Case No. 4,679.

FARRAR, v. WALKER et al.

{13 N. B. R. 82:[1] 3 Dill. 506, note; 1 N. Y. Wkly. Dig. 229; 2 Cent. Law J. 670.}

Circuit Court, E. D. Missouri. Oct. 15, 1875.

CORPORATIONS—CONTRACT FOR THE PURCHASE OF STOCK—FRAUDULENT REPRESENTATIONS—NOTE GIVEN FOR STOCK HELD AS ASSET OF CORPORATION FOR TWO YEARS—LACHES.

1. A contract to take stock in a corporation, induced by fraudulent representations on the part of the directors and officers of the corporation, is not void, but only voidable at the option of the stockholder.

{Cited in Florida Land & Imp. Co. v. Merrill, 2 C. C. A. 629, 52 Fed. 80; Merrill v. Florida Land & Imp. Co., 8 C. C. A. 444, 60 Fed. 21.}

2. Where a person was induced by the false and fraudulent representations of the directors and officers of a corporation to take stock in the corporation two years before its bankruptcy, for which he gave in payment his note secured by deed of trust on real estate, and during that period made no inquiry as to the true condition of the corporation, but suffered his note to be held out to the public as an asset of the corporation—the lapse is too long to allow the fraud to be pleaded against the creditors of the corporation, as represented by the assignee in bankruptcy, in avoidance of the obligation expressed in the note.

{Cited in Hurd v. Kelly, 78 N. Y. 597; Best v. Thiel, 79 N. Y. 18.}

Appeal from the United States district court for the eastern district of Missouri.

John Farrar, the complainant and appellant herein, brought his bill in the district court to enjoin the defendants {William R. Walker and Joseph T. Reister}, who are respectively the assignee in bankruptcy of the North Missouri Insurance Company, and the trustee in the deed of trust hereinafter mentioned, from selling certain realty described in the bill, and to have a certain deed of trust executed by the complainant, on said realty, for the purpose of securing his note for one thousand dollars, canceled and set aside. Said note and deed of trust were executed and delivered on the 30th of December, 1871, by complainant to said insurance company, which was a joint-stock corporation, in payment of the price of the shares of the capital stock of that company, each of the par value of one hundred dollars, which complainant at that time purchased of said company. The company was, on the 8th of November, 1873, adjudged bankrupt upon a creditor's petition filed on the 2d of October, 1873. The claim for the relief sought by the complainant was based on two grounds, viz.: First. On the ground of false and fraudulent representations concerning the financial condition of the company, alleged to have been made by the directors, officers, and agents of the company, at and before the time when said note and deed of trust were given, whereby complainant was induced to take stock in said company, and to give the note and deed of trust aforesaid in exchange therefor, and subsequentfalse and fraudulent representations made by said directors, etc., whereby complainant continued to be deceived as to the true character and financial condition of the company; and Second.

On the ground that complainant received no certificate of stock, and that, consequently, the consideration for the note and deed of trust fell. To complainant's bill, defendants interposed a demurrer, which the court below sustained, and a decree was entered dismissing the bill. [Case unreported.] From this decree complainant appealed to this court.

On the part of complainant the following points were made: 1. Fraudulent representations made by the authorized agents of a corporation, and by the company, in regard to material matters, constitute a good defense to an action for the subscription to stock made on the faith of such representations. Waldo v. Chicago, St. P. & F. du L. R. Co., 14 Wis. 575; Crump v. United States Min. Co., 7 Grat. 352; Wert v. Crawfordsville & A. T. Co., 19 Ind. 242; Crossman v. Penrose Ferry Bridge Co., 26 Pa. St. 69; Custar v. Titusville Gas & W. Co., 63 Pa. St. 381; Cunningham v. Edgefield & K. R. Co., 2 Head, 23; Sandford v. Handy, 23 Wend. 260. 2. The questions, of negligence or estoppel by some act of subscribers, have frequently been decided by the courts, and generally it is some extraneous circumstance showing acquiescence in the fraud, or a long lapse of time where the rights of others have intervened, which governs the cases where the contrary doctrine is laid down. Most of defendants' authorities are of these classes. 3. The question of completion of the contract in the bill is stated as follows: "That the

company refused to deliver the stock to complainant, and never did complete the contract on their part." The assignee seeks to hold the complainant to a contract never executed by the company. If the company was still doing business, complainant might compel the issue of the stock, but the assignee cannot issue it Complainant received no value or consideration for his money, and in equity ought not to be held to pay. Ang. & A. Corp. § 564. 4. The company could only contract by its president and secretary. 1 Wag. St. 764, §§ 21, 22. Therefore it could not be held on this contract at law. A bill in equity would have to be filed by complainant to get his stock. There is no mutuality of contract here, and complainant had a right to rescind. 5. There are cases where it has been held that absence of a stock certificate does not affect the stockholder's right to his stock, but the reason given is that the issue can be compelled. Not so in this case. 6. If complainant was guilty of laches, and for that reason ought to pay, it should be set up in an answer, so that a reply might be had. The bill on its face does not show laches. Therefore the demurrer should nave been overruled. 7. The assignee takes the bankrupt's estate with its burdens, and can enforce no contract that the company could not enforce, unless there are circumstances which estop complainant from setting up the fraud, such as laches, lapse of time, acquiescence or participation in the organization or transactions of the company after knowing the fraud. No such state, of facts exists in this case, so far as the record shows. 3 Ves. 288; 12 Ves. 349.

