to D_1 *Corp.* By holding D_2 *Corp.* "liable in equity," the court assumed D_2 *Corp.* was a fiduciary of these funds which D_2 *Corp.* held for the benefit of C_1. Instead of using these funds to pay C_1 outright, D_2 *Corp.* put D_1 *Corp.* in charge. D_1 *Corp.* diverted this trust fund to SH_1. D_2 *Corp.* was chargeable with this abuse of the trust fund by D_1 *Corp.*[126] Accordingly, C_1 had the right to an equitable accounting against D_2 *Corp.* In this accounting action, D_2 *Corp.* was called in the first instance to disgorge back into the trust the very funds purloined. Being unable to do so, C_1 was entitled to a money judgment for the defalcation. On this theory, C_1 was but a general creditor (a C_{g2}) of D_2 *Corp.* In contrast, Judge Whitson and the Ninth Circuit had established that C_1 had an equitable lien on the property of D_2 *Corp.* and that C_1 was a *secured* creditor of D_2 *Corp.*

The upshot of this misunderstanding is that the Supreme Court thought it had before it a case of an unsecured creditor (C_1) of D_2 *Corp.* claiming that *B Corp.* received assets in a collusive foreclosure sale. If the Supreme Court had acknowledged C_1's equitable lien on D_2 *Corp.*'s assets, it had no need to emphasize collusion in the foreclosure sale. All we would have had was

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[125] *Boyd,* 228 U.S. at 500 (citing Chicago, Milwaukee & St. Paul Ry. Co. v. Third Nat'l Bank, 134 U.S. 276 (1890)).

[126] The Supreme Court anticipated Dalton v. Meiser, 239 N.W.2d 9 (Wis. 1975), where *C* obtained a judgment against *D*. *D*'s mother borrowed money from *M Bank* to make *D* a gift of the proceeds. *D* directed *M Bank* to pay the proceeds to *X* in trust for *D*, with the intent of hiding the gift from *C*. *M Bank* followed instructions. *C* sued *M Bank* for aiding and abetting the occlusion of assets. *C*'s complaint survived demurrer. *M Bank* was to be jointly and severally liable with *X*, if the facts were proven. In short, Wisconsin banks have a duty to creditors of payees to assure that the payee uses the cash to pay creditors. *Id.* at 18.

B Corp.'s in rem liability as a bad faith transferee of a transferee for property D_1 *Corp.* fraudulently transferred to SP_2 as initial transferee.

4. *Boyd*'s Judgment Against the Railway

a. Piercing Corporate Veils

So far we have discussed C_1's claims against D_2 *Corp.* The lower courts ruled C_1 had an equitable lien on D_2 *Corp.*'s leasehold. The Supreme Court thought C_1 was a general creditor of D_2 *Corp.*, with no lien at all. It is time now to look at C_1's right against *B Corp.*, the buyer to whom SP_1 transferred D_2 *Corp.*'s assets.

The first issue to face Judge Whitson was that SP_2's mortgage foreclosure had been ably supervised by a circuit judge from the Eastern District of Wisconsin. How could Judge Whitson cancel or contradict that judgment of foreclosure, when the Wisconsin federal court had jurisdiction to render judgment?

> First it is to be observed that this court cannot review the judgment of a court of co-ordinate jurisdiction. Irregularities, erroneous conclusions, wrong views of the law, cannot stand as the sanction for disregarding what was adjudicated. Here it becomes important to understand the powers of a court of equity to relieve against a judgment fraudulently obtained.[127]

Where a party has obtained judgment in some other court by fraud, the current court is not bound to give it full faith and credit.[128] But, the court lamented, SP_1, D_1 *Corp.*, D_2 *Corp.* and *B Corp.* disclosed all. No fraud had been perpetrated on the Wisconsin court.

Nevertheless, Judge Whitson opined, the federal court in Wisconsin ought not to have approved the foreclosure sale. The reason why the Wisconsin court erred was that SH_2 had an interest in D_2 *Corp.*'s assets and SH_2 had an interest in *B Corp.*'s assets. In effect, the transfer of D_2 *Corp.*'s property to *B Corp.* was a transfer of SH_2's property to SH_2. As one cannot transfer to oneself, the sale is a nonevent. It ought not to have

[127] Boyd v. N. Pac. Ry. Co., 170 F. 779, 796 (C.C.D. Wash. 1909).
[128] Johnson v. Waters, 111 U.S. 640 (1884) (probate court sale).

been ordered by the Wisconsin court. In other words, the Wisconsin court should have pierced the corporate veil between *D_2 Corp.* and *B Corp.*[129] The purported sale was no sale. One cannot transfer property to oneself. The so-called sale to *B Corp.* was thus a "fraud in law."[130]

The Supreme Court would agree. The sale was no sale. Justice Lamar compared the situation with a workout agreement in which the C_{g2} of D_2

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[129] The passages that evidence such a conclusion are as follows:

> This leads to the inquiry whether the stockholders ⟦of *D_2 Corp.*⟧ and ⟦*SP_1*⟧ so shaped the decree and conducted the proceedings that the former by virtue of stock ownership, retained a beneficial interest in the property represented by the stock in the new company, which was brought into being pursuant to the plan of reorganization.

Boyd, 170 F. at 797.

> If in such a case as this an insolvent corporation can conclude ⟦sic⟧ its creditors by consenting to this misapplication of a part of its property, stockholders the while retaining an interest therein themselves, or creditors who do appear can defeat the claims of those without notice, there remains nothing of the doctrine that the property constitutes a trust fund for their benefit, and it may be dealt with regardless of their rights. The conclusion reached as to the real transaction seems to leave no equitable ground for ⟦*B Corp.*⟧ to stand upon which will preclude ⟦C_1⟧, with his hostile demand, from asserting his rights as against the conversion of assets and the continuance in interest of stockholders. The books term such conduct *a fraud in law*, apparently distinguishing it from covinous acts and false representations of fact, but for practical purposes, classifying it as subject to the same remedies. It is for this reason that ⟦*D_2 Corp.*⟧ did not bind its creditors in the litigation.

Id. at 805 (emphasis added).

> ⟦A⟧s to the assets of an insolvent corporation a general creditor cannot be precluded from sharing so long as they are sufficient to pay his demand, while the stockholders continue to hold a beneficial interest in the property through reorganization or otherwise.

Id. at 802.

[130] *Id.* at 805. Judge Whitson's theory was that *D_1 Corp* had fraudulently transferred 999 years of possession to *D2 Corp.* Fraudulent transfer is a theory that is inconsistent with piercing corporate veils. Judge Whitson is not contradicting himself here. The fraudulent conveyance was between *D_1 Corp.* and *D2 Corp.* Veil piercing was between *D2 Corp.* and *B Corp.*

Corp. consented to a haircut in order to enable the business to continue. Under such an agreement, creditors consent to a loss and to the fact that the SH_2 retain their shares the hope of restoring them to a positive value:

> Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders ⟦i.e., creditors⟧ and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by ⟦SH_2⟧ from themselves to themselves cannot defeat the claim of a non-assenting creditor. As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract reorganization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt the subordinate interest of ⟦SH_2⟧ would still be subject to his claim in the hands of ⟦*B Corp.*=SH_2=D_2 *Corp.*⟧.[131]

Here the key move is that SH_2 was D_2 *Corp.* and SH_2 was *B Corp.* The transfer was from SH_2 to SH_2, and this is an impossibility. A transfer requires a transferor and a transferee. Self-enfeoffment is nonsense![132]

b. Valuations as a Red Herring

Judge Whitson added some mysterious passages hinting (without saying) that the value of what D_2 *Corp.* conveyed to *B Corp.* exceeded the consideration *B Corp.* paid to SP_1. If so, this was what today Article 9 would call a commercially unreasonable sale--a theory that makes SP_1 liable to D_2 *Corp.* for the shortfall.[133]

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[131] N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 502 (1913).

