Statement of the case.

## Bronson et al. v. La Crosse and Milwaukie Railroad Company et al.*

1. Stockholders of a corporation, who have been allowed to put in answers in the name of a corporation, cannot be regarded as answering for the corporation itself. In a special case, however, where there is an allegation that the directors fraudulently refused to attend to the interests of the corporation, a court of equity will, in its discretion, allow a stockholder to become a party defendant, for the purpose of protecting—from unfounded and illegal claims against the company—*his own interest* and the interest of such other stockholders as choose to join him in the defence.
2. The filing of a cross-bill on a petition without the leave of the court is an irregularity, and such cross-bill may be properly set aside.
3. Judgments recovered against a corporation in Wisconsin, after the date of a mortgage by it, are discharged by a foreclosure of the mortgage.
4. Until the filing of his bill of foreclosure and the appointment of a receiver, a mortgagee has no concern or responsibility for or in the dealings of a mortgagor with third parties, such as confessing judgment, and leasing its property subject to the terms of the mortgage.
5. Where a mortgage is made in express terms subject to certain bonds secured by prior mortgage, these bonds being negotiable in form, and having in fact passed into circulation before such former mortgage was given, the junior mortgagees, and all parties claiming under them, are estopped from denying the amount or the validity of such bonds so secured, if in the hands of *bonâ fide* holders. Parties holding negotiable instruments are presumed to hold them for full value, and whether such instruments are bought at par or below it, they are, generally speaking, to be paid in full, when in the hands of *bonâ fide* holders, for value. If meant to be impeached, they must be impeached by specific allegations distinctly proved.
6. A court of equity, where a mortgage authorizes the payment of the expenses of the mortgagee, may pay, out of funds in his hands, the taxed costs, and also such counsel fees in behalf of the complainants as, in the discretion of the court, it may seem right to allow.

Bronson and Souter filed their bill in the Circuit Court for the District of Wisconsin, to foreclose a mortgage made on the 17th August, 1857, by the La Crosse and Milwaukie Railroad Company, a corporation of Wisconsin, covering a portion of a railroad made by the said company in that

* This case was decided at the last term.

State,—the portion being between Milwaukie and Portage City, about ninety-five miles, and called the Eastern Division.* The mortgage was made to the said Bronson and Souter as trustees, to secure the payment of bonds for one million of dollars issued by the company. *These bonds were payable to bearer* in New York, with interest at eight per cent., payable semi-annually. They were registered and countersigned by the trustees, and delivered to the company, and in the autumn of 1859 *had been negotiated and put into circulation.* They were for $1000 each.

The bill alleged that default had been made in the payment of interest, and prayed that the La Crosse and Milwaukie Railroad Company, and all other persons claiming under it, might be decreed to deliver to them, B. and S., or to their agents, and to put them into possession of, the railroad, with its appurtenances; and that all the income of the road might be applied to the payment of the moneys due, and to become due, on the mortgage or bonds; and that the road, with its rolling stock and franchises, might be sold, &c.; and that, pending the proceedings, a receiver might be appointed. The bill was filed December 9th, 1859.

An order *pro confesso* was entered against the company.

Certain other parties, however, besides the La Crosse and Milwaukie Railroad Company, were made parties to this bill.

1. The *Milwaukie and Minnesota* Railroad Company. This company had been organized upon a sale of the La Crosse and Milwaukie Railroad, just named, under a *third* mortgage, which had been made to one Barnes, as trustee, by the debtor company, junior to that of the complainants. This Barnes mortgage, with a supplement to it, was made to secure an issue of bonds to the amount of TWO millions of dollars. The mortgage and supplement, by its terms, was made subject to certain incumbrances, and, among them, "*to the bonds secured by a second mortgage on the Eastern Divi-*

* For an understanding of the position of this road, its Eastern Division, &c., see diagram, *infra*, p. 610.

Statement of the case.

*sion of the road to the amount of one million of dollars;*" the mortgage, to wit, now sought to be foreclosed. They also had on their back the indorsement thus:

"State of Wisconsin. La Crosse and Milwaukie Railroad Company, 3d mortgage sinking fund bond, seven per cent., &c.;" subject, among other things, "to a 2d mortgage on the same line of road of $1,000,000."

This company did not appear to the bill, but permitted it to be taken as confessed.

2. Certain private individuals—Zebre Howard, also Graham and Scott—were made defendants; the bill alleging that they had, or claimed to have, some interest in the mortgaged premises.

Howard answered the bill, setting forth that, on the 1st of May, 1858, he obtained a judgment against the debtor company, in the Circuit Court of Milwaukie County, for $25,586.78; and that this judgment remaining unpaid, he commenced suit thereon in the District Court of the United States, and recovered judgment in that court November 28th, 1859, for $16,379.86.*

Graham and Scott also answered the bill, setting up a judgment in their favor, recovered in the said District Court in December, 1859, for $41,008.86, founded on two former judgments in their favor in the State court.

The answer of Howard, and that of Graham and Scott, asserted that these judgments, respectively, were liens upon the mortgaged premises; and set forth various matters in defence against the relief prayed for by the complainants. Replications were filed to both these answers. No proof was made of these judgments other than that of their being included in a list of judgments appended to the report of a master in the case.

After the time had expired within which the Milwaukie and Minnesota Railroad Company ought to have answered, but before an order had been entered taking the bill against them *pro confesso*, one J. S. Rockwell, a stockholder of the

* There seemed to be some confusion about these dates, &c., not perfectly understood by the reporter.

said company, presented to the court his petition, charging collusion between the complainants or their agents and one Russell Sage, President of the said Milwaukie and Minnesota Company, to secure a foreclosure and sale in their cause, for the purpose of extinguishing the rights of the said Milwaukie and Minnesota Company, which was alleged to be the owner of the equity of redemption of the mortgaged premises; and that the President of the said last-named company, although requested by its stockholders, had declined to make any defence in this cause. The petition prayed leave to defend the bill, "*on the part of said company*, as a defendant therein, and to be let in and allowed to make such defence as he may be advised is proper or necessary, in the place of said company, as a party defendant to said action, and for a reasonable time to prepare and file his answer." Upon this petition, the court "ordered that the said Rockwell be, and hereby is, allowed to make defence to this bill in the name of said Milwaukie and Minnesota Railroad Company, to the same extent *as the said company could do*, under the rules and practice of this court." In pursuance of this order, Rockwell filed his answer, entitled "The separate answer of J. S. Rockwell, who, by the order of this court, is allowed to make defence to the bill, &c., in the name of the Milwaukie and Minnesota Railroad Company." This answer was signed by Rockwell individually.

