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Mortgages -- Corporations -- Removal of Trustees under Security Deeds of Trust

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North Carolina cases on the subject.[9] The cases heretofore have held that the important factor in determining the materiality of a representation is whether it is one that would have influenced the company in deciding the important questions of accepting the risk and fixing the premium rate.

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Mortgages—Corporations—Removal of Trustees under Security Deeds of Trust.

The defendant was named as trustee in a Georgia real estate mortgage securing a number of bonds. Thereafter the holders of ninety-two per cent of these bonds filed a petition in the Georgia court praying the defendant's removal from the trusteeship on the grounds that he was insolvent, that he had misappropriated trust funds committed to his care, that he had been convicted of a fraudulent breach of trust, and that for other reasons he was not a suitable person to act as trustee. Service was by publication. The lower court ruled that the action was properly brought. *Held,* by the Georgia Supreme Court, that the action should have been dismissed, since, *inter alia,* the proceeding was *in personam,* and service by publication was insufficient to give the court jurisdiction.[1]

Contrary to a proposition advanced by the court in its opinion,[2] it has been quite generally conceded that, even in the absence of statutory authority,[3] the equity court's inherent supervisory power over all trusts includes the power, in a proper case, to remove an unfit mortgage trustee.[4] In the situation which is perhaps most analagous in so far as the

[9] Fishblate v. Fidelity Co., 140 N. C. 589, 53 S. E. 354 (1906); Gardner v. North State Mutual Life Ins. Co., 163 N. C. 367, 79 S. E. 806 (1913).

[1] Caldwell v. Hill, 176 S. E. 381 (Ga. 1934).

[2] 176 S. E. at 382-385.

[3] Quite commonly statutes now provide a procedure for the removal of trustees. The grounds for removal are also stated in many. For example, KAN. REV. STAT. (1923) Ch. 67-412: "Trustees having violated or attempting to violate any express trust, or becoming insolvent, or of whose solvency or that of their sureties there is reasonable doubt, or for other cause, in the discretion of the court having jurisdiction, may, on petition of any person interested, after hearing, be removed by such court; and all such vacancies in express trusteeships may be filled by such court." These provisions are applicable to mortgage trusteeships. Sanders v. Hall, 74 F. (2d) 399 (C. C. A. 10th, 1934). The North Carolina statute, N. C. CODE ANN. (Michie, 1931) §2583 (a), provides for removal by vote of a majority of the note or bondholders, when the trustee has removed from the state, become a bankrupt, or, if corporate, ceased to do business, etc. This provision, however, is expressly stated to be "in addition to the rights and remedies now provided by law." §2583, as amended, Public Laws 1933, c. 493, provides for a proceeding before the clerk for the appointment of a successor where the trustee has absented himself or become otherwise incompetent.

[4] 4 THOMPSON, CORPORATIONS (3rd ed. 1927) §2667. On the removal of trustees generally see 1 PERRY, TRUSTS (6th ed. 1911) §275 *et seq.*

point here considered is concerned, *i.e.*, the trusteeship under the usual corporate mortgage,[5] this proposition has rarely been brought to question. The court, though reluctant[6] to alter a situation which the parties by their contract have created, will, nevertheless, remove a mortgage trustee when, in the exercise of a sound discretion, this expedient is necessary to a proper administration of the trust. A mere innocent breach of duty, however, though subjecting the trustee to liability for the damage caused thereby, will not justify his removal in the absence of evidence that such a course will result in some substantial benefit to the estate.[7] It must be shown that the trustee has become an incompetent person to execute the trust, either because of some personal disability, or because he has placed himself in a position antagonistic to the interests of the bondholders whom he represents. Insolvency,[8] permanent absence from the state,[9] collusion with the mortgagor,[10] willful breach of duty,[11] refusal to execute the trust upon proper demand be-

[5] Though the mortgagor was an individual in this case, the situation presented is comparable to that of the corporate mortgage in that the indenture was executed to secure an issue of coupon bonds rather than, as is the usual case with an individual's mortgage, one or a few promissory notes. Consequently the cases considered herein deal, in the main, with corporate mortgages.

