Volume 42 | Issue 3 Article 13

April 1936

Private Corporations--Foreclosure of Corporate Trust Indenture--Power of Equity Court to Disregard Contract Rights of Majority Bondholders

sound, as the plaintiff apparently failed to establish the authority of the agent to waive the breach of the condition.[21]

The statutory form[22] of the standard fire policy avoids many of the difficulties of the above clause as it omits the word "void" and inserts the following clause:

> "This company shall not be liable for loss or damage occurring . . . . while there is kept, used or allowed on the described premises . . . . gasoline . . ."

The effect of the statutory form is to make the clause an exception rather than a condition, as in the instant case. Should the agent, after loss, attempt to waive this clause, an insured would have to prove not only the agent's authority, but also a valid supporting consideration, because such a waiver in effect would create an entirely new contract.[23]

PRIVATE CORPORATIONS — FORECLOSURE OF CORPORATE TRUST INDENTURE — POWER OF EQUITY COURT TO DISREGARD CONTRACT RIGHTS OF MAJORITY BONDHOLDERS. — Following default in payment of interest and principal by defendant theatre corporation, plaintiffs as trustees for a large bond issue sought foreclosure by a court of equity in accordance with the provisions of the trust indenture.[1] The amended bill prayed for a receivership and for

[21] Plaintiff's witness (defendant's secretary) testified without contradiction that the agent had no authority to bind the defendant in this manner. See *supra* n. 19.

[22] W. VA. REV. CODE (1931) c. 33, art. 4, § 7.

[23] McCoy v. N. W. Mut. Relief Ass'n, 92 Wis. 577, 66 N. W. 697, 47 L. R. A. 681 (1896).

[1] In the ordinary case of default in bonded indebtedness, the trustee for the bondholders usually institutes suit to foreclose the mortgage security. Thereafter, certain individuals offer themselves as a Protective Committee for the bondholders, this being arranged often by the debtor's bankers or by the issuing house. The Protective Committee then invites deposit of the bonds, by the bondholders, those depositing passing thereby to the committee legal title and complete authority to act in foreclosure proceedings. There is retained by the depositors simply equitable title, evidenced by the certificate of deposit issued by the committee. Frequently, nearly all bondholders in this fashion turn over their holdings: in any event, a decided majority can normally be obtained without much effort. Eventually, at the subsequent foreclosure sale, a representative of the Protective Committee bids in the property at the upset figure fixed by the equity court. While the old bonds can be applied partially on the purchase price, new money has to be raised by the committee to take care of expenses of the suit, (including fees for the trustee and counsel, and court costs), and to pay off in cash the non-assenting minority bondholders. Of course by assessment proportionately against the de-

discretionary sale by the trustee of the mortgage *res;* later, the trustees also sought to oust the defendant's lessee on the ground that advantageous sale or lease of the theatre property might be jeopardized by the tenant's connection with a large motion-picture producing concern. Meantime, a Protective Committee had been organized and was functioning, having procured deposits of roughly two-thirds of the outstanding bonds. In spite of the express provision of the trust deed that no one or more bondholders should have "any right in any manner whatever to affect, disturb or prejudice" the lien of the mortgage by any action, or "to enforce any right" thereunder, except in the manner therein provided, a group of minority bondholders sought to intervene independently in the foreclosure proceedings. By the express language of the corporate indenture, every effort had been undertaken to prevent such interference by the minority with the broad discretionary powers vested in the trustees. The dissentient group, which held bonds totalling in face value about one-sixth of the debt, interposed a claim that one of the plaintiffs was disqualified from acting as trustee, in that this plaintiff was serving as depositary for the Protective Committee:[2] accordingly, it was insisted that minority intervention was vitally necessary in order to afford the trial chancellor an impartial survey of "a dispute between two groups of bondholders". The petition for intervention was granted, and the intervenors made parties defendant; they then moved forthwith for immediate sale.[3] The equity court, both on the intervenors' motion and *sua sponte,* decreed sale and refused to terminate the existing tenancy. However, it did not act on the petition of the trustees formally raising the question of their right to demand

positing bondholders, the latter may acquire full ownership of the property for their own account. However, it is more likely that the Protective Committee will decide to secure the necessary funds from the junior obligation holders and from stockholders. Technically, these groups have been wiped out by the foreclosure, but the Protective Committee usually agrees to let them get back in "on the ground floor". A striking feature of corporate reorganizations is the alacrity with which the offer is accepted: the investor always returns to his investment, feeling perhaps that he ought to have just one more "go" at that particular enterprise. So the net result becomes a new corporation conducting the business, but with the old familiar faces predominating behind the capital investment.