Fleming, another stockholder of the Milwaukie and Minnesota Company, presented a petition, charging collusion, as before charged in the petition of Rockwell, apparently upon the theory that Rockwell's was his individual answer, and not that of the company, and praying leave "to put in an answer for said Milwaukie and Minnesota Railroad *Company*, and that said *company* may have thirty days' time to perfect the same, and *prepare a cross-bill as shall be necessary*." Upon this petition, the court "ordered that the said Fleming have leave to put in answer *in the name of the Milwaukie and Minnesota Railroad Company*." Under this order, Fleming filed an answer, entitled, "The answer of the Milwaukie and Minnesota Railroad Company, one of the defendants to

the bill," &c. This answer was signed "The Milwaukie and Minnesota Railroad Company, by A. Fleming, stockholder;" and also, "A. Fleming, stockholder of the Milwaukie and Minnesota Railroad Company." The complainants filed replications to these answers, entitled "Replications, &c., to the answer of J. S. Rockwell," and "Replication, &c., to the answer of the Milwaukie and Minnesota Railroad Company."

The answer of Fleming set up, in general terms, that the bonds of the La Crosse and Milwaukie Company for the one million of dollars were issued, and the mortgage of the road to the complainants made, in violation of the charter of the company, and in fraud of the stockholders and creditors, and it then set forth six particular instances of the alleged fraud on the part of the company, or its officers and directors, in disposing of the bonds. These six instances being connected with the names of, 1st, Chamberlain; 2d, one S. R. Foster; 3d, J. T. Souter, a trustee and complainant; 4th, Greene C. Bronson, another trustee and complainant; 5th, one Prentiss Dow. The 6th charge had reference to a certain leasing of the road to Chamberlain. The answer proceeded thus:

The defendant, answering, states and shows, *upon information and belief*, that the said mortgage and the said one thousand bonds, to which the same is collateral security, was gotten up, contrived, and executed by the said railroad company, when the said company was well known to its board of directors to be greatly embarrassed in its pecuniary condition and affairs, for the corrupt and fraudulent purpose of disposing of said bonds, or a large part thereof, in payment of pretended debts to the officers and agents of said company, or their friends, without any consideration to be paid therefor, or in exchange for the stock of said company, then of little or no value, held by its officers and agents or their friends; and that, in point of fact, a large part of said bonds were so disposed of and given away in violation of the true intent and meaning of the charter of said company, in fraud of its creditors, and of this defendant in par-

ticular; that two hundred of said bonds, being those numbered from 651 to 825 inclusive, and from 851 to 875 inclusive, were delivered or given to the defendant, Chamberlain, in *pretended* payment or satisfaction of a claim of said Chamberlain for services rendered to said company, or for damages sustained by him by reason of the breaking up or surrender of a contract or contracts between him and said company, which claim was wholly fictitious, or was greatly over-estimated, for the fraudulent purpose of enabling him to receive and hold said bonds; that one hundred of said bonds were given to S. R. Foster, of the city of New York, as a security for a *pretended* indebtedness of said company to him, but that, in truth and in fact, said company was not indebted to said Foster, on a fair settlement of accounts, in any sum whatever, but that said Foster was largely indebted to said company; that about fifty-five of said bonds were delivered to the said complainant, J. T. Souter, either without any consideration at all, or as collateral security to or in exchange for certain bonds of the said company, theretofore issued corruptly and fraudulently, and without any legal authority whatever, by the said company, and popularly known as "Corruption Bonds," or "Barstow Bonds," and that said Souter gave no valid or valuable consideration therefor, but that the said transfer to him of the said fifty-five bonds was fraudulent; that fifteen of said bonds were delivered to the complainant, G. C. Bronson, in exchange for stock of the said company, and was pretended to have been sold to him for the stock of said company, which stock was at the time nearly or wholly worthless; and this defendant insists that neither the said company, nor its directors, officers, or agents, had any authority, power, or right whatever to purchase from said Bronson said stock for or on behalf of said company, and pay therefor with money or property or bonds of said company, and that said pretended sale of said fifteen bonds to said Bronson was illegal and fraudulent; that about six hundred of said bonds were sold and disposed of at the nominal price of 80 cents on the dollar, as follows, viz.: forty cents on the dollar of the amount specified in the said bonds, respectively, was to be paid in money, and forty cents on the dollar of said amount in the bonds of said company, known as aforesaid as "Barstow Bonds," or in the said bonds known as "Corruption Bonds," or in the stock of said company; and that the said company received for said six

hundred bonds only about one hundred and ninety thousand dollars in cash, and that it received in said bonds known as "Barstow Bonds" and "Corruption Bonds," and mostly in said Barstow bonds, so-called, about one hundred thousand dollars, and the remainder, to make up said eighty cents on the dollar, in the stock of said company; and this defendant insists that neither the said company, nor its directors, officers, or agents, had any authority, power or right to sell said bonds and receive the capital stock of said company in part payment therefor, and that all of said six hundred bonds, disposed of as aforesaid, are fraudulent and void, and ought to be surrendered and cancelled.

The answer further stated that one *Prentiss Dow*, who was an agent of the company, received fourteen of the bonds for a sum less than one thousand dollars.

It then set forth the circumstances attending a certain *leasing of the road* by the La Crosse and Milwaukie Company to Chamberlain, and the delivery of possession of the same, with its rolling stock and appurtenances generally. According to the terms of the lease referred to, Chamberlain bound himself, after paying the interest and existing claims arising out of prior liens and incumbrances, to apply the net proceeds of the road to the accruing interest on the bonds secured by the mortgage to the complainants. And the allegation of the defendant was, that Chamberlain and the complainants, or their agents, combined to withhold the payment of the interest, for the purpose and with the intent of forcing a sale of the road and its appurtenances, under the mortgage, for the benefit of Chamberlain, that he might become the purchaser; and that the present suit was instituted in pursuance of this arrangement; that Chamberlain had funds in his hands, the proceeds of the road, to pay the interest coupons due the 1st of September, 1859. The answer then set out the title of the Milwaukie and Minnesota Company under the foreclosure of the third mortgage.