[132] Except in California. Riddle v. Harmon, 162 Cal. Rptr. 530, 531 (Cal. App. 1980) ("We discard the archaic rule that one cannot enfeoff oneself . . . ").

[133] U.C.C. § 9-625(b). To be precise (as well as anachronistic), § 9-627(c) provides that

We are informed that SP_1's total secured claim was $152,335,155. D_2 *Corp.*'s net revenue at the time of foreclosure was $7.5 million. Interest under SP_2's mortgage agreement was 4 percent.[134]

> Taking these figures as a basis for calculation, we find that the net revenues under the receivership at 4 per cent. per annum, the interest rate of the prior lien, 100-year, $130,000,000 mortgage, were paying interest upon a valuation of $195,000,000.[135]

The insinuation was that the transaction gifted SH_2 with $42,664,845. If so, the foreclosure was a fraud on C_1, justifying C_1's equitable lien on *B Corp.*'s property. Such an insinuation contradicts piercing the corporate veil. Under veil piercing, there was no sale. Under the fraudulent transfer theory, there *was* a sale, but *B Corp.* received the assets of D_1 *Corp.* in trust for C_1. As it stood, if Judge Whitson was indeed invoking a fraudulent transfer, he was asserting two inconsistent theories, though it is hard to say the fraudulent transfer theory was really asserted. The disparate values could have been offered as a rhetorical device to bolster the veil-piercing theory, by suggesting that collusive foreclosure sales are generally an effective way for SH_2 to purloin value from C_1.[136]

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a disposition is commercially reasonable if it has been approved in a judicial proceeding.

[134] SP_2 was to advance $130,000,000 to *B Corp.* Paton v. N. Pac. R. Co., 85 F. 838, 840 (E.D. Wis. 1896).

[135] Boyd v. N. Pac. Ry. Co., 170 F. 779, 798 (C.C.D. Wash. 1919).

[136] According to two commentators:

> For the court did not deny that ⟦SP_1⟧, if they had so desired, would have been quite within their rights in wiping out ⟦C_{g2}⟧ and ⟦SH_1⟧ alike by a strict foreclosure. Its refusal to accept the apparent corollary of this right--namely, that ⟦SP_1⟧ might therefore arbitrarily share their claims with ⟦SH_2⟧ can be plausibly justified on the practical ground that such an arrangement between mortgagor and mortgagee is a dangerous practice; that it is *likely* to result in defrauding ⟦C_{g2}⟧ of equities that may *possibly exist* ; and therefore, that a court should penalize the practice in every case as a rule of thumb without going into the highly speculative question of whether there did in fact exist an equity of which ⟦C_{g2}⟧ were deprived in the particular case at bar.

James C. Bonbright & Milton M. Bergerman, *Two Rival Theories of Priority Rights of the*

Be that as it may, the Wisconsin federal court in *Paton v. Northern Pacific Railway Co.*[137] decided otherwise on the values exchanged. The case involved an attempt by general creditors (C_{g2}) of D_2 *Corp.* who had intervened in the foreclosure proceeding to block the sale because it constituted a windfall to *B Corp*. Judge James Graham Jenkins found that SP_1's secured claim was under water and that SH_2 could not possibly have snatched equity from the creditors:

> Can it fairly be said that any fraud here was perpetrated upon the creditors? What was the position of the stockholders? This property was incumbered to the amount of $152,000,000. There is no allegation in this bill, nor is there information within reach of the court in the record of the foreclosure suit, which shows the actual value of this railroad property; but it is clear that, at the time of the reorganization plan, the net earnings of the road were largely insufficient to pay its fixed charges, and that there was a continual annual deficit in that respect. So that, looking at the interest of ⟦SH_2⟧ in ⟦D_2 *Corp.*⟧ at the time this plan of reorganization was proposed, can it properly be said that the stock had any actual appreciable value? It might, under certain contingencies, have a certain market value for the purposes of control, if it could control, but certainly not with reference to the control of this property, which was within the custody of the court for the purpose of foreclosing the mortgages and protecting the creditors of the road. Under these circumstances, this reorganization agreement proposes that ⟦SH_2⟧ might have common stock in ⟦*B Corp.*⟧ upon paying $15 a share. What would they get? If the court has accurately placed these figures, there will necessarily be, under present conditions, not more than sufficient income to meet the net fixed charges, even under the plan of reorganization. What, then, was the

Security Holders in a Corporate Reorganization, 28 COLUM. L. REV. 127, 147-48 (1928) (footnotes omitted); *see also* Haines, *supra* note 9, at 401 ("*Boyd* was, in reality, a PROPHYLACTIC rule to ensure that no company value could bypass unsecured creditors and fall to equity . . . ").

[137] 85 F. 838 (C.C.E.D. Wis. 1896).

hope? That business would revive; that the country would recover from the panic of 1893, and, with the revival of business, the road would be able to meet its fixed charges, and in the time to come, possibly--though rather doubtfully, because, I think, experience has shown there are but few, if any, roads west of the Mississippi river that have been known to pay a dividend on their common stock--there might be realized some dividend upon the common stock. But for that possible hope, coupled, perhaps, with anticipated participation in the control of this road that might come in time, ⟦*SH_2*⟧, in order to acquire new stock ⟦in *B Corp.*⟧, must pay $15 a share. That was not for the property of ⟦*D_2 Corp.*⟧, but in the hope that in the future they might, in view of the possible revival of business and the growth of the country penetrated by the railroad, realize some profit upon the new, and recover the loss upon the old, investment, and that they have entered upon a doubtful speculation, and have yet received, and are likely to receive, nothing, is shown by the fact appearing in the record, that the stock, or the interest of ⟦*SH_2*⟧ upon which $10 a share has been paid, brings today less than $6 in the market.[138]

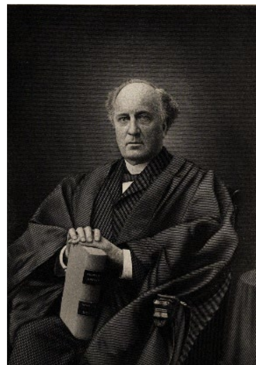

Figure Ten
Judge James Graham Jenkins (1834-1921)

[138] *Id.* at 842-43.

