

Case No. 7,178. JAMES V. ATLANTIC DELAINE CO. ET AL.  
[3 Cliff. 622.]<sup>1</sup>

Circuit Court, D. Rhode Island.

June Term, 1873.<sup>2</sup>

INSOLVENCY—ASSIGNOR AND ASSIGNEE—EXTINGUISHMENT OF  
DEBTS—RIGHTS OF ASSIGNOR—FRAUDULENT  
MISREPRESENTATIONS—EXECUTION OF RELEASE BY ASSIGNEE.

1. The complainant agreed with certain firms to construct and put in operation a factory. To obtain and secure a loan of money from these firms, he executed a mortgage, with power of sale for breach of condition, to the treasurer of the company, as trustee for the corporation, upon all his stock and interest in the company. He also executed to the same firm, as trustee of the lenders of the credit, separate mortgages of the same kind upon his homestead and farm, together with other property. Subsequently failing, he made an assignment of his property. By the terms of the assignment the liability to the company was made a charge upon the assets named in the assignment, with directions to the assignee to apply all the assigned estate, as he could, to the fulfilment of the contract of the assignor for the building and equipment of the mill. The assignee made an arrangement with the company to furnish the money to forward the contract of the assignor, and charge the same to the assets in his hands. Under this arrangement the factory was completed. The assignor continuing embarrassed, the trustee was directed to advertise the properties for sale. The assignee failing to raise the amount necessary to meet the assignor's liabilities, wrote to the treasurer of the company demanding a statement of the condition of the company, so that he could represent the assignor's stock in its true light and sell it for its true value. The trustee stated that such an account could not be given, and the assignee then obtained an injunction restraining the proposed sale of the stocks until the further order of the court. Certain of the mortgagor's creditors tendered to the company the amount of the mortgage debt which the company refused to accept, and the court passed an order enjoining the sale unless the trustee would file a stipulation not to enforce the mortgage against property subject to the lien of the complainant in that suit. Two suits were pending to redeem the properties mortgaged, and the order restraining the sale of the stock was in force when the sale of the homestead took place. On that day the trustee sent to the assignee a paper described as a statement of the company's affairs. He afterwards on oath acknowledged that it was transcribed from a private memorandum kept by him, and it nowhere appeared on the company's books. *Held:* That being furnished as a copy from the company's books, it must be assumed that the assignee received it as an official account and gave it full credence as furnished by the company's officers.
2. The alleged statement was not only false, but furnished with intent to deceive and defraud by promoting a settlement prejudicial to the mortgagor and more favorable to the company than truth and justice would admit. In such case the assignor is entitled to take the residue of the estate after his debts outstanding at the date of the assignment are paid.

[See note at end of case.]

3. By the extinguishment of the debts the assignee became the trustee of the assignor, and the latter clothed with all the rights of cestui que trust to the same extent as the creditors previously had been whose debts he had extinguished; and consequently the complainant could come into a court of equity and pursue the trust estate, it having been fraudulently or improperly parted with by the trustee, and under the decretal order the complainant was entitled to redeem the mort-

gaged property just as her intestate might have done, if the settlement and release had never been executed.

4. This case was twice referred to a master, but inasmuch as the exceptions which accompanied the respective reports made it necessary, if attempting to decide the case at this stage, for the court to adjudicate the whole controversy as if no reference had been made, the court again sent the whole case to the master with specific instructions for a statement of the accounts between the parties.

{See note at end of case.}

Exceptions to master's report recommitted, supplemental report and exceptions to supplemental reports.<sup>3</sup>

