Memorandum of Vice-Chancellor.

MEMORANDUM.

Filed June , 1920.

In Chancery of New Jersey

Between

MARIE SCHMIDT,

Complainant,

and

SCHMIDT REALTY AND CONSTRUCTION COMPANY, *et al.,*

Defendants.

Memorandum.

ON PLEADINGS AND PROOFS.

Messrs. McDermott and Enright, for the complainant.

Mr. Philip Zalkind, associated with Mr. Isaac F. Goldenhorn, for the Schmidt Realty and Construction Company, defendant.

LEWIS, *V.-C.*

This is a bill to foreclose a mortgage of $20,000, made by the defendant, Schmidt Realty and Construction Company, to the complainant, Marie Schmidt, dated June 8, 1908, and payable June 19, 1914, with interest at five per cent. Interest was in arrears for a long period. Foreclosure was resisted upon the grounds that the mortgage was without legal consideration, and that, aside from this contention, it had been satisfied and discharged.

Prior to the execution of the mortgage under foreclosure, complainant claims she placed the sum of $27,000 in the hands of the Schmidt Realty and Construction Company for the purpose of purchasing certain real estate, title to which was to be taken in complainant's name, but which was actually taken in the name of the Schmidt Realty and Construction Company. The present complainant thereupon brought suit to set aside the title in the company's name and to have it decreed to be in her personally, claiming that under these circumstances a trust resulted in her favor, and that the company should be held to hold the land thus purchased with her funds, as trustee for her benefit.

Subsequently that case was settled between the parties; a *lis pendens* that had been filed was cancelled; releases were executed; all the stock in the Schmidt Realty and Construction Company held by the complainant was surrendered by her to the company, and at that time the mortgage now under foreclosure was executed by the company in favor of the present complainant, securing a bond in the sum of $20,000.

The complainant contends that the adjustment of the preceding litigation, and other litigation affecting the company, then pending in other courts, and the surrender of the stock, constituted the consideration for this mortgage, and that it is a legal and valid consideration. The execution and delivery of the bond and mortgage involved are not questioned. Neither do the defendants question the calculation of the amount due thereon, as submitted by the complainant, so far as the accuracy of the calculation is concerned, but interpose their legal objections to the validity of the mortgage itself.

According to the calculation submitted, there was due on the mortgage the principal of $20,000, upon which, however, defendants were entitled to credits, amounting to $9,870.00, leaving a balance due on principal of $10,130.00, with accumulated interest thereon of $4,933.33, making a total of $15,016.33, for which sum final decree was rendered in favor of complainant.

The mortgage under foreclosure originally covered a tract of about one thousand lots, situated at Maywood, Bergen County, New Jersey, and was, at the date of its execution, subject to a first mortgage on said lands of $30,000, held by one Anderson.

About 144 lots were subsequently released from the Anderson mortgage, and as to those lots complainant's mortgage became a first lien.

Anderson's mortgage was foreclosed by George P. Rust, to whom it had been assigned. Complainant's mortgage was then held by Archibald C. Hart as trustee for the present complainant; and the Schmidt Realty and Construction Company and Hart were made defendants in the Rust foreclosure suit. A final decree was entered in that suit in favor of:

First: George P. Rust for $35,226.92;

Second: E. Max Applegate for $799.41;

Third: Archibald C. Hart for $18,250.84, all with interest and costs, against the Schmidt Realty and Construction Company, to be raised and paid out of the lands covered by the Rust mortgage.

The property was purchased at the sheriff's sale by William Wemple and A. C. Hart for the sum of $37,678.67, which was slightly less than the amount due on the Rust mortgage, and which left the Applegate mortgage, and complainant's mortgage, wholly unpaid.

To finance this purchase Wemple and Hart organized a corporation known as the Maywood Company, the incorporators being Wemple, Hart, Robert D. Kent and W. Howard Mears, and Edward F. Sackett. This new company executed two first mortgages to the Guarantee Mortgage and Title Insurance Company, one for $23,000 and one for $12,000, a total of $35,000. Hart and Wemple personally guaranteed payment by joining in the bond. To make up the difference they borrowed $8,646.19 from the Merchants' Bank of Passaic on their personal note, secured by mortgage.

To protect Marie Schmidt, the present complainant, whose then solicitor was A. C. Hart, one of the purchasers at the sheriff's sale, the Maywood Company executed a mortgage to A. C. Hart as trustee for Marie Schmidt for $19,113.34, which represented the amount then due on the original mortgage which is now under foreclosure.

The mortgage last referred to contained the following recital:

> "This mortgage is intended to be a lien upon the premises in question second only to the lien of two mortgages aggregating $35,000, one upon a part of the premises in question, and the other upon the balance thereof. It is covenanted and agreed between the parties in this mortgage, and the bond accompanying it, that, whereas the mortgagee, as trustee, but appearing individually in mortgage hereinafter mentioned, at the present time possesses a mortgage upon realty given as security for the payment of the principal before described in this mortgage and the bond accompanying it upon other realty than that described herein, should the party of the second part receive any payment from such other realty or from any other source upon said bond and mortgage it is to be credited upon the principal of this mortgage and the bond accompanying."

Memorandum of Vice-Chancellor.

It seems clear from this recital and the evidence in the case, that it was not the intention of the parties that the last mortgage was given in payment of the mortgage now under foreclosure, but that it was simply intended for the further protection of the complainant.

