THE CITY SAFE DEPOSIT AND AGENCY CO., LTD..... PLAINTIFF;

1921
March 14.

VS.

THE CENTRAL RAILWAY COMPANY OF CANADA..... DEFENDANT;

AND

W. D. HOGG..... CLAIMANT;

AND

THE CITY SAFE DEPOSIT AND AGENCY CO., LTD..... CONTESTING.

Railways—Receivership—Solicitor's fees—Priority—"Working expenditure"—Road never in operation—R.S.C. 1906, *c.* 37, *sec.* 2, *sub.-sec.* 34 (*g.*).

The defendant company was incorporated in 1903 for the purpose of constructing and operating a railway within the provinces of Quebec and Ontario. The railway was never physically completed and consequently never in operation; and in 1917 it was placed in the hands of a receiver appointed by the Court at the instance of the trustee for the bondholders of the company.

The claimant, amongst other creditors, filed his claim against the company. The same was contested before the Registrar acting as referee. The claim consisted of an amount representing the balance of an account for solicitor's fees and disbursements in respect of services rendered to the defendant company before the appointment of the receiver, and embraced such items as the preparation and promotion of private acts of parliament, attendances in England in connection with the floating of bond issues, preparing trust and mortgage deeds, drafting agreements for the construction of the railway, and generally attending to all legal matters pertaining to the business and affairs of the company. For a portion of this time the claimant was a director of the company, but his retainer as solicitor was not adverse to its interests.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Statement.

Held (by the Referee): That notwithstanding that the company was not in operation and never had a revenue account the claim should be regarded as "working expenditure" within the meaning of sec. 2, sub-sec. 34 (g) of the Railway Act, R.S.C. 1906, c. 37; and as such was entitled to be paid in priority to the claim of bondholders under a trust deed.

REPORTER'S NOTE.—No appeal was taken, and the report was formally confirmed by the court.

The claim was for the balance due for services rendered to and disbursements made for the defendant during several years, amounting to $6,085.65; and praying that the claim be declared privileged as "working expenditure" and be paid as such out of the fund in court.

The railway in question was never completed, and became insolvent. A receiver was appointed; and as certain moneys belonging to the company had been paid into court the Registrar of the Court, Charles Morse, K.C., was appointed Referee to enquire into and report upon this along with other claims filed by the creditors of the company.

December 15th, 1919.

The contestation of this claim by the plaintiff was now heard before the Referee, at Montreal.

W. D. Hogg, K.C., appeared in person.

J. W. Cook, K.C., and *A. Magee*, for plaintiff contesting.

11th November, 1920.

The Referee's report was now filed, and no appeal was taken from said report in so far as the claim in question was concerned.

14th March, 1921.

The claimant now moved to confirm the report as regards his claim and for judgment accordingly.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

The motion was heard by the Honourable Mr. Justice Audette, at Ottawa, and judgment rendered the same day confirming the report of the Referee, as prayed.

The report of the Referee is as follows:—

This is a claim for solicitor's fees and disbursements. The claimant acted as solicitor to the defendant company from the year 1905 to the end of the year 1917. Upon examination of his claim it will be seen that it consists of fees and expenses arising out of his retainer as solicitor for a portion only of the period mentioned. The services rendered and moneys paid out of pocket relate to a variety of matters, none of which however can properly be said to fall outside the ambit of a railway solicitor's employment or practice in Canada. They embrace the drafting of private Acts of Parliament relating to the company, and attending upon both Houses in connection with the passage of the same; attendances in England in looking after the bond issues; preparing mortgage trust deeds for securing bond issues; drawing agreements relating to the construction of the railway; generally attending to all legal matters pertaining to the business and affairs of the company; and advising the company and its officers in relation thereto. For a portion of this time Mr. Hogg was a director of the company; but his retainer as solicitor was not adverse to its interests. *Re Mimico Sewer Pipe &c., Co.* (1); *Pneumatic Gas Co.* v. *Berry* (2); *Denman* v. *Clover Bar Coal Co.* (3). The company does not contest his claim, but the plaintiff does.