The answer of Rockwell, the other stockholder, was substantially the same as that of Fleming.

The evidence in regard to these facts was very voluminous and intricate, making what the court styled "a *most* compli-

cated and difficult case."* It filled a volume of more than one thousand large pages of small pica, set "solid." The facts, too, were resolutely contested, the argument in this court, and chiefly upon them, having lasted six days. It is not possible to present here the evidence of them. As assumed by the court in the result and truth to have been proved, they were in substance somewhat thus, though this was not exactly the view taken of them by Mr. M. H. Carpenter, counsel of the defendants to the bill, who collocated, presented, and enforced the evidence of irregular dealing with singular eloquence and force.

1. *As respected Chamberlain.* This person, who had been a contractor on the western part of the road, held a claim for damages against the company, on account of their failure to fulfil their contracts made with him; a failure which arrested the progress of the work. In the autumn of 1857, upon the issue of the bonds of the company under this second mortgage, an arrangement was entered into by the company, by which he received, towards payment of this claim, the two hundred bonds in question; not at par, but *at fifty cents on the dollar.*

2. *As respected S. R. Foster.* He had lent to the company more than one hundred and fifty thousand dollars, and had taken their bonds as security. Among them were the one hundred in question. At a meeting of the board of directors, 24th of May, 1858, the matter between the parties was adjusted by delivery to him of forty bonds, called "land grant bonds." The terms on which he held them were not distinct; but it was not shown that he paid what is called their "face;" in other words, their par.

3. *As respected J. T. Souter.* The fifty-five bonds in controversy between him and the company were settled, as appeared by a receipt of one Guest, their chairman and vice-president, on 14th of September, 1858, by the delivery of other bonds to the company.

4. *As respected G. C. Bronson.* He had purchased fifteen

* See 1 Wallace, p. 411, note.

thousand dollars worth of stock from the company in the spring of 1857, and *paid eighty cents, cash, on the dollar*, the president, at the time, agreeing that the company would repurchase it at the same rate at any time thereafter, if he should wish to surrender it back. In September, 1858, they did take it back; and for this, delivered to him the fifteen bonds. A meeting of the board of directors on the 2d of that same September had resolved that it would take into consideration the stock theretofore purchased by Judge Bronson, as he had rendered many services to the company, for which he had received no compensation.

5. *As respected Prentiss Dow.* It appeared that *thirteen* bonds had been received by him, and that for these he paid the company at the time but $11,400 in cash, stock, and *other bonds*, the value of which was not so entirely evident. However, he was afterwards engaged in the company's service as its agent, settling claims against the company.

Without going into more particulars, it seemed that at the time these bonds were issued, and afterwards, the La Crosse and Milwaukie Company were a good deal pressed for money, as it remained all along. Before issuing the bonds now in question, it had printed and circulated a letter essentially as follows; and the bonds, when made, were sold pretty generally, it rather appeared, for what they would bring; and that what they would bring was sometimes not much. The transactions, so far as the reporter could understand the immense body of testimony, had a good deal the aspect which generally marks the fiscal arrangements of unfinished and embarrassed railroad companies endeavoring to get themselves into successful operation. While resorts to equivocal expedients might have been sometimes practised, many of the witnesses spoke without personal knowledge, and from impressions chiefly. The circular was thus:

"Office of the La Crosse
and Milwaukie Railroad Co.,
August 10, 1857.

"The importance of completing our road this season to the junction of the Western Division, sixty-one miles from Portage

City, by which we should not only control the coming winter's travel of the Upper Mississippi, but receive over 300,000 acres of our land grant, has decided the board of directors to place before the stock and bondholders extraordinary inducements to furnish the means necessary to accomplish this object. The sum required to meet the engagements of the company, and finish the road sixty-one miles beyond Portage City, is about $400,000. To obtain this sum, the company now offers to the holders of its stock and unsecured bonds (now so much depreciated in market) a new issue of one million of eight per cent. bonds, payable in 1870, secured by a deed of trust to Hon. Greene C. Bronson, and J. T. Souter, President of the Bank of the Republic, in New York, upon the Eastern Division of its road from Milwaukie to Portage City, ninety-five miles, subject to a prior lien of about $13,000 per mile.

"It was intended to issue this new loan exclusively to stockholders, receiving in payment $400 in the stock of this company, and $400 in cash for a bond of $1000, but it has been concluded to extend a like privilege to bondholders of the *unsecured* bonds of this company which are outstanding, receiving such bonds, with unpaid coupons flat, upon the same terms as the stock.

"The subscription will be paid as follows: one-fourth of the cash payment at the time of making the subscription; the remainder, with the stock or old bonds, to be surrendered either at the time of subscribing, or on the first day of September, when the new bonds will bear date and be ready for delivery.

"Books are now open at this office.

"BYRON KILBOURN,
"President."

6. *As to the charge of collusion of the complainants with Chamberlain in the proceedings to foreclose the mortgage.* This allegation was founded upon an agreement entered into with Chamberlain, on the 13th of November, 1859. At the time of this agreement he was in possession of the road and in the receipt of its earnings, and, for the purpose of giving to the trustees the control of its earnings during the proceedings to foreclose, he agreed to deposit them with the agent of the trustees, from day to day; and the trustees, on their part, *agreed* to appropriate them to the objects and uses

provided for in the lease, as the exigencies and working of the road might require. The trustees, in order to secure the control of the agents of Chamberlain, connected with the earnings of the road and the receipts of its revenues, stipulated for a supervision over them, and for the discharge of any of them from the service if desired. They provided, also, for access to the books and papers relative to the revenues, &c., of the road; also, for the appointment of a receiver in case of the non-fulfilment of the agreement on the part of Chamberlain.

The interest on the second mortgage bonds, then due on them, amounted to $40,000. It was now agreed, that the proceedings of foreclosure should be conducted amicably; that no considerable opposition should be made to them by Chamberlain; and, also, that the sale should be made, if practicable, subject to the lease to Chamberlain, and that no opposition should be made to his purchase of the road at the sale under the foreclosure; but the trustees reserved the right to bid at the sale for the protection of the bondholders. The trustees also agreed, that in case Chamberlain should become the purchaser, they would extend a credit of nine, and twenty-four months upon so much of the interest as had become due.