Certain mercantile firms, desirous of engaging in the manufacture of fabrics known as delaines, contracted with the original complainant to construct a factory for the purpose, and to put the same in operation, as he was known to possess great skill and experience in such enterprises, as well in the choice of sites and making the necessary erections, as in the selection of machinery and putting the same in operation. Five firms entered into an association for the purpose before they were incorporated, and to accomplish the object they agreed to create a stock of three hundred shares of \$1000 each; and it appeared that the complainant [Lucinda James] became the subscriber for one half the amount; and that they also contracted with him to build and equip the mill and put it in operation for the sum of \$260,000. He made that contract on the 1st Of January, 1851, prior to the passage of the act incorporating the company, which became a law at the next session of the legislature of the state, which convened in May following. Slight alterations were made in the contract by mutual consent subsequent to the act of incorporation, and on the 1st of August of the same year, the complainant associated with him his son-in-law as a contractor, and the incorporated company assumed the entire obligations of the contract as the other contracting party. Application was made at the same time by the complainant to the five firms whose members subscribed for the other half of the stock of the company, for a loan of 875,000, and it appears that they advanced him the amount for which he applied by signing accommodation notes and by accepting his drafts, and that he gave them satisfactory security for the loan in a mortgage executed to the treasurer of the company, as trustee for the corporation, which made the advances, including in the instrument all his interest in the stock and property of the company. He also executed to the same person, as trustee of the lenders of the credit, separate mortgages

of his homestead in the city of Providence, and of his farm in the town of Scituate, together with certain bonds and notes of a Western corporation. Though he obtained the pecuniary assistance for which he applied, yet it was not sufficient for the purpose, and on the 2d of September of the same year he failed in business, and made an assignment of all his property of every name and description to an assignee. His assets consisted of the several properties described in that mortgage, and of the other real and personal property, stock and promissory notes specified in the schedule annexed to the second deposition of the assignee, as exhibited in the record. By the terms of the instrument, he made his liability under the contract with the company for building and equipping the mill, a charge upon the assets specified in the assignment, and directed the assignee to apply all the assigned estate, as the same should come to his hands, to the fulfilment of that contract so far as the same was necessary to build and equip the mill and put the same in operation.

Due acceptance of the trust was made by the assignee; but he soon found that means to carry forward the work could not be raised fast enough by converting the assigned property into money; and to obviate that difficulty he made an arrangement with the company, through their treasurer, to supply the deficiency, and to charge the same to the assets in his hands. Advances were made by the treasurer under that arrangement, as claimed by the respondents, to the amount of \$53,314, and it appeared that the assignee completed and equipped the mill early in February, subsequent to his appointment, and that the mill with its machinery was delivered to the company in the course of that month. Success ultimately attended the enterprise; but the contractor, through whose skill and experience it was originated and put in operation, continued to be embarrassed, always claiming, however, that he would be able in time to meet his liabilities, and that the property mortgaged to the company would revert to him under circumstances which would enable him to save a large portion of his estate. Negotiations to that end were instituted early in that season, and were continued throughout the year, but they resulted in nothing of value to either party. Power to sell for breaches of condition was conferred upon the mortgagee or trustee in each of the mortgaged deeds, and it appeared that the person for whose benefit the respective mortgages were given directed the trustee to advertise the several properties for sale under that power, it being understood by the moving party that the mortgaged properties, other than the stock of the complainant in the company, should all be first sold and applied to discharge the mortgage debts. All of the advertisements bore date the 5th of February, but the respective sales were appointed for different days, the last of which, to wit, the sale of the homestead and of the stock held by the complainant in the company, for the 26th of that month, which was near the close of a short session of congress, and at a time when the assignor of the several properties was a senator in congress, and under the obligation of official duty to attend the daily sessions of the senate. Differences of opinion existed between the parties as to the amount due

from the mortgagor to the company, but it was known to the assignee that the sale of the Warwick farm and other collateral securities had reduced the original mortgage debt to \$52,000, and that he could have the contemplated sales postponed if he could raise that sum, as the disputed amounts were under arbitration; and if the corporation had any claim against him as assignee, they could enforce it by their charter lien, or in due course of legal proceedings. Efforts of various kinds were made to raise the necessary amount; but the assignee, finding it impossible to do so, in the absence of his assignor, on the 15th of February addressed a written communication to the treasurer of the company, and demanded "a statement of the condition, standing, and accounts of the company," so that he might be able to represent the stock advertised to be sold in its true light, "and make it sell for what it was worth."