[6] "It is generally a difficult thing to induce a court to remove a trustee. A court of equity has the power to do so, but will not regularly use that power." 4 COOK, CORPORATIONS (8th ed. 1923) §819.

[7] Matthews v. Murchison, 17 Fed. 760 (C. C. E. D. N. C. 1883). In Connover v. Guarantee Trust Co., 88 N. J. Eq. 450, 102 Atl. 844 (1918), the indenture provided that the bonds were to be secured by mortgages assigned and transferred to the trustee by the issuing corporation. The trustee accepted the corporation's own mortgages executed to itself. This was held to be beyond the authority of the trustee, consequently it was liable to the bondholders for any damages which might accrue, but the court refused to remove the trustee. There was no bad faith on its part, and "the trustee is a responsible banking institution. . . . The removal of a trustee is a matter directed to the sound discretion of a court; in the absence of bad faith upon the part of a trustee, he should not be removed unless some benefits to the trust can be accomplished by such removal."

[8] Insolvency does not *ipso facto* terminate the trust. Sanders v. Hall, 74 F. (2d) 399 (C. C. A. 10th, 1934); Mitchell v. Shuford, 200 N. C. 321, 156 S. E. 513 (1930). But it has long been recognized as a ground for removal, whether the trustee be an individual or a corporation. Iowa & Cal. Land Co. v. Hoag, 132 Cal. 627, 64 Pac. 1073 (1901); Reynolds v. New York Security & T. Co., 88 Hun 569, 34 N. Y. S. 890 (1895), *aff'd*, 157 N. Y. 689, 51 N. E. 1092 (1898); Clay v. Shela Valley Irr. Co., 14 Wash. 543, 45 Pac. 141 (1896). This is usually contained in the statutes providing for removal of trustees, see note 3 *supra*. If the trustee is no more than a bare stakeholder for the security, with no active duties to perform, the court in its discretion might properly refuse to remove him upon the grounds of insolvency alone.

[9] Ketchum v. Mobile & O. R. Co., 2 Woods 532, Fed. Cas. No. 7, 737 (C. C. S. D. Ala. 1876); 3 JONES, MORTGAGES (8th ed. 1928) §2296; *cf.* Ettlinger v. Schumacher, 142 N. Y. 189, 36 N. E. 1055 (1894) (holder of corporate bonds permitted to foreclose when trustee beyond the jurisdiction and unobtainable); Washington Etc. R. R. Co. v. Alexandria Etc. R. R. Co., 19 Gratt. 592, 100 Am. Dec. 710 (Va. 1870).

[10] Matter of Mechanics' Bank, 2 Barb. 446 (N. Y. Supreme Ct. 1848).

[11] North Carolina R. R. Co. v. Wilson, 81 N. C. 223 (1879) (trustee lent sinking fund money to a banking firm of which he was a member in violation of the provisions of the indenture).

ing made,[12] or any other fact showing the trustee to be incompetent will suffice. As this relief may be preventative as well as remedial, the trustee should be removed where he has placed himself in such a position that future injury may accrue to the trust therefrom. Thus where, at the time of foreclosure, the same party occupies the trusteeship under both prior and junior mortgages, he should be displaced from one or the other to obviate future embarrassment which may result from conflicts between the interests which he represents.[13] "Public policy requires, where controversies are brought into court, that each party should be represented by someone whose single object it is to secure all to which such party is entitled, unhampered by personal relations to an adverse party."[14]

A method of removal and substitution of trustees is frequently provided in the mortgage itself. Though the parties by their contract may not entirely deprive the court of its jurisdiction in this regard,[15] these provisions are generally upheld,[16] and an appointment made in compliance therewith will not be disturbed by the court except to correct some obvious abuse.[17] Thus where the power of removal and substitution is given to the majority of the bondholders under a corporate

[12] Harrison v. Union Trust Co., 144 N. Y. 326, 39 N. E. 353 (1895) (removal granted where trustee refused to convey property when ordered to do so by foreclosure decree).

