

bill does not disclose how the trustee, under the circumstances, by defending the action, could have realized anything for the bondholders. It is alleged also that the defendant mismanaged the foreclosure proceedings, but the facts are entirely insufficient to warrant the deduction. Not a single fact is alleged in reference to the conduct of the foreclosure suit which is not consistent with the hypothesis that the trustee did its whole duty, notwithstanding the small amount realized at the sale. The averments about the bid of Zephin Job do not show that he was responsible to the amount of the bid, or that it was not for the interests of the bondholders that the bid be set aside, as was done by the order of the court. The substantial cause of action upon the facts set forth is found in the breach of duty by the trustee in certifying and delivering the bonds to the Oregon Company without proper evidence of the purpose of that company to use the proceeds, as by its promises it was required to do.

The same disposition will be made of the several demurrers as was made in the Frishmuth Case, except as to the second, which alleges a defect of parties complainant. The present bill is brought in behalf of all bondholders who choose to join the complainant, and that demurrer is overruled.

Ordered accordingly.

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MORRIS et al. v. EAST SIDE RY. CO. et al.

MAXWELL v. SAME.

(Circuit Court, D. Oregon. June 24, 1899.)

**PLEDGES—COLLUSIVE SALE OF COLLATERAL—RIGHTS OF PURCHASER.**

An issue of \$300,000 of bonds of a street-railway company were pledged to a bank to secure notes for \$163,000, the loan being, in effect, made to the company. After maturity, and pending the foreclosure of a second mortgage given by the company, the bank transferred the notes and collateral to a second party, who at once advertised and sold the bonds under the terms of the pledge. They were purchased for \$173,000, which was less than the amount of the debt, of which the purchaser paid down \$10,000, borrowing the amount necessary to complete the payment on the next day and a day or two later, in accordance with a prior arrangement, borrowing the money to repay such loan from the bank which was the original pledgee on a rehypothecation of the bonds. *Held*, that the circumstances of the entire transaction indicated that it was not the purpose of the bank, by the sale of the collateral, to realize its debt, but that such sale was contrived to obtain the title of the pledgor to the bonds at a sacrifice for the benefit of either the bank or the purchaser, and in either case the holder would be permitted to enforce them, as against the company or its creditors, only to the extent of the debt secured.

These are suits in equity to foreclose a mortgage on the property of the East Side Railway Company.

Ralph E. Moody, for Morris & Whitehead.

Wirt Minor, for A. L. Maxwell, trustee.

W. A. Cleland, for East Side Ry. Co.

Milton W. Smith and W. S. Goodfellow, for German Savings & Loan Soc.

A. H. Tanner, for Charles F. Albee.  
Thomas N. Strong, for Washburn & Moen Mfg. Co.

**BELLINGER**, District Judge. The East Side Railway Company is a corporation organized and controlled by James and G. A. Steel. Prior to September, 1892, the Steels had borrowed money of the German Savings & Loan Society upon the security of bonds of the railway company, and in that month their indebtedness to the loan society was increased by an additional loan to \$83,000, for which they pledged 125 bonds of the railway company, of the par value of \$1,000. This was one-half of the bonds that the railway company was authorized to issue. These bonds were secured by a mortgage to the Security Savings & Trust Company, as trustee. Thereafter, in February, 1893, the directors of the railway company authorized the issue of 300 bonds, of \$1,000 each, secured as aforesaid, to take the place of the issue already authorized. Of the bonds so authorized 156 were issued to the Steels, and pledged by them to secure the existing debt to the loan society, for which a new note was executed, bearing date April 1, 1893, and the remaining bonds, 144 in number, were pledged to the loan society for a further loan of \$80,000, for which the Steels gave a second note, dated April 1, 1893. The bonds pledged to secure the \$83,000 note are described therein as numbered from 145 to 300, inclusive, while those pledged in the \$80,000 are described as numbered from 1 to 144, inclusive. It is contended for the Steels and the railway company that the \$80,000 is the debt of the company, and not of the Steels, who were required to give their individual note for the loan upon the advice of the attorney of the loan society that the railway company could not borrow money on its own bonds in this way, and that the understanding at the time was that bonds numbered from 145 to 300, inclusive, were pledged for the \$80,000 debt by the railway company, or in its behalf, and that these were otherwise unissued treasury bonds of the company. On the other hand, it is contended that the two notes for \$83,000 and \$80,000, respectively, are in effect for one debt of the aggregate sum of \$163,000, to secure which debt the entire issue of the bonds of the company are pledged, without distinction as to ownership or issue, but upon the assumption that said bonds were, and that they in fact were, the property of James and G. A. Steel; that all the bonds authorized by the company had been issued to the said Steels, and were their property at the time the loan was negotiated. In November, 1893, the railway company executed a second mortgage to the Northwest General Electric Company to secure \$37,639.95 then due that company, and further advances to an additional amount not exceeding \$25,000, and, further, to secure the sum of \$29,289 due from the railway company to the Commercial National Bank. This suit was begun by the electric company in December, 1893, to foreclose this second mortgage, and Joseph Simon was appointed receiver of the railway company's property. In the meantime the bonds pledged to secure the Steel notes were sold at auction, in San Francisco, in pursuance of notice duly given, and were purchased by Morris & Whitehead, bankers, parties herein. After their purchase, A. L. Maxwell

was substituted as trustee in the first mortgage for the Security Savings & Trust Company, and in that capacity brings his bill of complaint, in the nature of a cross bill herein, against the East Side Railway Company, to foreclose the said first mortgage.

The principal question that arises in the case involves the validity of this sale of bonds made in San Francisco,—the contention of the Steels and of the railway company being that the sale to Morris & Whitehead is a mere pretense, designed for the purpose of enabling the German Savings & Loan Society to foreclose for the face value of the bonds, instead of the amount due upon the notes, for which the bonds were pledged; and, furthermore, that the hypothecation of the unissued bonds, 156 to 300, inclusive, was unauthorized, the company being without authority to make such hypothecation; that the debt for which these bonds were hypothecated was that of the company, and not of the Steels, and, if such bonds were lawfully hypothecated, still their sale in the mode employed was unauthorized and void. The answer made to this is that the sale to Morris & Whitehead is bona fide; that the German Savings & Loan Society has no interest in the sale, but that it is immaterial as to this, for the reason that the latter might, as is claimed, have purchased the bonds at its own sale, under the power given it. As to the contention that bonds 156 to 300, inclusive, were unissued treasury bonds, and were not authorized to be sold in the mode employed, it is answered that there is no distinction as to the bonds and notes; that the two notes are evidences of one debt, and that the debt of the Steels; and that all the bonds pledged were their property; and, further, that it is immaterial whether the note for \$80,000 is for the debt of the East Side Railway Company, or whether bonds 156 to 300, inclusive, were treasury bonds or not, because (1) the Steels are the owners of practically all the stock of the railway company, and are therefore, in equity, the owners of the company's bonds, and (2) that neither the German Savings & Loan Society nor Morris & Whitehead had notice that the \$80,000 was for a company debt, or that the bonds referred to had not been issued. As to the issues of fact thus presented, the testimony of the officers of the German Savings & Loan Society, and of the managing member of the firm of Morris & Whitehead, is most positive that the former have no interest whatever in the purchase made by the latter. This testimony is uncontradicted, unless the circumstances of the case are against it. In July, 1897, the Steels applied to Morris & Whitehead to purchase bonds of the East Side Railway, and at the time furnished them a detailed statement of the company's affairs, its earnings and expenses, and business plans. The company was then in the hands of a receiver in the suit of the Northwest General Electric Company to foreclose a second mortgage held by it. James Steel testifies that he had a conversation with Mr. Morris, of Morris & Whitehead, about this time, in which he advised Mr. Morris that the electric company's mortgage was the key to the situation, and expressed the opinion that this claim could be purchased for much less than its face; that Mr. Morris said he thought he could work the matter through; that it was a good proposition; that thereafter, on the arrival of Mr. Morris' brother from the East, the witness and his brother took a private