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sable, to be erroneous and reversible upon appeal.¹⁹ Moreover, two suits had begun following two successive settlements, and the court felt that a mere defense to the pending action would not effectively prevent the repetition of this persistent persecution. Finally, the New York court has since reversed an injunction against an action pending, in violation of a settlement, in another branch of the supreme court; compelled resort to a defense in that action, even though the complaint therein attacked the character of the plaintiff in the injunction suit; and restricted the *Bomeisler* case to its special facts.²⁰

It is submitted that the principal case unnecessarily complicates the North Carolina procedure.

PHILIP E. LUCAS.

Receiverships—Priority of Operating Expenses Over Secured Creditors in the Corpus.

At the instance of parties other than the secured creditors a lumber corporation was put in the hands of a receiver with authority to continue the business. The court ordered the receiver to sell certain lumber, which was the sole asset of the company, and which had been pledged to appellants (secured creditors). The court further ordered the receiver to retain twenty percent of the money realized from the sale to pay the expenses of the receivership and to remit the balance to the secured creditors. *Held*, order affirmed. Where a receivership enures to the benefit of a lienholder, his lien is subordinate to the administrative expenses.¹

In *Fosdick v. Schall*,² the United States Supreme Court adopted the rule that in railroad receiverships the operating expenses have a priority in payment out of the current income over the mortgagees of the corpus, and a payment to the mortgagees out of the current income is a diversion which gives the operating expenses a priority on the corpus equal in amount to the diversion. The court declared that railroads were affected with such vital public interest that they were obligated to continue operation. This rule has been unanimously followed as to railroads,³ and later cases have added that if the current income be in-

¹⁹ *Erie Ry. Co. v. Ramsey*, 45 N. Y. 637 (1871); *Burke v. Burke*, 212 N. Y. 303, 106 N. E. 62 (1914).

²⁰ *Burke v. Burke*, 212 N. Y. 303, 106 N. E. 62 (1914).

¹ *Wood v. Woodbury & Pace, Inc.*, 217 N. C. 356, 8 S. E. (2d) 240 (1940).

² 99 U. S. 235, 25 L. ed. 339 (1878).

³ *Burnham v. Bowen*, 111 U. S. 776, 4 Sup. Ct. 675, 28 L. ed. 596 (1884); *Calhoun v. St. Louis & S. E. Ry.*, 14 Fed. 9 (C. C. D. Ind. 1880); *Clark v. Central R. R. & Banking Co.*, 66 Fed. 803 (C. C. A. 5th, 1895); *Central Bk. & Tr. Co. v. Greenville & Western R. R.*, 248 Fed. 350 (W. D. S. C. 1918); *Central Tr. Co. of N. Y. v. Pittsburg S. & N. R. R.*, 223 N. Y. 347, 119 N. E. 565 (1918); *McIlhenny v. Bing*, 80 Tex. 4, 13 S. W. 655 (1890); *Bellingham Bay Improv. Co. v. Fairhaven & N. W. Ry.*, 17 Wash. 371, 49 Pac. 514 (1897).

sufficient to meet the expenses of operation under the receivership, then they shall be a prior lien on the property itself.⁴ However, it has been pointed out that this latter doctrine is based on an extraordinary equitable power and is to be limited to cases where the public is interested in the continued operation of the business.⁵ The majority of courts have extended this doctrine to other public utilities⁶ such as telegraph companies,⁷ canal companies,⁸ and power and water companies.⁹ At this point there is a split of authority because other courts have held the doctrine inapplicable in cases other than those involving railroads.¹⁰ Since the rule has been held not to embrace other public utilities or quasi-public utilities, some courts have refused to apply it in cases involving gas companies¹¹ and electric power companies.¹²

When attempts were made to include strictly private corporations within the rule, the majority of courts deemed themselves without the power to do so.¹³ A New Jersey court¹⁴ went so far as to say, "The general power to authorize the issue of receiver's certificates of indebtedness for the purpose of continuing a business which exists in the case of a public corporation does not exist in the case of a private corporation. When a receiver is appointed of a private corporation, the court may authorize him to continue the business temporarily, but with the purpose of winding up, provided that the receiver has in his possession sufficient assets to enable him to go on; but if he should find it necessary to borrow money with which to continue the business, the

⁴ *Meyer Rubber Co. v. Georgetown & W. R. R.*, 174 Fed. 731 (C. C. E. D. S. C. 1909); *Central Tr. Co. v. Thurman*, 94 Ga. 735, 20 S. E. 141 (1894); *Standard Steel Works Co. v. Williams*, 155 Ga. 177, 116 S. E. 636 (1923); *Craver v. Greer*, 107 Tex. 356, 179 S. W. 862 (1916).