On the 3d of September, 1860, Fleming exhibited in the District Court, in this cause, a CROSS-BILL in the name of the Milwaukie and Minnesota Railroad Company, against the complainants, for discovery in support of the answer filed by him in the name of the company; and, on the same day, the court made an order on the cross-bill, that a subpœna should issue, and service be made on the solicitor of the defendants. Subpœna was issued accordingly. On the same day the court ordered that the said Bronson and Souter, defendants aforesaid, "do enter their appearance in this suit in the clerk's office, on or before the day and time at which this subpœna is returnable, as aforesaid; otherwise, the bill filed must be taken as confessed." The defendants to the cross-bill moved the court to strike it from the files, for the

reason that it had been filed without leave of the court, and, also, subject to this motion to strike off, filed a demurrer to it. The court subsequently made an order sustaining the motion.

The cause was finally heard below, and decree passed in favor of the complainants, for FIFTY CENTS ON THE DOLLAR of the amount, principal and interest, specified in the bond secured by their mortgage to the complainants, and directing a sale of the railroad between Milwaukie and Portage.* The road was at this time in the hands of a receiver.

On appeal here, the following were the principal points:

1. As to the answers of the two stockholders, Rockwell and Fleming, and of Fleming more particularly:—How far these answers of individual stockholders were to be regarded as answers of the Milwaukie and Minnesota Company?

2. Whether the cross-bill of Fleming had been properly dismissed? no leave having been asked to file it.

3. As respected the judgments of Sebre Howard and of Graham and Scott:—Whether they were liens?

4. The real nature and effect of the transactions with the parties: 1. Chamberlain [his bonds]; 2. S. R. Foster; 3. J. T. Souter; 4. Greene C. Bronson; 5. Prentiss Dow; 6. Chamberlain [his lease, &c.].

5. Whether, on the whole case, and in view of the express terms of the third mortgage, that its bonds, &c., were to be subject to the prior, or second mortgage, the complainants were entitled to have no more than fifty cents, as decreed them in the court below, on the dollar, or to have the full amount which the bonds on their faces called for.

*Mr. Carpenter, for the defendants:*

1. An issue was formed upon the record, between the complainants and the Milwaukie and Minnesota Railroad Company, by their filing a replication to its answer; and the complainants are now estopped from insisting that the *com-*

* Whether this decree directed also a sale of any portion of the rolling stock, was one of the questions litigated by the parties in a second appeal, reported *infra*, p. 609.

*pany* has not made defence. It is merely a question between the company and its stockholders, Fleming and Rockwell; and as the company did not in court object to the individual answer, but, on the contrary, retained counsel in this court to insist upon it, the company must be deemed to have ratified the act of its stockholders, and thereby to have recognized and ratified the answer so made in its name.

2. No leave was necessary to file the cross-bill. The leave which was granted to file the answer carried with it the leave to sustain the answer by testimony; and the cross-bill was a legitimate and proper method of obtaining such testimony. If leave were necessary, the order of the court upon the cross-bill, directing subpœna to issue, and ordering the defendants therein to appear and answer, was equivalent to leave.

3. As respects the judgments of Sebre Howard and of Graham and Scott. There appears to be some confusion or misapprehension of dates. As we understand them, the judgments were liens. The existence of judgments cannot be really doubted. The mention of them by the master in his *list of judgments* should be enough in the absence of counter-testimony.

4. The testimony, as we understand it, goes to show that these transactions with Chamberlain, Foster, Souter, Bronson, and Dow, were very irregular; that the parties were not *bonâ fide* holders for full value at all. The bonds were procured by the relations of confidence and control in which the parties stood to the road, by breaches of trust and confidence, implied, if not direct. Certainly, there were many of them got at enormous discounts. This sort of operation is a crying evil of our country. Men placed to manage corporations for the interest of the stockholders, manage them only for their own. They become contractors, half ruin the corporation, pay themselves with its assets at enormous discounts, then resuscitate things and are rich in the result. Here Chamberlain, confessedly, paid but fifty per cent. for his large amount. As to Souter, he was a trustee; a party who ought not to have dealt in these bonds at all.

Guest, under whose act he claims, was vice-president, no doubt; but this gave him no authority to make the transactions with Souter which he did. Bronson's claim is worse; he was a trustee and a stockholder both; stockholder in an insolvent corporation. He sold, or pretended to sell, his stock to the company for $15,000; bonds secured by mortgage on its property. This was a fraud upon its creditors. The assets of a corporation constitute a fund for the payment of its debts. "If they are held by the corporation itself, and so invested as to be subject to legal process, they may be levied on by such process. *If they have been distributed among stockholders*, or gone into the hands of other than *bonâ fide* creditors or purchasers, leaving debts of the corporation unpaid, *such holders take the property charged with the trust in favor of creditors*, which a court of equity will enforce, and compel the application of the property to the satisfaction of their debts."* Bronson was transformed by the operation which he effected, and which we object to, from the condition of one of the corporators of an insolvent corporation to that of its preferred creditor.

5. How does the notice on the back of the third mortgage affect the case? Even though the organization of the Milwaukie and Minnesota Company arose under a junior mortgage, it still claims with the rights of both a purchaser and a creditor, for it advanced its money on a specific lien.† Such a party may always set aside a fraudulent conveyance, even though when about to lend his money such conveyance may have been flouted in his face to prevent his doing so. These trustees nowhere assert that they hold for *full value*, or that any one under them does, though they state that the bonds were signed, registered, issued, and negotiated. Every one in Wisconsin knows that no full value was given. The term "Corruption Bonds" was not more the stigma of a fraud than an illustration of the natural tendency of language to assert proper nomenclature from new facts. The

* Curran *v.* State of Arkansas, 15 Howard, 307.

† Finch *v.* Earl of Winchelsea, 1 Peere Williams, 278.

circular issued August 10th, 1857, shows the circumstances under which parties were invited to buy these bonds. They were invited to irregular transactions; and the sequel showed that they profited well of their bidding.

6. The lease to Chamberlain was a part of the general style of management; and if the final arrangements by which the attempt to foreclose the second mortgage were facilitated are conceived of by the court as we conceive them, it will have no difficulty in simply affirming the decree.