To reiterate, however, Judge Jenkin's opinion contradicts *Louisville*, decided three years later. *Louisville* indicated that foreclosure is impossible over the veto of the C_g, regardless of valuations.[139]

In response to Judge Jenkin's opinion, Judge Whitson retorted that the SH_2 must obviously be getting hidden value; otherwise, why would they ever tender their D_2 *Corp.* shares together with $10 or $15 per share? This was indeed a good question.[140]

But, it seems, valuation did not matter after all:

> ⟦W⟧hether the stock in ⟦*B Corp.*⟧ secured ⟦by SH_2⟧ was valuable or not (although it proved to be immensely so, and then the existing revenues made it apparent that it would be), they did retain an interest. Its value does not enter into the consideration of the question; it is the retention of that interest which invalidates the transaction. The purpose throughout the proceedings, so often displayed, coupled with the manner in which it was finally consummated, leads irresistibly to the conclusion that which was designated as a reorganization was meant to be a reorganization in fact, and

[139] Louisville Trust Co. v. Louisville, N.A. & C. ry. Co., 174 U.S. 674, 684 (1899); *see supra* text accompanying notes 72-72.

[140] *Boyd*, 170 F. at 800-01. This invokes the so-called new value exception to the absolute priority rule. In the late twentieth century, a huge literature arose about whether this exception existed. The literature treated the question as a major Wall Street issue for elite chapter 11 cases. In fact, the new value exception was important only to real estate cases where the partners faced an income tax on recaptured building depreciation. These flailing partners filed in chapter 11 for the sole purpose of delaying the mortgage foreclosure sale until the market turned around. One major issue (never resolved) was: Who owned the new value contributed by the existing partners. Not the creditors, because no insider would ever contribute new value if the creditors simply took it. If the firm owned the new capital, then the amount of new value contributed was arbitrary. Whether the partners contributed $1 or $1 billion, the reorganized partnership put the money in its bank account, and that was the net worth of the partnership. On this basis, the auction made no sense. This did not keep the United States Supreme Court from implying that an auction is necessary to sustain a new value chapter 11 case. Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. Partnership, 526 U.S. 434, 457-58 (1999). For details, *see* David Gray Carlson & Jack F. Williams, The *Truth About the New Value Exception to Bankruptcy's Absolute Priority Rule*, 21 CARDOZO L. REV. 1303 (2000).

> not a foreclosure sale in the strict sense of the term.[141]

Thus, whether *B Corp.* paid reasonably equivalent value for what *B Corp.* received was not the point. *Boyd* is not a fraudulent transfer case.[142] *Boyd* speaks to the impossibility of D_2 *Corp.* selling to *B Corp.* where SH_2 was the shareholder of D_2 *Corp.* and also of *B Corp.*

At the Supreme Court level, Justice Lamar also cited financial facts insinuating that *B Corp.* was getting a windfall and was sapping value from the C_{g2}.[143] But, again, the ultimate result did not turn on valuations.

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[141] *Boyd*, 170 F. at 801. Notice here that "reorganization" is a nasty word, suggesting that all we have is a consensual workout where the C_{g2} agreed to take a haircut for the benefit of SH_2.

[142] *See* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 504-05 ("That such a sale would be void, even in the absence of fraud in the decree, appears from the reasoning in *Louisville* . . .").

[143] Writes Justice Lamar:

> The railroad cost $241,000,000. The lien debts ⟦SP_1's total claim⟧ were $157,000,000. The road sold for $61,000,000 and ⟦*B Corp.*⟧ at once issued $190,000,000 of bonds ⟦to SP_2⟧ and $155,000,000 of stock on property which, a month before had been bought for $61,000,000.

Boyd, 228 U.S. at 507. The $241 million number seemed to be "book value," with no relation to actual market value. The $61 million number is the value of the assets sold to *B Corp.* according to stipulation by the parties. The $150 million seems to be an arbitrary par value of the stock, which is entirely irrelevant to market value. This presentation is entirely unconvincing to show that *B Corp.* paid less than a reasonably equivalent value for the assets of D_1 *Corp.* and D_2 *Corp.*

Justice Lamar further wrote that, according to *B Corp.*:

> It is insisted, however, that not only the bid at public outcry, but the specific finding in the *Paton* case, established that the property was worth less than the encumbrances of $157,000,000, and hence ⟦$C_1$⟧ is no worse off than if the sale had been made without the reorganization agreement. In the last analysis, this means that ⟦C_1⟧ cannot complain if worthless stock in the new company was given for worthless stock in the old. Such contention, if true in fact, would come perilously near to proving that the new shares had been issued without the payment of any part of the implied stock subscriptions ⟦*i.e.*, $150 million⟧ except the $10 and $15 assessments. But there was an entirely different estimate of the value of the road when the reorganization contract was made. For that agreement contained the distinct recital that the property to be purchased was agreed to be "Of the full value of $345,000,000, payable in fully paid non-

Regardless of the values, the transaction was an impossibility because of veil piercing:

> The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of ⟦C_1⟧ to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances.[144]

Justice Lamar compared SH_2 to a debtor who bought at a foreclosure sale of his own property,[145] and to a debtor who buys at a tax sale.[146] Such a person is a redeemer, not a buyer. If a debtor redeems not knowing C_1 existed, such

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> assessable stock and the prior lien and general lien bonds to be executed and delivered as hereinafter provided.
>
> The fact that at the sale, where there was no competition, the property was bid in at $61,000,000 does not disprove the truth of that recital, and the shareholders cannot now be heard to claim that this material statement was untrue . . .

Id. at 507-08. The number $345 million would appear to be the sum of *B Corp.*'s debt to SP_2 and the par value of the stock issued by *B Corp.* Reference to par value as an element of valuation is quite illegitimate.

The dissent had no patience with this suggestion that *B Corp.* took value from C_{g2}: "The railroad company was hopelessly insolvent. Its annual deficit was about five million dollars . . . The receivership had already lasted for several years and the situation was growing steadily worse." *Id.* at 512.

Judge Randolph Haines generally credits Justice Lamar's estimate that *B Corp.* took a surplus away from the C_{g2}. He remarks, "The Court also must have been swayed by the actual performance of the company post confirmation." Haines, *supra* note 9, at 403. Judge Haines cites from the syllabus of the case that *B Corp.* earned $489,000 in its first year and $6 million in its second. 288 U.S. at 491. But positive income in *B Corp.* does not prove that *B Corp.* took surplus away from the C_{g2}. For example, suppose D_2 *Corp.* was worth $100 and SP_1 claimed $500. *B Corp.* buys for $100 and earns a profit over opportunity cost in the first year. This example suggests *B Corp.* took value only from SP_1, not from the unsecured creditors of D_2 *Corp.* This example, I think, is what actually happened in *Boyd.*

[144] *Boyd*, 228 U.S. at 507.

[145] *Id.* at 504.

[146] *Id.* at 507.

a debtor is by no means rid of C_1.

But Justice Lamar also sounded the opposite note. Perhaps a different foreclosure sale might be valid. Well aware of a like observation in *Louisville Trust Co. v. Louisville, New Albany & Chicago Railway Co.*,[147] Justice Lamar conceded that when it comes to railroads, the property foreclosed is of such enormous value that no buyer can be expected to come forward *except* a *B Corp.* who is organized to buy with financing organized by SP_1:

> The enormous value of corporate property often makes it impossible for one, or a score, or a hundred bondholders to purchase, and equally so for stockholders to protect their interests. A combination is necessary to secure a bidder and prevent a sacrifice. Cooperation being essential, there is no reason why ⟦SH_2⟧ should not unite with the bondholders ⟦i.e., SP_2⟧ to buy in the property.[148]

Once, it seems, judicial power to foreclose was doubted. "But it is now settled that such reorganizations are not necessarily illegal."[149] Such proceedings can even shut out dissenting creditors "who do not accept fair terms offered."[150]

B Corp. seemed to have raised the following point: If purchase by *B Corp.* is essential, the Supreme Court was teaching the C_{g2} of this world to hold out and not consent. Whereas the consenting creditors suffer the haircut, the holdout gets the full head of hair--a 100 percent payout.