⁵ *Craver v. Greer*, 107 Tex. 356, 179 S. W. 862 (1916).

⁶ 1 CLARK, RECEIVERS (2d ed. 1929) §470 (a).

⁷ *Keelyn v. Carolina Mutual Tel. & Tel. Co.*, 90 Fed. 29 (C. C. D. S. C. 1898).

⁸ *Hewitt v. Great Western Beet Sugar Co.*, 20 Idaho 235, 118 Pac. 296 (1911).

⁹ *Citizens Tr. Co. v. Nat'l Equipment & Supply Co.*, 178 Ind. 167, 98 N. E. 865 (1912).

¹⁰ *Farmers Loan & Tr. Co. v. Burbank Power & Water Co.*, 196 Fed. 539 (E. D. Wash. 1912); *Belknap Savings Bank v. Lamar Land & Canal Co.*, 28 Colo. 326, 64 Pac. 12 (1901); *Central Tr. & Savings Bank v. Chester County Electric Co.*, 9 Del. Ch. 247, 80 Atl. 801 (1911); *Wiggins v. Neversink Light & Power Co.*, 47 Misc. 315, 93 N. Y. Supp. 853 (Sup. Ct., 1905); *McDermott v. Pentrass Gas Co.*, 82 W. Va. 230, 95 S. E. 841 (1918).

¹¹ *McDermott v. Pentrass Gas Co.*, 82 W. Va. 230, 95 S. E. 841 (1918).

¹² *Farmers Loan & Tr. Co. v. Burbank Power & Water Co.*, 196 Fed. 539 (E. D. Wash. 1912).

¹³ *Hanna v. State Tr. Co.*, 70 Fed. 2 (C. C. A. 8th, 1895); *Smith v. Shenandoah Valley Nat'l Bank*, 246 Fed. 379 (C. C. A. 4th, 1917); *Standley v. Hendrie & Bolthoff Mfg. Co.*, 27 Colo. 331, 61 Pac. 600 (1900); *Oldroyd v. McCrea*, 65 Utah 142, 235 Pac. 580 (1925); 1 CLARK, RECEIVERSHIPS (2d ed. 1929) §470 (b).

¹⁴ *Lockport Felt Co. v. United Box Board & Paper Co.*, 76 N. J. Eq. 686, 70 Atl. 980 (Ch., 1908).

rule undoubtedly is that he should not be authorized to issue receiver's certificates to raise money therefor, which shall displace the lien of a subsisting encumbrance. The reason for this is very obvious. It would be a violation of that clause of the Federal Constitution which prohibits the states from passing laws violative of the obligations of contract."¹⁵ Other courts do not deem themselves without the power to order the business continued in cases of private corporations, but are reluctant to act.¹⁶ This is due to a feeling ". . . that the issuance of receiver's certificates in the case of private enterprise is not a sound exercise of judgment, rather than to any conclusion that they lack the power to issue certificates in such cases. Indeed the failure to distinguish between the power to issue and the propriety of issuing receiver's certificates has led to some confusion. Fundamentally the courts have as much right to issue receiver's certificates in the case of a strictly private enterprise as in the case of a quasi-public one."¹⁷ But regardless of theory, most courts refuse to allow the receiver of a private corporation to issue certificates with a prior lien on the corpus ahead of the mortgagees.¹⁸

The Supreme Court of the United States has not yet declared the doctrine inapplicable as to private corporations, but lower federal courts uniformly hold with the majority.¹⁹ It is a fear of abridging the mortgage contract and of taking the mortgagee's property right, his security, that causes these courts to proceed with the greatest caution in cases involving quasi-public utilities and to reject the doctrine where private corporations are involved.