*Messrs. Carlisle and J. S. Brown, contra:*

1. The answers by Fleming and Rockwell were not an appearance of the *company*, or answer of the *company*, in fact. The company was a distinct, political, or legal person, which could sue Mr. Fleming or Mr. Rockwell, or be sued by them. A corporation must appear by its authorized attorney, and its answer must be under seal, authenticated and attached by the proper officers. The law intrusted the management of its affairs to a board of directors, and in the eye of the law, and for purposes of this suit, they alone represent the company. It was for that board to determine whether any defence, and what defence, was expedient, and whether they would file an answer admitting our rights, or by silence give an admission in the law. That board of directors chose the latter mode, and upon that fact the court below gave us an order, *pro confesso*, against it. Its position as defendant to a foreclosure suit gave the court below no power to take the management of the suit from the directors (or, in other words, from the defendant interested) and give it to a man who, although stockholder, was in the law a stranger. It certainly gave no power so to do on a petition, without notice to the directors interested in the result. If they had abused their powers, or misrepresented the interests of the company in such a manner as to justify a decree of ouster, that should have been obtained by decree of a State court having jurisdiction over such matter, upon proper proceeding, for that identical purpose; and then the management of the company affairs and of its defence would be in

such new hands as the law intrusted them to, and not in a mere volunteer for the purpose of litigation.

2. The fact that the cross-bill was irregularly filed we think to be clear by the settled rules of chancery. The court below, itself, set it aside, though decreeing generally so much against us.

3. To entitle Graham and Sebre Howard to defend against the mortgage as a fraud upon creditors, it was necessary for them to set up in their answers, and to *prove* their relations as creditors at the *time* of the mortgage; a *subsequent* relation of creditors does not enable them to inquire into these frauds. No evidence of judgments is before the court but the list attached to the master's report, and this does not prove their dates or their existence. Courts do not allow litigation of abstract principles; and a party who complains of fraud must show that he can gain or lose by the decision of the court.

In their answers, Graham and Scott allege a judgment in the Circuit Court of Milwaukie County in September, 1858, and a judgment in the United States District Court in 1859, both of which were *subsequent* to the third mortgage. Howard alleges a judgment in the Circuit Court of the County of Milwaukie in May, and a subsequent judgment in the United States District Court in 1859, for the same cause of action.

4. The making of the mortgage and the issuing of the bonds is confessed. Now how stand the individual cases which make the most defined cause of defence?

*As to Chamberlain.* The two hundred bonds issued to him depend upon the power of directors in good faith to agree with a contractor upon the amount of damages done to him for breach of contract. Chamberlain had a just claim, and they pay him in bonds at their market rate. What objection is there to this, even if the rate is but fifty per cent.?

*As to Foster.* These one hundred bonds were sold in the regular course of business; and the directors afterwards, on settlement, allowed Mr. Foster an additional amount in land-grant bonds.

*As to J. T. Souter.* These fifty-five bonds were given in

exchange for other bonds of the company, for which the receipt of the vice-president is produced.

*As to G. C. Bronson.* The fifteen bonds of Bronson were delivered to him in exchange for stock purchased by him of the company, under an express agreement that they would repurchase at the same price,—eighty cents on the dollar.

*As to Prentiss Dow.* These bonds, fifteen only, were purchased and paid for by him in the regular course of business, and are long since sold.

Six hundred and fifteen bonds stand unimpeached by any legitimate testimony. The answer deals, indeed, in general allegations. It alleges that so many bonds were sold to various persons, for which, in the aggregate, only a certain sum was received in money, and the balance (of eighty cents on the dollar) in "Barstow Bonds," or "Corruption Bonds," or in stock. But what "Corruption Bonds" were, or "Barstow Bonds" are, we are not told. So we are uninformed as to what proportion was paid in money, what in stock, what in these bonds; nor does the answer distinguish between the different transactions. Indeed, only this kind of general allegation marks even those cases where specific charges are pretended to be set up. The charge as to the transaction with Foster merely alleges in general terms that the La Crosse Company was overreached. That as to Dow is in the same position. That as to Souter is a little more distinct in its charge of fraud on the La Crosse Company, but, like the rest, fails to state what bonds were so obtained. The charge as to Chamberlain is a general one, that in some way, under pretence of settling a claim for damages, he obtained a larger sum than should have been allowed him. The charge that directors made the mortgage in fraud of creditors is the one in which allegations are the most specific; but even with these no debts are stated, no creditors given, nor is it charged that any one of the holders of bonds was aware of the condition of the company, or of the fraudulent intentions of the directors. No combination is anywhere charged. Now, in all the cases specified, and in the remainder not specified,

we insist upon this rule, to wit, that when an answer seeks to attack bonds issued by a railroad company to various parties, by various transactions, and to set aside such bonds as fraudulent, it must, in regard to each transaction, contain all the allegations which would be necessary in an original bill against the holder to set aside such bonds.

5. The fact that the third mortgage was made subject in terms to the payment of the Bronson and Souter bonds in full, is ingeniously evaded by Mr. Carpenter. It is not met and answered. What equity have these junior mortgagees with such a fact in the case? Admit that the bonds were sold below par, or given away for nothing, still, had not the *stockholders*, when asking a new loan, a right to ratify them as against these parties? to say to parties proposing to lend, "We shall be happy to deal with you, but you must recognize *in full* the existing bonds. *Observe the conditions?*" That is what they did say. And subject to what was said the lenders lent: lending at higher rates in proportion as their security was impaired by its stipulated inferiority to the preceding debt. If the case were between original *stockholders*, denying the acts of the directors of the road, and the holders of the second mortgage bonds, an equity might exist. But the case is not that one.

6. Finally, it is to be remembered, that at the time when these bonds were negotiated, the whole Northwest, and especially Wisconsin, was under a cloud, and railroad property was of doubtful value. The division of the road in question was then subject to a mortgage of $13,000 on every mile. Interest was in arrears; and if the earnings of the road pending litigation on our mortgage were not faithfully applied to keep down interest on prior incumbrances, those prior incumbrances might be foreclosed, and sweep the entire property from under our mortgage. This, indeed, we may say, in passing, was the secret of the agreement in the lease to Chamberlain. Thirteen hundred thousand dollars in those days could not easily be raised for investment in Western securities. The circular of 17th of August, adumbrates, or rather projects, in broad cast, the case.

We submit that in such a case, indeed, that in most cases the negotiation and sale of railroad bonds do not stand upon the same footing as ordinary transactions between individuals. Whatever may be the opinion of any one as to the expediency of such a policy, the custom of the country has established a mode of dealing in such securities peculiar to itself. These bonds are universally sold in the market for what they will bring. They are not founded upon, nor do they presuppose a previous indebtedness to support them.

