



CUNNINGHAM v. MACON & BRUNSWICK RAILROAD COMPANY.

15 S. Ct. 361 (1895) | Cited 4 times | Supreme Court | March 4, 1895

MR. JUSTICE WHITE, after stating the case, delivered the opinion of the court.

The case of the appellants rests upon two distinct legal propositions. The first one asserts their right to be subrogated to a mortgage security taken by the State of Georgia, and, by virtue of such subrogation, to enforce the mortgage against the property of the railway company. The other proposition is that they are direct mortgage creditors and have a specific mortgage lien upon the property of the company.

A right of subrogation, such as is here claimed by the appellants, does not involve any direct lien in favor of the creditor, resulting from his position as such. It only exists in consequence of his being, as a creditor, entitled to enjoy certain rights which are vested in the surety at the time the subrogation is claimed. This principle is fundamental, and its application is fatal to the complainants. As the creditors' right to subrogation depends on the existence, in the surety, of the rights to which subrogation is sought, it follows that after the surety has parted with the thing given him for his protection, the creditor can have no subrogation to such thing. In the present case, when the subrogation was claimed, the State had divested herself of all her rights, under the mortgage of indemnity, by selling the mortgaged premises, and had applied the proceeds of the sale to the payment of the debt which the mortgage was given to secure. She had no longer any rights of her own, therefore no subrogation could be derived through her. Aside from this consideration, in order to enforce equitable subrogation against a surety, he must be made a party to the cause. The State of Georgia is not, and cannot be, without her consent, impleaded. All the foregoing doctrine was applied and carefully stated in *Chamberlain v. St. Paul & Sioux City Railroad*, 92 U.S. 299, 306, where, speaking through Mr. Justice Field, the court said: "Whatever right the plaintiff had to compel the application of the lands received by the State to the payment of the bonds held by him, it was one resting in equity only. It was not a legal right arising out of any positive law or any agreement of the parties. It did not create any lien which attached to and followed the property. It was a right to be enforced, if at all, only by a court of chancery against the surety. But the State being the surety here, it could not be enforced at all, and not being a specific lien upon the property, cannot be enforced against the State's grantees. Where property passes to the State, subject to a specific lien or trust created by law or contract, such lien or trust may be enforced by the courts whenever the property comes under their jurisdiction and control. Thus, if property held by the government, covered by a mortgage of the original

owner, should be transferred to an individual, the jurisdiction of the court to enforce the mortgage would attach, as it existed previous to the acquisition of the government. *The Siren*, 7 Wall. 158, 159.



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But where the property is not affected by any specific lien or trust in the hands of the State, her transfer will pass an unencumbered estate."

The appellants must therefore rely for the maintenance of any rights they may possess upon their second proposition, which is to the effect that the bonds which they hold were secured by the statutory mortgage created by the act of 1866, and that the mortgage rights thus existing were not affected by the sale made by the State in 1875, but are yet subsisting, and may be enforced against the mortgaged property in the hands of the present defendant. It is obvious that if the statutory mortgage created by the act of 1866 was solely for the indemnification of the State and not for the security of the bondholders, the latter, whatever may be their indirect rights by subrogation, cannot directly avail themselves of the statutory mortgage. *Chamberlain v. St. Paul & Sioux City Railroad*, 92 U.S. 299; *Tennessee Bond Cases*, 114 U.S. 663. In order, therefore, to give them the relief which they seek, the statutory mortgage must be treated as having been given to secure the holders of the bonds. But if this view be taken, the claim here asserted is untenable. If there be a mortgage in favor of complainant's bonds, it must result from the terms of the act of 1866; but these bonds were not issued under that act, and owe their existence to the authority conferred by the act of 1870. This act reserved no mortgage, and the bonds of relator, having been issued under it, do not purport to be secured by mortgage. The claim that they are so secured is deduced from this contention. The act of 1870, it is asserted, purported to be an amendment to the act of 1866; therefore, the provisions as to mortgage found in the act of 1866 were incorporated into and became a part of the act of 1870. Between 1866 and 1870, however, the following amendment to the constitution of Georgia was adopted, and it was in force when the act of 1870 was passed:

"The general assembly shall pass no law making the State

a stockholder in any corporate company; nor shall the credit of the State be granted or loaned to aid any company without a provision that the whole property of the company shall be bound for the security of the State, prior to any other debt or lien, except to laborers; nor any company in which there is not already an equal amount invested by private persons, nor for any other object than a work of public improvement."