(1) [1895] 26 O.R. 289. (2) 113 U.S. 322.
(3) [1912] 7 D.L.R. 96.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

Mr. Hogg's fees and expenses were settled and paid in full by the company up to the month of August 1911; and since that date, while he has never had a settlement in full, he has been paid certain sums from time to time on account. At the request of the company, on the 1st May, 1914, Mr. Hogg prepared a statement of his account showing that there was a balance due claimant at that date of $4,895.09 after giving credit for the sum of $415 paid to him, and that amount was admitted by the company as due the claimant, and entered in the books of the company as a liability. Since the last mentioned date the claimant has rendered professional services and paid out moneys in connection with the business of the company amounting to the sum of $1,275.56. On account thereof he was paid certain sums, between the 16th day of February and the 25th day of September, 1917, amounting in the whole to $85. By adding the sum of $4,895.09, admitted as due on 1st May, 1914, to the above-mentioned sum of $1,275.56 and deducting from the total the sum of $85 we have the sum of $6,085.65, the amount claimed herein.

The claim was filed, in pursuance of my advertisement calling upon creditors to file claims, on 8th April, 1919.

[The Referee here discusses certain facts not essential to be stated.]

We now come to the real controversy between the parties to the contestation, namely, the question whether Mr. Hogg's claim is entitled to rank as "working expenditure" under the provisions of section 138 of "The Railway Act," read in the light of the interpretation embodied in sec. 2, sub-sec. 34 of the Act.

It is well to mention here as a matter of legislative history that "legal expenses" were first made part of "working expenditure" by sec. 2 (x) of 51 Vict., c. 29 (1888). Before 1st February, 1904, when the Act 3 Edw. VII, c. 58, came into force "working expenditure" was a prior charge, next to penalties, only on the rents and revenues of the company. But by the last mentioned Act, this priority was extended to affect the property and assets as well as the rents and revenues of the company. The last mentioned Act was carried into chapter 37, R.S.C. 1906.

Section 138, thereof, in part, reads as follows: "The company may secure such securities by a mortgage deed creating such mortgages, charges and encumbrances upon the whole of such property, assets, rents and revenues of the company, present or future, or both, as are described therein: Provided that such property, assets, rents and revenues shall be subject, in the first instance, to the payment of any penalty then or thereafter imposed upon the company for non-compliance with the requirements of this Act, and next, to the payment of the working expenditure of the railway."

Sec. 2, sub-sec. 34 reads as follows:

"(34) 'Working expenditure' means and includes

(*a*) all expenses of maintenance of the railway.

(*b*) all such tolls, rents or annual sums as are paid in respect of the hire of rolling stock let to the company, or in respect of property leased to or held by the company, apart from the rent of any leased line.

(*c*) all rent charges or interest on the purchase money of lands belonging to the company, purchased but not paid for, or not fully paid for.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

(*d*) all expenses of or incidental to the working of the railway and the traffic thereon, including all necessary repairs and supplies to rolling stock while on the lines of another company.

(*e*) all rates, taxes, insurance and compensation for accidents or losses.

(*f*) all salaries and wages of persons employed in and about the working of the railway and traffic.

(*g*) all office and management expenses, including directors' fees, and agency, legal and other like expenses.

(*h*) all costs and expenses of and incidental to the compliance by the company with any order of the Board under this act, and

(*i*) generally, all such charges, if any, not hereinbefore otherwise specified, as, in all cases of English railway companies, are usually carried to the debit of revenue as distinguished from capital account."

Both of the above quoted enactments were amended by 9-10 Geo. V, c. 68, but not so as to affect the questions arising on the proceedings before me.

As there does not appear to have been any penalty imposed upon the company under this section the payment of the "working expenditure" of the railway will take priority over any other of the claims filed under and by virtue of the reference to the undersigned. * * * * * * * *

Coming now to a determination of the question as to whether Mr. Hogg's claim should be ranked or classified as "working expenditure," it is well to note that light is to be had on this question from the American decisions rather than from the English. This is very clearly pointed out in a dictum by Strong J. in *Wallbridge* v. *Farwell* (1).

(1) 18 Can. S.C.R. 1 at p. 4.