The evidence further establishes that the Maywood Company mortgage was subsequently satisfied by the payment of $6,000, and that complainant has received from releases and sale of certain of the lots covered by the Maywood Company mortgage the sum of $1,140.00, and from releases on the sale of lots covered by the mortgage under foreclosure the sum of $2,730.00, making a total, as heretofore indicated, of $9,870.00, for which credit has been given upon the amount claimed to be due on the original mortgage, which is the one now under foreclosure.

I am satisfied from the proofs presented that the defenses interposed cannot be sustained, and that, in this suit, which is simply for the foreclosure of the mortgage in question, complainant is entitled to her decree for the amount shown to be due in the calculation referred to.

A decree will be advised in accordance with these views.

New Jersey Court of Errors and Appeals

Between MARIE SCHMIDT, Complainant Respondent, And ALBERT A. RAPHAEL, Trustee in Bankruptcy of Schmidt Realty & Construction Co., et al., Defendants Appellants.	On Appeal from Chancery.

BRIEF FOR APPELLANT ALBERT A. RAPHAEL, TRUSTEE, ETC.

Statement of the Case.

The complainant, Marie Schmidt, filed her bill of complaint to foreclose a certain mortgage dated June 8, 1908, made to her by the Schmidt Realty & Construction Co., to secure the payment of $20,000.00 on June 19, 1914, with interest from June 19. 1908 at five per cent. per annum, payable semi-annually. The mortgage covered certain lands and premises of the said Schmidt Realty & Construction Co., located in the Borough of Maywood, Bergen County, New Jersey. The complainant alleges that $20,000 of principal money less various sums paid for releases of the mortgaged premises was due on said bond and mortgage. The bill prays for an accounting and for foreclosure and sale (Case, pages 1-31).

The Schmidt Realty & Construction Co., filed its answer denying the validity of the mortgage and that the complainant has a lien on the property of the defendant. In the answer said defendant also sets up that the complainant was one of its original incorporators and had received shares of stock therein, both preferred and common (Case, page 34).

Said defendant further alleges that the complainant herein began an action against said defendant in this honorable court and filed a lis pendens in the County Clerk's office thereby hampering the defendant in its business; that subsequently in order to relieve the situation, said defendant was advised to enter into negotiations for settlement which resulted in the execution of the mortgage now under foreclosure. Said defendant further alleges that the actual amount invested by the complainant was less than $14,000.00.

The answer of the said defendant further sets forth the foreclosure of a prior mortgage held by George P. Rust which was a first lien on the greater part of the property covered by complainant's mortgage; that at the foreclosure sale A. C. Hart and William L. Wemple purchased the property; that said Hart represented the complainant herein and said Wemple was representing said defendant. It is further alleged that Wemple and Hart organized a corporation known as The Maywood Company which took over the premises purchased by them as aforesaid; that the said The Maywood Company executed certain mortgages to secure the purchase money and at the same time issued to the said Hart as trustee for the complainant herein a mortgage on its whole property for the sum of $19,133.34 dated March 11, 1914. which was the amount due on the mortgage herein foreclosed on said last mentioned day.

The answer of said defendant further alleges that the complainant herein without knowledge or notice to said defendant sold and disposed of the said mortgage without giving the said defendant the benefit thereof. The said answer set up as a special defense that the sole consideration for the mortgage under foreclosure was a transfer of stock above mentioned and that the said bond and mortgage was void at its inception and is now void because given in violation of the terms of the Corporation Act; and it is further alleged that more than $6000.00 have been received by the complainant on account of principal and interest.

This answer was on motion of complainant struck out by order of the court made November 4, 1918 (Case, page 44).

Pursuant to said order an amended answer was filed (Case, page 45).

In this answer the said defendant denied the indebtedness and the making of a valid bond and mortgage and set up specifically that the said mortgage was without valid consideration and was given in exchange for stock contrary to provisions of the General Corporation Act of this state. This answer again sets up the foreclosure of the Rust mortgage; the purchase by Hart, solicitor and trustee for the complainant, and Wemple, attorney and counsel for this defendant, of the premises at the Sheriff's Sale and the Sheriff's deed to them. The answer further alleges the organization of The Maywood Company and the execution and delivery of the new mortgage by The Maywood Company to the complainant for the aforementioned sum as full payment of the money due at that time on the mortgage under foreclosure (Case, page 48).

The answer further alleges receipt by the complainant of large sums of money on account of the mortgage of The Maywood Company, and the disposition of The Maywood Company mortgage in utter disregard of the rights of said defendant. This answer further sets forth that the amount paid into the treasury of this defendant company by the complainant for the shares of stock issued to her, the return of which was a consideration for the mortgage, was less than $14,000.00 (Case, page 49).

After the taking of testimony and presentation of proofs, the Vice Chancellor before whom the cause was heard found that there was due complainant the sum of $15,099.91 and advised a final decree accordingly, directing the sale of the premises described in the bill to make said last mentioned amount with interest from the date of the decree with costs (Case, page 114).

Subsequently on April 6, 1920, upon showing that the Schmidt Realty & Construction Company had been adjudicated a bankrupt and Albert A. Raphael had been appointed trustee in bankruptcy, an order was made directing said Albert A. Raphael as such trustee be substituted as defendant in place and stead of said Schmidt Realty & Construction Company to the end that he might prosecute an appeal from the final decree entered in the cause.

Specifications of Error.

The appellant respectfully insists that the decree is erroneous in the following respects:

1. That the court below should have held the mortgage null and void because the consideration for the bond and mortgage was the transfer of stock from the complainant to the said defendant in violation of the terms of the General Corporation Act of the State of New Jersey.