Under these provisions, if we were to construe the act of 1870 as desired, the result would be to make that act clearly violate the amendment to the constitution just cited; for, if the statutory mortgage secured the bondholders, then the bonds, issued under the act of 1866, were necessarily secured by a first mortgage, and those issued under the act of 1870 by a second. This conclusion can be avoided only in one or the other of two ways. First, by contending that the incorporation of the provisions of the act of 1866 into the act of 1870 made the bonds, issued under the latter act, equal in rank of mortgage with the bonds issued under the former; but to admit this contention would make the act of 1870 void, because it would, if thus construed, impair the obligations of the contract made with the holders of the bonds first issued. Or, second, by contending that, inasmuch as the mortgage created by the act of 1866 was in favor of the State and not in favor of the bondholders, the issuance of the



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bonds of the second series simply increased the aggregate amount of the State's liability, and that there was no difference between the two in rank of lien and mortgage, since the State held both the first and the second series, and the two were practically issued under one act. But this would be an assertion that the statutory mortgage created by the act of 1866 was solely for the benefit and indemnification of the State, and that the holders of the bonds were not directly interested therein. If this position be assumed, it defeats the complainants, as we have already seen.

However, it is claimed that even if the State's endorsement of the bonds, issued under the act of 1870, was in violation of the constitutional amendment, the only result is to render the endorsement void, and thus the bonds are left outstanding as

valid contracts of the railroad company, secured by the statutory mortgage reserved in the act of 1866. This contradicts the plain text of that act, since it only purported to reserve a mortgage in favor of bonds endorsed by the State. And, besides, if this argument were adopted, it would render efficacious a legislative violation of the constitutional amendment, since it presupposes that there was power in the general assembly to allow the mortgage security, which had been taken by the State solely in order to secure the bonds she had guaranteed, to be transferred to others as a means of securing bonds to which her guaranty could not be constitutionally affixed. In other words, that the State, having a first mortgage security, which she had taken to secure bonds, of which she was an endorser, could vitiate such security by allowing others to participate in the benefits thereof, and thus do by indirection what the constitution forbade her to do directly.

Nor does the case of *Railroad Companies v. Schutte*, 103 U.S. 118, sustain this argument of the appellants. There the State of Florida issued her bonds to aid the railroads, securing herself by a first mortgage on the roads, and taking in exchange bonds of the companies. It was certified on the state bonds that they were protected by a first mortgage "as security for the holders thereof." The bonds, thus drawn, were endorsed by the railroad companies and issued by them. The obligation of the State was found unconstitutional, but it was held that, inasmuch as the railroad companies had endorsed the bonds thus drawn, they had guaranteed the existence of the mortgage, and the holders of the bonds were therefore entitled, as against them, to insist upon the validity of the mortgage and to assert legal rights by virtue thereof. In the present case there is no mention of the existence of a mortgage on the face of the bonds declared on by the complainants; nor is there any statement of such mortgage in the act of 1870 under which they were issued. The claim here is merely that a mortgage resulted from the statute passed in 1866, which statute in express terms reserves a mortgage only for such bonds as are endorsed by the State. The case relied on involved no question of the existence of a mortgage, but

the point at issue was whether an admittedly existing mortgage could be enforced against the corporation. Here, on the contrary, the question is, whether the mortgage under the act of 1866 ever existed quoad the bonds issued under the act of 1870.



