No. 67 O.D.

Nat. Union Bank

vs

Nat. Mechanics Bk.

Decree

Filed December 19th, 1894.

The National Union Bank of Maryland

vs.

The National Mechanics Bank of Baltimore et al.

Court of Appeals of Maryland.

October Term, 1894

The Appeal *in this case standing ready for hearing, was argued by Counsel for the respective parties, and the proceedings have since been considered by the Court.*

It is thereupon, this nineteenth *day of* December 1894, *by the* **Court of Appeals of Maryland,** *and by the authority thereof, adjudged, ordered and decreed that the* decree of the Circuit Court of Baltimore City made in this cause on the twenty sixth day of September in the year 1894 be and the same is hereby reversed with costs to the appellant, and the cause remanded for further proceedings in conformity with the opinion of this Court.

Robinson C.J.
Boyd
Bryan
Fowler
Briscoe
McSherry JJ.

Jno. M. Robinson

Wm Shepard Bryan

Jas McSherry

A. Hunter Boyd

John P. Briscoe

David Fowler

In October 1893 George W. S. Hoffman, W. E. Hoffman and John W. Hoffman, partners trading under the firm name of W. H. Hoffman and Sons, executed a Deed of Trust, in which their wives joined, to John B. Ramsay and Simon P. Schott by which they conveyed all their property "including all of the joint stock of the co-partnership and all of the separate estate of each of the partners in trust for the payment of partnership and individual creditors according to their respective rights and interest therein".

The Circuit Court of Baltimore City assumed jurisdiction of the trust and after the sale of the property, which will be more particularly hereinafter referred to, an audit was made distributing the proceeds of sales, etc. The Appellant held at the time of the assignment two notes of the firm, each being for the sum of five thousand dollars and endorsed by George W. S. Hoffman and J. W. Hoffman individually. With each note there were deposited bonds of the Gunpowder Valley R. R. Co. of the par value of $7500.00 as collateral security with the usual authority to the Bank to sell at public or private sale in case of default. The Appellant filed its claim for the amount of the notes, together with costs of protests, against the estates of the firm and of the individual endorsers. The National Mechanics' Bank of Baltimore excepted to the allowance by the auditor of the claim of Appellant because it had not credited the value of the collateral security held by it and the Appellant excepted to the audit for the reason, as it alleges, that the real estate held and owned by the three members of the firm was their individual property and not partnership assets.

An agreement was filed in which certain facts are admitted and the Court below was authorized to pass a pro forma order sustaining the exceptions to the claim of the Appellant and overruling those filed by it. A pro forma order was accordingly passed and an appeal taken to this Court.

The principal questions presented for our consideration are;

1st. Is the Appellant entitled to a distribution on its whole claim without crediting the value of the securities held by it as collateral?

2d. Is the real estate held by the members of this firm to be treated as partnership or individual property, so far as the Appellant is concerned?

If the Appellant had sold the securities held by it between the dates of the assignment and the distribution there could be no question about the right of the trustees or the creditors to require it to credit its claim with the net proceeds of such sale. The case of Third National Bank vs Lanahan, trustee, 66 Md. 461 has established that as the law of this State whatever may be the effect of the decisions elsewhere, cited by the Appellant, and it is a just and equitable rule. Such being the case would there be any equity in permitting the Appellant to receive a dividend on its whole claim simply because it saw proper to delay realizing on its securities until after distribution was made? We think not. The creditor who holds collateral securities for his claim has the advantage over other creditors to the extent of their value, or what he may realize upon them, but he should not be permitted to have in addition thereto what in many cases might be equivalent to double dividends, or even more. If for example the collaterals realized fifty per centum of the creditor's claim and the debtor's estate would only pay fifty cents on the dollar, the creditor with the security would be paid in full whilst the others would receive only one-half of their claims. Great inconvenience and cost would oftentimes follow the practice contended for in the distribution of insolvent estates in addition to the undue advantage given the creditor holding the collaterals. For if the whole claim be distributed to and the dividend exceeded the difference between the value of the collaterals and the amount of the claim the creditor would have to refund or deduct from his dividend the balance which would require another audit thus involving the estate in unnecessary cost and delay. The value of the collaterals would have to be ascertained before the dividend was paid to the creditor so as to properly protect the insolvent estate for if this be not done and the dividend was more than the difference between the value of the collaterals and the amount of the claim the trustee would have to look to the creditor holding the collaterals for the excess paid him and possibly the estate would sustain loss by not being able to recover the amount.