North Carolina, in an early case, followed the rule of the majority,²⁰ refusing to apply the doctrine to private corporations. In that case a receiver was appointed for a lumber corporation, with authority to take charge of all the corporate property. The receiver, pursuant to this authority, attempted to take possession of lumber in the hands of a creditor who held subject to a mechanic's lien. The court, upholding the creditor, said: "His lien, if he has one, appears to have attached to the lumber before the appointment of the receiver, and he has the clear right under section 1783 of *The Code* to the full amount of any lien he may be entitled to, free from any possible or probable charges which might be fixed upon it, if it went into the hands of a receiver, for costs and expenses of the suit including the receiver's

¹⁵ *Id.* at 690, 70 Atl. at 981.

¹⁶ *In re Holmes Mfg. Co.*, 19 F. (2d) 239 (D. Conn. 1927); *Glenn v. Martin*, 208 Ala. 247, 94 So. 351 (1922); *Cox v. Snow*, 47 Idaho 229, 273 Pac. 933 (1929).

¹⁷ *Cox v. Snow*, 47 Idaho 229, 234, 273 Pac. 933, 935 (1929).

¹⁸ See notes 13 and 16, *supra*.

¹⁹ Note (1926) 40 A. L. R. 244, 247.

²⁰ *Huntsman Bros. & Co. v. Linville River Co.*, 122 N. C. 583, 29 S. E. 838 (1898).

charges."²¹ This rule was later recognized in a strong *dictum*: "the doctrine of *Fosdick v. Schall* seems to be restricted to railroads and similar, or *quasi*, corporations. The weight of authority is that the rule applicable to railroad cases in regard to the displacement of the lien of the mortgage does not extend to private corporations. . . . 'Where the parties are all before the court, and do not object, and where it is necessary to put the property in a marketable shape, it seems that the court may authorize the payment of claims in preference to mortgage liens. But the weight of authority holds that it is not the province of a court of equity to undertake the management of a private business, and to create liens thereon without the consent of the mortgagee, and that it cannot displace the lien of the mortgage where the mortgagee asserts an independent title under his instrument of mortgage giving him the right of possession'."²² One year after this decision, North Carolina ignored this rule. In *Armour & Company v. Peoples Laundry Co.*,²³ where a receiver was appointed on a creditor's bill to wind up an insolvent laundry corporation, the court authorized the receiver to carry on the business by the issuance of certificates which were given a priority in the corpus ahead of the mortgagee. This was done despite the fact that the mortgagee did not consent to the proceeding. The court cited no authority; neither did it attempt to limit the power to allow receivership expenses a priority in the corpus ahead of the mortgagee in other or similar situations. North Carolina had enacted a statute fifteen years before, which was not mentioned in the decision. The statute provides: "Before distribution of the assets of an insolvent corporation among the creditors or stockholders, the court shall allow a reasonable compensation to the receiver for his services, not to exceed five percent upon receipts and disbursements, and the cost and expenses of administration of his trust and of the proceeding in said court, to be first paid out of said assets."²⁴ The court in the foregoing case may have adhered to the statute as a basis for its decision. However, the statute fails to explain the *Armour* case, since it was also in force at the time of the earlier *dictum* which pronounced a contrary view. What, then, is the basis for the *Armour* case? A privately owned laundry is obviously not a public utility affected with

²¹ *Id.* at 586, 29 S. E. at 839. Code section today is N. C. CODE ANN. (Michie, 1939) §2435, which provides, as it did then, for the securing of mechanic's liens.

²² See *Roberts v. Bowen Mfg. Co.*, 169 N. C. 27, 32, 85 S. E. 45, 48 (1915).

²³ 171 N. C. 681, 89 S. E. 19 (1916). The case of *Cox v. Snow*, 47 Idaho 229, 273 Pac. 993 (1929), cites this North Carolina case with others to demonstrate the right of a court to authorize receiver's certificates where the purpose is other than the preservation of the property, but provided no vested interests are disturbed.

²⁴ N. C. CODE ANN. (Michie, 1939) §1215.

a public interest. The court does not say that the issuance of the receiver's certificates was essential to the preservation of the property pending liquidation. It merely says that protection of the fund demanded that the property be placed in the hands of a receiver and so managed as to produce the best results for the creditors. The court in this case seems to have limited its concern to the unsecured creditors, to the unreasonable detriment of the secured creditors who had loaned money to the corporation in reliance on the supposed security which a mortgage gives.