In a passage that would become crucial for the reorganization bar, Judge Lamar responded that the holdout's

> interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization,

[147] Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co., 174 U.S. 674, 683 (1899) ("railroad trust deeds, are ordinarily so large in amount that on foreclosure thereof only the mortgagees, or their representatives, can be considered as probable purchasers").

[148] *Boyd*, 228 U.S. at 504.

[149] *Id.* at 503.

[150] *Id.* at 503-04.

> could not thereafter be heard in a court of equity to attack it. If, however, no such tender was made and kept good he retains the right to subject the interest of ⟦SH_2=*B Corp.*⟧ in the property to the payment of his debt. *If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities.*[151] (emphasis added).

This last sentence proves the case does not turn on fraudulent transfer theory. It indicates that SP_1 and SP_2 were to be viewed as holding valid mortgages that were senior to any lien C_1 might obtain. If *B Corp.* fraudulently received property in bad faith, and if SP_2, knowing all, finances the purchase, SP_2 is likewise a bad faith purchaser who is beholden to the beneficiary of this trust. If so, how could SH_2=*B Corp.*'s property ever be valueless to the C_{g2}? This property is valueless only if SP_2's lien on *B Corp.*'s property is senior to C_1's equitable lien on that property.[152] Piercing the veil would leave SP_2 a senior secured creditor. A fraudulent transfer would have subordinated SP_2 to C_1's equitable lien.

c. Res Judicata

Judge Jenkins, said Judge Whitson, should not have permitted the foreclosure sale, because it was a fraud in law. But he did indeed permit it. No C_{g2} appealed.[153] Why wasn't C_1 (one of the C_{g2}) bound by this?

Judge Whitson conceded that, had C_1 been notified of the mortgage foreclosure and had C_1 been given an opportunity to object, C_1, after objecting, would have been bound by the decree of the federal court in Wisconsin. If C_1 had been a party to the foreclosure, C_1 could have

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[151] *Id.* at 508 (emphasis added).

[152] Two commentators read the Supreme Court opinion thusly:

> The Supreme Court held that the judicial sale pursuant to a reorganization plan constituted fraud in law against ⟦C_1⟧ and affirmed a decree making his claim a lien upon the property of ⟦D_2 *Corp.*⟧ in the hands of ⟦*B Corp.*⟧ *but subject to the mortgages placed thereon at the time of reorganization*. (emphasis added).

Douglas & Frank, *supra* note 9, at 1011.

[153] Because *B Corp.* bought the claims upon which the challenge was based.

appealed the foreclosure and won a reversal.[154] But C_1 was not made a party and so C_1 was not bound by the decision of the Wisconsin court:

> We thus pass to the final question, which must be considered in its double aspect, namely, whether ⟦C_1⟧ is bound by virtue of the jurisdiction of the court over the property and the notice to general creditors, coupled with the actual notice that there was a foreclosure, that receivers were appointed, that the property was operated under the receivership, that it was sold, that the purchaser went into possession, and thereafter ⟦D_2 *Corp.*⟧ in its corporate capacity ceased to be an active and going concern.[155]

Judge Whitson wrote:

> Counsel for ⟦*B Corp.*⟧ have met the contention in this way:
>
> > When property of ⟦D_2 *Corp.*⟧ has been seized at the instance of ⟦SP_1⟧ and administered by a court of equity having undoubted jurisdiction both of parties and subject-matter, may a ⟦C_{g2}⟧ of ⟦D_2 *Corp.*⟧, by a subsequent independent proceeding, attack the judgments disposing of that property without submitting a particle of evidence to show that the court in rendering those judgments was not fully aware of every fact relied on as a ground for vacating them?
>
> The question as propounded must be answered in the negative. But did the court have jurisdiction of the parties?[156]

Granted, Judge Whitson conceded, a creditor with mere knowledge of the proceeding who failed to intervene would be bound.[157] And the court

[154] As occurred in Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co., 174 U.S. 674 (1899).

[155] Boyd v. N. Pac. Ry. Co., 170 F. 779, 797 (CC.D. Wash. 1909).

[156] *Id.* at 802.

[157] *Id.* Justice Lurton in dissent claims C_1 did indeed have knowledge of the fiduciary

proceeded to find that C_1 was never notified of the foreclosure proceeding. To be sure, SP_1 published notices of the foreclosure in midwestern newspapers. But C_1 lived in Washington. "Notices to creditors were not published in any newspaper in the city of Spokane, where ⟦C_1⟧ resided, and those which were published were not called to his attention."[158]

In mortgage foreclosures, the debtor and junior interests holders (tenants holding through the debtor or junior lienors) must be notified and a hearing must be held. The reason for this is that foreclosure obliterates the property interests of these junior parties. But the unsecured creditors of the debtor have no property interest in the debtor's property. For that reason, unsecured creditors are not necessary parties in mortgage foreclosures. In fact, the standing of an unsecured creditor without a judicial lien would be flatly denied.[159] It should be remembered, however, that C_1 had an equitable lien on D_1 *Corp.*'s property. C_1 was no mere general creditor. Thus, on the Judge Whitson's view, C_1 was an omitted party.

The Supreme Court's attitude toward res judicata was different. In the courts below, C_1 had an equitable lien on D_2 *Corp.*'s assets and so was a necessary party in the mortgage foreclosure. But in the Supreme Court's view, C_1 was an *unsecured* creditor of D_2 *Corp.*[160] Therefore, under mortgage law, C_1 was an improper party. Nevertheless, the Supreme Court

proceeding. N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 514-15 (1909).

[158] *Id.* It will be recalled that one day after C_1 secured judgment against D_1 *Corp.*, SP_1 won foreclosure against D_1 *Corp.* and D_2 *Corp.*, thereby ostensibly depriving both D_1 *Corp.* and D_2 *Corp.* of any property.

[159] Stout v. Lye, 103 U.S. 66, 70 (1880) (unsecured creditors cannot contest the validity of a mortgage foreclosure, but a creditor with a judicial lien may do so).

[160] In dissent, Justice Lurton wrote:

> Here is a single creditor who comes forward many years after a judicial sale under a general creditors bill and a mortgage foreclosure bill which had been ending several years, and asserts the right to ignore the judicial sale and the title resulting and asks to have the purchaser of ⟦D_2 *Corp.*⟧ subject to his *non-lien claim*, but because of any actual fraud in the sale, nor because he can show that he has in any way suffered a loss by reason of the plan of reorganization under which the sale was conducted, but solely and simply because ⟦SH_2⟧ of ⟦D_2 *Corp.*⟧ are said to have participated in some way in the benefits of the sale.