Independently of this, it is too late for any corporation, municipal, railroad, or other, to issue bonds, to sell or negotiate them in ordinary transactions, and then come into *this* court, with a hope of getting clear of any portion of the payment of them. Repudiation, in whatever garb or guise it has presented itself, within these precincts, and in *this* purprise, has been invariably sent away; driven out with peremptory orders never, in any form, to appear again. Such doctrines as have been asserted in some of our legislatures, and tolerated even in certain courts of the States, have been frowned on as dishonoring the law, and dishonoring the land.* If, in particular cases, they have worked hardship to particular persons, or in particular regions, they will do infinite service to the country in that they keep in full life the sense of obligation which should ever attend the creation of debt, and that they maintain, in its proudest elevation, that honorable justice which is the standing interest of all countries and of all times.

Mr. Justice NELSON delivered the opinion of the court:

As the two stockholders (Rockwell and Fleming), though not made defendants by the bill, were permitted, by leave of the court, to appear and put in answers in the name of the Milwaukie and Minnesota Company, it is material to inquire into the effect to be given to them. That they can-

* See Mercer County *v.* Hacket, 1 Wallace, 83; Gelpcke *v.* City of Dubuque, Id. 175, REP.

not be regarded as the answers of the corporate body is manifest, as a corporation must appear and answer to the bill, not under oath, but under its common seal. And an omission thus to appear and answer according to the rules and practice of the court, entitle the complainants to enter an order that the bill be taken *pro confesso*. A further objection to the practice of permitting a party to appear and answer in the name of the corporation is the inequality that would exist between the parties to the litigation. The corporation not being before the court, it would not be bound by any order or decree rendered against it, nor by any admissions made in the answer or stipulations that might be entered into by the parties or their counsel. It is thus apparent, that while the name of the corporation is thus used as a real party in the litigation so far as the rights and interests of the complainants are concerned, it is an unreal and fictitious party so far as respects any obligation or responsibility on the part of the respondents.

It is insisted, however, that the directors of this company refused to appear and defend the bill filed against them, and for the fraudulent purpose of sacrificing the interests of the stockholders; and, hence, the necessity, as well as the propriety and justice, of permitting the defence by a stockholder in their name.

Undoubtedly, in the case supposed, it would be a reproach to the law, and especially in a court of equity, if the stockholders were remediless. But in such a case, the court in its discretion will permit a stockholder to become a party defendant, for the purpose of protecting his own interests against unfounded or illegal claims against the company; and he will also be permitted to appear on behalf of other stockholders who may desire to join him in the defence. But this defence is independent of the company and of its directors, and the stockholder becomes a real and substantial party to the extent of his own interests and of those who may join him, and against whom any proceeding, order, or decree of the court in the cause is binding, and may be enforced. It is true, the remedy is an extreme one, and

should be admitted by the court with hesitation and caution; but it grows out of the necessity of the case and for the sake of justice, and may be the only remedy to prevent a flagrant wrong. A complainant, if he chooses, may compel a corporation to appear and answer by a writ of *distringas;* or he may join with the corporation, a director, or officer, if he desires a discovery under oath. But we are not aware of any other except a complainant who can compel an appearance or answer.

Now, although the appearance and answers of the stockholders (Rockwell and Fleming) were irregularly allowed by the court, as each was permitted to appear and answer in the name of the company, yet, as the defence set up is doubtless the same as that which they would have relied on if they had been admitted simply as stockholders, we are inclined to regard the answers the same as if put in by them in that character, in the further views we shall take of the case. Each one swore to the truth of his answer in the usual way.

Before we enter upon an examination of the merits of the case, it will be proper to dispose of the cross-bill filed by Fleming against the complainants.

This bill was filed in the name of the company alone, signed by their solicitors and counsel. The name of Fleming does not appear. And in addition to this, it appears that Fleming, in his petition for leave to appear and answer the bill in the name of the company, also asked leave to file a cross-bill. Leave was granted to put in the answer, but not to file the bill. The filing of it subsequently, therefore, was an irregularity for which the court below very properly afterwards set it aside. The cross-bill, so much spoken of in the argument, is thus out of the case. In this connection we may as well refer to the answers of the judgment creditors, who were made parties defendant to the bill of complaint.

Sebre Howard recovered a judgment in the United States District Court, on the 28th November, 1859, against the La

Crosse and Milwaukie Railroad Company, for the sum of $16,379.86; and Graham & Scott, a judgment in a State court of Wisconsin, on the 25th November, 1858, against the same company for the sum of $29,820.71; and another judgment in the same court, on the 21st September, 1858, for the sum of $11,188.15; and also a judgment against the same company, in the United States District Court, on the 11th January, 1860, for the sum of $44,413.18. This latter judgment appears from the answer, as we understand it, to have been founded on the two previous judgments in the State court. Now, it appears that each of these judgments were recovered after the date of the third mortgage of the La Crosse and Milwaukie Company, upon the foreclosure of which the Milwaukie and Minnesota Company was formed. The liens of these judgments were subsequent to this mortgage, and were cut off by its foreclosure. Indeed, the judgment of Howard, of November, 1858, and the last judgment of Graham & Scott, which was recovered in 1860, never were liens upon any interest in the road of the La Crosse and Milwaukie Company, the defendants in the judgments, as the equity of redemption had already passed to the purchaser under the sale to Barnes in the foreclosure of the third mortgage, and afterwards became vested in the Milwaukie and Minnesota Company. These judgment creditors, therefore, according to their answers, have no interest in the subject-matter of this litigation. We may add, that as replications were filed to the answers, the proof of these judgments should have been produced at the hearing. But the only proof of them that we have found in the record, is in a list of judgments annexed to the report of the master. They were material, and were put in issue by the replication.

These answers of the judgment creditors being thus disposed of, the issues in the case are brought down to those raised by the answers of Rockwell and Fleming, in the name of the Milwaukie and Minnesota Company, which we have agreed to consider rather by indulgence than as matter of strict right, as the answers of the individual stockholders.

And this brings us to an examination of what may be called the merits of the case.