The long established practice in proceedings of this kind in this State requires the creditor in presenting to the Auditor prima facie proof of ~~his~~ claim to swear "that no part of the money intended to be secured by such note hath been received or any security or satisfaction given for the same except what (if any) is credited". — following the language required for authenticating claims in the Orphans Court.

The claim in controversy in this case was supported by the affidavit of the Cashier of the Bank to the above effect. Such language is not meaningless but was evidently inserted for the purpose of requiring the creditor either to surrender the securities or credit his claim with their value before it is distributed to.

The value of the securities thus held should be ascertained and credited on the claim before distribution is made. That can be easily done by relevant testimony taken under authority of the Court when no sale has taken place. This was the practice in bankruptcy proceedings and is not without precedent in other Courts. See In re Bridgman 1 B.R. 312, Amory vs Francis 16 Mass. 308, Farnum vs. Boutelle 13. Metc. 159, First National Bank vs. Eastern Railroad 124 Mass. 524 and Bell vs. Fleming 1 Beas. 13.

There was therefore no error in the pro forma decree in regard to that ruling.

In considering the question as to the right of the Appellant to have the real estate treated as the individual property of the members of the firm, and not as partnership assets, we must bear in mind the fact that W. H. Hoffman was the original owner of all this property and that whilst it was thus owned by him he was in partnership with his three sons trading under the name of William H. Hoffman and Sons, being the style of the firm subsequently adopted by them. If a Deed of Trust similar to the one made by the sons had been made in the lifetime of the father, by the members of the original firm, it would hardly be contended that the real estate should be treated as partnership property - certainly not as against the individual creditors of William H. Hoffman.

By his last will and testament the senior Hoffman charged an annuity upon the "Gunpowder Mill" property for the purpose of keeping a burying ground, etc. in proper condition and made certain provisions for his wife. He directed his executors to ascertain the value of the rest of his property and gave it, with the exception of one-twentieth thereof left to Peter

Vondersmith, his son in law, to his three sons and his daughter, Lydia A. Smyser, to be divided between them equally, share and share alike. He directed that in the division his son John W. Hoffman should have the property known as the Gunpowder Mill, chargeable with the annuity aforesaid, together with certain water rights and four hundred acres of land connected therewith known as "Paper Mill Hills", also a part of the tract of the land known as "Laurel Hills", one hundred yards wide on each side of a stream. He also directed that in the distribution his son George W. S. Hoffman was to have the "Marble Vale Mill" property, containing 218 acres and his son William E. Hoffman was to have his "Clipper Mill" together with a tract of land called "Grist Mill Hills", containing 257 acres, also a tract called "Addition to Grant Mill Hills", containing seven and one-quarter acres and some houses named by him. He provided that the property thus given to his three sons should be taken by them in the distribution at the prices or values fixed by the appraisers as provided for in his will and then directed that "all the rest of my property and estate not hereinbefore devised or specially distributed + + + + shall be sold or disposed of by my said Executors + + + + and the proceeds of such sale or sales be so distributed among my said four children as to make the share of each under these provisions of my will equal the one to the other." Subsequently his son-in-law and his daughter conveyed their respective interests to the three sons "as individuals".

It is admitted in the agreed statement of facts that after the father died the three sons continued to trade under the firm name of

William H. Hoffman and Sons and opened on their firm books an account headed "Real Estate" in which they entered all the property so derived by them and continued the same on their books in that way;" that between the said three sons all the said real estate was always considered in their business as co-partnership property and was treated between themselves as such, but that the title to the same appeared in the land records of Baltimore County and in the office of the Register of Wills of Baltimore County, as having been derived by them under the will of their said father and the conveyances of said Vondersmith and Smysen, as has been hereinbefore stated, and no conveyance was made by them to the said partnership."

It must be conceded that there is nothing on the face of the will that would indicate any intention of the testator to vest the property in his three sons as partners, but on the contrary it is apparent that he intended them to own individually certain properties which he directed to be given them as above stated.

The property was at the time the partnership was formed the individual property of the three members. So far as the record discloses nothing has since been done to transfer the property to the firm or vest any interest in it excepting the entries in the books and the fact that the real estate was considered in the business as co-partnership property and so treated between the members, as above stated. We are therefore met with the inquiry whether that is sufficient to authorize a Court of Equity to treat the proceeds of sale as partnership assets when called upon to decide between the creditors of the firm and those of the individual members.

