

Security Mortgage Co. Vs. Powers

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Appeal No. : 278 U.S. 149

Appellant : Security Mortgage Co.

Respondent : Powers

Judgement :

Security Mortgage Co. v. Powers - 278 U.S. 149 (1928)

U.S. Supreme Court Security Mortgage Co. v. Powers, 278 U.S. 149 (1928)

Security Mortgage Co. v. Powers

No. 32

Argued October 12, 1928

Decided December 10, 1928

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CERTIORARI TO THE CIRCUIT COURT OF APPEALS

FOR THE FIFTH CIRCUIT

SYLLABUS

1. When it is asserted that real property, or its proceeds, in a bankrupt estate is subject to a lien for attorney's fees arising from a loan contract secured by the land and made before the bankruptcy proceedings were begun, the contract is to be construed and the validity of the lien determined by the bankruptcy court, in accordance with the law of the state where the contract was made and the land is situated; but whether the liability is enforceable in the circumstances may raise federal questions peculiar to the law of bankruptcy. P. [278 U. S. 153](#) .

2. Petitioner held promissory notes secured by land in Georgia. The land was acquired from the debtor by one who assumed and agreed to pay the debt and later was adjudicated a bankrupt. The notes provided for 10% attorney's fees "if collected by law or through an attorney at law." After the adjudication, there was a default in the payment of interest; petitioner notified the original debtor of its election to declare the principal due, and took against the original debtor only, without joining the bankrupt or the trustee, the steps prescribed by 4252 of the Georgia Code, which provides that obligations to pay attorney's fees upon any note in addition to interest "are void" unless the debtor fails to pay the debt on or before the return day of the court to which suit is brought for collection of the same, and which requires the holder to serve notice on the debtor of his intention to sue and of the term of court. The suit having resulted in a judgment against the original debtor for

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principal, interest, and attorney's fees, and declaring these amounts a special lien on the property, and the property having in the meantime been sold in the bankruptcy court and bought in by the petitioner, the question arose whether credit for the attorney's fees should be allowed the petitioner out of the proceeds of the sale, which remained subject to the lien.

HELD

(1) Enforcement of the lien for the attorney's fees was not precluded by 63 of the Bankruptcy Act upon the ground that the liability remained contingent until after the bankruptcy adjudication. The lien was not contingent, and property subject to a perfected lien securing a liability still contingent at the time of bankruptcy is not discharged from the lien by the adjudication. P. [278 U. S. 155](#) .

(2) The contingent obligation to pay attorney's fees having been part of the original loan transaction, and the consideration for the lien having been the loan -- a " present consideration " -- and not the attorney's services, allowance of the attorney's fees was not excluded by 67d of the Bankruptcy Act. P. [278 U. S. 156](#) .

(3) Section 4252 of the Georgia Code does not mean that a contract to pay attorney's fees shall be void until validated thereunder; it merely adds a statutory condition to the contract. P. [278 U. S. 156](#) .

(4) If the petitioner in this case, which knew that the bankrupt had assumed and become primarily liable for the debt, failed to notify the trustee of its election to declare the debt due or of the suit under 4252, Georgia Code, or if its sole purpose in bringing that suit, knowing the defendant, the original debtor, to be insolvent, was to increase by the amount of the attorney's fees the claim payable in bankruptcy under the lien -- it is not entitled to credit for the attorney's fees. Pp. [278 U. S. 157](#) -158.

3. Where the grounds upon which the circuit court of appeals had affirmed a judgment were found by this Court to be untenable, but there were other reasons requiring the same results if facts, not included in the stipulated record, were found to exist, the case was reversed and remanded to the district court with directions for further proceedings. P. [278 U. S. 159](#) .

21 F.2d 965 reversed.

Certiorari, 276 U.S. 610, to a judgment of the circuit court of appeals which affirmed a judgment of the district court, in bankruptcy, disallowing a claim for attorney's fees.

MR. JUSTICE BRANDEIS delivered the opinion of the Court.

