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STATE v. BROWN ET AL.
 Md. 1891.

Court of Appeals of Maryland.

STATE

v.

BROWN ET AL.

Feb. 20, 1891.

Appeal from circuit court, Washington county.

West Headnotes

Canals 68 ⚡21

68 Canals

68I Establishment, Construction, and Maintenance

68k21 k. Mortgages. **Most Cited**

Cases

The state chartered a canal company, and subscribed to its capital stock. Afterwards an act was passed authorizing the issue of bonds secured by a mortgage on its revenues, and the state waived its liens in favor of such bonds. Held, that the state, having waived its liens in favor of such bonds, cannot, on default, on the ground that the bonds are a lien on the revenue only of the canal, insist upon the canal itself being sold, instead of allowing the bondholders to take possession and by managing the property produce revenues with which to pay their debt.

Canals 68 ⚡21

68 Canals

68I Establishment, Construction, and Maintenance

68k21 k. Mortgages. **Most Cited**

Cases

The bondholders in such case, may incur the property in order to repair it, and so put it in condition to earn revenues.

Canals 68 ⚡21

68 Canals

68I Establishment, Construction, and Maintenance

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Cases

The state chartered a canal company, and subscribed to its capital stock. Afterwards an act was passed authorizing the issue of bonds secured by a mortgage on its revenues, and the state waived its liens in favor of such bonds. The mortgage provided that if the company should pay the interest on the bonds, and provide a sinking fund to meet the principal when due, it should retain the management of the property, and receive the revenues, but if it should fail to comply with these conditions "from any cause except a deficiency of revenue arising from a failure of business without fault on the part of said company," then the mortgagees should have the right to take possession and receive and appropriate the revenues to their debt. Held, that the mortgagees had the right to take possession of and manage the canal on failure of the company to pay the interest on their bonds, where such failure was due to inability of the company because of damage to the canal, which it was not financially able to repair, to manage the property so as to make it produce revenue.

Corporations 101 ⚡180

101 Corporations

101IX Members and Stockholders

101IX(A) Rights and Liabilities as to Corporation

101k180 k. Management of Corporate Affairs in General. **Most Cited Cases**

Where there is a difference of opinion between bondholders of a canal company,

after default, as to what proceedings will best subserve their interests, the will of the majority must govern.

***374** Argued before MILLER, ROBINSON, IRVING, BRYAN, MCSHERRY, FOWLER, and BRISCOE, JJ.

Bernard Carter, for the State.

S. Teackle Wallis, John K. Cowen, B. T. Johnson, B. S. Johnson, Henry H. Keedy, and J. Clarence Lane, for appellees.

ROBINSON, J.

Before proceeding to consider the several questions, which have been argued with so much ability in this case, it is necessary to refer briefly to certain facts connected with the history of the Chesapeake & Ohio Canal Company, out of which this litigation has arisen, and to refer also to the successive steps which have been taken in the progress of the suit from the filing of the original bill down to the final decree from which these appeals were taken. This company was chartered as far back as 1824 for the purpose of uniting the waters of the Ohio river with the waters of Chesapeake bay. It does not appear that any effort was made to build the canal west of Cumberland; but its construction from that point to Georgetown, in the District of Columbia, was deemed of great public importance, especially as affording an outlet for the large and valuable coal fields of Allegany county. Its estimated cost was about eight millions of dollars, and of this amount the state of Maryland, by loans and subscriptions to the capital stock, furnished the large sum of seven millions. The work was prosecuted from time to time till the latter part of 1841, when, having exhausted all its available resources, further operations were suspended. The state was unwilling, and was in fact, it may be said, unable, at that time, to furnish any further pecuniary aid, and, the company itself being without credit, all efforts to raise money for the com-

pletion of the canal were unsuccessful. Its completion to Cumberland, however, was a matter of vital importance, for upon the shipment of coal from that point the tolls and revenues of the canal mainly depended. So it was in this emergency that the act of 1844 was passed, by which the company was authorized to issue bonds to the amount of \$1,700,000; and, in order that these bonds might be negotiated on the best possible terms, the state waived its own liens upon the tolls and revenues of the canal in favor of said bonds, and with the consent of the company pledged the entire net tolls and revenues for the payment of the interest, and to provide a sinking fund for the redemption of the bonds at their maturity. And the act further authorized the company to execute "any deed or mortgage necessary to give the fullest effect to the provisions of the act." It was in pursuance of this act that the mortgage of 1848 was executed, and with the money arising from the sale of these bonds the canal was finally finished to Cumberland. Now, it can hardly be necessary to say that in this, as in ***375** many other like public improvements, the hopes and representations of its promoters have never been realized. With the exception of a brief interval the revenues of the canal during the 40 years of its operation have barely been sufficient to meet its current expenses, and the state today has never received a dollar, either on its loans, or subscriptions to the capital stock. The bondholders under the act of 1844 have shared pretty much the same fate, and the company is now indebted to them, interest and principal, exceeding four millions of dollars. While thus burdened with debt, the freshet of 1877 occurred, in consequence of which the canal was badly damaged, and, in order to repair it, the company was obliged to apply to the legislature for authority to issue bonds to the amount of \$500,000, and to mortgage

the entire property and revenues of the canal to secure the payment of the interest and principal of these bonds; and these bonds, known as the "Repair Bonds," are the first and paramount lien upon the revenues at least of the canal. And then again, in the spring of 1889, another and more disastrous freshet happened, and the company, without money and without credit,--in fact, hopelessly insolvent,--has never been able to repair and restore the canal as a waterway, in consequence of which from that time to the present all business along its entire line has been suspended. Now, in this state of things, the bill of the trustees of the bondholders of 1844 was filed. The bill alleges the insolvency of the company, its long and continued default in the payment of interest and principal of the bonds now overdue, its inability to repair the canal, and the entire suspension of business along its whole line, and prays for the appointment of receivers to take possession of and to repair and operate the canal, and to pay over its net revenues to the complainants until the interest and principal of their bonds were fully paid. A few days afterwards a bill was also filed by the trustees of the holders of the repair bonds of 1878, claiming that their mortgage was the first lien upon the property and revenues of the canal, and alleging that a default had occurred on the part of the company, such as, by the terms of the act and of their mortgage executed thereunder, entitled them to the appointment of a receiver and foreclosure, and praying for the appointment of receivers and for a sale of the canal. On the petitions of the attorney general and Bernard Carter, trustee and executor, the state and Mr. Carter were made parties defendants. To these bills answers were filed by the state and by the company, each denying that a case had been made out for the appointment of receivers, and both submitting the question as to a sale of the

canal to the determination of the court.

Upon the case as thus presented the learned judge below decided that the bondholders, under the act of 1844, were entitled to the appointment of receivers to take possession of the canal; and, secondly, that, if there could be any question as to their right in this behalf, there could be none as to the right of the holders of the repair bonds of 1878, which were the first liens upon the revenues of the canal. Receivers were thereupon appointed, and directed to make a full and thorough examination as to the condition of the canal, to estimate the probable cost of repairing and putting it in good condition, and whether it was feasible to operate it when repaired, and to report the same, together with the reasons on which their judgment was founded, for such further action in the premises as the court might deem proper. After an examination in pursuance of this decree the receivers were of opinion that it was inexpedient to undertake to repair the canal by issuing receiver's certificates, and further, that, if repaired and put in proper condition, there was no reasonable prospect of its being able to earn revenue applicable to the payment of the bonds of 1844. After the report of the receivers was put on record, an amended answer in the nature of a crossbill was filed by the state, praying for a sale of the entire property of the canal under the mortgages held by the state. Upon the case as thus presented, the court, after full hearing, decided that it was inexpedient to undertake to repair the canal through the agency of receivers, and that the complainants were entitled to a decree for the sale of the property and franchises of the canal, free and clear of all liens and incumbrances. The court further decided that the lien of the bondholders of 1844 extended only to the revenues and tolls, and that, in the event of a sale, they stood in the relation of simple unsecured creditors merely

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as to the proceeds of sale. Before a decree was signed in conformity with the opinion of the court, a petition was filed by the trustees under the mortgage of 1848, claiming the right to redeem the repair bonds of 1878 and the mortgage executed to secure the payment of the same, and which constituted the first lien on the revenues of the canal; and, upon the payment of interest and principal, to be subrogated to all the rights and remedies of the holders of said bonds. In answer to this petition the trustees and bondholders of 1878 aver their willingness to accept the interest and principal of the bonds held by them, and to transfer the same to the petitioners, so that they may be subrogated to all their rights to which the holders of the bonds are entitled under the act of 1878. Upon the filing of this petition a final decree was passed by which the court decreed that the entire property and franchises of the canal should be sold at public auction, but at the same time directed a suspension of the sale upon the following, among other, conditions set forth in the decree: (1) That the trustees of the bondholders under the act of 1844 shall within 60 days bring into court the repair bonds of 1878, or pay into court an amount equal to the interest and principal of said bonds. (2) Upon a compliance with this condition the trustees shall be subrogated to all the rights and remedies of the holders of the repair bonds of 1878, and shall be entitled to the possession of the canal, with full power to operate the same. (3) That the trustees shall by the 1st of May, *376 1891, at their own expense, to be reimbursed out of the net revenues of the company, put the canal in good repair and condition. And after prescribing the manner in which the revenues shall be applied the decree further provides that if, at the end of four years, the revenues shall be sufficient to pay the operating expenses and the cost of restoring it as a waterway, and such li-