"What I desire to explain, however, is this. In assenting to the judgment of the court dismissing these appeals I do not by any means intend to preclude myself in future, should the question be raised in proper form and in an appropriate case, from considering whether the principle which is now universally recognized in the United States as to the applicability of current earnings to current expenses, incurred either whilst or before railway property comes under the control of the court by being placed at the instance of mortgagees in the hands of a receiver, in preference to mortgage creditors whose security has priority of date over the obligation thus incurred for working expenses, should be adopted by our courts. This doctrine is now firmly settled in the United States, where railway mortgages exactly resemble those in use with us, and which do not at all resemble the securities of debenture holders under the English system of securities for borrowed capital; and the practice referred to is so pregnant with justice, good faith and equity that there may be found strong reasons for applying it here when the question arises." Mr. Abbott, at pp. 134, 135 of his work on Railway Law does not hesitate to disagree with Strong J. as to the desirability of applying the American rule to the construction of the Canadian Act of 1888, which made working expenditure a first charge on "rents and revenues" only. He says:—"It seems to the author that the mortgagee is entitled to presume that the income of the company has been properly applied; and it would seem hardly just when he comes to realize his security that he should find it largely impaired by overdue and outstanding debts, taking precedence of his claim on the ground that they were incurred for the 'working expenditure' of the railway; and these

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

words in the Act would seem to include only the expenditure necessary to work and carry on the railway, and not past due debts; the author would, therefore, prefer the doctrine laid down in *Gooderham* v. *Toronto & Nipissing Ry. Co.* (1), notwithstanding the very broad language used by the (now Chief Justice of the Supreme Court) in the dictum above cited."

Mr. Jacobs in his work on Railway Law (pp. 191-5) comments at large on the *Wallbridge case* (*supra*). He finds the equitable doctrine prevailing in the United States, referred to by Strong J. in the *Wallbridge case*, adequately expressed in Baldwin's *American Railroad Law* (2). But he points out that this American doctrine was disapproved [in an expression of opinion merely] by Killam J. in *Allan* v. *Manitoba, etc., Ry. Co.* (3). On the whole Mr. Jacobs' observations favour Strong J's. view of the policy of applying the American doctrine. At p. 194 of his work he says:— "If a retrospective construction is put upon the words 'working expenditure' as occurring in sections 138 and 141 of this Act, then we have the American doctrine in its entirety, with the added advantage that we have in section 2 (34), a very ample definition of what constitutes 'working expenditure' * * * From the very nature of some of the items set forth in section (2) 34, the lien for working expenditure must be retrospective to the appointment of a receiver."

The difference between the English doctrine, or principle, and that prevailing in the United States may be usefully demonstrated by taking a single item from Mr. Hogg's claim and finding how it is

(1) 8 Ont. App. 685. (2) [1904] p. 555 et seq.
(3) 10 Man. 143. at p. 149.

treated by the courts of the two countries. One of the items of the claim is for "preparing bill for Parliament to confirm transfers and for other purposes, attendances at House of Commons and Senate in connection with same," etc. Now, Stirling J., *In re Mersey Railway Co.* (1), refused an application for authority to be given to the receiver to pay out of a fund in court the expense of the promotion of a bill in parliament to empower a railway to work its trains by electricity, because he did not think that the expense of promoting such a bill could be regarded as "working expenditure" under The Railway Companies Act, 1867, 30-31 Vict. (Imp.) c. 127, sec. 4. On the other hand, in *Bayliss* v. *L. M. & B. Ry. Co.* (2), we have a judge of one of the Circuit Courts of the United States (Drummond J.) instancing the services of an attorney in drawing up a bill for the legislature concerning the business of a railroad as properly coming within the term "labour" as applied to the operation of the road.

Now, as the Railway Act, R.S. 1906, c. 37, sec. 2, sub.-sec. 34, expressly makes "legal and other like expenses" part of the "working expenditure" of a railway, there is no need to look for outside aid to determine it to be such; but as Mr. Cook contended that the legal expenses mentioned in the Act were referable only to *railways in operation*, I think it well to refer to such authorities as I have encountered in considering the effect of this contention.

Before doing this, however, I wish to observe that as the test of the priority accorded to claims of this nature is whether the services rendered have benefited the property mortgaged and so improved the security of the mortgagees (See Domat, Les Lois Civiles &c.

(1) [1895] 72 L.T.N.S. 535. (2) 9 Biss. C.C. 90.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

tit. 1—Sec. V., Art. XXV.; Beach on Receivers, 2nd ed., by Alderson, sec. 391; also Minister of Railwals *vs.* Quebec Southern Ry. before Referee,—final report—25 May. 1908. p. 3), it would seem that legal services rendered in conserving the charter of the company and in settling the formalities of its bond issue would respond in the fullest way to this test. As already pointed out, Mr. Jacobs in his work on the Railway Act thinks that some of the items in sec. 2, sub-sec. (34) contemplate claims accruing before the appointment of the receiver, and he instances the rent of lands transferred to the railway as one of them. Literally *rent* is no more a part of working expenditure than fees payable for legal services of the character above mentioned.