Boyd, 228 U.S. at 511-12.

treated C_1 as a necessary party. Granted, the Circuit Court for the Eastern District of Wisconsin had jurisdiction to issue a decree. It was error to do so, as was later established in *Louisville*. Reversal on appeal should have followed. But the court's judgment of foreclosure was still entitled to res judicata respect if no appeal followed. "But inasmuch ⟦C_1⟧ was not a party to the record that decree was not binding upon him as res judicata, and the opinion not being controlling authority, cannot be followed . . . "[161]

B Corp. had cited some cases that said if SP_1 had foreclosed on the property of D_2 *Corp.* and no fraud was perpetrated on the foreclosing court, the foreclosure was worthy of res judicata effect. Justice Lamar indicated discomfort with these precedents:

> This makes the creditor's legal right against ⟦SH_2's⟧ interest ⟦*sic*⟧⟦[162]⟧ depend upon the motive with which they act and the method by which they carry out the scheme. If they do so by means of a private contract, though in ignorance of the existence of the creditor, the property remains liable for his debts. If they do so by means of a judicial sale under a consent decree and in like ignorance or disregard of his existence, the result is said to be different, although ⟦SH_2⟧ should reserve exactly the same interest and deprive ⟦C_1⟧ of exactly the same right.[163]

Justice Lamar noted that *B Corp.* had bought $14,000,000 in unsecured claims of C_{g2} against D_2 *Corp.*,[164] which permitted *B Corp.* to receive a dividend from some unencumbered assets D_2 *Corp.* owned. Justice Lamar assumed that this dividend meant that every C_{g2} was paid--except C_1.[165]

For, if purposely or unintentionally ⟦C_1⟧ was not paid, or provided for in

[161] *Id.* at 505.

[162] Of course, SH_2 *had* no interest in the assets *B Corp.* bought from SP_1, unless SH_2=*B Corp.*

[163] *Boyd*, 228 U.S. at 503.

[164] "⟦Y⟧et ⟦*B Corp.*⟧ purchased unsecured claims aggregating $14,000,000. Whether they were acquired because of their value, to avoid litigation, or in recognition of the fact that such claims where superior to the rights of ⟦SH_2⟧, does not appear, nor is it material." *Id.* at 504.

[165] This might be inaccurate. The lower court opinions do not indicate that *B Corp.* took the whole of the dividend.

the reorganization, ⟦C_1⟧ could assert his superior rights against the subordinate interests in the property transferred to ⟦*B Corp.*⟧. ⟦SH_2⟧ were in the position of insolvent debtors who could not reserve an interest as against creditors.[166]

SH_2 and C_1 are discussed here as if *B Corp.* was dissolving and distributing the assets first to the creditors and then to SH_2. Note that SH_2 and *B Corp.* are treated as separate persons.

There follows what might be frankly described as an incoherent passage. The thrust of the paragraph seems to be that if some genuinely independent buyer had emerged, SH_2 could be relied upon to represent the interests of C_{g2}.

> In saying that there was nothing for the unsecured creditors ⟦*B Corp.*'s⟧ argument assumes the very fact which the law contemplated was to be tested by adversary proceeding in which it would have been in the interest of ⟦SH_2⟧ to interpose every valid defense.[167]

Of course, there *was* such an adversary proceeding. C_{g2} challenged the sale on the basis that value was being taken from C_{g2}. In *Paton v. Northern Pacific Railway Co.*,[168] this claim was expressly rejected.

The incoherent passage continues:

> If, after a trial, a sale was ordered, ⟦the SH_2⟧ were still interested in making the property bring its value, so as to leave a surplus for themselves ⟦after C_{g2} were paid⟧ as ultimate owners. Even after the sale ⟦which required court ratification⟧, ⟦SH_2⟧ could have opposed its confirmation if the bids had been chilled . . . ⟦SH_2⟧ . . . in lawfully protecting themselves, would necessarily have protected ⟦C_{g2}⟧.[169]

But because *B Corp.* was under control of SH_2, "all these tests and

[166] *Id.* at 504.
[167] *Id.* at 505-06.
[168] 85 F. 838 (C.C.E.D. Wis. 1896).
[169] *Boyd*, 228 U.S. at 506.

safeguards were withdrawn."[170] SH_2 could not be trusted to shill at the foreclosure auction, in order to drive the price up for the benefit of the C_g.

To summarize, the Supreme Court wrongly assumed that C_1 was an unsecured creditor of D_2 *Corp.*--a C_{g2}. It ruled that a collusive mortgage foreclosure is an impossibility because piercing of veils must follow. After piercing, we witness SH_2 buying SH_2's property at SP_1's foreclosure sale. Any C_{g2} who is party to such a foreclosure may block the sale and hold up the foreclosure. C_1, supposedly without knowledge of the foreclosure proceeding, may disregard it and obtain a lien on *B Corp.*'s property as if it were D_2 *Corp.*'s property.

One last remark: Both Judge Whitson and Justice Lamar assume that, had C_1 known about the foreclosure sale in time to intervene, C_1 would have been bound by Judge Jenkins's ruling in *Paton*. How is it that C_1 must undertake the burden of intervening or forever be barred by the foreclosure? Why couldn't C_1 simply stand aloof and seek later to impose a lien on *B Corp.*'s assets?

Classically, C_1 could, for selfish reasons, bring a private creditor's bill establishing C_1's priority over C_{g2}'s subsequent creditor's bill. But in *Boyd*, C_{g2}'s bill was first. In it, C_{g2} purported to act for all unsecured creditors willing to contribute legal fees to generate a fund in which all the C_{g2} would share equally. C_1 was therefore invited to join the C_{g2} party. If he had received this invitation, C_1 could not turn it down. The foreclosure was binding on C_1--if C_1 had knowledge of the invitation.[171] The matter was treated as a class action in which class members, being invited in, could not opt out.[172]

IV. The Modern Doctrine of Mere Continuation

Boyd was not a fraudulent transfer case because the sale of D_2 *Corp.* assets to *B Corp.* did not hinder D_2 *Corp.*'s unsecured creditors. Rather, it

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[170] *Id.*

[171] Glenn disagrees. GLENN, *supra* note 9, at § 224, at 390 ("The creditor is not obliged to seek preventive relief by appearing and opposing the plan").

[172] For a modern instance, *see In re* Drexel Burnham Lambert Group, 960 F.2d 285 (2d Cir. 1992). Class actions under Federal Rules of Civil Procedure 23(1) are mandatory, but those certified under Rule 23(a)(3) must include an opt-out. "Limited funds" to reimburse the class is ground to prevent opt out. Jeanne L. Schroeder & David Gray Carlson, *Third Party Releases Under the Bankruptcy Code After Purdue Pharma*, 21 AM. BANKR. INST. L. REV. 1, 58-59 (2023).

was a veil-piercing case. A fraudulent transfer theory requires a finding that the foreclosure deprived the C_{g2} of realizable value. But *Boyd* turned on the structure of the deal. The C_{g2} had a blocking position even if SP_1 was entirely under water. They could claim the sale was no sale.