Instead of complying with that demand, the trustee called upon the assignee to convince him that such an account could not be made at that time, and he professed to believe that the assignee was satisfied with his explanations; but it was evident that he was under a mistake, as it appeared that failing to obtain the required statement, he instituted a suit in equity in the state court against the trustee to enjoin the proposed sales of the several properties, and that the court, no satisfactory accounts having been rendered, enjoined the sale of the stock until the further order of the court. Proceedings to accomplish the same object were also instituted by certain creditors of the mortgagor having a lien upon the Scituate farm, in the course of which the creditors tendered to the company the amount of the mortgage debt, which the company refused to accept; and the court passed an order enjoining the sale, unless the trustee would file a stipulation not to enforce the mortgage against the property subject to the lien of the complainant in that suit. Efforts were made by the assignee to prevent the sale of the homestead, but without success, because it appeared that the sale was made at the time specified in the advertisement prepared and published by the trustee. Two days before the sale of the homestead, the assignee informed the mortgagor that he had succeeded in stopping the sale of the stocks, but that the application for an injunction as to the sale of the other properties had been denied; and it appeared that it was on the very day that the sale of

the homestead took place that he gave to his assignee a full description of the nature of the efforts he had made to prevent the consummation of that design. Such a statement as that demanded was not furnished during the controversy growing out of the application to enjoin the proposed sales, and the letter of the assignee addressed to the assignor on the day of the sale, furnished no evidence that negotiations were pending for a settlement, or for a transfer of the equities of redemption. Two suits were pending to redeem the properties mortgaged, and the order of the state court restraining the sale of the stock was in full force when the sale of the homestead took place. Both of these parties were in some respects the representatives of the original owner of the property, and as such were bound to good faith in their dealings with the same; but they were pursuing opposite aims, as the trustee was endeavoring to effect a sale of the mortgaged properties, and the assignee was exerting all his power to prevent the accomplishment of that object. Nothing occurred to change these relations prior to the sale of the homestead; but it appeared that the trustee on the same day addressed a letter to the assignee, enclosing a paper which he described "as a statement of the affairs of our company," without making any reference to the fact that the assignee had ten or twelve days before demanded of him a statement of the condition, standing, and accounts of the company, which he had neglected and refused to furnish. A similar request had previously been made and refused, and the charge was, that the statement as furnished was incorrect and untrue, and that it was so made and rendered with intent to deceive and defraud the assignee, and that the assignee was thereby deceived as to the true state of the accounts, and that he was thereby induced to entertain a proposition which resulted in a withdrawal of the injunction suit and in the execution of mutual releases between him as such assignee and the respondent corporation, in respect to the entire interest of the complainant in all the assigned and mortgaged property.

In a prior opinion in the same case, the court ordered a decree referring the same to a master. [Case No. 7,177.] By that order the court set aside the instrument of release and settlement executed by the assignee of the original complainant to the treasurer of the corporation respondents, and adjudged and decreed that the same were void, as having been obtained by the assignee by fraudulent representations and concealment. Such an adjudication entitling the complainant to relief, the court sent the cause to a master to take an account of all the dealings between the original complainant and his assignee and the respondent company or their treasurer, including an account of all assigned and mortgaged property held by the original complainant, and by him assigned and mortgaged to those parties, or which passed or came into the hands, possession, or control of the respondent company or their treasurer under the operation of the said instruments of settlement and release, and in any other manner subject to the payment of the debts, if any, due to the creditors of the original complainant, as secured by the instrument of assignment.

Pursuant to that decretal order, the master gave notice and heard the parties, and on the 10th of December, 1870, made his report to the court, annexed to which were the exceptions of the parties to the finding of the master; and the court, having heard the case upon the exceptions to the master's report, passed an order that the report be recommitted to the master with instructions that he append to it a supplemental report comprising two summary statements, showing, first, the result to which he came under the theory of accounting first adopted on motion of the complainant; secondly, showing the result to which he came under the second theory, which he adopted at the suggestion of the respondents, reserving the exceptions filed by each party, and giving to each party the right to except to the supplemental report.