The above procedure regularly employed in the past has now been supplemented by the corporation reorganization method set forth in Section 77B, of the amended federal bankruptcy law. But see *In re* Tennessee Pub. Co., 81 F. (2d) 463 (1936).

[2] The upper court held that the deposit agreement did not create any financial interest which might run counter to the plaintiff's duties as an impartial trustee.

credit or bonded indebtedness as against their bid, if they were to buy in at foreclosure sale. Plaintiffs appealed from the decrees as to immediate sale and as to continuation of the tenant's leasehold. The underlying issue was the extent of the chancellor's jurisdiction to decree relief, irrespective of the provisions of the trust indenture.[4] *Held,* that the contract rights of the parties should be effectuated, "in the absence of fraud or some other defined ground warranting equity interference." Decrees reversed. *Cleveland Trust Co. v. Capitol Theater Co.*[5]

An important jurisdictional question met with at the start has to do with the authority of the trial court even to entertain such a foreclosure suit, in the light of the existing statutory procedure for sale by trustees under a trust deed.[6] It seems clear that the statute simply provides means for relieving courts from congestion where an adequate remedy can be made available without resort to the equity side; obviously, the complicated corporate bond issue should not be disposed of by so drastic a method. The present decision has inferentially established the jurisdiction of a West Virginia chancellor to handle corporate reorganizations, where the powers of the trustee under an intricate and involved instrument[7] cannot properly be exercised.[8] The doctrine of this sound holding seems sufficiently comprehensive to cover any state court receiver-

[3] The Protective Committee desired that foreclosure sale be deferred until contact had been made with all bondholders, — and until a satisfactory reorganization plan had been approved not only by the bondholders but, as well, by the Securities and Exchange Commission, in Washington. The plaintiff trustees, believing such procedure desirable and beneficial to everyone alike, urged on the court the advantage of temporary delay.

[4] It is to be noted that the corporate reorganization had barely been begun in the principal case. While the foreclosure suit was in progress, and the Protective Committee had been set up and was functioning, nevertheless the whole issue of sale procedure was in dispute. The question of postponement had to be disposed of before the majority group could formulate their plan for buying in the property. Next, the extent of their privilege of paying the purchase price with bonds would eventually have to be ascertained. Finally, the details of recapitalization should presumably require approval by the appropriate authority.

[5] 183 S. E. 457 (W. Va. 1936).

[6] W. VA. REV. CODE (1931) c. 38, art. 1, § 2. By letter addressed to counsel in the case at bar by the Clerk of the Supreme Court of Appeals, the views of counsel were specifically requested by that Court on the broad issue:

"If the instrument securing the bonds is a Deed of Trust with full powers in the Trustees, why Equity?"

[7] Hanna & Lightner v. Galford, 55 W. Va. 160, 47 S. E. 359 (1905); Elder v. Gibson, 109 W. Va. 582, 155 S. E. 662 (1930).

[8] George, Trustee v. Zinn, 57 W. Va. 15, 49 S. E. 904 (1905); Mankin v. Dickinson, 76 W. Va. 128, 85 S. E. 74 (1915); Downes v. Long Lumber Co., 99 W. Va. 267, 128 S. E. 385 (1925); Finnell v. Jordan, 102 W. Va. 339, 135 S. E. 179 (1926).

ship proceeding following a mortgage default, where the parties desire to avoid the 77B federal bankruptcy reorganization.