2. Because the court below should have held that the making, execution and delivery of The Maywood Company mortgage to the complainant resulted in a satisfaction and discharge of the mortgage in suit, or entitled the Schmidt Realty & Construction Company to the full benefit of the value of the security afforded by said mortgage.

3. Because the court below should have permitted the said defendant to show the actual consideration which passed from the complainant to the said defendant upon the organization of the company and was in reality the consideration for which the bond and mortgage were given.

Brief of Argument.

I. The bond and mortgage under foreclosure was illegal at its inception because the consideration for the same was the purchase of stock by the defendant company from the complainant in violation of the terms of the General Corporation Act of the State of New Jersey.

Prior to the making of the mortgage, the complainant held 122 shares of common stock of the defendant company of the par value of $100 each, and 234 shares of preferred stock of the same par value. In fact, she was the only owner of preferred stock. (Case, page 89, line 10 et seq.) When the bond and mortgage foreclosed, was executed, no money consideration whatever was turned over to the company.

The execution and delivery of the bond and mortgage to the complainant was in effect a purchase of its stock by the defendant corporation.

> "Under the Corporation Act of 1896, there is an implied grant of power to corporations

> to purchase shares of their own capital stock provided such purchase is required for legitimate corporate purposes, but not otherwise."

See Knickerbocker Imp. Co. vs. Assessors, 74 N. J. L., 586.

This suggests the question as to what may be a legitimate corporate purpose.

In Oliver vs. Rahway Ice Co., 64 N. J. Eq., 598, Vice Chancellor Stevens in the course of his opinion says:

> "I do not suppose that this decision goes the length of authorizing a corporation to purchase and pay for its own stock if such purchase and payment will disable it from paying its debts in full or of authorizing a corporation to contract with one or more of its share holders to buy shares and so convert them into creditors entitled to come in on an equality with other creditors."

Furthermore our New Jersey Corporation Act provides in Section 30, as follows:

> "The directors of a corporation shall not make dividends except from its surplus or from net profits arising from the business of such corporation, nor shall it divide, withdraw or in any way pay to the stockholders or any of them any part of the capital stock of such corporation or reduce its capital stock except as authorized by law."

The effect of the transaction between the defendant company and complainant was to make her practically a preferred creditor with a mortgage lien upon all the assets of the company. Surely this is not a legitimate corporation purpose and in view of the fact that such a course of proceeding is expressly prohibited, by statute, we respectfully insist that the bond and mortgage were invalid at the inception and that the court below should have so held.

II. The execution and delivery of the Maywood Company mortgage to the complainant resulted either in satisfaction and discharge of the mortgage in suit, or at least entitled the defendant corporation to the full benefit of the value of the security afforded by said mortgage.

The mortgage under foreclosure in this suit was originally a second lien as to nearly all the land described therein. There was a prior mortgage given, known as the Anderson mortgage which was subsequently acquired by George P. Rust, and foreclosed by him.

This Rust mortgage was given to secure the principal sum of about $30,000. (See testimony of William Solomon (Case, page 64, lines 30, et seq.). The Rust mortgage included about 900 lots and was a lien prior thereon to the mortgage here under foreclosure. There was about 140 lots in the mortgage now under foreclosure here not included in the Rust mortgage. (Case, pages 70-71.)

The witness Zalkind, the president of the mortgagor company testified that Mr. Hart represented the complainant when this Rust mortgage was foreclosed and that a Mr. Wemple was the attorney for the defendant company and was helping the president thereof to straighten out its affairs (Case, page 87).

Mr. Wemple and Mr. Hart purchased the property sold under the Rust foreclosure and organized the Maywood Company to take over the property (Case, page 87). Thereafter and on March 11, 1914, the Maywood Company made a mortgage to A. C. Hart as trustee for the complainant in this suit, to secure the payment of $19,133.34, being the amount then due on the mortgage here under foreclosure (Case, page 88). This mortgage and the bond accompanying it, is found in the printed case (pages 143 to 154).

After the foreclosure of the Rust mortgage, the witness William Solomon testified that Mr. Hart, who was counsel for the complainant herein and her trustee, "in accordance with his promise gave Mrs. Schmidt, a third mortgage as security for the payment of a mortgage which she was seeking to foreclose in this action" (Case, page 67, line 40 and page 68).

Complainant admits that she received the sum of $1140 from releases of the Maywood mortgage which she credits on the amount claimed by her in this suit (Case, page 73, lines 30-40).

See also her exhibits (Case, page 169).

The witness Solomon testified that the Maywood loan was cancelled for $6000 (Case, page 69).

See also the statement of counsel for the complainant (Case, page 73, lines 30-40).

This amount is also credited on complainants statement in her exhibits (See Case, page 169).

The defendant company was the owner of the property under foreclosure of the Rust mortgage. Mr. Hart was representing the complainant and Mr. Wemple was representing the defendant company. In order to finance the situation the Maywood Company was formed. After providing for the security of the moneys advanced to purchase the property on the Sheriff's sale of the Rust mortgage, the Maywood Company gave the complainant a mortgage to secure a sum according to the amount then unpaid in the mortgage under foreclosure here. The subsequent action of the complainant confirms the claim of Mr. Zalkind the president of the company that the property was to be bought in in such a way as to cancel any obligations against the defendant company.

At least the Maywood mortgage stood as security for the money now claimed to be due and secured by the mortgage here under foreclosure.

The moneys received from releases of the Maywood mortgage had been credited by the complainant on the amount claimed here to be due on the mortgage under foreclosure.