A chaotic but oft-cited modern case fails to follow *Boyd* in this regard. In *Ed Peters Jewelry Co. v. C & J Jewelry Co.*,[173] *D Corp.* was under water to *SP*s blanket lien on all assets. *D Corp.* was indebted to C_1. *D Corp.* suggested that *SP* foreclose and sell to *B Corp.*, a new entity which *SH* would incorporate. *B Corp.* would assume liabilities "to essential trade creditors"[174]--but not to C_1. *D Corp.* dissolved and all the employees of *D Corp.* became employees of *B Corp.*

C_1 brought suit against *D Corp.*, *B Corp.*, *SP*, and *SH* alleging various theories,[175] including fraudulent transfer and piercing the *D Corp.-B Corp.* veil. At trial before a jury, after C_1 rested its case, the district court, under Federal Rule of Civil Procedure 50(a),[176] awarded judgment against C_1 on all counts. C_1 appealed, claiming it presented enough evidence to sustain a

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[173] 124 F.3d 252 (1st Cir. 1997).

[174] *Id.* at 257.

[175] *Id.* at 166. C_1 also sued *SH* and *SP* for intentionally interfering with C_1's contractual role as sales agent for *D Corp.* The idea was that C_1 had a reasonable expectation that C_1's role of sales agent of *D Corp.* would continue. When *B Corp.* declined to hire C_1 s agent, C_1's expectation was dashed. The First Circuit ordered that this claim be presented to the jury. Since this theory was not based on collecting C_1's antecedent debt from *D Corp.*, this issue falls beyond the scope of this article. Later, a jury would decide that *SH* and *B Corp.* were liable, but the court upheld the district court in deciding against C_1 on this tort claim. Ed Peters Jewelry Co. v. C & J Jewelry Co., 215 F.3d 182, 193 (1st Cir. 2000).

[176] According to Rule 50(a):

> (a) Judgment as a Matter of Law
>
> (1) *In General.* If a party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that issue, the court may:
>
> . . .
>
> (B) grant a motion for judgment as a matter of law against the party on a claim . . . that, under the controlling law, can be maintained or defeated only with a favorable finding on that issue.

Fed. R. Civ. P. 50(a).

jury verdict.

The First Circuit held that C_1 had no fraudulent transfer theory because *D Corp.* was under water to *SP*'s blanket lien. The transaction did not hinder C_1. The non-fraudulent security interest did. But C_1 at first successfully asserted a veil piercing theory--which the court called *successor liability*. "⟦A⟧n intervening foreclosure sale accords ⟦*B Corp.*⟧ no automatic exemption from successor liability."[177]

> Following the October 1993 foreclosure sale by ⟦*SP*⟧, the then-defunct ⟦*D Corp.*⟧ unquestionably remained legally obligated to ⟦C_1⟧ for its sales commissions, even if the lack of corporate wherewithal rendered the obligation unenforceable as a practical matter. True, ⟦*SP*⟧ might had sold the ⟦*D Corp.*⟧ assets to an entity with no ties to ⟦*D Corp.*⟧, but that is beside the point, since ⟦C_1's⟧ successor liability claim alleges that ⟦*B Corp.*⟧ *is* ⟦*D Corp.*⟧ in disguise. As ⟦C_1⟧ simply seeks an equitable determination that ⟦*B Corp.*⟧, as ⟦*D Corp.*'s⟧ successor, is liable for the sales commissions ⟦C_1 earned from ⟦*D Corp.*⟧, its claim in no sense implicates any lien interest in any former ⟦*D Corp.*⟧ asset.[178]

In other words, C_1 had not lien, But C_1 could proceed to get one after piercing the veil between *D Corp.* and *B Corp.* Accordingly, the court ruled that C_1 "was entitled to attempt to prove that ⟦*B Corp.*⟧, as ⟦*D Corp.*'s⟧ "successor," became liable for ⟦*D Corp.*'s⟧ debt to ⟦C_1⟧ because ⟦*B Corp.*⟧ is a 'mere continuation'" of the divesting corporate entity."[179]

According to Rhode Island law,[180] five factors might indicate that *B Corp.* is a mere continuation of *D Corp.* and thus is liable for *D Corp.*'s debts.

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[177] *Ed Peters Jewelry Co.,* 124 F.3d at 267 (citations omitted); *accord*, Wells Fargo Vendor Fin. Servs., LLC v. Nationwide Learning, LLC, 429 P.3d 221, 231 (Kan. App. 2018).

[178] *Ed Peters Jewelry Co.,* 124 F.3d at 268.

[179] *Id.*

[180] Casey v. San-Lee Realty, Inc., 623 A.2d 16, 19 (R.I. 1993).

(1) *D Corp.* transferred all its operating assets.[181]
(2) *B Corp.* paid an inadequate consideration.
(3) *B Corp.* continued the business of *D Corp.*
(4) *B Corp.*'s officers had been *D Corp.*'s officers.
(5) *D Corp.* was insolvent at the end of the day.

Item (2) deserves our attention. Its assertion contradicts *Boyd.* The fact that *B Corp.* in *Peters* supposedly paid an inadequate consideration trespasses into fraudulent transfer territory. This reflects the fact that fraudulent transfers to insiders are evidence the corporate veils ought to be pierced. Yet veil piercing and fraudulent transfer are contradictory theories.[182]

In *Peters*, the First Circuit was keen for a jury to decide that *D Corp.* and *B Corp.* were the same person.[183] But it felt compelled to honor item (2) from the list supplied by Rhode Island law. The evidence had to show that *B Corp.* paid *D Corp.* too little.

There is an insurmountable roadblock to such a conclusion. The First Circuit had just finished ruling that C_1 had no viable fraudulent transfer theory because *SP* was under water with respect to its floating lien. Therefore, it must be the case that *D Corp.* conveyed assets worth zero to *B Corp.*, who paid a sum to *SP* in the foreclosure sale, but none to *D Corp.* If *B Corp.* did not underpay for fraudulent transfer purposes, how could there be a different result for the veil piercing theory?

The brutal answer is that there cannot be a different result. The First Circuit, however, purported to find evidence from which a jury could conclude that *B Corp.* paid *D Corp.* 12.5 cents on the dollar.[184] Its calculation of this ratio is, however, nonsensical.[185] Anything *B Corp.* paid

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[181] The *Peters* court found this was true even though *D Corp.*'s real property was conveyed to an affiliate of *B Corp.* Ed Peters Jewelry Co., v. C & J Jewelry Co., 124 F.3d 252, 269-70 (1st Cir. 1997).

[182] Schroeder & Carlson, *supra* note 19, at 564-65.

[183] Later, the First Circuit reversed course and held that, as piercing the veil was an equitable remedy, C_1 was not entitled to a jury determination on piercing. Ed Peters Jewelry Co. v. C & J Jewelry Co., 124 F.3d 252 (1st Cir. 1997).

[184] *Id.* at 270.

[185] The First Circuit read the record as showing that value (unencumbered) of *D Corp.*'s assets was $4 million. *B Corp.* paid *SP* $500,000 as a down payment (which sum was lent back to *B Corp.*). *B Corp.* borrowed the rest of the price owed to *SP* from *SP.*

went into the rightful pocket of *SP*, and C_1 was completely unprejudiced by the collusive foreclosure.

But the First Circuit moved its chess piece in an unexpected direction. If *B Corp.* paid too little, this would have been evidence of *D Corp.*'s bad intent. Even if *B Corp.* paid zero to *D Corp.* (for equity worth zero), there was other evidence on the record that *D Corp.* specifically sought to launder its assets of C_1's unsecured claim against *D Corp.* Since *D Corp.* had a bad intent toward C_1, a jury could decide that *D Corp.* and *B Corp.* were the same person. Item (2) was satisfied by this evidence of *D Corp.*'s animus toward C_1.