The problem presented by the minority bondholders' petition seeking intervention is much more difficult.[9] The essential principle is well-settled in the ordinary situation where litigants attempt to intervene: they must show an interest not represented fairly by a party already before the court. In order that complete justice be done, equity will normally admit such intervenors; otherwise, it might appear inequitable to deny an interested party a hearing on some theory of virtual representation.[10] The trial chancellor here ignored the provisions of the indenture seeking to burke minority intervention, thus indicating that the right to their day in court could hardly be contracted away. The language of the upper court is not altogether precise on this point.[11] Arguably, the lower court erred in not excluding the minority altogether, in accordance with the express stipulations of the mortgage; in other words, the right to intervene had been voluntarily relinquished. Nevertheless, equity courts are as a rule so reluctant to refuse intervention that the instant case should scarcely be deemed a binding precedent. Clearer *dicta* should be necessary before the profession can safely assume that the chancellor will enforce to the letter an agreement not to intervene.[12]

Once the court had assumed jurisdiction of the subject-matter of the suit, the decree for the sale of the property should *prima facie* have complied, under the authorities, with the terms of the indenture.[13] The vital issue in the case, — and the one which

---

[9] See Moore and Levi, *Federal Intervention, I. The Right to Intervene and Reorganization* (1936) 45 YALE L. J. 565, at 603.

[10] Fowler v. Lewis's Adm'r, 36 W. Va. 112, 14 S. E. 447 (1892); Freeman v. Egnor, 72 W. Va. 830, 79 S. E. 824 (1912); Cassady v. Cassady, 74 W. Va. 53, 18 S. E. 829 (1914); Robertson Grocery Co. v. Kinser, 93 W. Va. 172, 116 S. E. 141 (1923); Lynch v. Armstrong, 99 W. Va. 609, 130 S. E. 268 (1925); Stevenson v. Machine Co., 103 W. Va. 120, 136 S. E. 695 (1927); Conley v. International Pump Co., 237 Fed. 286 (1915); Guaranty Trust Co. of N. Y. v. Chicago, M. & St. P. Ry. Co., 15 F. (2d) 434 (1926); CLEPHANE, EQUITY PLEADING (1926) § 31. *Cf.* Fed. Eq. Rules § 37.

[11] ". . . . The above quoted provisions of the instrument indicate the pains exerted in the preparation of the trust *to prevent interference with the trustees by minority bondholders*. . . . . In the absence of fraud or other misconduct on their part, the trustees are entitled to proceed *in reasonable compliance with the terms of the trust*. . . . . ." (Italics supplied). (183 S. E. 457, 460).

[12] The writer believes (a) the upper court did not hold squarely against minority intervention, and (b) the trial chancellor did not abuse his discretion in permitting such intervention despite the trust provisions.

[13] Crumlish v. Railroad Co., 32 W. Va. 244, 9 S. E. 180 (1889); Atkinson v. Beckett, 34 W. Va. 584, 12 S. E. 717 (1890); George, Trustee v. Zinn, *supra* n. 8, at 25, 26; Copelan v. Sohn, 75 W. Va. 83, 82 S. E. 1016 (1914);

concerns most of those who have to do with corporate reorganization practice, — is the extent to which the trial court may disregard the express arrangement between the parties, in order to achieve complete fairness in the result. Conversely stated, the point in dispute is whether the chancellor's discretion may be controlled wholly by a contract of adhesion, — a contract in which the terms are usually phrased in accordance with a form prescribed by the issuers, to which terms the minority bondholder may "adhere" if he chooses to invest in the particular issue, but which terms he cannot change by any process of bargaining at arm's length.[14] No doubt historically the flexible jurisdiction of equity, viewing each case on its facts and bound by precedent only where principle was concerned, once actively bestirred itself to remold contracts in order to avert hardship. Indeed, the underlying test was originally one of fairness, — no hard bargain could survive the chancellor's decree.[15] During the last century, the concept of freedom of contract became paramount in the common law.[16] In this modern period of the decadence of equity,[17] it has been the practice to look first to the contract of the parties, and secondarily to the defined ground for equity intervention. Normally, in the absence of fraud or mistake, the agreement made is thus enforced, no matter how unfair its terms may prove to be. To-day, considerations of hardship often play little part in cases where "equity follows the law"; it is frequently unnecessary that one who seeks equity should do equity.[18] Accordingly, in the present litigation,

---

Wytheville Ice Co. v. Frick, 96 Va. 141, 30 S. E. 491 (1898); New York L. Ins. Co. v. Kennedy, 146 Va. 197, 135 S. E. 882 (1926).

