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Tort Claims as Operating Expenses Given Priority Over Mortgage Liens as to Earnings of a Street Railway Company in Receiver's Hands

TORT CLAIMS AS OPERATING EXPENSES GIVEN PRIORITY OVER MORTGAGE LIENS AS TO EARNINGS OF A STREET RAILWAY COMPANY IN RECEIVER'S HANDS—Appellants filed claims based on injuries to persons and damages to property arising out of the operation of the Union Traction Company prior to the appointment of a receiver. Appellants claimed a right to preference and priority of payment as a part of the usual, natural and ordinary operating expense of the railroad, and that the mortgagees took their mortgages with the understanding that all railroad operating expenses were to be paid out of current revenues before such mortgages had any claim upon such revenues. Held, claims against the railway company for injuries to persons and damages to property before, as well as after, appointment of receiver therefor are "operating expenses" entitled to priority over mortgages in payment.[1]

While there is no precedent in Indiana law for this decision, upon analysis of other authority and of the principles involved, it seems to be a desirable result.

That operating expenses constitute a preferred claim on moneys received from such operation is well settled.[2] As to just what claims shall constitute

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Holmes v. Holmes (1893), 133 Ind. 386, 32 N. E. 932; Dietyman v. Mullin (1900), 108 Ky. 610, 57 S. W. 247; Smith v. Smith (1897), 98 Tenn. 101, 33 S. W. 439; Hodgkinson v. Hodgkinson (1895), 43 Neb. 269, 61 N. W. 577.

[18] These states are Michigan, Massachusetts, Connecticut, and Rhode Island. See Marri v. Stamford St. R. Co. (1911), 84 Conn. 9, 78 Atl. 532; Bolger v. Boston Elevated Ry. Co. (1910), 205 Mass. 420, 91 N. E. 389; Blair v. Seitner Dry Goods Co. (1915), 184 Mich. 304, 151 N. W. 724; Golden v. R. L. Green Paper Co. (1922), 44 R. I. 231, 116 Atl. 579.

[19] Holbrook, The Change in the Meaning of Consortium (1923), 22 Mich. L. Rev. 1.

[20] Flandermeyer v. Cooper (1912), 85 Ohio St. 327, 98 N. E. 102; Moberg v. Scott (1917), 38 S. D. 422, 161 N. W. 998.

[1] McCullough v. Union Traction Co. of Indiana, Supreme Court of Indiana, 1933, 186 N. E. 300.

[2] Jones, Mortgages, Sec. 827; Clark v. Central Railroad & Banking Co. of Georgia (1895), 66 Fed. 803 (C. C. A., 5th); Texas & Pacific Railway Company v. Johnson (1890), 16 Tex. 421, 13 S. W. 463, 18 Am. St. Rep. 60.

operating expenses, the authorities have not been in complete harmony. At an early date even the right of employees to have their wages paid out of earnings while the road was in receivership was disputed, but it was finally allowed on the ground of public policy.[3] Liens of materialmen were denied priority until the case of *Fosdick v. Schall*[4] which has been widely followed.[5] Some courts allowed priority for liens of supply claimants but denied it to tort claimants on the ground that while the former was necessary to the continued operation of the road, "to keep the road a going concern,"[6] the latter had no such basis.

Those courts which have denied preference to tort claims have advanced the following reasons for their decisions: that such claims are not based on any consideration accruing to the benefit of the mortgage security or tending to preserve or enhance its value,[7] nor are they incident to running the railroad, nor to procuring traffic,[8] that to sustain such claims, it must be held that the bondholders impliedly assumed liability for negligence of the railroad company,[9] or that the claimants have superior equities[10] and that such claims are not only not necessary, but are actually deleterious to operation.[11]

The underlying problem in all these cases is suggested by one or two of the above reasons: that to allow tort claims a prior lien over the mortgage creditors is, in effect, to make the latter pay for wrongs not committed by them, but by the railroad company. The arguments which meet this position most squarely are presented in the principal case: that the mortgagees accept their mortgages with full knowledge that all legal liabilities resulting from operation and all necessary expenses are to be paid before any of the earnings are available for mortgage debts; among such legal liabilities is that of claims and judgments for accidents and injuries to persons and property, unavoidable risks in the operation of the business. Such claims are considered operating expenses when the company itself runs the road or when the receiver runs it[12] and there is no sound reason for classing them otherwise because they arose a short time before a receiver was appointed.

Many other reasons have been advanced by various courts to justify decisions in accord with the principal case. One of the more conspicuous is that the mortgagee is in privity voluntarily with the tortfeasor, while

[3] Douglass v. Cline (1876), 12 Bush. 608 (Ky.).

[4] (1878), 9 Otto (99 U. S.) 235.

[5] Hale v. Frost (1878), 99 U. S. 389; Citizens Trust Company v. National Equipment & Supply Co. (1912), 178 Ind. 167, 98 N. E. 865, 41 L. R. A. (N. S.) 695; Turner v. Indianapolis, B. & W. Ry. Co. (1878), 24 Fed. 366 (D. C. Ind. and S. D. Ill.), 8 Biss. 315.

[6] Easton v. Houston & T. C. Ry. Co. (1889), 38 Fed. 12 (C. C., E. D. Texas).

[7] St. Louis Trust Company v. Riley (1895), 70 Fed. 32 (C. C. A., 8th).

[8] Davenport v. Alabama & C. R. Co. (1875), 2 Woods 519, 7 Fed. 8 (C. C., S. D. Ala.).

[9] Hale v. Frost (1878), 99 U. S. 389.

[10] Hiles v. Case, Receiver (1880), 14 Fed. 141 (D. C., E. D. Wis.).

[11] St. Louis Trust Company v. Riley (1895), 70 Fed. 32 (C. C. A., 8th).

[12] Cowdrey v. R. R. Co. (1876), 93 U. S. 352, 23 L. ed. 950; Klein & Wife v. Jewett (1875), 26 N. J. Eq. 474; Texas & Pacific Railway Company v. Johnson (1890), 16 Tex. 421, 13 S. W. 463, 18 Am. St. Rep. 60; Mobile & Ohio Railroad Company v. A. Davis (1884), 62 Miss. 271; Ex parte Brown & Wife (1880), 15 S. C. 518.

the accident victim certainly is not and there is a strong equity in favor of an involuntary creditor.[13] Also, there is involved in such cases an important public policy in the security of the people—*"Salus populi suprema lex"*—outweighing that of keeping the railroad a "going concern."[14] Furthermore, the very income in question was produced by exercising the franchise granted by the state to the railroad company, to which adhere inseparably certain duties and liabilities and which is answerable, out of revenues produced by its exercise, for torts commited in its exercise.[15] While *contra* cases go on the theory of benefit to the mortgagee, they disregard altogether the correlative burdens.[16] Receivership is an equitable doctrine and must be administered equitably,[17] and tort claims, being of a peculiarly meritorious nature,[18] should be favorably considered by chancery. By coming into equity to ask receivership, the mortgage creditors agreed to submit to all superior equities and to all necessary incidents of good management, one of which is payment of valid tort claims.[19] The liability which the law creates in such cases is not inferior in merit to a debt arising out of a contract.[20]

The tendency of the later and better-reasoned cases is to allow tort claims to be classed as operating expenses and, as such, given priority over mortgage liens, so that the decision in the principal case seems right on authority (though the cases are not numerous) and on principle. M. C. M.

RES JUDICATA—PRIVIES—WHAT MIGHT HAVE BEEN ADJUDICATED WAS ADJUDICATED—After the death of a testator in 1905, the trustees under his will brought an action in 1906 for the construction thereof, making the widow, daughter and the daughter's two children parties defendant. The court construed the will to provide a life estate in the income from the land to the widow, a certain sum for life to the daughter if she should survive, and the trustees to retain title to the land until the two grandchildren, who were specifically named in the will, reached twenty-one, paying them support, etc., and the fee to go to them on attaining that age. The widow survived the daughter, dying in 1929. Shortly thereafter, appellants, sons of the daughter by a later marriage and not in being at the time of testator's death, filed a partition suit alleging that they were each owners of an undivided one-fourth of the real estate. The lower court held they were bound by the prior judgment. On appeal, they contend that the court did not actually determine whether the provisions as to the trustee's holding title until the appellees, the two named grandchildren, were twenty-one was a restraint on alienation, and hence, the decree was not res judicata. Held, bound by the prior decree.[1]

This holding is entirely in accord with a long line of Indiana authorities, and is a recognition of the rule that "what might have been adjudicated

[13] Green v. Coast Line R. Co. (1895), 97 Ga. 15, 24 S. E. 814.
[14] Ibid.
[15] Ibid.
[16] Ibid.
[17] Fosdick v. Schall (1878), 9 Otto (99 U. S.) 235.
[18] Ex parte Brown (1880), 15 S. C. 518.
[19] Ibid.
[20] Ibid.
[1] Reynolds v. Lee Appellate Court of Indiana, June 28, 1933, 186 N. E. 337.