The Florida Furniture Company was adjudicated bankrupt in the Southern District of Florida. Among its assets was real estate in Georgia, acquired by purchase from the Hanson Motor Company. An ancillary receiver appointed in the Northern District of Georgia took possession of this property. It was subject to a loan deed (see *Scott v. Paisley*, [271 U. S. 632](#)) given to secure notes of the Hanson Company for \$90,000 and interest, which the furniture company had assumed and agreed to pay. The trustee in bankruptcy applied for leave to sell the property free from the lien. The secured notes were held at the time of the adjudication and thereafter by the Security Mortgage Company. An order was served upon it to show cause why the trustees' application should not be granted. It appeared, but made no opposition. Leave to sell was granted, preserving to the lien creditor its rights in the proceeds of the sale. Under that order, the property was sold, and the mortgage company became the purchaser at a price exceeding the amount of all liens. It asked to be allowed as a credit against the purchase price, among other things, the sum of \$9,442.40 for attorney's fees.

The secured indebtedness was represented by a principal note and 10 coupon interest notes. Each note contained the following clause:

"With interest after maturity until paid at eight percent per annum with all costs of collection, including ten percent as attorney's fees, if collected by law or through an attorney at law."

So far as appears, the mortgage company did not employ

an attorney until after it had been served with the order to show cause, on the trustee's application for leave to sell the property. There had been no default before the adjudication. Thereafter, a coupon interest note matured and was not paid. Before the leave to sell was granted, the mortgage company, because of this

default, gave notice to the Hanson Company of its election to declare the principal note due. It also gave to the Hanson Company notice in writing that it intended to bring suit in the City Court of Atlanta and to claim the attorney's fees, unless the indebtedness was paid. Twelve days later, the mortgage company brought such a suit against the Hanson Company, without attempting to join the bankrupt, the receiver, or the trustee. It does not appear that notice of the acceleration of the principal note, or of the intention to sue, or of the bringing of the suit against the Hanson Company was given to the bankrupt, the trustee, or the receiver. Prior to the sale of the property by the trustee, judgment was entered against the Hanson Company for the principal and interest and for \$9,442.40 attorney's fees. That judgment declared those amounts to be a special lien upon the property.

Over the objection of the trustee, the claim for attorney's fees was allowed by the referee as a credit against the purchase price. The district judge disallowed it without writing an opinion. The certificate of the referee set forth the facts, and the parties stipulated that the "certificate contains all of the facts necessary to a clear understanding of the issue made on appeal to the Circuit Court" of Appeals. That court affirmed the judgment. 21 F.2d 965. This Court granted a writ of certiorari. 276 U.S. 610. Whether disallowance of the credit for attorney's fees was error is the sole question for decision.

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Under 67 of the Bankruptcy Act, the trustee takes property subject to valid liens existing at the time of the institution of the bankruptcy proceedings. The mortgage company makes no contention that the judgment in the state court establishes as *res judicata* either the claim for attorney's fees or the existence of the lien therefor. It concedes that, by no action in the state court and by no act of the mortgage company could a lien be attached to the property after it had passed to the trustee (*see* *Murphy v. Hofman Co.*, [211 U. S. 562](#)), and that the bankruptcy court must determine for itself whether a lien exists and the amount of the indebtedness secured thereby. *See* *Hebert v. Crawford*, [228 U. S. 204](#) ; *Chicago Board of Trade v. Johnson*, [264 U. S. 1](#) , [264 U. S. 11](#) . The proceedings in the state

court are relied upon merely to show compliance with the condition which 4252 of the Georgia Code makes a prerequisite to the enforcement of any contract to pay attorney's fees. See *Stone v. Marshall & Co.*, 137 Ga. 544; *Turner v. Peacock*, 153 Ga. 870, 879.

The provision of the Georgia Code is this:

"Obligations to any attorney's fees upon any note or other evidence of indebtedness, in addition to the rate of interest specified therein, are void, and no court shall enforce such agreement to pay attorney's fees unless the debtor shall fail to pay such debt on or before the return day of the court to which suit is brought for the collection of the same: Provided, the holder of the obligation sued upon, his agent, or attorney notifies the defendant in writing, ten days before suit is brought, of his intention to bring suit, and also the term of the court to which suit will be brought."