Furthermore the $6000 received on cancellation of the Maywood mortgage has also been credited.

It should be observed that no notice whatever was given to the defendant company that the complainant herein intended to dispose of or cancel the Maywood mortgage.

By reference to exhibits of the complainant (Case, page 169) it appears that the release of only forty lots realized the sum of $1140. This mortgage, it should be remembered, covered about nine hundred lots. Therefore it would appear that there was ample security here to satisfy the whole of the complainant's alleged claim if properly negotiated. It is very apparent that the sum of $6000 was a very inadequate sum for which said mortgage was cancelled and the defendant company's equitable rights extinguished.

The defendant company is certainly entitled to the benefit of this additional security.

We quote from 27 Cyc. page 1406 as follows:

"When a mortgagee has additional or callateral security for his debt, or other means of securing its payment and avails himself thereof, the mortgage is discharged or reduced to the extent to which the mortgagee's proceedings have resulted in satisfaction of his claim. And this is the rule also where he voluntarily releases his other security or remedy or loses it by laches or neglect under such circumstances that the subsequent enforcement of the mortgage for its full amount would work injustice to the mortgagor or a fraud on the rights of third parties having an interest."

The cancellation of the Maywood mortgage for an inadequate sum has worked an injustice to the defendant company herein. It was equitably entitled to have the lands subject to the Maywood mortgage applied to the extinguishment of any claim of the complainant and in such a way to best conserve the interests of the defendant company.

The appellant herein is the trustee in bankruptcy of the defendant company and represents the creditors thereof and as such is entitled to have the security held by the complainant to be so marshalled as to realize the best possible results for the creditors of the bankrupt.

If it shall be held that the execution of the Maywood mortgage to the complainant did not result in a satisfaction of her claim alleged in the mortgage under foreclosure, it certainly entitled the defendant company to the benefit of the additional security afforded by said mortgage.

III. The defendant company should have been permitted to show the actual consideration which passed from the complainant to the defendant company upon the organization thereof, which was in reality the consideration for the bond and mortgage given.

The complainant was stockholder in the defendant company to a substantial amount.

The appellant herein is interested in conserving the assets of the company for the menefit of its creditors.

The president Zalkind was not permitted to testify as to the amount which was originally received from the complainant for the stock issued to her and subsequently delivered back to the company on the execution of the bond and mortgage under foreclosure.

The rights of the complainant under any circumstances could not exceed the amount she had advanced for her stock.

At page 108 of the Case, on objection of complainant's counsel, the witness was not allowed to go into the original sonsideration for the issue of the stock. On his direct examination said witness Zalkind was asked to state the circumstances upon which the original mortgage was given. This examination was objected to by complainant's counsel and sustained by the Court. (Case, page 82).

In the answer of the defendant company it is alleged that not so much as $14,000 was paid by the complainant for her stock.

There is no rule of evidence or other substantive law which prevents the proof of actual consideration of instruments of this kind.

Our Evidence Act (Compiled Statutes, page 2225, section 15) provides as folows:

> "In every action upon a sealed instrument, and where a set off is founded upon a sealed instrument, any party may plead and set up as a defense thereto fraud in the consideration of the contract upon which recovery is sought or the want or failure of consideration, the same as if such instrument were not sealed."

In order to properly present its defense the defendant company should have been allowed to prove the actual consideration in this instance and should have been allowed to prove all the circumstances leading up to the making of the bond and mortgage under foreclosure. The complainant under the most favorable view of her claims was not entitled to more than her original investment. The complainant not only attempted to acquire the position of a secured creditor in place of that of a stockholder; but also attempted to deplete the assets of the company by acquiring a greater interest as such creditor than she has as stockholder.

The defendant company should have been allowed to present this evidence in support of its claim set forth in the First Point of this brier.

Finally the appellant herein, the trustee in bankruptcy of the Schmidt Realty & Construction Company succeeded to all the rights of the said company and particularly for the benefit of the creditors thereof. To permit the complainant herein to enforce her mortgage and particularly for the amount mentioned in the decree in the Court below, has tended to give her a great advantage over other creditors of the bankrupt company and has in effect absorbed all the assets of the bankrupt corporation to the prejudice of the equitable rights of the other creditors of said bankrupt.

The appellant respectfully submits for the reasons hereinabove set forth that the decree made in this cause should be reversed and set aside.

Respectfully submitted

LUM, TAMBLYN & COLYER,
Solicitors for and of counsel with appellant Albert A. Raphael, Trustee in bankruptcy of Schmidt Realty & Construction Company.

Ralph E. Lum,
Of counsel with said appellant.

Gallert, Hilborn & Raphael,
(of New York) also of counsel with said appellant.

31086

58 JUN.T. 1920

Arthur W. Cross, Law Printer, 243 Market Street, Newark, N. J.

New Jersey Court of Errors and Appeals

No. 58, June Term, 1920.

Between MARIE SCHMIDT, *Complainant-Respondent,* *and* ALBERT A. RAPHAEL, Trustee in Bankruptcy of Schmidt Realty & Construction Company, *et al.,* *Defendants-Appellants.*	*On Appeal from Chancery.* *Sat below:* WALKER, *C.* LEWIS, *V.-C.*

BRIEF IN BEHALF OF COMPLAINANT-RESPONDENT.

Statement of the Case.