Enough was done under that order to constitute, as the master supposed, a compliance with these instructions, and he accordingly, on the 20th of June, 1872, made a supplemental report which appeared in the record. Prior to the hearing upon the exceptions to the master's report, the respondents filed a petition for a rehearing of the case upon the merits, but they withdrew the same at the suggestion of the court that the application was premature when the hearing was asked upon the exceptions, it being understood that the withdrawal was without prejudice to the right to renew it at the proper time. On the 19th of August, 1872, the master filed his supplemental report, to which were annexed the exceptions of the respective parties; and on the 3d of September following the respondents filed their petition for leave to review the original decretal order. Sufficient appeared in the original record to satisfy the court that the exhibit made by the treasurer of the company to the assignee as the basis of the settlement between the parties was erroneous and false; and the court accordingly found that the settlement and release executed by the assignee of the original complainant were obtained by fraudulent representations and concealment.

Certain statements appeared in the original report of the master which tended to show that the court erred in that finding of fact. Such also were the views of the respondents; and it appeared that they, in pursuance thereof, on the 3d of September in the same year, renewed their application for a review of the original case, insisting that the decretal order was for the wrong

party; and it also appeared that the court, in view of the statements contained in the report of the master, tending to show that the court erred in the said finding, passed an order granting a rehearing "as to that fact," and gave leave to each party to take further proof on the question whether the statement of the accounts furnished by the treasurer of the corporation to the assignee, was or was not false, as found by the court. Proofs were taken by both parties under that order, and the cause, on the 23d of October following, came to hearing upon the proofs exhibited and the exceptions of the respective parties to the supplemental report of the master.

Jas. H. Parsons, Thos. A. Jenckes, and Caleb Cushing, for complainants.

A. Payne, R. W. Greene, and B. R. Curtis, for respondents.

Before CLIFFORD, Circuit Justice, and KNOWLES, District Judge.

CLIFFORD, Circuit Justice. Questions of considerable difficulty are presented in the case, which arise out of the application for a review, and others arise upon the exceptions filed by the respective parties both to the original and supplemental reports of the master, all of which are still open for consideration, as it was not intended that any of them, except the one withdrawn by the complainant, should be superseded by any subsequent order in the cause. Before attempting to examine the several exceptions to the master's report, it becomes necessary to decide whether the view of the court as embodied in the decretal order is correct, as that presents a preliminary question which, if decided in favor of the respondents, will terminate the controversy.

Coming to the application for review, the question is, whether the statement of the accounts furnished by the treasurer of the corporation to the assignee of the original complainant was or was not false, as found by the court in the opinion delivered at the time the decretal order was entered. Aid in solving the questions presented will be derived from a proper understanding of the exact relations which the parties sustained to each other in the original transactions, out of which the controversy has arisen; and for that purpose it will be necessary to refer very briefly to the original record, as those relations commenced in an enterprise which originated even before the respondent company was incorporated. (At this point the court recited the facts substantially as they appear in the statement.)

Facts and circumstances were introduced at the original hearing sufficient to satisfy the court that the charge made in the bill of complaint was true, and the court accordingly entered the decretal order, which is the subject of complaint in the application for a rehearing.

Having carefully weighed the facts and circumstances introduced in evidence, the court came to the conclusion that the release given by the assignee to the company was void, and adjudged and decreed that the same be set aside as having been obtained by fraudulent representations and concealments. Certain suggestions were made at the recent ar-

gument to the effect that the exhibit in question was not properly before the court at the final hearing, when the decretal order under revision was entered; but it cannot be necessary to consume time in discussing that proposition, as the record is full of evidence to refute it, and to show that both parties, as well as the court, treated it as a most material part of the proofs of the case. Undoubtedly it first came into the case as an exhibit to the deposition of the treasurer of the company, and it is equally true that certain portions of his deposition were excluded as unauthorized at that time by the acts of congress; but the record shows that the time for taking proofs was subsequently enlarged, which enabled the respondents to retake that deposition and some others which had been excluded under the same ruling, congress having in the mean time made parties competent witnesses in equity suits as well as in actions at law. Nor is there any doubt entertained that the decision was correct upon the evidence then before the court in entering the decretal order. Much discussion on that topic is unnecessary, as the proposition is scarcely denied.