[14] *Cf.* the opinion of the upper court as to this: ". . . . All purchasers of the bonds bought in the light of those emphatic stipulations. By becoming purchasers, they voluntarily subscribed to the terms of the instrument. . . ." (183 S. E. 457, 460). Yet express provisions in other contracts of adhesion, (such as insurance policies), do not necessarily control the court. "Thus, to hold an insured strictly to terms in the choosing of which he had no part, and the meaning of which he often cannot understand, would often work gross injustice which the courts are loth to inflict." VANCE, INSURANCE (2d ed. 1930) 201. Perhaps the difference lies in the fact that America has not yet become a nation of investors, as it is already one of insurance policyholders.

[15] *Cf.* "Laws covet to be ruled by equity." ST. GERMAIN, DOCTOR AND STUDENT (1518) (18th ed. 1815) Dial. I, c. XVI, 45.

[16] "To permit parties to enter into contracts, obtain their benefit, and then to repudiate any obligations undertaken is *prima facie*, at all events, contrary to the interests and well-being of any society." *Per* Jessell, M. R., in Printing, *etc.*, Co. v. Sampson, L. R. 19 Eq. 462, 465 (1875).

[17] See Pound, *The Decadence of Equity* (1905) 5 COL. L. REV. 20.

[18] The outstanding authority to this effect is naturally Graf v. Hope Bldg. Corp., 254 N. Y. 1, 171 N. E. 884 (1930), cited by the court in the principal case (183 S. E. 457, 459). The Graf case is noted *inter alia* in (1930) 30

the decision merely proceeded in accordance with current judicial thought in holding that "courts of equity are not vested with unlimited authority to disturb rights of contract." The trial chancellor was reversed, in so far as the traditional power of equity had permitted the decree for immediate sale.[19]

There is no absolute standard by which one can criticize such a holding that the provisions of the deed of trust must govern in foreclosure proceedings, on the issue as to whether the discretion is to be in the trustees or in the chancellor. Certainly, the question is one of policy. In exceptional cases, equity has indeed modified contractual rights. For example, equity will allow delay of sale under a deed of trust where prior judgment liens are concerned and it is necessary to resort to equity to enforce these liens. There the sale is said to be according to the rules of equity, without regard to the provisions of the trust instrument.[20] A similar result has been reached where the amount of the debt secured by the trust deed is uncertain, and yet to be determined,[21] — or when it is shown that the sale would be against good conscience, or that particular circumstances, extrinsic to the instrument, would render enforcement inequitable and work irreparable injury.[22] Had it been conclusively shown here that to follow the terms of the trust deed as to sale would have led to an inequitable result inuring to the bondholders, the court should have been allowed to interfere with the terms of the trust deed, and to decree sale. After all, it is more than likely the reviewing court felt on these facts that the minority intervenors had failed to make out their case.

COL. L. REV. 1064; (1931) 16 CORN. L. Q. 106; (1931) 29 MICH. L. REV. 380; (1931) 79 U. PA. L. REV. 229; (1931) 17 VA. L. REV. 80, and in (1931) 40 YALE L. J. 141.

[19] *Cf.* on the general problem of the power of a court of equity, Note (1930) 44 HARV. L. REV. 92.

[20] Barbour v. Tompkins, 31 W. Va. 410, 7 S. E. 1 (1888); Hart v. Larkin, 66 W. Va. 227, 66 S. E. 331 (1909).

[21] Marshall v. Porter, 71 W. Va. 330, 331, 76 S. E. 653, 654 (1912); McGraw v. Morgan, 85 W. Va. 257, 101 S. E. 463 (1919); Fine v. Zirkle, 88 W. Va. 265, 106 S. E. 631 (1921).