Some fourteen years ago the complainant, an elderly widow, invested a small fortune in a land scheme in which one Philip Zalkind and his associates were interested. Mr. Zalkind appears at one time to have been her lawyer (p. 80), but later became the president of Schmidt Realty & Construction Company. Mrs. Schmidt seems not to have known at the time that it was a corporation (p. 80), but to have paid in, according to a witness produced by the defendant corporation, somewhere between $23,000 and $27,000 (misprinted $37,000, p. 75). There were issued to her 230 shares of the preferred (all the issue of preferred) and 122 shares of common stock of the company (p. 89). In 1907 or 1908 (p. 55) the complainant became dissatisfied and employed Mr. Hart, the present Prosecutor of Bergen County, who brought proceedings in Chancery against Mr. Zalkind and two others, charging them with obtaining money from her amounting to about $25,000 and buying property in the name of the Schmidt Realty & Construction Company in spite of representations that the property was to be bought in in her name (pp. 56 and 57). Before reaching a final hearing an agreement was made, dated May —, 1908, between Schmidt Realty & Construction Company, a defendant in said action, Philip Zalkind and the complainant. This agreement is printed at page 161, &c., and recites several pending actions which it appeared to the advantage of the parties to settle. In it complainant agreed to turn over to Schmidt

Realty & Construction Company all the stock of the company which had been issued to her, and to assume and pay certain indebtedness due to one Sophie Muller, to procure, cancel and turn over a promissory note of $1,000 which was then the subject matter of an action pending between Sophie Muller as plaintiff and the said company as defendant, to procure a general release from said Sophie Muller, to execute a release, deliver up possession of the premises occupied by her and deliver to the said Zalkind books, papers, vouchers, documents, furniture and other personal property, all of which had been in her possession (pp. 162, 163). It is clearly an instrument designed to compromise and settle the controversies between the parties, based upon the consideration of past and present payments and other elements of value. For the several acts to be performed by her under this agreement and in partial payment of the large sums of money invested and agreed to be paid by her, she was to receive and later did receive from the Schmidt Realty & Construction Company a mortgage to secure the sum of $20,000, dated June 8, 1908 (Exhibits A and B, printed at pages 125 to 140). This mortgage was executed by the company, acting by Philip Zalkind, who signed as president. It covered a large tract of land in the Borough of Maywood and was second to a mortgage and other liens of about $30,000 (p. 131), and contained a provision for the release of any lot or lots embraced in it at the rate of $30 per lot (p. 132). Later Mr. Zalkind re-financed the first mortgage and arranged to have 140 lots released from what were prior mortgages, and thereupon the $20,000 mortgage became a first mortgage upon the 140 lots (p. 83).

In the mortgage made by the Schmidt Company, Mrs. Schmidt was under agreement to release these 140 lots as well as others at $30 each (p. 132), or the entire plot for $4,200. This parcel of 140 lots was sold by the Sheriff of Bergen County under the execution issued in this cause for $5,000.

Upon the balance of the property, estimated to contain 900 lots, when subdivided for that purpose, Mrs. Schmidt's mortgage became a fourth mortgage, subject to the mortgages of George P. Rust and E. Max Applegate. From 1908 to 1912, inclusive, numerous releases were made by Archibald C. Hart, in whose name the Schmidt mortgage stood, to the Schmidt Company, for which it paid over $2,400 (p. 168). In 1912 the company was dissolved.

Interest was permitted to accumulate on these prior mortgages and taxes to become in arrear (p. 81, p. 101, ll. 18, 19), and in or about 1912 the Rust mortgages were foreclosed.

The Schmidt Realty & Construction Company was made a defendant and the final decree, dated April 7, 1913 (p. 155), ordered a sale to raise and pay to George P. Rust on his two mortgages $35,226.92, to E. Max Applegate on his mortgage $1,799.41, and to Archibald C. Hart on his mortgage (being the Marie Schmidt mortgage assigned to him in trust), $18,250.84, all with interest and costs.

Under the fi. fa. issued on this decree the premises embraced in the Marie Schmidt mortgage outside the 140 lots released as above, were sold by the Sheriff of Bergen County on December 17, 1913 (see report of sale, p. 158). This sale produced scarcely enough to cover the Rust mortgages, interest and costs, cutting off the mortgage of Applegate and the mortgage held by Mrs. Schmidt.

The sale took place after numerous adjournments (apparently thirty, indicated by adjournment fees on p. 159). Zalkind's efforts to secure a loan from other sources failed, and Mr. Wemple and Mr. Hart purchased the property.

Mr. Zalkind speaks of Mr. Wemple's efforts to aid the Schmidt Company, but states that, in his presence, Mr. Wemple told the Sheriff he was buying for himself and Mr. Hart (p. 87). This was an open declaration that he was acting for himself and not the Schmidt Company. There is no evidence that Mr. Wemple purchased for Zalkind or the company, and Mr. Hart, against whom Mr. Zalkind was very bitter (p. 60), certainly did not. Zalkind testified that it was not bought in in pursuance of an understanding between him, representing the company, and Mr. Hart (p. 85). It is apparent that Mr. Rust, upon whose mortgages there were large arrears of interest (p. 168) after the execution had been in the Sheriff's hands some eight months without any prospect of payment by the Schmidt Company, insisted on a sale, and that Wemple and Hart concluded to buy, without any agreement or understanding with the Schmidt Company. No demand or claim was ever made on them by this company on the theory that they had purchased in its interest. The claims against the 900-lot tract thus sold aggregated over $59,000 (p. 158), and the purchase price was $37,600.78. Mr. Hart and Mr. Wemple conveyed to a corporation known as the Maywood Company, and this company executed mortgages to other parties for