The validity of the lien claimed by the mortgage company for attorney's fees must be determined by the law of Georgia, for the contract was there made and was secured by real estate there situate. [Humphrey](#)

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v. Tatman, [198 U. S. 91](#) . See *Benedict v. Ratner*, [268 U. S. 353](#) , [268 U. S. 359](#) . The construction of the contract for attorney's fees presents, likewise, a question of local law. See *Farmers' & M. Bank v. Fed. Reserve Bank*, [262 U. S. 649](#) , [262 U. S. 660](#) . Whether the liability is, under the circumstances, enforceable against the proceeds of the sale raises federal questions peculiar to the law of bankruptcy. The character of the obligation to pay attorney's fees presents no obstacle to enforcing it in bankruptcy, either as a provable claim or by way of a lien upon specific property. The obligation is held to be enforceable by action *in personam* in the federal courts for Georgia, *Perry v. John Hancock Life Insurance Co.*, 2 F.2d 250.

The mortgage company contends that, although the collection of the note was made not through the suit in the state court, but through the uncontested sale in

the bankruptcy court, it should be deemed a collection "by law or through an attorney" within the meaning of the contract. Many decisions of the courts of the state lend support to that contention. They hold that attorney's fees are recoverable not like costs, as an incident of the suit, but as a part of the principal debt; [[Footnote 1](#)] that, by the giving of notice of intention to sue, the commencement of the suit and the failure of the debtor to pay on or before the return day, a vested right arises which a later payment of the debt could not affect; [[Footnote 2](#)] that the liability for attorney's fees is not dependent upon the collection having been made through a suit brought in compliance with the Code; [[Footnote 3](#)] and that it may be enforced against the

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land held as security; although the debtor has become insolvent, *McCall v. Herring*, 116 Ga. 235, 238-239; or the property has passed to an administrator, *Harris v. Powers*, 129 Ga. 74; or to a receiver, *Guarantee Trust & Banking Co. v. American National Bank*, 15 Ga.App. 778, 782-784. [[Footnote 4](#)] The trustee does not question that the Hanson Company became personally liable for the attorney's fees, despite the proceedings taken in bankruptcy. His objections go only to the enforcement of the liability against the proceeds of the property sold.

First. The trustee contends that the credit for the attorney's fees was precluded by provisions of the Bankruptcy Act. He insists that, at the time of the adjudication, the liability was contingent, since at the time there had not been any default, and under 63 of the Bankruptcy Act, a contingent claim is not provable. [[Footnote 5](#)] But the mortgage company does not seek to prove the claim in bankruptcy. It asks to have it allowed as a part of the principal debt, which is secured by a lien upon the property sold. The federal courts for Georgia have, in a series of cases, refused to permit this to be done, on the ground that the liability was contingent at the time of the adjudication.

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See *In re Weiland*, 197 F. 116; *In re Ledbetter*, 267 F. 893; *In re Hotel Equipment Co.*, 297 F. 842, 845; *In re Stamps*, 300 F. 162. Compare *In re Gimbel*, 294 F. 883. We find nothing in the Bankruptcy Act to justify such a refusal. The lien was not inchoate at the time of the adjudication. It had already become perfect when the principal note and the loan deed securing it were given. Property subject to a lien to secure a liability still contingent at the time of bankruptcy is not discharged from lien by the adjudication. The secured obligation survives, and if it is that of a third person, is usually unaffected by the bankruptcy. When, by the happening of the event, the contingent liability becomes absolute, the lien becomes enforceable, [[Footnote 6](#)] though this occurs after the adjudication.

Second. The trustee contends that allowance of the credit is barred by 67d, because the liability for attorney's fees, not having become absolute until after the adjudication, is excluded by the provision which allows outstanding liens "to the extent of such present consideration only." The contention has support in *In re Mobile Chair Co.*, 245 F. 211. [[Footnote 7](#)] But it was rejected, and we think properly, in *In re Rosenblatt*, 299 F. 771. The contingent obligation to pay attorney's fees was a part of the original transaction. The consideration for the lien was not the attorney's services, but the \$90,000 advanced by the mortgage company, and this was a present consideration. See *Bank of Lumpkin v. Bank*, 35 Ga.App. 340.