[13] Farmer's Loan & Trust Co. v. Northern Pac. R. Co., 70 Fed. 423 (S. D. N. Y. 1895); Northampton Trust Co. v. Northampton Traction Co., 270 Pa. 199, 112 Atl. 871 (1921). *Contra:* Clyde v. Richmond & D. R. Co., 55 Fed. 445 (C. C. E. D. Va. 1893) (trustee held under twelve different mortgages on the same railroad system; bondholders committee was denied the right to intervene in foreclosure proceedings in the absence of a positive showing of negligence or inability to represent their interests upon the part of the trustee).

[14] Kephart, J., in Northampton Trust Co. v. Northampton Traction Co., 270 Pa. 199, 112 Atl. 871, 872 (1921). Some of the decisions, however, have displayed a reluctance to remove the trustee or to allow intervention by bondholders merely because of some mutual interest existing between trustee and mortgagor, majority bondholders committee, etc. Bowling Green Trust Co. v. Virginia Passenger & Power Co., 132 Fed. 921 (C. C. E. D. Va. 1904) (trustee corporation and mortgagor corporation controlled by the same group); Continental & C. Trust & S. Bank v. Allis-Chalmers Co., 200 Fed. 600 (E. D. Wis. 1912) (trustee "coöperating" with a combination to reorganize the mortgagor company); Fidelity Trust Co. v. Washington-Oregon Corp., 217 Fed. 588 (W. D. Wash. 1914) (trustee's position as depositary for bonds under reorganization agreement not grounds for removal); McPherson v. Commercial Bldg. & Securities Co., 206 Iowa 562, 218 N. W. 306 (1928) (trustee indirectly interested in protection of directors of mortgagor and will not proceed as "aggressively" as would bondholder).

[15] *Cf.* Wright v. Pitts, 62 App. D. C. 217, 66 F. (2d) 197 (1933).

[16] JONES, *loc. cit. supra* note 9. *Cf.* Fletcher v. Rutland & B. R. Co., 39 Vt. 633 (1858) (statute, passed after the execution of the mortgage, which in effect nullified power of appointment was in violation of the contract clause of the United States Constitution); Farmers' Loan & Trust Co. v. Hughes, 11 Hun 130 (N. Y. Supreme Ct. 1877) (former trustee enjoined from bringing actions as trustee after removal).

[17] However, the court will be very reluctant to disregard the method provided. Dillaway v. Boston Gaslight Co., 174 Mass. 80, 54 N. E. 359 (1899).

mortgage, the motives for its exercise cannot be questioned so long as no abuse of trust to the detriment of minority bondholders appears; with this limitation, the decision of the majority as to the adequacy of the reasons for removal is conclusive.[18] However, a strict construction is always accorded these provisions.[19] Any failure to comply with the stipulated formalities is likely to prove fatal.[20] But it is unnecessary to follow the statutory procedure, where one exists, since the trustee is replaced under the contract of the parties rather than through the ordinary legal machinery.[21] Likewise, the appointee will succeed to the trusteeship without any formal conveyance from his predecessor.[22] Where the mortgage was executed by an individual, some of the earlier cases have shown a tendency to weaken the effect of the power of appointment by construing it as personal to the creditor named in the indenture. It has been held that it is neither assignable with the debt,[23] nor delegatable to an agent.[24] But even where this view has been adopted the more recent cases show a tendency to construe the instrument so as to avoid its application,[25] and no such limitations are placed upon the power when granted to the holders of bonds secured by a corporate mortgage.[26]

Removal pursuant to such mortgage provision may be accomplished without notice to interested persons, even though court approval be the final step required. The parties by their contract have provided the remedy, thus rendering the customary legal formalities unnecessary.[27] But where no such provision is found in the mortgage, there must be some jurisdictional basis for the court to take action in the matter. Either all the parties concerned must be joined in the litigation, or the property involved must have been brought within the ambit of the court's control. In the former case the action is *in personam.* Mort-

[18] March v. Romare, 116 Fed. 355 (C. C. A. 5th, 1902).

[19] THOMPSON, *op. cit. supra* note 4, §2668.