[22] Tooke v. Newman, 75 Ill. 215 (1874); Gato v. Christian, 112 Me. 427, 92 Atl. 489 (1914); American House Hotel Co. v. Hemenway, 237 Mass. 180, 129 N. E. 371 (1921); McCombs v. Elmes, 197 Mass. 19, 83 N. E. 306 (1907); Case v. O'Brien, 66 Mich. 289, 33 N. W. 405 (1887); Leak v. Armfield, 187 N. C. 625, 122 S. E. 393 (1924). See Mayor, *etc.* of City of Baltimore v. United Ry. & Electric Co., 108 Md. 64, 69 Atl. 436 (1908); City of Detroit v. Detroit United Ry., 226 Mich. 354, 197 N. W. 697 (1924); Norfolk Southern Ry. Co. v. Guaranty Trust Co., 13 F. (2d) 979 (1926); N. J. Nat. Bank & Trust Co. v. Lincoln Mortgage & T. G. Co., 105 N. J. Eq. 557, 148 Atl. 713 (1930); New York State Rys. v. Security Trust Co., 135 Misc. Rep. 456, 238 N. Y. S. 354 (1929).

In other words, there had been no showing of extreme hardship to the minority if the sale were *reasonably* deferred: the "equities" of the litigation appeared to be with the trustees. Viewed thus, the syllabus may seem broader than the record in this litigation actually requires. Certainly it is unlikely that the informed discretion of the chancellor in corporation reorganization work may be *wholly* excluded by a myriad of paragraphs in the indenture.

The present decision accordingly is one of considerable import for corporate bondholders. It has settled the issue of foreclosure jurisdiction, and has indicated that a very strong showing must be made before the terms of the bond issue may be disregarded wholly. Thus the court has upheld an authority in the majority bondholders, controlling the discretion of the trustees, where so stipulated. Perhaps, a more definite ruling may soon be had on the privilege of the minority to intervene in every case, agreements to the contrary notwithstanding.

QUASI-CONTRACTS — RECOVERY FOR MISTAKE OF LAW — SETTLEMENT OF DISPUTED CLAIM. — At a prior time, action had been begun against the present plaintiff, as receiver of an insolvent bank, to compel him to pay over the entire depositor's claim of a county. Believing that the county had priority over general creditors by virtue of an earlier decision[1] and at the direction of the commissioner of banking, plaintiff paid the claim in full. Subsequently, the Supreme Court of Appeals held that a county was not entitled on these facts to preference over general creditors.[2] Plaintiff then sued to recover the overpayment on the ground of mistake of law. *Held,* that there can be no recovery. *Finnell v. Peoples Bank of Keyser.*[3]

The doctrine that money paid under a mistake of law cannot be recovered is almost universally recognized.[4] Before the nine-

[1] Woodyard v. Sayre, 90 W. Va. 295, 110 S. E. 689, 24 A. L. R. 1497 (1922).
[2] Calhoun County Court v. Mathews, 99 W. Va. 483, 129 S. E. 399, 52 A. L. R. 751 (1925).
[3] 182 S. E. 888 (W. Va. 1935).
[4] Bilbie v. Lumley, 2 East 469 (1802); Gaffney v. Stowers, 73 W. Va. 420, 80 S. E. 401 (1913); Shriver v. Garrison, 30 W. Va. 456, 4 S. E. 660 (1887); Beard v. Beard, 25 W. Va. 486, 52 Am. Rep. 219 (1885): Haigh v. United States Bldg. *etc.* Ass'n, 19 W. Va. 792 (1882); Mayor of Richmond v. Judah, 5 Leigh 305 (Va. 1834); *Cf.* Burgess v. City of Cameron, 113 W. Va. 127, 166 S. E. 113 (1932); and for a compilation of cases with annotations, see (1911) 19 Ann. Cas. 794; (1926) 42 A. L. R. 305; (1927) 48 A. L. R. 1381; (1928) 53 A. L. R. 949; (1929) 63 A. L. R. 1346; (1931) 75 A. L. R. 658;