For the defendants it was urged: 1. The contract between complainant and the company to take stock, was not void by reason of the fraud alleged, but voidable only at the option of the party defrauded. Oakes v. Turquand, L. R. 2 H. L. 325, 344, in cases there decided; Reese River S. M. Co. v. Smith, L. R. 4 H. L. 64, 2 Ch. App. 604; Upton v. Englehart [Case No. 16,800]; Clarke v. Dickson, El., Bl. & El. 148, and cases there cited. 2. The bill not showing any disaffirmance prior to the company's bankruptcy of the contract to take stock, and not showing that complainant used reasonable diligence in discovering the alleged fraud, or made any inquiry whatever as to the truth of the alleged representations, or that he was not otherwise guilty of laches, said contract cannot be avoided as against the company's creditors. Upton v. Englehart supra, and cases there cited; Upton v. Hansbrough [Case No. 16,801]; Clarke v. Dickson, supra. 3. The alleged misrepresentations, although they might constitute a good defense as against the company itself, constitute no defense as against the creditors of the company, represented by its assignee in bankruptcy. Ogilvie v. Knox Ins. Co., 22 How. [63 U. S.] 380; Upton v. Hansbrough, supra; Oakes v. Turquand, supra; Clarke v. Dickson,

supra. 4. It is not essential, in order to constitute a person a stockholder in a joint-stock corporation, that a certificate should be issued to him. Agricultural Bank v. Burr, 24 Me. 256; Same v. Wilson, Id. 273; Ellis v. Essex Merrimack Bridge, 19 Mass. [2 Pick.] 243; Chester Glass Co. v. Dewey, 16 Mass. 94; Hoagland v. Bell, 36 Barb. 57; Thorp v.

Woodhull, 1 Sandf. Ch. 411; Commercial Bank v. Kortright 22 Wend. 348; Ang. & A. Corp. (9th Ed.) 563, 564. In the course of the argument the court expressed the opinion that the want of a certificate of stock was immaterial.

Henderson & Shields, for complainant.

Wm. R. Walker, for defendants.

MILLER, Circuit Justice. This is a suit brought by the plaintiff, who was a stockholder in the North Missouri Insurance Company, to get rid of the payment of a note for one thousand dollars, which he had given in the purchase of stock. Mr. Farrar took stock in the company, and gave this note in payment for that stock, secured by deed of trust on real estate. Two years after the giving of the note, the North Missouri Insurance Company failed, and was put in bankruptcy, and Mr. Walker was appointed assignee of the company, and being about to enforce that obligation for the benefit of the creditors, Mr. Farrar files his bill in the district court in chancery, seeking to enjoin the sale of the mortgaged property, or rather the property conveyed by the deed of trust, which was about to be foreclosed. In that way he brings the proceeding into court to declare the note null and void, and he makes on his bill undoubtedly a case of fraudulent conduct on the part of the board of directors, or the officers of the insurance company—the whole of them—in publishing and representing to him very fraudulently and very falsely, that the insurance company was on its feet, in a prosperous condition; had a large amount of valuable assets beyond its liabilities, and that it was a good thing to take its stock; whereas he alleges that was false, and that the company was then insolvent, that these men knew it and that he was defrauded in becoming a stockholder. We may say at the beginning, and the authorities on this point are clear, that if the corporation was still in existence, and was solvent and doing business, and suit was brought upon that instrument Mr. Farrar could have pleaded these things in avoidance of that conveyance, and they could not have enforced it against him. But things are changed; the corporation has become bankrupt; it has no interest whatever in this conveyance, because, whether enforced or not, the corporation is dead, will not exist as an entity again, and will never receive a dollar of this money. It is now a question between the creditors of that corporation who are represented by Mr. Walker, the assignee, and a

stockholder, who is indebted to the corporation for its stock, and while my first impressions were pretty strong against the idea that this liability could be enforced under such circumstances, and I was very much inclined to overrule the demurrer, and require the parties to answer and let all the facts be shown on a final hearing, due consideration has changed my mind on the subject, and compels me to the conclusion that the bill must be dismissed, and that is this: That the paper, as it stands, admitting the fraud and everything, is not of that class of paper which is absolutely void, but is a paper, or contract, or obligation, which was voidable at the option of Mr. Farrar. He could, notwithstanding the fraud, hold on to the stock and take the chances of its becoming valuable; or he could say, if he chose, "I don't think it is worth the trouble to go into a fight to avoid this obligation." In other words, it was his option to avoid that contract or stand by its legal results, and if this failure had occurred within two, three, or even four months after he took the stock and became a stockholder in the company, I should be inclined to say that he had not had a reasonable time in which to examine into the affairs of the company, and see whether he had been defrauded; and that he had still remaining his option, even after the bankruptcy of the company and the appointment of an assignee, to move to set aside that conveyance, if he could show that it was fraudulent. But the business of these corporations is so managed in this country, that justice requires, at all events, that if one of its stockholders should make this paper and obligation, secured by real estate, which goes into the hands of the officers as so much assets of the corporation, and is paraded before the public as an asset, and he stands up for two years and lets that note and obligation of his, secured by real estate, be counted every year, or in every semi-annual statement that is made to the public, as so much cash, which the creditors of that company may look to to cover their losses—then it is too late, the lapse is too long to allow the fraud to be pleaded. Mr. Farrar was for two years a stockholder in that corporation; he had a right to access to all its books, and to vote for its directors; it was his duty to interest himself in its management so far as to see that what it said was true; that its directors were honest; that he should use his influence to get honest men in, and yet during these two years he stands up and does nothing, makes no inquiry, no investigation. It is too late when the creditors pursue the corporation into bankruptcy, and the assignee pursues him for his note, to turn around and say, "I find out that I was swindled; I was there two years and I might have found it out and not let everybody trade on my note deposited there, but I was cheated, and I now rescind this contract." On that ground alone the bill comes too late, and the demurrer to the bill was properly sustained in the district court.

The judgment of the district court is affirmed.

[1] [Reprinted from 13 N. B. R. 82, by permission.]