"Operating expenses" as found in the American cases is a phrase tantamount to that of "working expenditure" as used in our Railway Act, for the verb "operate" is derived from the latin "operari," meaning "to work." Wood on *Railroads*, (ed. 1894), vol. 3, p. 1990 et seq., says: "The 'operating expenses' include all taxes, the wages of all employees, officers and agents employed in operating the road, etc. They include also the payment of the annual salary of an attorney which falls due within a short time prior to the receivership. The services of an attorney are very properly considered necessary to the proper protection and administration of the affairs of the company." In *Gurney* v. *Atlantic and G. W. Ry. Co.* (1), there was:—"An order appointing a receiver of a railroad company directed him, among other things, to pay debts 'owing to the labourers and employees' of the company 'for labour and services actually done in connection with that company's railways.' *Held*

(1) 58 N. Y. 358.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

that it included a claim of counsel for professional services rendered by him on employment of the company in litigations relating to the railway, its interests and business." In High on *Receivers* 4th ed., p. 531 et seq., it is stated: "As regards claims for construction prior to receivership, when mortgages securing bonds of the company are executed upon its unfinished road, which show upon their face that the work of construction shall be carried to completion, and that the mortgage lien shall attach to the road as completed, the new road thus constructed after the execution of the mortgages may be regarded as a 'useful improvement' for the purpose of determining the right of creditors for such construction to priority over bondholders. If the road passes into the hands of a receiver before payment for such construction is made, and if the receiver's net income from operation is diverted to payment of interest upon the mortgage bonds and to permanent betterments of the property, priority may be allowed for such construction as against the bondholders. Upon similar grounds claims for labour in construction, operation and maintenance, which are entitled to liens under the laws of the State, may be allowed priority, although incurred more than six months before the receivership." The case of *Bayliss* v. *L. M. & B. Ry. Co.*, (1), already cited, is also useful in this connection. Drummond J. (at p. 94) says:—"Take the case for example of the services performed by counsel in obtaining the right of way on land for depots and other purposes. That may also fairly come within this class of service. It is said that it is part of the construction of the road. That is true in one sense, but it may also be a part of the operation of the road. After a road has its roadbed

(1) 9 Biss. C.C. 90.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

made, its iron down, and has run cars over it, it is not a finished road. There are always more or less things to be done besides, in order to make the road complete, and to enable the company to operate it successfully. It may be said this is a nice distinction, but one, I think, it is indispensable we should make in a case of this kind, and we must, for the purpose of doing equity, give to some extent a liberal construction to the language the court used on this occasion; and, it seems to me, under this view of the case, the labour performed by counsel may be just as important, indeed more important, than the labour performed by the ordinary labourer, or by the brakeman, engineer or fireman."

Mr. Hogg's claim is wholly anterior in its origin to the appointment of the receiver in this case. Nothing is charged for services or disbursements after the interim appointment of the receiver in December, 1917. That necessitates a consideration of the point as to whether arrears of working expenditure are exigible under the provisions of the Railway Act. On this point we have some assistance from an English case decided by Kay J. in 1890, under sec. 4 of the Railway Companies Act. After holding that when a receiver of the undertaking of a railway company has been appointed in pursuance of the above section, the moneys received by him must first be applied by him in providing for the working expenses, Kay J., *In re Eastern and Midlands Ry. Co.* (1), says:— "Then it is said that there are certain arrears of these instalment payments, and that although it might be right to make current payments, it is not right to pay the arrears. But the answer is a very simple one. Are arrears of working expenses not 'working

(1) [1890] 45 Ch. D. 367, at p. 386

expenses?' They are not the less 'working expenses' because they are arrears. 'Working expenses' does not mean, necessarily, current payments; and if arrears are not paid, as I understand, the owners of the rolling stock have power to retake possession of it. Therefore, there is just as much reason for paying arrears as there is for paying the current payments." As a creditor having a first charge or lien upon an insolvent railway may, under sec. 26 of the Exchequer Court Act, obtain an order for the sale of the railway or its rolling stock, etc., this gives the above quoted observations of Kay J. an important bearing on the case in hand.