A later case, concerning a private corporation, involved the relative priority of claims growing out of a receivership obtained by a simple contract creditor without objection.²⁵ The following order of priorities was observed: the mortgages existing on the property at the time of purchase and the purchase money mortgages, the court costs and expenses of receivership, claims for labor incurred prior to the receivership, tort claims accruing prior to the receivership, and finally, *the claim of the mortgagees under mortgages executed by the corporation prior to the receivership*. The purchase money mortgage gained its priority on the theory that whenever property is acquired by a purchase money mortgage the vendee never has the legal title but only the equity of redemption. The expenses of the receivership achieved priority under C. S. 1215, previously referred to. The claims for tort and labor took priority by virtue of a statute,²⁶ in existence at the time, which provided that mortgages of corporate property did not take priority over executions on tort or labor judgments against the corporation. The ordinary mortgages of the corporation are placed last on the list of priorities on the theory that one who takes a mortgage on corporation property does so with the knowledge of these statutes. It is to be noted that the court applied C. S. 1215 as applying to expenses incurred by operation of the business in receivership.

The majority of courts have recognized two exceptions to the rule that the doctrine is inapplicable to private corporations. Expenses may be placed ahead of secured creditors: first where the expenses were necessary to preserve the property from deterioration pending the liquidation²⁷ and, second, where the secured creditors consent.²⁸ As above shown, North Carolina at times has failed to recognize the rule at all. Assuming that it recognizes the rule, it apparently, by the principal case

²⁵ *Humphrey Bros. v. Buell-Crocker Lumber Co.*, 174 N. C. 514, 93 S. E. 971 (1917).

²⁶ N. C. CODE ANN. (Michie, 1939) §1140. This was formerly contained in two sections but has been incorporated into one and amended to apply only to public service corporations.

²⁷ Note (1909) 7 MICH. L. REV. 239.

²⁸ 1 CLARK, RECEIVERSHIPS (2d ed. 1929) §477.

and a previous one,²⁹ has added a third exception, namely, that if the court feels an operating receivership will enure to the benefit of the secured creditors by making the liquidation of the assets more successful, either by selling them in the usual course of business rather than by a forced sale or by caring for them pending the sale, then the court is justified in granting a receivership with the expenses being first paid out of the fund realized by the sale, although the secured creditor did not consent thereto.

Where the majority rule is ignored, as in the *Armour* case, general creditors of a private corporation are allowed to try the experiment of a receivership with authority to operate the business in the hope that the business can be made to pay under the receivership, although it failed to do so under its officers. This is done at the expense of the non-consenting secured creditors if the experiment is a failure.

CLAUD WHEATLY, JR.

Taxation—Alimony Trusts—Power of Divorce Court to Modify as Determining Settlor's Taxability.

In the recent case of *Helvering v. Fuller*,¹ a wife obtained a Nevada divorce, the decree incorporating and approving a pre-divorce agreement. The agreement provided for an irrevocable trust, created by the husband, income from which was payable to the wife for ten years for her support and maintenance, when the corpus was to become hers absolutely; for other property settlements; and for waiver by each of all claims against the other. *Held*: Trust income was not taxable to the husband.

In the companion case of *Helvering v. Leonard*,² a wife obtained a New York divorce, the decree incorporating and approving a pre-divorce agreement. The agreement provided for the creation by the husband of an irrevocable trust comprised partly of bonds the principal and interest of which he guaranteed. The trust income³ was payable to the wife for life for her support and maintenance, corpus to be held for their children on her death. *Held*: The trust income was taxable to the husband.

Why this disparity in tax liability growing out of facts essentially similar, differing only in minor detail? The opinion in the *Leonard* case relies on two distinguishing characteristics which determine the issue: 1st—Taxpayer Leonard guaranteed the principal and interest on

²⁹ *Bank of Pinehurst v. Mid-Pines Country Club, Inc.*, 208 N. C. 239, 179 S. E. 882 (1935).

¹ 310 U. S. 69, 60 Sup. Ct. 784, 84 L. ed. 715 (1940).

² 310 U. S. 80, 60 Sup. Ct. 780, 84 L. ed. 721 (1940).

³ \$5000 a year was to be paid to each of three children, remaining amount to the wife.