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These conclusions are decisive of the cause, but other considerations, which affect the merits of the controversy, are equally fatal to the appellants. It cannot be doubted that, even if the bonds issued under the act of 1870 were secured by the statutory mortgage reserved by the act of 1866, they were second in rank, and therefore their holders were junior mortgage creditors. Nor can it be gainsaid that the statutory mortgage conferred upon the State a power to sell the mortgaged property. This power was exercised in 1875. The grounds upon which it is asserted that the sale was void are: First, that before the sale it was announced that only bonds of the issue of 1866 would be received in payment, and that at the sale it was declared that such bonds would only be received at their market value. There is no averment in the bill that the first mortgage creditors complained of these requirements, nor does it contain any allegation that the holders of the second series of bonds, who are now championing the rights of the first mortgage creditors, bid at the sale, or in any way manifested their willingness to free the property from the first mortgage debt. The rights of the second mortgage creditors were necessarily subordinate to the paramount rights of the creditors first in rank. The property of the company had been for nearly two years under seizure, the default having occurred in 1873. It was the plain duty of the second mortgage creditors, if they were interested in preventing the sale and wished to tender their bonds in payment, to bid a sufficient amount to lift the prior encumbrance. Not only it there no averment that they did this, but the bill contains an assertion that in the event the mortgage indemnified only the State, then equality of rank existed between the holders of the second and the holders of the first series of bonds, and upon this alleged equality the complainants, as holders of the second series, base their claim to participate

ratably in the distribution of the purchase money, and thus infringe upon the unquestioned rights of the bondholders under the act of 1866.

The other ground of attack upon the sale was the incapacity of the State to purchase at her own sale, which it is claimed resulted from the fact that the statutory mortgage reserved by the act of 1866 made the State a trustee for the bondholders. Conceding this, the State was both a trustee and a mortgagee, and she had a direct individual interest in the property, by reason of her endorsement on the bonds. The general assembly of the State of Georgia had expressly authorized the governor to bid in the property, on behalf of the State, in case there was no bid sufficient to protect the outstanding obligation which bore the State's endorsement. Even if this provision be considered inapplicable upon the ground that the State could not lawfully bid at the sale under a power conferred upon herself by herself, the complainants' position would be untenable. It is conceded that the settled doctrine in Georgia is that the purchase by a trustee is not absolutely void, but merely voidable at the option of the cestui que trust. *Worthy v. Johnson*, 8 Georgia, 236. Let us suppose, for the sake of argument, that the cestuis que trustent in this case were the holders of the bonds which were issued under the act of 1866 and of those which were issued under the act of 1870. The bill contains an averment that the holders of the first class surrendered their bonds to the State after her purchase of the property, and that she has discharged her liability under her endorsement upon their bonds. In retiring these bonds the State paid off the first mortgage debt, not only to the extent of her bid, but to nearly twice its amount. The action of the first mortgage creditors in acceptance the extinguishment



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by the State of their securities and the mortgage by which they were secured was, in effect, a ratification of the sale, and established its legal validity so far as they were concerned.

Under these circumstances, conceding that the second series of bonds were secured by a second mortgage, their holders cannot equitably be allowed to avoid the sale without tendering

reimbursement of the amount of the first mortgage. Their claims were subordinate to those of the holders of the first series, and they have no recourse until the latter are paid, and it would be grossly inequitable to allow them to avoid a sale which has been ratified by those who were primarily interested in the price resulting therefrom without compelling them, as a prerequisite, to do equity by protecting the first encumbrancers. *Collins v. Riggs*, 14 Wall. 491; *Jones on Mortgages*, sec. 1669; *Pomeroy's Equity*, sec. 1220 et seq. Instead of doing this, although nearly two years had elapsed between the sale and the filing of the bill, the complainants assert that their bonds are, in the contingency last stated, equal in rank of mortgage lien with those of the holders of the first series, and hence that they are entitled to an equal participation in the proceeds of the mortgage property. Indeed, in the discussion at bar, the contention was advanced that the retirement of the first mortgage bonds, by the State, after her purchase, extinguished the prior mortgage by which they were secured, and that, the sale being voidable at the instance of complainants, -- an option which their bill asserts, -- the second mortgage, which was held by them, has thus become first. No offer to pay the amount of the first mortgage was made prior to the purchase of the property by the defendants, and their title cannot now be divested, even if such an offer were made. We think the complainants are not entitled to the relief which they claim, and that the property passed to the defendant free from any lien under the statutory mortgage arising from the act of 1866 or 1870, even if from the latter any such mortgage ever resulted.

Affirmed.