Suppose that it is so, still it is insisted that the new evidence taken under the recent leave granted for that purpose is sufficient to show that the finding of the court was erroneous; but the court is not able to concur in that view. Instead of that the new evidence convinces the court that the original decision was correct, and that the release executed by the assignee was properly set aside, as having been obtained by fraudulent representations and concealment. Considerable embarrassment, it must be confessed, was experienced in conducting the original investigation, as the books of the company were not before the court; but the facts and circumstances adduced in evidence were amply sufficient to convince the court that the account exhibited was not an official account made by the company or by its managers, and that it was not an account copied from any official statement of the affairs of the company in respect to its dealings with the original complainant. All doubt upon the subject is now removed, as the party who furnished it to the assignee, as the basis of the settlement, confesses under oath that it was transcribed from a private memorandum kept by him, and that it nowhere appears on the books of the company as an exhibit of their affairs, which, of itself, in view of the circumstances attending the settlement and transfer, is sufficient to justify the finding of the court, as it falsely



purports to lie “a true copy from the books.” Reference to the charter will show that the annual meetings of the company were required to be held on the first Wednesday of February in each year, and the bylaws require that the directors at each annual meeting should give a summary account of their management to the company for the preceding year, and at all other times when required by the stockholders representing one third of the capital stock. Apart from that it was also made the duty of the treasurer to render to the directors semi-annually an account of the affairs of the company, and at all other times when required, and at each annual meeting to exhibit his account to the corporation. Inasmuch as this statement was furnished as a true copy from the books, it must be assumed that the assignee received it as an official account, made under the obligation of law and of the contract between the parties to which it related, and that he gave it full credence as an official exhibit made by the proper officers of the company in the performance of their appropriate duties.

Nothing of the kind, however, appears on any of the books, and the party who furnished it testifies under oath that “it came from my private letter book.” Items of large amount were included in the statement, which do not appear in the books at all, and some of those which do appear are erroneous in large amounts, as is evident from the proofs exhibited in the record, thus fully justifying the remark of the court in the former opinion that the statement was inaccurate in large amounts and greatly to the prejudice of the original complainant. Viewed in every aspect, it is the conclusion of the court, not only that it was false, but that it was furnished with the intent to deceive and defraud by promoting a settlement prejudicial to the original complainant and more favorable to the respondent corporation than truth and justice would admit.

In such a case the settled rule is, that the assignor is entitled to take the residue of the estate after his debts outstanding at the date of the assignment are paid. *Halsey v. Fairbanks* [Case No. 5,964]; *Brashear v. West*, 7 Pet. [32 U. S.] 608.

By the extinguishment of the debts the assignee became the trustee of the assignor, and the latter became clothed with all the rights and powers of a cestui que trust, to the same extent as the creditors previously had been whose claims he had extinguished. *Lazarus v. Commonwealth Ins. Co.*, 5 Pick. 81. Consequently the original complainant was the proper party to come into a court of equity and pursue the trust estate, it appearing that it had been fraudulently or improperly parted with by the trustee. *Story, Eq. Pl. § 221*; *Oliver v. Piatt*, 3 How. [44 U. S.] 400; *Lewin, Trusts*, 730; *Hovenden v. Annesley*, 2 Schoales & L. 633.

Tested by these considerations, the court is of the opinion that its finding as exhibited by the decretal order is correct, and that the original complainant was and is entitled to the relief therein adjudged and decreed. Renewed reference to the defences set up in the answer will not be necessary, as those matters were fully considered in the former opin-

ion, to which reference is made as expressive of the present conclusions of the court. The complainant being thus entitled to relief, the only remaining question of much importance is, what is the proper measure of that relief, which is a question of great difficulty and embarrassment.

