

Kaplan v. Chase Nat. Bank of City of New York

281 N. Y.S. 825

N. Y. Sup. 1934

Jun 16, 1934

STEUER, JUSTICE:

Defendant was the so-called “trustee” of an issue of debenture bonds of the General Theatres Equipment Company. Plaintiffs sue as bondholders for equitable relief made necessary by certain acts of defendant claimed to be in violation of its fiduciary duty.

The indenture under which the debentures were issued contains a covenant given by the corporation to the defendant that the former will not create or suffer to exist any lien or pledge upon the stock of its subsidiaries without making ratable provision for the securing of the bonds in question, with the exception that the covenant shall not apply to a pledge or lien securing notes maturing not more than one year after their respective dates.

On May 6, 1930, defendant loaned the corporation \$2500300 secured by Fox Film A stock on the latter’s demand note. On July 7, 1930, a similar sum was loaned on similar collateral. Eleven days later, 1000000 was paid on account of this indebtedness. On October 10, 1930, defendant advanced \$6000000 additional and surrendered the two outstanding notes, taking in return a note for \$10000000 payable in six

months and additional stock as collateral, continuing to hold the stock already pledged as part of the security for this note. Later defendant demanded and received additional collateral for this note and another indebtedness. The note was renewed upon maturity until September 28, 1931.

The question is whether the transaction is a violation of the covenant in the indenture. If it is, there can be no dispute that the defendant violated a duty to the bondholders in participating in an act which it undertook to prevent the corporation from doing. Defendant claimed that the demand notes were paid by the \$10 000 000 note, and hence there was no outstanding indebtedness for a year. Under the circumstances, the question is undoubtedly one of intent. The intent found here was one to avoid the provisions of the indenture which was accomplished by stamping the notes paid and indulging in the other mummeries of banking practice. There was no real payment.

Defendant's second contention is that even if there was no payment, the collateral secured the last note which matured within the prescribed time, and hence there is no violation. Before making such an argument, one should note that the provision requires that no such pledge shall be suffered to exist; that is, allowed to continue. This means that a pledge of security for an obligation should not be allowed to continue, and to come within the exception the obligation must be one actually maturing within

a year and not only made to appear so through financial prestidigitation or ingenuity of counsel.

... The relief to be given is not to return the collateral to the receiver of the corporation, but to do what the defendant should have done, apply it ratably to the debentures.

Judgment for the plaintiff to the extent indicated in the foregoing memorandum, with appropriate exceptions to both sides. Submit findings accordingly June 21, 1934.