ens as may be adjudged preferred liens for labor, then such failure of tolls and revenues shall be conclusive evidence that the canal cannot be operated so as to produce revenue with which to pay its funded indebtedness. It is from this decree that these several appeals have been taken.

Now, it will be observed that, although the court had decided that the liens of the bondholders of 1844 was upon the tolls and revenues and not upon the *corpus* of the canal, yet this question is by the decree reserved for final determination, when the proceeds of sale shall have been brought into court for distribution. So the real question after all is whether the court was right in suspending the sale, and in decreeing that the trustees of the bondholders of 1844 were, upon compliance by them with the terms and conditions of the decree, entitled to the possession of the canal, with authority to repair and operate it, with the view of ascertaining whether, under their management, it could be made to produce any revenue applicable to the payment of its bonded indebtedness. And this depends--*First*, upon the rights of the trustees under the act of 1844, and the mortgage of 1848, executed in pursuance thereof; and, *secondly*, upon their rights as purchasers of the repair bonds of 1878. We have already referred to the circumstances under which the act of 1844 was passed, to the fact that the canal was finished with the money arising from the sale of the bonds issued under it, and to the further fact that the value of the large amount of stock held by the state, and the security of its loans by way of mortgage, absolutely depended upon the canal's being finished to Cumberland; and to induce persons to invest their money in these bonds the state, by this act, waived its own liens, and declared that these bonds should be preferred liens on the tolls and revenues of the canal. It was to carry out the provisions of this act that the mortgage of 1848 was

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executed, by which the company mortgaged its entire revenues to secure the payment of the interest, and to provide a sinking fund to pay the principal upon the maturity of the bonds, with power and authority on the part of the grantees to enter and take possession of the canal and receive its revenues, "upon the default of the company to fulfill its engagements in the premises." The right to enter is, however, subject to the following condition: "That so long as the canal company shall comply with its agreement by paying all the interest upon said bonds as the same falls due, and by providing an adequate sinking fund for the redemption of said bonds, it shall retain the management of the canal and its works, and collect and receive the revenues and tolls, but if they fail to comply with these conditions from any cause except a deficiency of revenue arising from a failure of business without fault on the part of said company," then the "grantees may demand, and shall thereupon receive, possession, and shall appropriate all said tolls and revenues in the manner hereinbefore provided." But for this covenant for possession on the part of the mortgagor the right of the trustees to enter and take possession of the canal upon "the default of the company to perform its engagements in the premises" could not be questioned. Not only is this right conferred by the terms of the mortgage, but, independent altogether of an express grant, it is a right to which they would be entitled by operation of law. So the inquiry comes to this: In what manner, and to what extent, is this right qualified by the covenant? The appellants contend that it is to be construed as an agreement between the parties that if there shall be a deficiency of revenue from any cause whatever without "the fault of the company," using the term "fault" in the sense of bad faith or mismanagement, the company shall still be entitled to its control and

management. And if the canal has been damaged by storms and freshets, disasters which its officers could not foresee or avert, and the company is unable to repair and restore it as a water-way, in consequence of which it is not in a condition to earn revenue, its failure to earn revenue under such circumstances cannot be considered the fault of the company within the meaning of the covenant. On the other hand, it is insisted that the term "fault," as here used, is to be understood in its broader sense, as meaning not only mismanagement, but also any legal default on the part of the company in view of its obligations to the public to operate it as a public work. Strictly speaking, the term "fault" may in itself be susceptible of either construction; but when it is considered in the light of the circumstances under which the mortgage was executed, there cannot be, it seems to us, any difficulty as to the real meaning of the parties. Although the company was chartered as a private corporation, the canal itself was in a certain sense a public work, in the construction and operation of which the public had an immediate interest; and, while the state was willing to waive its own liens, and, with the assent of the company, to pledge its entire tolls and revenues for the payment of the bonds to be issued under the act of 1844, yet if, from failure of business without the fault of the company, the revenues should be insufficient for this purpose, the state--the owner of the greater part of the capital stock--was unwilling to surrender the control and management of the canal to the mortgagees or other parties. No one supposed for a moment that the canal, under any circumstances, would not yield revenue sufficient to pay its operating expenses, and to keep it in proper repair. The act of 1844 in fact provided that no bonds should be issued for the completion of the canal until one or more coal companies or individuals had

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guarantied *377 the transportation of not less than 195,000 tons of coal a year for five years; and the mortgage recites that this guaranty had been given in terms satisfactory to the state. The tolls from the transportation of this coal were deemed, no doubt, sufficient at least to pay the interest, and to provide a sinking fund for the redemption of the bonds at maturity. But if this guaranty should fail, if from failure of business without fault of the company the revenues should be insufficient for this purpose, it was still to retain the control of the canal. The parties, however, were dealing with revenues of a canal in a condition to earn revenue by the transportation of coal and other produce. It was a failure of business in the sense of a depression in or want of business, and not, as the court below says, an incapacity to do business by reason of the inability on the part of the company to repair it and put it in a condition to earn revenue. And when it was agreed that the mortgagor should retain possession of the canal even though its revenues might be insufficient to enable the company "to perform its engagements in the premises," the parties meant "revenues" which the canal was able to earn as a water-way, according to the objects and purposes of its incorporation. By no fair rule of construction can the "failure of revenue," as used in the covenant for possession, be construed as a failure arising from an inability on the part of the company to repair it and put it in a condition to earn revenue. A state of things exists never contemplated by the parties. The canal, in its present condition, is useless as a water-way; the company is insolvent, and without means to restore it; and, under such circumstances, the right of the trustees of 1848 to enter and take possession is in no manner restricted or qualified by the covenant relied on by the appellant.

But if there could be any doubt, as to this

right, under the mortgage of 1848, no one, it seems to us, can question their right in this respect as purchasers of the repair bonds of 1878, and which, according to [Virginia v. Canal Co.](#), 32 Md. 501, constitute the first lien upon the revenues at least of the company. The mortgage to secure the payment of these bonds provides, it is true, that, upon the default of the company in the payment of three successive coupons, the trustees may, at the request in writing of a majority of the holders of the bonds, institute proceedings of foreclosure and for the appointment of receivers. And it further provides that until such default no proceedings of any kind, either at law or in equity, shall be instituted; it being the intent, says the mortgage, that until such default the company shall retain the control and management of the canal. But if a default has occurred according to the terms of the mortgage, these covenants cannot be construed as operating to deprive the mortgagees of any remedy to which they are by law entitled. By such default they have the right to foreclose, to ask for the appointment of receivers, and to enter and take possession of the mortgaged property. These are remedies to which the mortgagee, in the absence of covenants to the contrary, is entitled, upon the default of the mortgagor. [Burnell v. Martin](#), 2 Doug. 417; [Schoole v. Sall](#), 1 Schoales & L. 176; [Garforth v. Bradley](#), 2 Ves. Sr. 678. If, then, the trustees for the holders of the repair bonds of 1878 would be entitled to enter and take possession upon the default of the company to pay the coupon, and according to the terms of the mortgage, the trustees of the bondholders of 1844, as purchasers of the repair bonds, are by the well-settled principles of subrogation or substitution entitled to the same remedy. 2 Story, Eq. Jur. § 1023; 4 Kent, Comm. 162; [Denman v. Nelson](#), 31 N. J. Eq. 452. So, in any aspect in which the right of these trustees

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may be considered, whether under the act of 1844 and the mortgage of 1848 executed thereunder, or as purchasers of the repair bonds of 1878, we are of opinion that by the default of this company to pay its indebtedness according to the terms of these mortgages they are entitled to take possession of the canal upon the terms prescribed by the decree. But then it is said whatever may be the rights of the trustees as against the company, the state has the right, under its mortgages, to insist upon the sale of the entire property and franchises of the canal. Now upon what grounds can this right be supported? To induce the bondholders of 1844 to furnish the money necessary to complete the canal the state not only agreed to waive its own liens upon its revenues, but agreed also that the company should pledge them by mortgage as security for the payment of these bonds. And now, when the state and the company have operated the canal till they are no longer able to operate it, and when the canal itself is no longer in a condition to earn revenue, and the company during all these 40 years has been in default in the payment of its indebtedness according to the terms of the mortgage, and when the bondholders ask to be allowed to take possession of the canal, and to repair and operate it for the purpose of ascertaining whether it can be made to produce any revenue applicable to the payment of the mortgage, the state interposes and insists that it shall be sold clear of the liens of these bondholders, which the state agreed should be preferred liens upon its revenues, and when it is sold the state further claims as against them the entire proceeds of sale because their liens, it is said, extend to the revenues only, and not to the property of the canal. In other words, the state insists that they shall be deprived of the only remedy open to them by which they may have the opportunity at least of reimbursing themselves for the money

which they, at the instance of the state, furnished to finish the canal. So it is not the case even of a junior incumbrancer asking for the sale of mortgaged property and the proceeds of sale to be applied to the payment of the several liens upon it according to their priority; but it is one in which the state, holding liens upon the revenues and property of an unfinished canal, in order to induce others to furnish the money necessary to finish it, waives its own lien upon the revenues in favor of *378 such persons, and then insists that the canal shall be sold, whereby these liens are destroyed. We do not see on what ground, legal or equitable, such a contention as this can be supported. But then again it is said these trustees ought not to be permitted to burden the company with any additional indebtedness by undertaking to repair the canal, because the record shows that if repaired it cannot be made to produce any net revenue. Now, what is the proof upon this point? There is, it is true, the report of the receivers appointed by the court below; but then against this is the report of the receivers appointed by the supreme court of the District of Columbia, in which they come to a different conclusion. So, after all, it is a question in regard to which fair, impartial, and competent persons may honestly differ. There is, too, the report of the company, which shows, for the past 12 years at least, the revenues have not been sufficient to pay the operating expenses; but then it does not necessarily follow that better results may not be expected from the management of others more directly interested in developing the earning capacity of the canal to its utmost extent. If it should fail, after a fair trial, to yield any revenue applicable to the payment of the bonds of 1844, the decree below directs it shall be sold at public auction. The fact that it has in the mean time been repaired and put in good order along its entire line ought, it seems, to enhance

its marketable value, whether sold as a water-way or to be used, as was argued, for the construction of a railroad. If so, and the state, according to its contention, be entitled to the proceeds of sale, its interests could not be injuriously affected by having it repaired and restored as a water-way. But be this as it may, if the trustees are lawfully entitled to its possession, they ought to be allowed to put it in a condition to produce revenue; otherwise its possession would be without benefit to them. And while a court of equity will not permit a mortgagee to burden the estate by the expenditure of money for unnecessary and useless repairs, it will authorize him to make such repairs as may be necessary for the preservation and beneficial occupation of the property. *Sandon v. Hooper*, 6 Beav. 246; *Neesom v. Clarkson*, 4 Hare, 97; *Iron Co. v. King*, 2 *Cush.* 400; 2 *Jones, Mortg.* §§ 1126, 1131. We have not deemed it necessary to consider whether, in the event of a sale, the lien of the bondholders of 1844 will attach to and follow the proceeds of sale, or whether they are limited to the tolls and revenues. The court below was of opinion they had a lien upon the revenues only, but this question was by the decree from which these appeals were taken reserved for final determination, when the proceeds of sale are brought into court for distribution. This much, however, we may say: It is a question which the parties are entitled as matter of right to have decided before a sale is made. If the bondholders have no lien upon the proceeds of sale, they have practically no interest in the sale; whereas if they have a lien, it will be to their interest to see that the canal brings its fair value. For the same reasons the state is equally interested in having the rights of the respective parties determined.

As to the appeal of Mr. Carter, trustee and executor, it is sufficient to say, if there is any difference of opinion among the bond-

holders whether their interests will be best subserved by these proceedings, the will of the majority must in this, as in other like cases, govern. The suit was brought by the trustees at the request of a majority of the bondholders, and so long as they act in good faith, and for the purpose of carrying out the trust reposed in them under the mortgage, a minority bondholder has no right to interfere with them in the discharge of their duty. *Shaw v. Railroad Co.*, 100 U. S. 605. A good deal was said about the veil which conceals the real motives that have prompted this litigation. Whatever they may be, we must deal with the case as it is presented by the record, and, so dealing with it, we are of opinion that the decree below must be affirmed.

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State v. Brown
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