Twice the court has referred the case to a master, with a view to solve the difficulty and to discover the true theory of doing justice between the parties without complete success, since the exceptions which accompany the respective reports make it necessary for the court to adjudicate the whole controversy to the same extent as if no reference had been made.

Separate examinations of the several exceptions under the circumstances will not be attempted, because it would extend the opinion to an unreasonable length without accomplishing anything of value to either party. Such an investigation would not serve any useful purpose, because neither the reports of the master, nor the exceptions, nor both combined, are of a character to enable the court to come to a satisfactory result without a further reference. Much has been accomplished by the master which will be of great value in the further investigation of the subject, and the criticism of the parties, exhibited in their exceptions, will also be of service in framing a new report; but the court is not able to deduce from the record in its present condition, without performing work which belongs to a master, such a result as the court is prepared to adopt as the final decree in the case.

Governed by these considerations, the court will send the whole case to the master, with more specific instructions for a new report, and for a statement of the accounts between the parties in respect to the mortgage debt. Under the decretal order the complainant is entitled to redeem the mortgaged property just as her intestate might have done if the settlement and release mentioned in the decretal order had never been executed. The release and settlement having been set aside, because obtained by fraudulent representations and concealment, it is clear that the complainant is entitled to have an account against the respondents as against mortgagees wrongfully in possession, including the net and annual profits of the property without being accountable for the losses of subsequent years. All sums due to the mortgagee will first be charged to the mortgaged estate, as ascertained from the agreements and actual dealings of the parties, whether advanced to the actual mortgagor or his assignee. Having ascertained

the unpaid balance of the mortgage debt including interest to the present time, the master will next proceed to take an account of the net earnings of the mortgaged property, as against a mortgagee wrongfully in possession, deducting insurance, taxes, repairs, including ordinary improvements such as relate to the operative machinery and the motive power of the mill, and including all the net earnings subject to those deductions, whether actually declared as dividends or not, and however the same may have been expended or appropriated. Earnings of one year are not to be set off by the losses of a subsequent year, as the respondents are to be treated as mortgagees wrongfully in possession, but in ascertaining the earnings of a particular year, the losses of that year are to be deducted from the gross earnings in order to ascertain the net earnings of the year, as well as the cost of insurance, taxes, repairs, ordinary improvements, running expenses, and commissions. Shares of the stock paid, the complainant is entitled to recover in specie, but the complainant is not entitled to recover the thirty-seven shares never paid, as it cannot be said that those shares are wrongfully in the possession of the respondents. Nothing having been paid for the same, the court is of the opinion that no recovery can be had on account of those shares.

Estimates of earnings will be made on the basis of the shares paid, without including those not paid, and the master, on stating the accounts, will be governed by the principles herein laid down, and will deduct the amount of the unpaid mortgage debt from the amount of the earnings of the mortgaged property, adjusting interest to the present time, and state the exact amount which the complainant is entitled to recover. Interest upon the total amount of profits earned prior to the date of the decretal order, will be computed from the date of that order to the completion of the report of the master. Profits earned subsequently to the date of the decretal order will only bear interest from the close of the last year included in that computation. Power is vested in the master to call for new accounts, and to hear the parties further if necessary, to enable him to state the account as required, and he will submit his draft report to them, as required by the rules.

[NOTE. The defendants then appealed to the supreme court, where the decree was reversed, and the bill dismissed, in an opinion by Mr. Justice Strong, who said that canceling an executed contract is an exertion of the most extraordinary power of a court of equity. Such power should never be exercised except in a very clear case. When false representations are alleged, their falsity must be certainly proved, and it must be shown that the complainant has been deceived and injured by them. The fundamental averment of fraud in this case is not sustained by proof, and, moreover, the bill was not filed until nearly six years had elapsed. Air. Justice Clifford dissented. 94 U. S. 207.]

<sup>1</sup> [Reported by William Henry Clifford, Esq., and here reprinted by permission.]

<sup>2</sup> [Reversed in 94 U. S. 207.]

<sup>3</sup> The first opinion delivered in this case by Judge Clifford may be found [Case No. 7,177].