$43,646, and then a mortgage to Archibald C. Hart, trustee of Marie Schmidt, for $19,113.34 (p. 145). But it became necessary, as appears from the testimony of defendant's witness, Mr. Corbin (pp. 106, 107), for Mr. Wemple and Mr. Hart to become personally liable on the bonds or notes to make the mortgages ahead of Mrs. Schmidt available as a means of raising money. They did not become personally liable on the bond and mortgage given by Maywood Company to Mr. Hart for Mrs. Schmidt. This mortgage of the Maywood Company to Mr. Hart as trustee for Mrs. Schmidt contained this provision:

> "It is covenanted and agreed between the parties to this mortgage and the bond accompanying it that whereas the mortgagee as trustee but appearing individually in mortgage hereinafter mentioned at the present time possesses a mortgage upon realty given as security for the payment of the principal before described in this mortgage and the bond accompanying it upon other realty than that described herein should the party of the second part receive any payment from such other realty or from any other source upon said bond and mortgage it is to be credited upon the principal of this mortgage and the bond accompanying."

Subsequently a number of releases were made for lots covered by this Maywood mortgage for which Mrs. Schmidt received $1,140, and in December, 1916, Mrs. Schmidt received the further sum of $6,000 and discharged this mortgage. In the present foreclosure Mrs. Schmidt in ascertaining the amount due on her mortgage deducts all moneys received by her from any source (p. 169). The balance due her is over $15,000.

The hearing before the Vice-Chancellor was completed on March 25, 1919 (p. 92), and the decree appealed from bears date April 9, 1919 (p. 114). The Trustee in Bankruptcy, Albert A. Raphael, substituted as appellant, was appointed Trustee on April 10, *1919,* and qualified on April 3, *1920* (p. 117). The notice of appeal was filed April 7, 1920. In the meantime, on October 29, 1919, the mortgaged premises, approximately 140 lots, were sold by the sheriff of Bergen County to the complainant for $5,000.

The Schmidt Realty & Construction Company was dissolved (p. 81) for non-payment of franchise taxes, February 28, 1912 (P. L. 1912, pp. 959, 983, 988), and all powers conferred by law upon it declared inoperative and void. The exercise of its charter powers after that date constituted a misdemeanor.

Corporation Act, Sec. 144.

BRIEF OF ARGUMENT.

I.

The bond and mortgage under foreclosuse were not illegal in their inception, or without adequate consideration.

It is true, as stated in appellant's brief, that Mrs. Schmidt was at one time the holder of 234 shares, being all the issued shares of the preferred stock of Schmidt Realty & Construction Company, and the holder of 122 shares of common stock as well, all of the par value of $100 each (p. 89). But it is also true that she claimed that the property purchased with her money, about $25,000, was to be bought in her name and not in the name of the company. She claimed that she had advanced $27,000 to Mr. Zalkind and his associates (p. 76), and Mr. Zalkind claimed that she had paid only $23,000 (p. 75). Claiming thus she brought an action in the Court of Chancery to set aside the title in the company and to have it decreed in her personally (p. 57). Negotiations were then opened for a settlement and as a result an agreement was entered into between the Schmidt Company, Philip Zalkind and Mrs. Schmidt (copy on page 161, &c.). This agreement recites the pendency of various actions, and provides that Mrs. Schmidt give up her stock in the company, pay a note held by one Sophie Muller, indemnify the company against liability on a note of $1,000 held by said Muller, give a general release, remove from the premises occupied by her and deliver up certain books, papers, vouchers, &c., to Zalkind.

It is apparent from the proofs that the making of the mortgage was in settlement of pending litigation and upon a full consideration. It will be observed that Mrs. Schmidt not only gave up her stock, but also made further payments, and performed other acts, any one of which would form a valuable consideration. Settlements of controversies thus made are encouraged by the courts and they will not inquire into the adequacy or inadequacy of the consideration.

Bowers Dredging Co. v. *Hess,* 71 L. 327.

Mrs. Schmidt not merely gave up her stock; she claimed that the property itself, bought with her money, was to be placed in her name and was hers. She gave up this claim as well, and she relinquished a part of the money which she had originally invested, so that instead of receiving $23,000 to $27,000, she accepted a mortgage for $20,000, subsequent to prior mortgages of $30,000, and agreed to make further payments in addition.

In the answer filed by the Schmidt Company, and struck out by the Chancellor, it was admitted that a settlement was made with her under which the company issued a second mortgage for $20,000 to her, she agreed to return all the shares of stock which she held in the company to its treasurer, and as a result of such settlement she resigned as a director and officer of such corporation, removed from the occupancy of premises owned by the company, and her connection with the company was severed (p. 38). Said answer further states (p. 38) that the Schmidt Company "resumed business with the full good faith, intention and expectation to pay to the said Marie Schmidt the full amount represented by the said mortgage herein sought to be foreclosed, and interest, according to its tenor."

The acquisition of Mrs. Schmidt's stock by the corporation under the circumstances was for a legitimate corporate purpose, and such an acquisition is sanctioned by the law of this State.

Chapman v. *Ironclad Rheostat Co.*, 62 L. 497;
Berger v. *U. S. Steel Corporation*, 63 E. 809, 813.

There is no evidence that any one, outside of Mrs. Schmidt, ever put any money into this corporation. She held all the preferred stock and a large block of common. After the execution of the mortgage numerous releases, releasing over eighty lots, were executed by Mr. Hart, who held the mortgage for her, to the Schmidt Company (p. 168).

