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Recent Decisions

RECENT DECISIONS

ASSIGNMENT OF CONTRACT—RIGHTS OF ASSIGNEE AGAINST TRUSTEE IN BANKRUPTCY.—In a proceeding for the reorganization of a corporation under Chapter X of the Bankruptcy Act, the trustee in bankruptcy seeks to recover money due the debtor under a bilateral contract whereby the debtor was to furnish and maintain certain advertising signs in consideration of the payment to it of fixed sums at stated intervals. The debtor assigned the right to receive the payments to accrue under this contract to the respondent, as security for advances made to the debtor. The respondent claims the fund by virtue of this assignment, the trustee by virtue of the title he acquired under the Bankruptcy Act. On motion for reargument of an appeal from a judgment of the District Court, *held*, under New York law the assignment was valid and enforceable against the trustee in bankruptcy. *Rockmore v. Lehman*, 129 F. (2d) 892 (C. C. A. 2d, 1942).

The court reached this result only after repudiating the views upon the New York law expressed by the majority in a previous opinion rendered in the case[1] and substantially adopting the opinion delivered by the dissenting judge.[2] On the first argument of this appeal, the majority held that the assignment only created an equitable lien which would arise when the payments became due, and that the lien would not prevail against an execution creditor or a trustee in bankruptcy, who under Section 70 (c) of the Bankruptcy Act, occupies the position of a judgment creditor armed with an execution.[3] The assignment was considered no more than a promise to pay the assignee out of funds to be created by the assignor's performance of the contract.

It is well settled that an outright transfer or a mortgage of chattels, not yet owned by the transferor or mortgagor, is ineffective to pass any legal interest therein, unless some further act is performed after the transferor or mortgagor acquires title to the property.[4] The equitable mortgage on after-acquired personal property was resorted to in order to soften the rigor of this rule.[5] In *Holroyd v. Marshall*,[6] the House of Lords enforced a mortgage on after-acquired chattels by construing the instrument so that it would operate as a present agreement to give a lien, which agreement would be specifically enforceable in equity. As a result when the property is acquired, an

1. 128 F. (2d) 564 (C. C. A. 2d, 1942). Judge Augustus N. Hand wrote the majority opinion, which was concurred in by Judge Frank. The importance of the points of law involved in the case is evidenced by the fact that law firms, representing the principal New York City banks, filed an *amicus curiae* brief on the motion for reargument, urging that the assignment prevail against the trustee in bankruptcy.

2. Judge Clark wrote the dissenting opinion.

3. 52 STAT. 879 (1938), 11 U. S. C. A. § 110-c (Supp. 1942).

4. *Nemo dat quod non habet.* Zartman v. First National Bank, 189 N. Y. 267, 82 N. E. 127 (1907). See also Holroyd v. Marshall, 10 H. L. Cas. 191, 11 Eng. Rep. R. 999 (1862); Jones v. Richardson, 10 Metc. 481 (Mass. 1845); Smithurst v. Edmunds, 14 N. J. Eq. 408 (1862); Richardson v. Washington, 88 Tex. 339, 31 S. W. 614 (1895).

5. See Stone, *The Equitable Mortgage in New York* (1920) 20 COL. L. REV. 520. In this article the present Chief Justice of the United States makes an exhaustive study of the New York equitable mortgage doctrine in all its ramifications. See also Williston, *Transfer of After-Acquired Personal Property* (1906) 19 HARV. L. REV. 557.

6. 10 H. L. Cas. 191, 11 Eng. Rep. R. 999 (1862). Though this case is a landmark in the law, Justice Story, as early as 1843, arrived at a similar conclusion in Mitchell v. Winslow, 2 Story 635, Fed. Cas. No. 9, 673 (1843).

equitable lien immediately attaches to it, which will prevail over everyone except purchasers for value without notice. In general our American courts are in accord with the *Holroyd* case.[7] The courts of New York, however, have qualified the doctrine in one important respect. While the New York courts will enforce a mortgage on after-acquired property between the parties to the agreement,[8] and against subsequent purchasers with notice,[9] it was decided in the leading case of *Rochester Distilling Co. v. Rasey*,[10] that the mortgage on after-acquired property will not be enforced against a levying creditor of the mortgagor or his trustee in bankruptcy. This decision still represents the New York law.[11]

In the first decision rendered in the principal case, the majority opinion, in holding that the assignment created at best an equitable lien which would disappear against the trustee in bankruptcy, relied upon the *Rochester Distilling Co.* case[12] and cases dealing with accounts receivable to be created in the future.[13] However, the case of the after-acquired chattel is not in point, for the obvious reason that there is nothing in existence which can be assigned. The same is true of an account receivable which will arise solely by virtue of work performed or goods sold, where there is no pre-existing obligation upon the part of either party to pay or perform.[13] The difference between such a case and the instant case may be illustrated by the simple distinction between a unilateral and a bilateral contract. In the former case there is nothing to assign until the work is performed or the goods sold; in the latter there is something in existence which can be assigned, namely the right to receive payments under an existing contract. It is true that the debt will not come into existence until the promised act is performed, but that is because the latter is merely a condition to payment and not because it is the source of payment. An assignment of wages furnishes a simple example. Where there is a contract of employment, the assignment is presently effective, even though made before the employee enters upon the work;

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7. Borden v. Croak, 131 Ill. 68, 22 N. E. 793 (1889); Wright v. Bircher, 72 Mo. 179 (1880); Smithurst v. Edmunds, 14 N. J. Eq. 408 (1862); Akers v. Rowan, 33 S. C. 451, 12 S. E. 165 (1890); Richardson v. Washington, 88 Tex. 339, 31 S. W. 614 (1895); Horner-Gaylord Co. v. Fawcett, 50 W. Va. 487, 40 S. E. 564 (1901). *Contra*: Moody v. Wright, 13 Metcalf 17 (Mass. 1847); Federal Trust Company v. Bristol County Street Ry., 222 Mass. 35, 109 N. E. 880 (1915).

8. McCaffrey v. Woodin, 65 N. Y. 459 (1875); Deeley v. Dwight, 132 N. Y. 59, 30 N. E. 258 (1892).

9. Kribbs v. Alford, 120 N. Y. 519, 24 N. E. 811 (1890); Duffus v. Bangs, 122 N. Y. 423, 25 N. E. 980 (1890); Central Trust Co. v. West India Improvement Co., 169 N. Y. 314, 62 N. E. 387 (1901); Diana Paper Co. v. Wheeler Green Electric Co., 228 App. Div. 577, 240 N. Y. Supp. 108 (4th Dep't, 1930).

10. 142 N. Y. 570, 37 N. E. 632 (1894).

11. Zartman v. First National Bank, 189 N. Y. 267, 82 N. E. 127 (1907); MacDonnell v. Buffalo Loan, Trust and Safe Deposit Co., 193 N. Y. 92, 85 N. E. 801 (1908); Titusville Iron Co. v. City of New York, 207 N. Y. 203, 100 N. E. 806 (1912). See criticism of the holding in Rochester Distilling Co. v. Rasey by Chief Justice Stone, *loc. cit. supra*, note 5.

12. 142 N. Y. 570, 37 N. E. 632 (1894). Zartman v. First National Bank, 189 N. Y. 267, 82 N. E. 127 (1907); MacDonnell v. Buffalo Loan, Trust and Safe Deposit Co., 193 N. Y. 92, 85 N. E. 801 (1908); Titusville Iron Co. v. City of New York, 207 N. Y. 203, 100 N. E. 806 (1912).

13. *In re* McCrory Stores Corporation, 73 F. (2d) 270 (C. C. A. 2d, 1934).

where there is no such contract, there is nothing to assign.[14] The majority would have been justified in applying the doctrine of the *Rochester Distilling Co.* case to the principal case only if the contract involved was not in existence at the date of the assignment.[15]

An assignment of an existing contract right requires no further act of the parties to fully vest the right in the assignee.[16] The instrument of assignment of its own force operates as a complete present transfer of the contract right.[17] Because such an assignment is a present transfer, it is valid and enforceable against subsequent assignees and creditors of the assignor.[18] In its final opinion in the principal case, the court recognized the recent decision of the Court of Appeals in *Kniffin v. State of New York*,[19] as representing the present New York law. In that case a building contractor assigned moneys "due or to become due to it" under a contract with the state. After the assignor was adjudicated a bankrupt, the state paid the assignee the last payment remaining due under its assignment out of moneys, which had been earned after the date of the assignment.[20] The assignor's trustee in bankruptcy sued the state to recover the moneys remaining unpaid under the contract, including the sum paid by the state to the assignee. In denying a recovery of the sum paid to the assignee, the court held that the assignment antedated the bankruptcy and was superior to later liens, assignments and claims of general creditors.[21]

Whether the assignment is termed a legal or merely an equitable assignment seems

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14. Matter of Black, 138 App. Div. 562, 123 N. Y. Supp. 371 (2d Dep't, 1910); Jules-Wallace & Co. v. R. A. Management, Inc., 148 Misc. 180, 265 N. Y. Supp. 610 (App. Term, 1st Dep't, 1933). See also RESTATEMENT, CONTRACTS (1932) § 154 (1).

15. Field v. Mayor, 6 N. Y. 179 (1852) (citing Mitchell v. Winslow, *supra* note 6); Alchar Realty Corp. v. Meredith Restaurant, Inc., 256 App. Div. 853, 8 N. Y. S. (2d) 733 (3d Dep't 1939); Shaefer Brewing Co. v. Amsterdam Tavern Inc., 171 Misc. 352, 12 N. Y. S. (2d) 701 (1939); Tailly v. Official Receiver, 13 App. Cases 523 (1888). See also article by Chief Justice Stone, *loc. cit. supra,* note 5.

16. Salem Trust Co. v. Manufacturer's Finance Co., 264 U. S. 182 (1924); Superior Brassiere Co. v. Zimetbaum, 214 App. Div. 525, 212 N. Y. Supp. 473 (1st Dep't 1925).

17. Devlin v. Mayor, 63 N. Y. 8 (1875); Close v. Independent Gravel Co., 156 Mo. App. 411, 138 S. W. 81 (1911); Winn v. Fort Worth Ry. Co., 12 Tex. Civ. App. 198, 33 S. W. 593 (1896). See Farrell v. Passaic Water Co., 82 N. J. Eq. 97, 88 Atl. 627 (1913), for a discussion of the historical foundations of the rule.

18. Williams v. Ingersoll, 89 N. Y. 508 (1882); Niles v. Mathusa, 162 N. Y. 546, 57 N. E. 184 (1900); Riverside Contracting Co. v. City of New York, 218 N. Y. 596, 113 N. E. 564 (1916); Hinkle Iron Co. v. Kohn, 229 N. Y. 179, 128 N. E. 113 (1920); Arrow Iron Works v. Greene, 260 N. Y. 330, 183 N. E. 515 (1932).

19. 283 N. Y. 317, 23 N. E. (2d) 853 (1940).

20. The important fact that the payment was made out of moneys, virtually all of which were earned after the date of the assignment, does not appear in the opinion of the court. However, the *amicus curiae* brief states this to be the fact, referring to the record on appeal in the case.

21. The fact that the assignment was filed under the provisions of § 16 of the Lien Law does not prevent the decision from constituting an authority for the principle for which it is cited. The validity of the assignment rests on the assignment itself and not on the filing. Edison Electric Illuminating Co. v. