EXTENT TO WHICH MORTGAGE COVERS INCOME AND FUNDS DERIVED THEREFROM. One of the most important of the rules laid down in *Fosdick* v. *Schall*[1] is that even where a mortgage on a railroad gives a lien on the income of the road in express terms, the income out of which the mortgagee is entitled to be paid, while out of possession, "is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipments, and useful improvements. Every railroad mortgagee," said the court, "in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income." It follows from this that persons to whom debts are due at the time a mortgaged road goes into the hands of a receiver for "necessary operating and managing expenses, proper equipments, and useful improvements, are entitled to a priority over mortgage creditors as to any fund derived from income which may be received by the receiver from the company.[2]

RULE AS TO CORPUS OF THE MORTGAGED PROPERTY. As a general rule, the rights of first mortgage creditors are superior to those of creditors of any other class, so far as the *corpus* of the mortgaged property is concerned. No lien equal to theirs can be given by the mortgagor to material-men, or others to whom debts may become due, for current expenses, even by an express mortgage.[3] But the lien of mortgage creditors only extends to the interest of the mortgagor; and, where the mortgage is made to cover after-acquired property, a lien for the purchase-money retained upon supplies sold, the mortgagor, after the execution of the mortgage, will take precedence of the mortgage lien, if the supplies furnished are not affixed to the realty.[4] If so affixed, the mortgage lien attaches, and takes precedence.[5] There are only two exceptions, so far as *ante*-receivership debts are concerned, to the general rule as to the superiority of the mortgage lien: The first is that, where current earnings have been used by the officers of a company for the benefit of mortgage creditors in paying bonded interest, purchasing additional equipments, or making permanent improvements on the fixed property, the mortgage security is chargeable, in equity, with the restoration of the fund thus improperly diverted.[6] The second exception is that, where it is necessary to pay employes back wages in order to retain their services, or to pay a debt for *ante*-receivership operating expenses in order to maintain business relations with the claimant, and the retention of such employes, or the maintenance of such relations, as the case may be, is indispensable to the welfare of the road, and such debts cannot be paid out of income, the receiver may be authorized to raise the necessary funds by issuing certificates of indebtedness, which shall take precedence of first-mortgage bonds.[7]

APPLICATION OF THE INCOME OF THE RECEIVERSHIP TO THE PAYMENT OF ANTECEDENT DEBTS. In *Fosdick* v. *Schall*[8] the proposition was laid down that "when a court of chancery is asked by railroad mortgagees to appoint a receiver of railroad property, pending proceedings for foreclosure, the

[1] 99 U. S. 252. See, also, Gilman v. Illinois & M. Tel. Co. 91 U. S. 603, (1875;) American Bridge Co. v. Heidelbach, 94 U. S. 798, (1876;) Galveston Railroad v. Cowdrey, 11 Wall. 459, (1870.)

[2] American Bridge Co. v. Heidelbach, 94 U. S. 798, (1876;) Gilman v. Illinois & M. Tel. Co. 91 U. S. 603, (1875.)

[3] Galveston Railroad v. Cowdrey, 78 U. S. 459, (1870;) Meyer v. Johnston, 53 Ala. 237, (1875.)

[4] Galveston Railroad v. Cowdrey, 78 U. S. 459, (1870;) Myer v. Car Co. 102 U. S. 1, (1880;) U. S. v. Railroad Co. 12 Wall. 362, (1870.)

[5] Dunham v. Railway Co. 68 U. S. 254, (1863.) Contra, Collins v. Central Bank, 1 Ga. 435, (1846.)

[6] Fosdick v. Schall, 99 U. S. 253, 254; Burnham v. Bowen, 111 U. S. 783, S. C. 4 Sup. Ct. Rep. 675, (1884.)

[7] Miltenberger v. Logansport Ry. Co. 106 U. S. 286, (1882;) S. C. 1 Sup. Ct. Rep. 140.

[8] 99 U. S. 251 et seq.

court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during the receivership of outstanding debts for labor, supplies, equipment, or permanent improvement of the mortgaged property, as may, under the circumstances of the particular case, appear to be reasonable;" and "that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipments provided, or lasting and valuable improvements made, out of earnings which ought in equity to have been employed to keep down debts for labor, supplies, and the like, it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business."

In *Hale* v. *Frost*[1] the supreme court went a step further and held "that the net earnings of the road while in possession of the court, and operated by its receiver, are not necessarily and exclusively the property of the mortgagees, but are subject to the disposal of the chancellor in the payment of claims which have superior equities, if such be found to exist," and that the claims of certain parties who had furnished supplies to the road after default in the payment of interest were entitled to be paid in full before any part of the income was applied to the payment of mortgage creditors.

There had been no diversion of the current debt fund in that case without the application of income out of which the debts in question might have been paid, to the payment of antecedent current debts due at the time of the first default in the payment of interest, can be denominated a diversion.

In the latest case in point, *Burnham* v. *Bowen*,[2] in which, as in the *Fosdick* v. *Schall* and *Hale* v. *Frost*, the opinion was delivered by Mr. Chief Justice WAITE, the supreme court of the United States has carried the doctrine of *Fosdick* v. *Schall* to its ultimate conclusion, and laid down a tolerably clear and explicit rule upon this subject. After quoting the rule laid down in *Fosdick* v. *Schall*, that "the income out of which a railroad mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvements," and that "every railroad mortgagee, in accepting his security, impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim on the income," the chief justice proceeded: "Such being the case when a court of chancery, in enforcing the rights of mortgage creditors, takes possession of a mortgaged railroad and thus deprives the company of the power of receiving any further earnings, it ought to do what the company would have been bound to do if it had remained in possession; that is to say, pay out of what it receives from earnings all the debts which in equity and good conscience, considering the character of the business, are chargeable upon such earnings. In other words, what may properly be termed the debts of the income, should be paid from the income before it is applied in any way to the use of the mortgagees. The business of a railroad should be treated by a court of equity, under such circumstances, as a 'going concern,' not to be embarrassed by any unnecessary interference with the relations of those who are engaged in or affected by it."

In this last case the court expressly held that though there had been no diversion by the company of the current earnings from the payment of the current expenses, a debt incurred over eleven months before the appointment of a receiver, for coal used in the company's locomotives, should be paid out of the income of the receivership, upon the ground that it was a debt which it would have been the company's duty to pay out of the net earnings if the re-

[1] 99 U. S. 339, (1878.)

[2] 4 Sup. Ct. Rep. 677, (1884.)

ceiver had not been appointed.[1] The rule laid down in *Burnham* v. *Bowen* commends itself by its clearness, but that case, like the others from which I have quoted, furnishes no test by which we may distinguish between current debts entitled to be paid out of current income and those which have fallen into the mass of ordinary floating debts, and ceased to be entitled to any preference.[2] The real question in such cases seems to be whether or not the debt is stale. *Vigilantibus non dormientibus æquitas subvenit.* If the claimant has been guilty of laches, no preference will be allowed. It is difficult, if not impossible, to lay down any fixed rule or rules as to when claims should be considered stale. Each case must be governed by the particular facts which appear therein. The limit of six months fixed in the principal case does not seem to be supported by the authorities.

The following are cases in which a preference has been allowed claims more than six months old: In *Douglass* v. *Cline*[3] the company had defaulted in the payment of bonded interest more than eight months before the appointment of a receiver, and wages earned after the default were ordered to be paid out of the net income of the receivership, though no special equities appeared. In *Skiddy* v. *Railroad Co.*[4] unassigned claims for labor performed during the 12 months prior to the receiver's appointment were allowed against the receiver's net income. In *Williamson's Adm'r* v. *Washington City, V. M. & G. S. R. Co.*[5] claims for services rendered and materials furnished in 1874 and 1875 were allowed a preference, though no receiver had been appointed until June, 1876. In *Atkins* v. *Railroad Co.*[6] a railroad company, being unable to pay its employes, obtained a loan of the amount due for wages from certain bondholders, to whom notes for the amount loaned were given. The loan was made in order to prevent an impending strike, and upon the condition that the amount loaned should be applied to the payment of the wages then due, and that the notes given the lenders should be paid out of the first net income of the road. A receiver was appointed about 22 months after the debt was incurred, and it was held that the net income of the receivership should be applied towards the repayment of the loan.[7] And in *Hale* v. *Frost*[8] a claim for materials furnished before default in the payment of bonded interest, and about three years before the appointment of a receiver, but for which a note had been given, which only matured about 16 months before a receiver was appointed, was allowed against a fund in court.

On the other hand, it has been held that an order appointing a receiver which authorized him "to pay the amounts due and maturing for materials and supplies about the operation and for the use of" a road, did not authorize him to pay a renewed promissory note given for re-rolling iron for the use of the road three years before his appointment.[9] So, where the president and directors of a road had contracted a debt for supplies and repairs in 1874 and

[1] The debt was evidenced at the time the receiver was appointed by business paper of the company, maturing at a future date, and this paper was renewed at maturity, but whether by order of court or not does not appear.

[2] Debts of the latter class are never paid out of the receiver's income. Duncan v. Railroad Co. 2 Woods, 542, (1876;) Brown v. Railroad Co. 19 How. Pr. 84, (1860;) Huidekoper v. Locomotive Works, 99 U. S. 258, (1878.)

[3] 12 Bush, 608, (1876.)

[4] 3 Hughes, C. C. 320, (1879.) It has since been held that assigned and unassigned claims stand upon the same footing. Union Trust Co. v. Walker, 107 U. S. 596, (1882.)

[5] 33 Grat. 624, (1881.)

[6] 3 Hughes, C. C. 307, (1879.)

[7] Persons who lend money for payment of bonded interest are not entitled to any preference. Railroad Co. v. Douglass, 12 Bush, 673, (1877.)

[8] 99 U. S. 389, (1878.) A claim for materials furnished for construction purposes was disallowed, but for the reason, as it seems, (33 Grat. 631,) "that this material was used in the construction of an independent branch road." See, also, Union Trust Co. v. Souther, 107 U. S. 591, (1882;) S. C. 2 Sup. Ct. Rep. 295; Taylor v. Railroad Co. 7 Fed. Rep. 377, (1880.)

[9] Brown v. Railroad Co. 19 How. Pr. 84, (1860.)