In the foreclosure action brought by George P. Rust a decree for the amount due her against the defendant company was made on April 7, 1913; this decree has never been attacked or opened by the company and still stands as a valid decree in her favor. Until the present foreclosure action was brought this mortgage was repeatedly recognized by the corporation, and no intimation that it was invalid was ever given. Aside from this the mortgage having stood for twelve years, and the company in the meantime having been dissolved for non-payment of taxes (p. 81) and gone into bankruptcy, it is impossible at this late day, even if the agreement were to be set aside, to restore Mrs. Schmidt to her original rights in the stock.

Oliver v. *Rahway Ice Co.*, 64 E. 596, 599, and cases cited;
Chapman v. *Ironclad Rheostat Co.*, 62 L. 498.

II.

The execution and delivery of the Maywood Company mortgage to complainant was not in pursuance of any agreement with the Schmidt Company, and involved no obligation on its part, and the lands of Maywood Company so mortgaged were secondarily liable as those of a surety only for the moneys due complainant, and could be released and discharged upon any consideration satisfactory to complainant.

In appellant's brief the claim is rather weakly made that the large parcel described for convenience as containing 900 lots, although not actually cut up into lots, was bought in or was to be bought in by Mr. Wemple and Mr. Hart in such a way as to cancel the obligation of the defendant company to Mrs. Schmidt. No citation of testimony is given to support this claim. The burden of proving this fact and of proving that the mortgage given by the Maywood Company was in payment of the old mortgage owned by Mrs. Schmidt was upon the defendant.

The rule is stated in the case of *Dibble* v. *Richardson,* 171 N. Y. 131; 63 N. E. 829:

> "The question remains whether this transaction canceled or extinguished the debt of Mr. Richardson. As there was no agreement that the bond and mortgage should be accepted as payment, the effect thereof upon the debt depends upon presumption. The rule governing the subject is well settled. Where a creditor accepts the obligation of a third party for a debt contracted contemporaneously, the presumption is that it was taken in payment, and the burden of proving the contrary rests upon him who asserts it. Where, however, the obligation is received for a precedent debt, the presumption is that it was not taken in payment, and the burden of proof is shifted accordingly. (Citing cases.)
>
> As the bond and mortgage were received for a precedent debt, the burden of showing that it was taken in payment rested upon the plaintiff, who furnished no evidence upon the subject, and hence the presumption that it was not taken in payment must prevail. Therefore, upon the facts as they now appear, the old debt of Mr. Richardson was still in existence when Mrs. Callahan died, &c."

The further claim is made in appellant's brief: "At least the Maywood mortgage stood as security for the money now claimed to be due and secured by the mortgage here under foreclosure."

If the word "surety" were substituted for "security" this statement of claim could not be excepted to. As a matter of fact, the Maywood Company and the mortgage given by it became from the execution of said mortgage sureties for the old debt of the Schmidt Company and liable for the payment of so much as could not be realized on the unsold land of the Schmidt Company sought to be sold under this foreclosure. This is apparent not only from the presumption above recited, but from the conduct of the parties and the terms of the Maywood Company mortgage (p. 150) wherein provision is made for the credit upon the Maywood Company mortgage of all moneys received by the mortgagee from the unsold property of the Schmidt Company or from any other source. Under these circumstances the moneys received from the Maywood Company for releases and in discharge of the mortgage were, of course, to be credited upon the principal debt, as all payments by a surety, generally speaking, are to be credited on the debt of the principal. The creditor cannot demand payment but once, but the creditor may upon any consideration acceptable to him, or without consideration, release the surety without discharging the principal.

A release to a surety does not discharge the principal. 32 Cyc., 156.

As between two sets of sureties on successive bonds of a guardian, a release by the ward of the set secondarily liable will not affect the liability of the others. 32 Cyc., 156, Note 24.

Where the grantee in a deed assumes a mortgage he becomes as to the mortgagor the principal debtor and the mortgagor a surety (*Green* v. *Stone,* 54 N. J. Eq. 387, 390); the mortgagee under such circumstances may release the mortgagor from his personal liability, without discharging the land or the grantee who assumed the debt. *Jones on Mortgages,* page 741.

On the foreclosure of the Rust mortgages a final decree was made in favor of Mr. Rust on his two mortgages, E. Max Applegate on his mortgage, and Archibald C. Hart, who then held the Schmidt mortgage for complainant, and had been or was her attorney and solicitor. After the execution reached the Sheriff the sale was adjourned from time to time (apparently thirty times, p. 159) and sold on December 17, 1913. Pending the adjournments efforts had been made in behalf of the Schmidt Company to obtain a loan, but these had failed, and the property was purchased by Mr. Hart and Mr. Wemple. Mr. Wemple was not called as a witness by defendant, but it is clear that while he had at one time attempted to aid Mr. Zalkind in procuring a loan, that when the sale took place he did not bid for the Schmidt Company, but in the presence of Zalkind, for himself and Mr. Hart (p. 87). There was no pretense that the mortgage of the Maywood Company was made to Mrs. Schmidt in pursuance of any arrangement, agreement or understanding with the Schmidt Company. Mr. Zalkind, the president of that company, testifies that he was not apprised of the fact that Mrs. Schmidt had obtained such a mortgage (pp. 84, 88).