Before we take up the questions presented by these answers to the bill which bear upon the merits, it will be proper to refer to some matters there presented, and very much discussed on the argument, which, in our judgment, should be laid entirely out of the case, as tending only to confuse and embarrass the real questions involved. We refer to those parts of the answers which relate to the dealings between the La Crosse and Milwaukie Company and Chamberlain, in which the complainants in this suit were not concerned, and with which they had no connection, as, for instance, the lease of the road to Chamberlain, and the allegation of fraud against him and against the company in conducting the business of running the road under this lease. Also, in respect to other contracts between these parties in relation to the indebtedness of the company to Chamberlain, and to the building and completion of unfinished portions of the road, and equipping it with the rolling stock for use. These relate to the dealings of the mortgagor, the La Crosse and Milwaukie Company, with a third person, over which the complainants, as mortgagees, had no control, and for which they were not responsible. These dealings were subsequent to the execution and lien of the mortgage, and could not affect prejudicially the rights of the mortgagees. They had no interest in the earnings of the road, or concern in the appropriation of them, until the filing of the bill and the appointment of a receiver.

The only matters, therefore, set forth in these answers, and in the proofs, which have any bearing on the merits, are:

1. The allegation that Chamberlain received from the La Crosse and Milwaukie Company two hundred of the bonds secured by this mortgage fraudulently and without consideration.

2. That S. R. Foster received one hundred of the bonds in the same way.

3. That J. T. Soutter, one of the trustees, received fifty-five of them, and refused to deliver them to the company.

4. That Greene C. Bronson, the other trustee, received fifteen for the stock of the company.

5. That Prentiss Dow, an officer of the company, received fourteen for less than one thousand dollars.

And 6. That Chamberlain, who had covenanted, in the lease of the road from the company, to apply the proceeds derived from the use of it to the payment of the interest accruing on the bonds, withheld the payment in pursuance of a fraudulent arrangement with the trustees, or with their agents, for the purpose of bringing about a foreclosure of the mortgage, that he might be enabled to purchase the road.

These are the allegations that bear upon the merits of the controversy, and deserve to be considered. We shall not, however, encumber this opinion with any very detailed explanation of them, but shall briefly refer to the proofs relating to each of these charges.

1. *As to Chamberlain.* It appears that he held a large claim for damages against the company, on account of their failure to fulfil contracts made with him to build the Western Division of the road. The work on the road was suspended by reason of this failure. And in the fall of 1857, upon the issue of the bonds of the company, under this second mortgage, an arrangement was entered into by the company, by which he received these two hundred bonds, at fifty cents on the dollar, towards payment of this claim.

2. *As to S. R. Foster.* He had loaned the company over one hundred and fifty thousand dollars, and had taken their bonds as security, and, among others, the one hundred in question. It appears that, at a meeting of the Board of Directors, 24th May, 1858, the matter between them was adjusted by delivery of forty land-grant bonds to Foster.

3. *As to T. J. Soutter.* The fifty-five bonds in controversy between him and the company were settled, as appears by a receipt of their chairman and vice-president, on 14th September, 1858, by the delivery of other bonds to the company.

4. *As to G. C. Bronson.* He had purchased fifteen thousand dollars of stock, one hundred and fifty shares, from the company, in the spring of 1857, and paid eighty cents cash on

the dollar, the president at the time agreeing that the company would repurchase it at the same rate, at any time thereafter, if he should wish to surrender it back. The company was, doubtless, pressed for money at the time. At a meeting of the Board of Directors, on the 2d of September, 1858, it was resolved, that it would take into consideration the stock theretofore purchased by Judge Bronson, as he rendered many services to the company for which he had received no compensation; and afterwards, in September of the same year, it appears that the president of the company, who had induced him to purchase the stock, received it back, and delivered to him the fifteen bonds in question. The truth of the case, therefore, is, that instead of receiving from the company the money he had advanced for the stock, according to their agreement, he received in place of it only bonds of the company of less than half the value; and, as it appears, nothing for his legal advice and services.

5. *As to Prentiss Dow.* It appears that but thirteen bonds had been received by him, and for which he paid the company, at the time, $11,400 in cash, stock, and other bonds, and was afterwards engaged in its service as agent, settling claims against the company.

In this connection, it is proper to refer to the terms, as published in a circular by the La Crosse and Milwaukie Company, and under which these bonds were negotiated and put into circulation. This paper is dated August 10th, 1857. The company state, that the importance of completing the road this season to the junction of the Western Division (sixty miles from Portage), by which they would not only control the coming winter's travel of the Upper Mississippi, but receive over 300,000 acres of the land grants, have determined the Board of Directors to place before the stock and bondholders extraordinary inducements to furnish the means; that the sum of $400,000 would be required. To obtain this sum, the company now offers the holders of its stock and of unsecured bonds, a new issue of one million of 8 per cent. bonds, &c. The terms proposed are, to receive in payment for a bond of $1000, $400 in cash, and the like

sum in the stock or unsecured bonds of the company. It was upon these terms that the directors went into the market, in the city of New York and elsewhere, for the purpose of negotiating the bonds which now constitute the subject of litigation.

6. *As to the charge of collusion of the complainants with Chamberlain, in the proceedings to foreclose the mortgage.* This allegation is founded upon an agreement entered into with Chamberlain, on the 13th of November, 1859. At the time of this agreement he was in possession of the road, and in the receipt of its earnings, and the obvious object of it, on the part of the trustees, was to procure the control of the net proceeds of its earnings, pending the proceedings of foreclosure. For this purpose, Chamberlain agreed to deposit the whole of the earnings with the agent of the trustees, from day to day; and the trustees, on their part, agreed to appropriate them to the objects and uses provided for in the lease, as the exigencies and proper working of the road might require. The trustees, in order to secure the fidelity of the officers and agents of Chamberlain, connected with the earnings of the road and the receipt of its revenues, stipulated for a supervision and control over these persons, and for the discharge of any of them from the service, in case of a dereliction of duty. They provided, also, for access to the books and papers relating to the revenues, management, and running of the road; also, for the appointment of a receiver, in case of the non-fulfilment of the agreement on the part of Chamberlain. These provisions were very important, as the revenues of the road, according to the terms of the lease, after covering running expenses and paying the interest on prior incumbrances, were to be applied to the discharge of the interest on these second mortgage bonds. The interest then due on them amounted to $40,000. It was also agreed that the proceedings of foreclosure should be conducted amicably; that is, no unreasonable opposition should be made to them by Chamberlain. It was further agreed that the sale should be made, if practicable, subject to the lease of Chamberlain, and that no

opposition should be made to his purchase of the road at the sale under the foreclosure; but the trustees expressly reserved the right to bid at the sale for the protection of the bondholders. The trustees also agreed that, in case Chamberlain should become the purchaser, they would extend a credit of nine and twenty-four months upon so much of the interest as had become due.