[20] The attempted substitution was held ineffectual in the following cases. Speers Sand & Clay Works, Inc. v. American Trust Co., 37 F. (2d) 572 (C. C. A. 4th, 1930); Griffin v. Haden, 172 Ga. 478, 157 S. E. 686 (1931); Equitable Trust Co. v. Fisher, 106 Ill. 189 (1883); James v. James, 260 Mass. 19, 156 N. E. 745 (1927). But *cf.* Balfour-Guthrie Inv. Co. v. Woodworth, 124 Cal. 169, 56 Pac. 891 (1899) (method of proof of appointment of successor trustee provided in the mortgage not exclusive); Underhill v. Whitney, 88 Colo. 608, 299 Pac. 12 (1931) (court refused to allow collateral attack by one who was a stranger to the trust).

[21] Raleigh Real Estate & Trust Co. v. Padgett, 194 N. C. 727, 140 S. E. 714 (1927).

[22] Craft v. Indianapolis, D. & W. Ry. Co., 166 Ill. 580, 46 N. E. 1132 (1897).

[23] Clark v. Wilson, 53 Miss. 119 (1876).

[24] Watson v. Perkins, 88 Miss. 64, 40 So. 643 (1906). *Contra:* Michael v. Crawford, 150 S. W. 465 (Tex. Civ. App. 1912).

[25] West v. Union Naval Stores Co., 117 Miss. 153, 77 So. 961 (1918).

[26] City Bank & Trust Co. v. Graf, 175 Ga. 340, 165 S. E. 238 (1932).

[27] Macon & Agusta R. Co. v. Georgia R. Co., 63 Ga. 103 (1879); Pillsbury v. Consolidated E. & N. A. Ry. Co., 69 Me. 394 (1879).

gagor, trustee, and bondholders, or their representatives, are necessary parties.[28] Here the court has power over the person of the trustee to compel a transfer by him of his interest in the entire *res* to his successor. Where a part of the security is real property located in another jurisdiction the conveyance will be recognized in the courts of its *situs*. It is not the decree of the removing court which is being effectuated but the act of the parties which, though perhaps under judicial duress, is none the less valid.[29] But if the trustee be not found within the state, the court must obtain jurisdiction over the property before it may divest the trustee of his interest therein. The decree will be *in rem*, and cannot operate upon property beyond the state line.[30] Once this jurisdiction over the property is acquired, interested parties not otherwise obtainable may be served by publication.[31] Where the trustee's interest in the security is dubbed "legal title," or "lien," there is little doubt but that he can be served by publication. However, the situation presented to the Georgia court is more perplexing. Under the rule prevailing in that state the trustee has no more than a mere power or agency in regard to the property, while the legal title to the security is in the bondholders.[32] On this basis it was held that there was nothing before the

[28] Hidden v. Washington-Oregon Corp., 217 Fed. 303 (W. D. Wash. 1914); Inhabitants of Anson v. Somerset R. Co., 85 Me. 79, 26 Atl. 891 (1892); Cory v. Clmstead, 154 Tenn. 513, 290 S. W. 31 (1926).

[29] Smith v. Davis, 90 Cal. 25, 27 Pac. 26 (1891); Poindexter v. Burwell, 82 Va. 507 (1886) ("The doctrine is that if the person to do the act decreed is within the jurisdiction of the court, and the act may be done without the exercise of any authority *operating territorially* within the foreign jurisdiction, the court may act *in personam*, and oblige the party to convey, or otherwise to comply with its decree."); Penn v. Lord Baltimore, 1 Ves. Sr. 444 (Ch. 1750); Beale, *Equitable Interests in Foreign Property* (1907) 20 HARV. L. REV. 382. It has been held that a court may appoint a receiver and decree foreclosure though the property lies beyond its jurisdiction. Paget v. Ede, L. R. 18 Eq. 118 (1874). Likewise the court of one state can order foreclosure of a mortgage upon a railroad which extends through several states. Craft v. Indianapolis, D. & W. Ry. Co., 166 Ill. 580, 46 N. E. 1132 (1897); Union Trust Co. v. Olmsted, 102 N. Y. 729, 7 N. E. 822 (1882). But here again it is the conveyance of the parties which is recognized by a foreign court. The decree cannot *per se* have an extraterritorial effect. Lynde v. Columbus, C. & I. C. Ry. Co., 57 Fed. 993 (C. C. D. Ind. 1893). Statutes commonly provide that the court's decree may in certain cases operate as a conveyance. N. C. CODE ANN. (Michie, 1931) §607. The degree, however, cannot have the effect of transferring property beyond the jurisdiction of the court which renders it. This must be done by compelling the parties to execute a conveyance. 4 POMEROY, EQUITY JURISPRUDENCE (4th ed. 1919) §§1317, 1318.