In round II of the *Peters* appeal, the First Circuit sheepishly took the chess piece off the board. On remand, the district court had noted that not a single Rhode Island case supported the proposition that piercing the veil could be a remedy for fraud. The First Circuit responded: maybe so, but the First Circuit made an *Erie* guess as to Rhode Island law and the district court had no business making a different guess. But on second thought, the Third Circuit noted that fraud involves an affirmative misrepresentation by *D Corp.* or *B Corp.* to C_1 upon which C_1 relied.[186] Since the record showed no such statement, Item (2) could not be met. Piercing was unjustified.

Although the First Circuit's analysis of veil piercing leaves much to be desired,[187] the case can be read as rejecting *Boyd*, which held that when *SH*

"Therefore, with a total *minimum* asset value just under $4 million, and a *de facto* purchase price below $500,000, a rational jury could conclude that ⟦*B Corp.*⟧ acquired ⟦*D Corp.*'s⟧ assets at 12.5 cents on the dollar." *Id.* at 271.

[186] *But see* Acme Sec., Inc. v. CLN Props, LLC (*In re* Acme Sec., Inc.), 484 B.R. 475, 486-87 (Bankr. N.D. Ga. 2012) (suggesting that under Georgia law oppressive conduct with no misrepresentation or reliance could constitute fraud). In *Acme*, Judge Paul Bonapfel faced a Georgia Supreme Court dictum that piercing the veil could occur when a mortgage foreclosure was "a fraudulent attempt to avoid liabilities; or . . . the purchaser is a mere continuation of the predecessor corporation. Bullington Union Tool Corp. 328 S.E.2d 726, 728 (Ga. 1985). The dictum was unexplained, and Judge Bonapfel reasoned that fraud cannot be misrepresentation coupled with reliance, since no misrepresentation attended the foreclosure procedure followed in *Acme*. Judge Bonapfel speculated that fraud without misrepresentation might occur if there was circumventing and cheating in the nature of fraudulent transfer.

[187] Later, the district court took the successor liability issue away from the jury. It decided that *B Corp.* did indeed pay adequate consideration. The First Circuit had merely claimed that a trier of fact *could* find the consideration to be inadequate. But, as the trier of fact, the district court found as a *factual* matter than consideration was adequate. Therefore, successor liability failed. *Ed Peters Jewelry Co.*, 124 F.3d at 272.

sets up *B Corp.* to buy at the foreclosure by *SP*, the foreclosure sale is a nullity. *D Corp.* still owns the asset purchased, because *D Corp.* and *B Corp.* are the same person. *Peters* ends up holding that where *B Corp.* paid zero for equity worth zero, there can be no successor liability.

A more thoughtful rejection of *Boyd* is *Acme Security, Inc. v. CLN Properties, LLC (Acme Security, Inc.)*,[188] where *D Corp.* was under water to *SP*. A wrinkle in this case is that *B Corp.* did not buy *D Corp.* assets at a foreclosure sale. Rather, *B Corp.* bought *SP*'s secured claim (with money advanced to *B Corp.* by *SH*). *B Corp.* then offered to "accept the collateral" from *D Corp.* in exchange for cancellation of *D Corp.*'s debt to *B Corp.* "Accepting the collateral" is Article 9 talk for a strict foreclosure. It requires *D Corp.*'s consent.[189]

Subsequently, *D Corp.* entered into bankruptcy proceedings. A chapter 7 trustee apparently abandoned the encumbered assets to *B Corp.*, which took over title via collateral acceptance. C_1 therefore stepped forward to claim the benefit of veil piercing.

After a careful consideration of the Georgian "mere continuity" cases:

> the Court concludes that Georgia law permits a corporation that acquires assets for a fair and adequate consideration through a legitimate exercise of its remedies under the ⟦UCC⟧ to establish that it is not a "mere continuation" of the original debtor when it does not receive the benefit that the original debtor received arising from the debt in question;⟦190⟧ when the transaction generally affects all existing creditors equally; and when the transaction does not deprive the creditor of a remedy against the debtor because, as a matter

[188] 484 B.R. 475 (Bankr. N.D. Ga. 2012).

[189] U.C.C. § 9-620(a)(1).

[190] This sentence was crafted to honor two Georgia piercing precedents. In the first, *D Corp.* had breached a contract with C_1. *D Corp.* transferred all assets to *B Corp. B Corp.* provided services to C_1. When C_1 did not pay, *B Corp.* sued. C_1 successfully asserted "mere continuation" for the purpose of setting off *D Corp.*'s liability against *B Corp.*'s right to payment. A triangular set off became proper because *D Corp.=B Corp.* Johnson-Battle Lumber Co. v. Emanuel Lumber Co., 126 S.E. 861 (Ga. Ct. App. 1925). In the other, D Corp. bought advertising. B Corp. reaped the benefit. Therefore, B Corp. has to pay for the ads that D Corp. had contracted for. Pet Care Professional Ctr., Inc. v. Bellsouth Advertising & Publishing Corp., 464 S.E.2d 249 (Ga. Ct. App. 1995).

> of fact, it had no such remedy.[191]

The court thought piercing the veil when the C_g were not harmed created social harms:

> Imposing successor liability under the "mere continuation" theory here would effectively require the liquidation of a closely-held family-owned corporation . . . that suffers financial reversals and ends up with assets worth substantially less than the debt that encumbers them, unless a sale to an independent third party can be arranged. As this matter illustrates, a third-party sale of a hopelessly insolvent company in many instances is not possible; the only hope for realization of any going concern value, the preservation of jobs, and the avoidance of disruption of customer expectations is for the existing owners-managers to take the assets and start over. If an owner-manager who does so ends up with a new company that remains liable for all of the existing debts, such a course of action obviously makes no sense.
>
> An owner-manager in such a situation would face a Hobson's choice: start over with a new entity that has the same impossible financial problems as the existing one or suffer the liquidation of the existing one. Of course, the latter outcome will most likely be the eventual result of the former choice. A new corporation burdened with the debts of the existing one will have no better hope of continuing its operations in the long term.[192]

Judge Bonapfel went on to note the *Boyd* result becomes a disincentive for SP to advance funds to a small business, because selling to B Corp. (as organized by *SH*) is *SP*s best hope for recovering the loan. Thus, *Acme Security* represents an *Erie* guess that Georgia law contains no absolute priority rule.

These sentiments underlie congressional rejection of *Boyd* in small business reorganizations. New subchapter V of chapter 11 permits

[191] *In re* Acme Sec., Inc., 484 B.R. at 492.
[192] *Id.* at 494.

confirmation of a plan even though pre-petition *D Corp.*, through a confirmed plan, conveys all assets to post-petition *D Corp.=B Corp.*[193]

In contrast, Kansas embraces *Boyd*. In *Crozier v. Menzies Shoe Company of Detroit Michigan*,[194] D Corp., sold assets to B Corp., including accounts receivable. C_1 had judgment against *D Corp.* and garnished an account debtor (*AD*) on the theory that *AD* owed *D Corp. B Corp.* intervened to claim that *B Corp.* owned *AD*'s obligation; therefore garnishment by *D Corp.*'s creditor C_1 was inappropriate. *B Corp.* pointed out that *B Corp.* paid fair market value for *D Corp.* assets, and the C_g actually received these proceeds, though C_1 did not. The court allowed the garnishment to proceed.