Third. The trustee contends that, under the Bankruptcy Act, the claim must be disallowed, because, by the

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Georgia Code, the contract was void unless and until the statutory condition had been complied with; that, consequently, at the time of the adjudication, no valid contract existed, and that the bankrupt's estate cannot be affected by a validation, equivalent to the making of a wholly new contract, occurring thereafter. This seems to be the view taken by the federal courts for Georgia. See *In re Stamps*, 300 F. 162, 164. The question depends primarily upon the construction of 4252 of

the Georgia Code, and thus primarily upon the local law. The language of the statute lends some color to the trustee's contention. No case in a court of the state has been called to our attention in which consideration of this contention was had. Those which discuss the significance of the word "void," as used in this section, throw little light upon it. [[Footnote 8](#)] Despite the language employed, we are of opinion that the legislature did not contemplate validation of a void contract, but merely added a statutory condition to the written contract to pay attorney's fees.

Fourth. Two further possible objections to the allowance of the attorney's fees are suggested. The first is lack of notice to the trustee of the action of the mortgage company which resulted in the judgment in the state court recovered against the Hanson Company. The principal note was payable in 1930, with a provision for acceleration in case of default. The mortgage company's election to declare it immediately due, for default in payment of the interest coupon, was exercised after it had been made a party to the trustee's application for leave to sell -- a proceeding which would presumably result in payment of the debt. The referee did not find whether

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or not the mortgage company gave the trustee notice of its election to accelerate the maturity of the principal; or notice that the suit had been brought. The mortgage company then knew that the bankrupt had agreed with the Hanson Company to pay the note and that the property had become primarily liable for the debt. If it failed to give the trustee notice of the election and of the intention to bring suit, we think that it is not entitled to the credit for attorney's fees. For, if he had been notified, the trustee might have arranged to pay the note on or before the return day of the suit against the Hanson Company. The purpose of the Georgia statute is clear. It is to protect the debtor, in spite of default, from any liability for attorney's fees unless he fails to pay after the lapse of the ten days from receiving notice of intention to sue and such further time as must intervene between the commencement of the suit and the return day. *Harris v. Powers*, 129 Ga. 74, 88; *Edenfield v. Bank of Millen*, 7 Ga.App. 645, 648. The legislature cannot have intended that the creditor should be able to impose the additional liability for

attorney's fees, without giving to the real debtor the notice and opportunity to pay which the statute contemplated that a debtor should have. This objection also involves primarily a question of local law, and no decision directly in point has been found. But decisions applying the Georgia statute to somewhat similar situations support this conclusion. [[Footnote 9](#)]

Fifth. The remaining suggested objection is this: the trustee asserts that, at the time of the commencement of the suit against the Hanson Company, it was absolutely insolvent and without assets, and that the sole purpose of bringing the suit against it was to increase, by the amount of the attorney's fees, the claim payable in bankruptcy

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under the lien. It is settled that the mere fact of the debtor's insolvency under the state law does not prohibit the rendering of a judgment for attorney's fees. "Such a condition," says the court in *Harris v. Powers*, 129 Ga. 74, 86,

"may make it more difficult, and sometimes impossible, for a creditor to realize upon his judgment; but he is not debarred from the privilege of obtaining it."

The case at bar presents, however, additional facts. It is asserted that the suit against the Hanson Company was brought not for the purpose of collecting the debt, but solely for the purpose of enhancing the amount which was obtainable without suit through the lien upon the proceeds of the property. If this is true, the statutory provision designed for the protection of the debtor was employed solely as a means of oppression. We will not assume, in the absence of a decision by a Georgia court, that the legislature intended to permit such use.