[30] Parker v. Kelley, 166 Fed. 968 (C. C. W. D. N. Y. 1908); *cf.* Lindsley v. O'Reilly, 50 N. J. L. 636, 15 Atl. 379 (1888).

[31] Ketchum v. Mobile & O. R. Co., 2 Woods 532, Fed. Cas. No. 7,737 (C. C. S. D. Ala. 1876) (trustee served by publication): State Nat. Bank v. Syndicate Co. of Eureka Springs, Ark., 178 Fed. 359 (W. D. Ark. 1910) (nonresident bondholders may be served by publication); Marshall v. Kraak, 23 App. D. C. 129 (1904) (removal valid even without service by publication where trustee had left the jurisdiction). But *cf.* Washington Etc. R. R. Co. v. Alexandria Etc. R. R. Co., 19 Gratt. 592, 100 Am. Dec. 710 (Va. 1870).

[32] See the court's discussion 176 S. E. 384-385.

court upon which service by publication could be predicated, despite the fact that the security was Georgia realty. This conclusion is not altogether without support,[33] and it follows logically from the premise if we permit our deductions to lead us through the esoteric technicalities with which the field of mortgage law is replete. But in this respect there is no empirical difference between trustees of Georgia and of North Carolina real estate. In the last analysis what the trustee does have, whether it be legal title, lien, power, or whatnot, is intimately associated with the property conveyed as security. The court's control over the latter should form a basis for publication of service. Mere names should not alter the situation. Otherwise substantial interests of bondholders may sometimes be sacrificed for the preservation of this legal will-o'-the-wisp that is the trustee's interest, an interest that exists only for the protection of the bondholders, and serious difficulties might arise should the trustee choose to absent himself at a time when his services are most necessary.[34]

JOEL B. ADAMS.

Trial Practice—Power of Court to Increase Damages as Condition to Denial of Motion for New Trial.

A jury in a federal district court awarded the plaintiff $500 damages for personal injuries caused by the defendant's negligence. On the plaintiff's motion a new trial was ordered because of inadequacy of damages unless the defendant consented to increase the verdict to $1500. The defendant consenting, the motion for new trial was automatically denied, and the plaintiff appealed to the circuit court of appeals where the trial court's action was reversed.[1] Defendant obtained certiorari in the Supreme Court, which divided five to four in upholding the action of the intermediate appellate court.[2]

Mr. Justice Sutherland, writing the majority opinion, said that the imposition of such a condition on the denial of a motion for a new trial violated the plaintiff's right to jury trial, as guaranteed by the Seventh Amendment. He traced the historical development in early English mayhem cases of the procedure followed by the trial court in this case, but concluded that those cases had been overruled and were not the common law at the time the Constitution was adopted. The converse

[33] *Cf.* Sanders v. Hall, 74 F. (2d) 399 (C. C. A. 10th, 1934).

[34] Ordinarily a trustee must obtain court approval in order to free himself from the trust if he chooses to resign. Under the doctrine of the principal case, the Tennessee court would have authority to approve such resignation, since the *situs* of the trust is within its jurisdiction. *Cf.* Sanders v. Hall, 74 F. (2d) 399 (C. C. A. 10th, 1934).

[1] Schiedt v. Dimick, 70 F. (2d) 558 (C. C. A. 1st, 1934).

[2] Dimick v. Schiedt, 55 Sup. Ct. 296 (U. S. 1935).