The current of authority in the United States as to claims for working expenditure incurred before the appointment of a receiver is in accord with the English case last referred to. The leading case is that of *Fosdick* v. *Schall* (1), where Waite, C.J. (at p. 254) says:—"It often happens that, in the course of the administration of the cause, the court is called upon to take income which would otherwise be applied to the payment of old debts for current expenses, and use it to make permanent improvements on the fixed property, or to buy additional equipment. In this way the value of the mortgaged property is not unfrequently materially increased. It is not to be supposed that any such use of the income will be directed by the court without giving the parties in interest an opportunity to be heard against it. Generally, as we know both from observation and experience, all such orders are made at the request of the parties or with their consent. Under such circumstances, it is easy to see that there may sometimes be a

(1) 99 U.S. 235.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

propriety in paying back to the income from the proceeds of the sale what is thus again diverted from the current debt fund in order to increase the value of the property sold. The same may sometimes be true in respect to expenditures before the receivership. No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must to a greater or less extent influence the Chancellor when he comes to act. The power rests upon the fact, that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained." In the case of *Turner* v. *Indianapolis B. & W. Ry. Co.* (1), Drummond J. discusses the reasons for the preference extended to overdue working expenditure, holding that such preference is not based upon the theory that working expenditure is a lien on the road but inheres in the equitable jurisdiction of the court to protect the claims of those who have enhanced the value of the property by their services, etc. At p. 320 he says:— "The experience of the court which, it may be said, has been obtained by the management for many years of immense amounts of this kind of property, has satisfied it that practically it would be well nigh impossible, looking at things as they actually exist, to operate the roads by receivers without some allowance for claims of the character mentioned, existing at the time of their appointment."

(1) 8 Biss. 315.

In some jurisdictions in the United States the courts limit the period for preference or priority to attach to six months antecedent to the appointment of the receiver. But the weight of authority is against this limitation. In *Northern Pacific* v. *Lamont* (1), Caldwell J. delivering the judgment of the Circuit Court of Appeals for the 8th Circuit, said (p. 24):—"A preferential debt is not barred though contracted more than six months before the appointment of a receiver. As to such debts there is no arbitrary 'six months' rule, as has been often decided." This opinion is supported by the case of *Hale* v. *Frost* (2), where the Supreme Court of the United States gave priority to a claim for materials furnished three years before the appointment of the receiver; and by the case of *Burnham* v. *Bowen* (3), where the same tribunal gave preference to a debt for coal supplied some eleven months before the receiver was appointed. (See 30 Am. L. Rev. at p. 168 for a full discussion of this subject).

Of course this principle does not extend to according preference or priority to working expenditure prescribed by any statute of limitations. This is very succinctly put in Beach on *Receivers*, sec. 392:—"Just as long as the debt may be, or could have been enforced against the company, it should be considered as retaining its preferential character and entitled to the privilege of preferential debts. Such time is that prescribed by the statute of limitations, which alone should, and reasonably can, bar preferential debts."

In the case of *The Minister of Railways and Canals for the Dominion of Canada* v. *The Quebec Southern Railway Company, et al*, the Registrar of this court

(1) 69 Fed. Rep. 23. (2) 99 U.S. 389.
(3) 111 U. S. 776.

1921

THE CITY SAFE DEPOSIT AND AGENCY CO. LTD. v. THE CENTRAL RAILWAY CO. OF CANADA. AND HOGG AND THE CITY SAFE DEPOSIT AND AGENCY CO. LTD.

Report of the Referee.

(now the Honourable Mr. Justice Audette), sitting as referee, allowed a claim of Messrs. Greenshields, Greenshields & Heneker for legal services as working expenditure, the same having accrued before the appointment of a receiver therein. He also allowed in the same way a claim of Messrs. W. de M. and H. M. Marler for legal services as notaries accrued before the receivership. These rulings have not been published in the official reports of the court. However, we have a similar decision in a claim for legal expenses by the Registrar, sitting as referee, in the case of *The Royal Trust Company* v. *The Atlantic and Lake Superior Railway Co.*, which is reported in 13 Ex. C. R. 42, at p. 50.

Following these precedents, which it is to be noted are in harmony with the American decisions, the finding upon the contestation of Mr. Hogg's claim for the sum of $6,085.65 must be that it is entitled to be collocated as a privileged claim for "working expenditure," and, as such, authorized to be paid out of the fund in the hands of the receiver in priority to the claim of the trustee for the bondholders.

Judgment accordingly.