> The contracting parties made some provision for the collection of outstanding accounts of ⟦*D Corp.*⟧ and for their application to the satisfaction of its debts, but the rights of creditor are not limited to any fund thus created. If that fund is insufficient or inconvenient to reach, they are entitled to sweep these agreements aside, for the contracting parties could bind nobody but themselves. They could not prejudice the rights of creditors. . . . The parties who brought about this arrangement and effected this transaction could not create and establish ⟦*B Corp.*⟧ as the business successor of ⟦*D Corp.*⟧ and shape its corporate structure and business policy and endow it with the advantages of the latter without also imposing on it the disadvantages, that is, the liabilities of ⟦*D Corp.*⟧ The capital and assets of ⟦*D Corp.*⟧ were a trust fund for the payments of its debts. ⟦*B Corp.*⟧ holds and enjoys all, or nearly all, the assets of ⟦*D Corp.*⟧; it did not procure them as a wholly independent purchaser at a fair sale, nor otherwise freed of the pertinent liabilities attaching thereto.[195]

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[193] 11 U.S.C. §§ 1181(a), 1191(b). On subchapter V and absolute priority, *see* Paul W. Bonapfel, *A Guide to Small Business Reorganization Act of 2019*, 93 AM. BANKR. L.J. 571, 607-08 (2019).

[194] 175 P. 376 (Kan. 1918)

[195] *Id.* at 377; *accord*, Avery v. Safeway Cab, Transfer & Storage Co., 80 P.2d 1099,

A note about this passage: although the theory is piercing the veil,[196] it trespasses into fraudulent transfer territory when it refers to the assets of *D Corp.* being a trust fund for the C_g. Such a reference suggests *D Corp.* transferred legal title to *B Corp.* for the benefit of its C_g. But how could this be if *D Corp.* and *B Corp.* are the same person?

This case did not involve a foreclosure sale, which illustrates the point that piercing the veil is a theory that exists quite independently from (though consistent with) a collusive foreclosure sale. A recent Kansas case, *Wells Fargo Vendor Financial Services, LLC v. Nationwide Learning, LLC*,[197] confirms this ancient holding, though it does mix up piercing theory with fraudulent transfer theory. The case involved an Article 9 foreclosure. In *Nationwide*, there were factual disputes as to whether the old shareholders were the new shareholders, whether the employees were the same, and whether the business of *B Corp.* was the same or a different business than that which was conducted by *D Corp.* The case was remanded on these points, but the court also confirmed that C_1 could have judgment against *B Corp.* even if *D Corp.* was entirely under water when *SP* enforced its security interest. The fact that C_1 lost no value "cut[] against"[198] successor liability but did not rule it out.[199]

1101 (Kan. 1938) ("No formal arrangements were made to care for the other debts of [*D Corp.*], yet the negotiators deliberately disabled [*D Corp.*] from any possible further exercise of its corporate functions. Sometimes this sort of conduct on the part of corporations . . . is fraudulent. But it may not be intentionally so; perhaps no intentional fraud inhered in this transfer. But where the transfer of assets strips [*D Corp.*] of all its assets, and disables the corporation from earning money to pay its debts, thus leaving creditors . . . no resources to which they may look for the payment of their due, the net result is in legal effect a fraud; and the courts will subject the transferee to liability for the satisfaction of claims against the corporation whose assets it has absorbed"); Board of Cnty. Comm'n v. Park Cnty. Sportsmen's Ranch, LLP, 271 P.3d 562, 574 (Colo. App. 2011) (successor liability imposed even though *SP* was under water).

[196] The *Crozier* court went on to suggest that the president of *D Corp.* (who became the president of *D Corp.*) was also liable to C_1. Crozier v. Menzies Shoe Co. of Detroit, Mich., 175 P. 376, 377 (Kan. 1918). There was no indication in the case that the president was a shareholder, and so this would appear to be shorthand for breach of fiduciary duty the president owed to *D Corp.* Since C_1 had judgment against *D Corp.*, C_1 could garnish any payment intangible *D Corp.* owned, including *D Corp.*'s right to sue its president.

[197] 429 P.3d 221 (Kan. App. 2018).

[198] *Id.* at 273.

[199] In terms of mixing up the theories, the *Nationwide* court thought it necessary that there be a transfer from *D Corp.* to *B Corp.* The point of veil piercing, however, was that

Pennsylvania[200] and New Jersey[201] seems to favor *Boyd*. Several courts, when listing the requirements of "mere continuation" do not list theft of value as a requirement, which leaves the *Boyd* question open.[202]

CONCLUSION

Piercing the corporate veil and fraudulent transfer avoidance are inconsistent theories. The first maintains that the transferor and the transferee are the same person. If so, the transfer is a contradiction. One cannot transfer to oneself. No transfer ever occurred. The second maintains that a transfer occurs between two separate persons.

In famous case of *Northern Pacific Railway Corp. v. Boyd*,[203] the Supreme Court took the corporate buyer at a foreclosure sale to be a mere continuation of the defaulting corporate debtor. It therefore pierced the corporate veil and allowed an unpaid creditor a remedy against the buyer. The reason for this is that the shareholders of the defaulting debtor were also the shareholders of the buyer. In short, the foreclosure sale was "collusive," and veil piercing must follow.

Boyd involved the foreclosure of an underwater mortgage. No equity existed for the general creditors of the debtor. For this reason, *Boyd* is a veil-piercing case. It is not a fraudulent transfer case, as is widely claimed.

In modern times, when the mortgage is under water, only a few states pierce the veil between a debtor who grants a mortgage and the buyer who purchases at the foreclosure auction. These few states, in effect, apply an "absolute priority rule" to collusive mortgage foreclosures. A majority of states announce that the buyer is a mere continuation of the defaulting debtor only when the transaction deprives the creditor of value. In effect, these states require the presence of a fraudulent transfer in order to justify piercing the corporate veil. Today, collusive mortgage foreclosures are

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no transfer was accomplished at all.

[200] Continental Ins. Co. v. Schneider, 810 A.2d 127 (Pa. 2002), *aff'd*, 873 A.2d 1286 (but remanding on continuation of ownership grounds); *see* KIND Operations, Inc. v. Cadence Bank (*In re* PA Co-Man, Inc.), 644 B.R. 553, 633-47 (Bankr. W.D. Pa. 2022).

[201] Glynwed, Inc. v. Plastimatic, Inc., 869 F. Supp. 265 (D.N.J. 1994).

[202] Priestley v. Headminder, Inc., 647 F.3d 497, 505 n.3 (2d Cir. 2011) (New York law); New York v. National Service Indus., Inc., 460 F.3d 201 (2d Cir. 2006) (New York law).

[203] 228 U.S. 482 (1913), *aff'g* 177 F. 804 (9th Cir. 1910), *aff'g* 170 F. 770 (1909).

typically avoidable only if the general creditors can prove the buyer paid too little. In only a few states does the *Boyd* principle live on.

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