Neither of the two objections to the allowance of the credit last discussed appears to have been considered by the referee or by either of the lower courts. Nor does the certificate of the referee contain the specific findings of fact necessary to support either of them. The court of appeals rests its affirmance of the judgment denying the credit for attorney's fees upon provisions of the Bankruptcy Act which we hold are not applicable, or upon a construction of the Georgia statute which we

deem erroneous. Under these circumstances, the decree of the circuit court of appeals must be reversed, with directions to remand the case to the district court. But the district court shall be directed to treat the stipulation concerning the certificate as failing to include elements essential to a final adjudication; to determine whether or not either of these two objections, which we hold meritorious if sustained by the facts is so sustained; and, if so sustained, the credit for attorney's fees shall be disallowed. If the

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district court finds that neither of said objections is so sustained, credit for the attorney's fees shall be allowed, for the amount due and secured by the lien, in conformity with this opinion. [[Footnote 10](#)]

Reversed.

[[Footnote 1](#)]

Royal v. Edinburgh-American Co., 143 Ga. 347, 350; *Evans v. Atlantic Nat. Bank*, 147 Ga. 621.

[[Footnote 2](#)]

Harris v. Powers, 129 Ga. 74, 86-88; *Mount Vernon Bank v. Gibbs*, 1 Ga.App. 662; *Valdosta R. Co. v. Citizens' Bank*, 14 Ga.App. 329, 332-333; *Equitable Life Assurance Society v. Pattillo*, 37 Ga.App. 398.

[[Footnote 3](#)]

Guarantee Trust & Banking Co. v. American National Bank, 15 Ga.App. 778.

[[Footnote 4](#)]

In *Equitable Life Assurance Society v. Pattillo*, 37 Ga.App. 398, it was held that the holder of a secured note providing for attorney's fees might at the same time sue at law *in personam* and proceed to foreclose under a power of sale, and that, if the debt was not paid before the return day of the suit, he might retain the

attorney's fees from the proceeds of a sale made under the power before entry of the judgment. It is only when the default in payment was due to the creditor's failure to perform a duty to realize upon collateral held that the right to attorney's fees is denied. *Compare Rylee v. Bank of Statham*, 7 Ga.App. 489, 495-498.

[[Footnote 5](#)]

For cases to that effect involving similar contracts for attorney's fees under the laws of other states, see *In re Roche*, 101 F. 956; *In re Jenkins*, 192 F. 1000; *British & American Mortgage Co. v. Stuart*, 210 F. 425, 430. *Compare Gugel v. New Orleans National Bank*, 239 F. 676; *First Savings Bank & Trust Co. v. Stuppi*, 2 F.2d 822.

[[Footnote 6](#)]

See *In re Stoddard Bros. Lumber Co.*, 169 F.190, 195; *In re Farmers' Supply Co.*, 170 F. 502, 506, 507; *In re Sullivan*, 21 F.2d 834; *Estes v. Estes & Sons*, 24 F.2d 756.

[[Footnote 7](#)]

See, in accord, *Matter of Quertimont*, 10 A. B.R. (N.S.) 47 (Referee W.Va.).

[[Footnote 8](#)]

Compare the statement in *Johnson v. Globe Co.*, 11 Ga.App. 485, that, prior to notice, the right to attorney's fees is "embryonic only," *with* that in *Mt. Vernon Bank v. Gibbs*, 1 Ga.App. 662, 666, that, upon payment before return day "the obligation to pay attorney's fees becomes void."

[[Footnote 9](#)]

Loftis v. Alexander, 139 Ga. 346; *Chamlee v. Austin*, 150 Ga. 279.

[[Footnote 10](#)]

Compare [32 U. S.](#) *Lear*, 7 Pet. 130; *Chicago, Milwaukee, etc., Ry. Co. v. Tompkins*, [176 U. S. 167](#) , [176 U. S. 179](#) -180; *United States v. Rio Grande Irrigation Co.*, [184 U. S. 416](#) ; *Lincoln Gas & Electric Light Co. v. Lincoln*, [223 U. S. 349](#) , [223 U. S. 364](#) -365; *Swift & Co. v. Hocking Valley Ry. Co.*, [243 U. S. 281](#) , [243 U. S. 289](#) ; *Hammond v. Schappi Bus Line*, [275 U. S. 164](#) , [275 U. S. 172](#) .

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