The Sheriff's sale produced enough, or nearly enough, to pay the Rust mortgages, and the mortgages of Applegate and Mrs. Schmidt, as well as all interest of the Schmidt Realty & Construction Company, were cut off by such sale. Mr. Hart and Mr. Wemple, after purchasing the large tract, conveyed to Maywood Company, and thereafter Mr. Hart, having in mind the trust relation to Mrs. Schmidt above recited, caused to be executed by the Maywood Company to himself as her trustee a mortgage dated March 11, 1914, for the sum of $19,113.34, covering the parcels of land which have been described generally for convenience as 900 lots. This was to satisfy his duty as trustee and to add to the security of his client for any sum which she might not realize from the small parcel of 140 lots on which her mortgage still remained the first lien. He did not intend the Maywood Company to become primarily liable for this debt, nor did he intend to in anywise advantage the Schmidt Company. He and the Maywood Company intended only that it should become a surety to the extent of the security of the mortgage to the payment of the debt by the principal debtor, the Schmidt Company. As between the Schmidt Company and Mrs. Schmidt she was entitled to resort to the property not sold under the Rust mortgage for the amount due on her mortgage, but as between her and the Maywood Company she was privileged, in case the property not covered by the Rust foreclosure should prove insufficient, to resort to the property covered by the Maywood mortgage. Both these mortgages were subsequently assigned by Mr. Hart to Mrs. Schmidt. Whether anything would ever become due to Mrs. Schmidt on the Maywood Company mortgage or not, could only be definitely ascertained by a foreclosure and sale of the 140 lots, or pending such foreclosure and sale, the amount could be settled by agreement between Mrs. Schmidt and the Maywood Company. This was done, she receiving some $1,140 by way of releases made under the Maywood Company mortgage, and $6,000 by a payment in gross. These payments relieved the Maywood Company property of the lien of this mortgage.

Mrs. Schmidt was under no duty to the Schmidt Company, the principal debtor, to wait until after the foreclosure of the mortgage on the 140 lots, to take what she could get on the Maywood Company mortgage. If Mrs. Schmidt had foreclosed at once against the Schmidt Company and been paid the full amount of her debt, she could not have resorted to the Maywood Company mortgage, except for a deficiency. She had the right to foreclose the Schmidt mortgage on the remaining 140 lots at that time, and if she had done so the decree against the Schmidt Company would have been more by $7,140 than the present decree.

The quotation in appellant's brief from 27 Cyc., p. 1406:

> "When a mortgagee has additional or collateral security for his debt or other means of securing its payment, and avails himself thereof, the mortgage is discharged or reduced to the extent to which the mortgagee's proceedings have resulted in satisfaction of his claim."

need not and generally cannot be controverted. In this instance the Schmidt Company mortgage has been reduced to the extent indicated, but the subsequent paragraph of such quotation does not apply where the additional security was given not by the principal debtor, but by another who stood in the relation of a surety to such principal debtor. This is clear from the citation of authorities above given.

It is further claimed that the cancellation of the Maywood mortgage has worked an injustice to the defendant, Schmidt Company. We have shown that the acquisition of the Maywood mortgage and the adjustment of the amount due upon it have resulted to the great benefit of the Schmidt Company, the mortgagor, but passing this for a moment, there is nothing in the case to show that the mortgagor has not had the benefit of the full value of all the mortgaged premises. The large parcel covered by the Rust mortgages was sold after a long delay by the Sheriff for the best and highest price he could obtain in cash. Efforts had been made to raise money to pay off the first mortgage, but these had failed, and the property was sold without realizing anything on the Applegate mortgage or on the Schmidt mortgage. So far as appears no objection was made to the sale and no claim or demand ever put forward that the property did not bring an adequate price. As between the holder of the

Schmidt mortgage and the Schmidt Company the price realized at the sale is the legal standard of value.

Snyder v. *Blair,* 33 E. 208;
Currie v. *Sisson,* 34 E. 578;
Fischer v. *Spierling,* 107 Atl. 420.

III.

The defendant company cannot complain of the rejection of the testimony offered as to the consideration of the Schmidt Company mortgage.

The defendant company called as its first witness William Solomon, who testified to many facts connected with the inception of the mortgage. Mr. Zalkind, the former president of the company (p. 81) and former attorney of Mrs. Schmidt (p. 80), examined him. Mr. Solomon stated the claims of Mrs. Schmidt, that she had advanced $27,000 to $29,000 (p. 76), and Mr. Zalkind's claim that she had paid only $23,000. Mr. Zalkind himself testified to the large number of shares held by Mrs. Schmidt, aggregating at par $35,600 (p. 89). But the conclusive proof as to the consideration of the mortgage was the agreement produced by the defendant Schmidt Company, showing the consideration and terms of the proposition under which the mortgage was made.

No error harmful to the defendant corporation was made in the exclusion of testimony by the Court below.

A special appeal in behalf of creditors of the bankrupt Schmidt Company is attempted on the last page of appellant's brief.

This bankruptcy proceeding is open to direct suspicion. The bankrupt is a New Jersey corporation, but the bankruptcy proceedings are in New York. They were begun out of the jurisdiction of our courts pending the foreclosure proceedings (pp. 110, &c., which cover a session of the court March 13, prior to a later session on pp. 92, &c.).

Although the company was adjudicated a bankrupt—it had been dissolved seven years before for non-payment of taxes—on March 11, 1919, and a trustee appointed April 10, 1919, he did not qualify until April 3, *1920* (p. 117), several months after the mortgaged premises had been sold by the Sheriff under the execution in this cause. Whether the creditors or trustees be responsible, this conduct suggests obstruction rather than diligence.

IV.

We respectfully submit that the decree of the Chancellor should be affirmed.

McDERMOTT & ENRIGHT,
Counsel of Respondent.