It is supposed that the arrangement was entered into for the fraudulent purpose of enabling Chamberlain to purchase the road at the foreclosure sale, and thereby cut off subsequent incumbrances, and especially the rights and interests of the Milwaukie and Minnesota Company, formed under the third mortgage. But there is no evidence of this charge in the proofs, nor even of any previous dealings between the parties, tending to this conclusion. They came together for the first time after the trustees had determined to foreclose the mortgage for default in the payment of interest, and finding Chamberlain in the possession of the road, and refusing to deliver it over to the trustees, as provided for in the mortgage, but, on the contrary, insisting upon his right to run the same pending the legal proceedings, it is not strange that the trustees should have endeavored to arrange with him for a supervision and control, in the meantime, over the earnings and management of the road, and that he should forbear any unreasonable opposition to the foreclosure suit. And as to the provision relating to the purchase in case of a sale, there is nothing in it interfering with any rights that belonged to the trustees, or to the prejudice of third parties, the judgment creditors, or company formed under the third mortgage. In a word, the arrangement was highly beneficial to the bondholders represented by the trustees, and prejudicial to no one concerned in the foreclosure suit.

We shall not, however, dwell longer on this branch of the case; indeed, much that we have thus far said has been rather by way of explanation, and for the purpose of clearing it of matters and issues that do not belong to it, and have served only to confuse and embarrass its consideration. In view of this object and purpose, we have referred to the two

answers of the stockholders, Rockwell and Fleming, and have endeavored to separate the irrelevant matter from that which bore upon the merits, so as to confine the examination to the latter, namely, to the charges against the validity of the bonds impeached, of the number of some three hundred and eighty, in the hands, or which passed into the hands of several individuals named, and have shown, as we think, by a reference to the proofs, that these charges are not well founded. The general and sweeping allegations against the other portion of the bonds, without specification or identity, we have not specially noticed. These charges are too general to be entitled to consideration, and the proofs relied on are as general and indefinite as the allegations.

We have also shown that the judgment creditors who appeared and answered have no interest in the matters in controversy; and, lastly, that the charges of a fraudulent collusion between the trustees and Chamberlain rest upon suspicion instead of upon proofs.

We now come to a branch of the case which presents a more conclusive answer to all the charges, whether in allegations or in proofs of the respondents, and overrides all other views that may or can be taken of them.

As we have seen, this third mortgage, under which the Milwaukie and Minnesota Company was formed, was executed and delivered to Barnes, the trustee, on the 22d June, 1858, to secure the payment of an issue of $2,000,000 in bonds, and a supplement to this mortgage was executed to the same trustee, on the 11th August following.

These two mortgages, or rather one in two parts, were, in express terms, *made subject, among other incumbrances mentioned, to the bonds secured by a second mortgage on the Eastern Division of the road, to the amount of one million of dollars.*

Again, the bonds issued under this third mortgage, one of which is in the proofs, have an indorsement on the back, as follows: "*State of Wisconsin, La Crosse and Milwaukie Railroad Company, third mortgage sinking fund bond, seven per cent.,*

*&c.;*" subject, among other things, "*to a second mortgage on the same line of road of* $1,000,000."

At the time this third mortgage was executed, and thus made subject to the second mortgage bonds, all these bonds had been negotiated by the company, and were in circulation in the business community. They were all negotiated in the months of September, October, November, and December, 1857. This, the company, of course, well knew at the time of the execution of the third mortgage, and knew, also, of the circumstances attending the negotiation of them. They had received and were in the enjoyment of the avails of them, and with this knowledge, and under these circumstances, the third mortgage, and the bonds issued under it, were made in express terms subject to the payment and satisfaction of the bonds issued under the second. All persons, therefore, taking these third mortgage bonds, or coming in under the mortgage, took them and came in with a full knowledge that the mortgagor had made the security subject to the prior lien and indebtedness. Even if there had been any valid objection to these bonds under the second mortgage, it was competent for the obligor to waive them, and no better proof could be furnished of the waiver, than the acknowledgment of the full indebtedness, by making the subsequent security subject to it. This was a question that belonged to the obligor to determine for himself when giving the third mortgage; but, besides this, what right have those coming in under it to complain? They come in with full notice of the acknowledgment of the indebtedness and previous lien; and, especially, what right have the Milwaukie and Minnesota Company to complain, who purchased the equity of redemption through Barnes, their agent, subject to the previous incumbrances of $1,000,000. They have the benefit of that incumbrance by an abatement of that amount in the price of the purchase.

Without pursuing the case further, we are satisfied the decree of the court below, reducing the indebtedness of the La Crosse and Milwaukie Company to the bondholders, is

erroneous, and that the decision should have been for the full amount of one million of dollars, and interest.

WE SHALL, THEREFORE, REVERSE the decree, and remit the cause to the Circuit Court of the United States for the District of Wisconsin, with directions to enter a decree for all the interest due and secured by the mortgage, with costs; that the court ascertain the amount of moneys in the hands of the receiver or receivers from the earnings of the road covered by the mortgage, which may be applicable to the discharge of the interest, and apply it to the same; and that if the moneys thus applied are not sufficient to discharge the interest due on the first day of March, 1864, then to ascertain the balance remaining due at that date, and in case such balance is not paid within one year from the date of the order of the court ascertaining it, then an order shall be entered directing a sale of the mortgaged premises, under the direction of the court, and on bringing the proceeds into court, they shall be applied to the payment of the balance of interest; and if they exceed such balance, shall be applied to the future accruing interest down to the sale; and if they exceed that, to the principal of the bonds, in case the bondholders assent, or *pro rata* to those who may assent, and any remaining balance of the proceeds to be invested, under the direction of the court, for the payment of future accruing interest, and ultimately the principal.

AND FURTHER, that in case the interest upon the bonds is paid without a sale, the decree shall remain as security for subsequent accruing interest, and ultimately for the principal.

AND FURTHER, that the court may pay out of moneys in the hands of the receiver, or out of the proceeds, the taxed costs of the trustees in the proceedings for the foreclosure of the mortgage, not taxed and received from the defendants in those proceedings; and also such counsel fees in behalf of the trustees, as the court, in its discretion, may seem right to allow.

DECREE ACCORDINGLY.