If this property had been purchased with partnership funds for the use and on account of the firm it would be immaterial that the title stood in the name of the individual members, as a Court of Equity would treat it for all the purposes of the partnership as firm property and hence it would be liable to the partnership creditors to the exclusion of the individual creditors until the former are satisfied. In that case there would be an implied or constructive trust in favor of the partners, as such, which would inure to the benefit of the creditors of the firm. But when it ~~has~~ been acquired in the manner above stated the question arises whether those dealing with the members of the firm have not the right, in the absence of some notice or knowledge to the contrary, to assume that the public records inform them correctly as to the ownership of the property notwithstanding the private understanding between the partners themselves.

Creditors have sometimes suffered great hardships by Courts of Equity declaring property standing in the name of one person to be in trust for the benefit of others, but such decisions are rendered to prevent injustice being done those whose money purchased the property and relief is only granted to them when their claims are established by clear, direct and explicit proof. This Court has said "This strictness of proof is required because of the danger of rendering titles depending on deeds and other written documents insecure". Witts vs. Horney, 59 Md. 586.

The same reasoning applies to real estate held of record by members of a firm as tenants in common. When it is sought to change such property from individual to partnership property, the record evidence all pointing to it being the former, a Court of Equity should not act upon doubtful proof, particularly when the rights of strangers or third parties are to be affected. The public records will be of but little avail if the private books and intentions of partners are to entirely control and determine the character of ownership of real estate.

If property is purchased with partnership funds and conveyed to one or more of the partners as individuals, the entries of the firm books would have great, possibly controlling, weight as to whether it should be treated ~~it~~ as partnership or individual property but courts should require more than private entries and understandings between partners to overcome the public records in cases such as this. No one would suppose from reading the will of William H. Hoffman that the property belonged to the partnership. Persons dealing with the individual members would be led to believe from that will that they owned the property individually and inasmuch as it was once the separate property of the members we are not prepared to break down all the safeguards and protection intended by our Registry Acts by announcing as the law of this State that partners can so change the character of real estate, originally owned by them as individuals, and not in any way derived from the partnership, as to give priority to firm creditors over their separate creditors simply by making entries in their books and treating it between themselves as partnership property, without giving some notice, or doing some acts equivalent to notice, to their individual creditors. The agreed statement of facts does not show that the appellant had notice of any facts that should have put its officers on inquiry. The statement is not as full as it might have been. It does not even show what business the firm was engaged in but from the arguments and what we gather from the record we assume that they were manufacturing paper. Nor is it definitely stated whether the business was conducted in one or more paper mills, although it is shown that William H. Hoffman died owning real estate consisting of three paper mills, farm lands, etc. It would certainly have been much more satisfactory if the facts had been fully set out so as to enable the Court to understand the exact character and extent of the use of the real estate by the firm. But it is admitted that the property was acquired under the will of William H. Hoffman and by the deeds of Mr. Vondersmith and Mrs. Smyser and that no conveyance was made by the members of the firm to the partnership. As to what uses, if any, this firm, engaged in manufacturing paper, made of the farms, dwelling houses and other property not necessarily incident to the paper mills the record is silent, but it is certain that without some notice that they were treated as partnership property no one dealing with the individual members of the firm would be expected to so regard it, and the ordinary use of that kind of property, such as cultivating or renting the farms, occupying or renting the houses &c., would not put creditors on inquiry or be sufficient notice that they were treated as partnership property.

If the paper mills themselves and such other real estate as would properly be used in connection with them were treated by the partners as firm property and were so used as to give notice to creditors of the individual members of the firm that they had been put into the partnership as part of the common stock and were entered on the books of the firm in such way as to comply with the Statute of Frauds then the partnership creditors might properly be given priority over the separate creditors to the extent of the proceeds of sales of such property. The record does not disclose such facts as would justify us in determining that question, but as the decree must be reversed the Court below can authorize testimony to be taken on that subject. We have carefully examined the authorities cited by the counsel for the respective parties, as well as many others, and have found considerable apparent conflict between some of them. But when the facts of them are carefully examined it will be found that the most of them are in accord with our conclusions which might be summarized as follows:

1st. That as the farms, houses and similar property were not purchased with partnership funds, for partnership purposes, but were, as far as the public records show, the separate property of the individual members and were not incident to the business of the firm, the fact that the partners entered them on the firm books and treated them as firm property is not sufficient to change them into partnership property and the proceeds of sales of them should be applied to the payment of the claims of individual creditors prior to those of the partnership creditors.

2^d. That if the paper mills and such other real estate connected therewith, as would be necessary for the convenient and proper conduct of the business, were treated by the partners as partnership property, were put into the firm business as part of the common stock and were so entered in the books of the firm as to comply with the Statute of Frauds then the partnership creditors should have priority over the general creditors of the individual partners in the distribution of the proceeds of sales of such property — provided this class of property was so used as to give notice to the latter that it was treated as partnership property and was substantially involved in the business of the firm.

There is still another question to be disposed of. It is contended that the appellant is estopped from claiming that the real estate is individual and not partnership property by reason of its signing a recommendation to the Court to ratify its sale reported May 1st 1894 by John B. Ramsay, one of the trustees.

Mr. Ramsay and Mr. Schott, the trustees, differed as to the propriety of a sale of the property remaining unsold at the price which had been offered — the latter thinking that in time a better price could be obtained whilst the former thought it best to sell at once. Mr. Ramsay reported the sale and Mr. Schott was required to show cause why it should not be made. The American National Bank, of which Mr. Schott was cashier, was the only creditor opposing the sale and Mr. Ramsay undertook to secure the concurrence of enough creditors to overcome the opposition of that Bank. Accordingly the National Mechanics' Bank, of which Mr. Ramsay was president and which was the largest creditor, signified, through its attorneys who were also attorneys for the trustees, its concurrence in the sale to the officers of the appellant which was the next largest creditor and sought their consent. It was explained to them that by the proposed sale the creditors of William H. Hoffman & Sons would get about 33⅓ ~~and~~ ⅓ per cent. of their claims and it was thought that the concurrence of two such large creditors would influence the others. The appellant fully understood that the 33⅓ per cent. was to come from the sale of the property mentioned in these proceedings. The appellant, the Mechanics' Bank and another creditor signed a paper requesting the Court to ratify the sale, whereupon Mr. Ramsay sent out a circular letter to the creditors of the firm asking their concurrence in the sale, stating that the proposed sale would pay the creditors about 33 1/3 per cent. of their claims and that these two banks approved of it. It is admitted that the officers of the Union Bank asked the counsel for the trustees and Mechanic's Bank whether the signing of the concurrence to the sale would affect the claim of the Union Bank and "were told that ~~it~~ would not and that it only meant an assent to said sale at the price proposed. But nothing was said by either side as to the claim against the property as individual or firm property."

We do not think the facts stated in the record are sufficient to estop the appellants. It is perfectly apparent that the differance between the trustees was as to the price to be obtained for the property - whether the offer received by Mr. Ramsay should be accepted or they should wait for a better price. There is not a particle of evidence tending to show that the property did not bring its full value or that any of the creditors have been injured. The only creditor that filed objections to the appellants' claim on this ground is the Mechanic's Bank, which had concurred in the sale before the appellant did. It could not therefore claim that it was misled by the act of the appellants. But before the officers of the appellant signed the recommendation they inquired of the attorneys representing the Mechanic's Bank and the trustees who were seeking their concurrence whether it would affect the claim of the Union Bank and were told it would not. There can be no question as to what claim was referred to as the agreed Statement shows that "The claim of the Union Bank was filed long prior to any sale against both the partnership and the endorsers of the notes held by the bank." It would perhaps be more equitable to say that the Mechanic's Bank should be estopped from questioning the right of the Union Bank to assert its claim after having induced it to sign the concurrence by the assurance that such act would not affect its claim. But there is no proof that any creditor was either misled or injured by the action of the appellant and nothing in the record to justify an inference that such was the case.

This Court in Hardy & Brothers vs. Chesapeake Bank 51 Md. 590 in speaking of the doctrine of an estoppel in pais said "It can therefore only be set up and relied on by a party who has actually been misled to his injury; for if not so misled he can have no ground for the protection that the principle affords". From what we have already said it can be seen that we think that an application of the above principle of law to the facts of this case disposes of the question of estoppel.

The decree pro forma must be reversed and the cause remanded for further proceedings in accordance with this opinion.

Decree reversed and cause remanded with costs to the appellant.

E. Remanded. No. 67 O.D.

40 sides.

The National Union Bank
of Maryland
vs.
The National Mechanics' Bank
of Baltimore et al.

Robinson C. J. Bryan, McSherry,
Fowler, Briscoe and Boyd J.

Opinion by Boyd J.

To be reported

Filed December 19th, 1894.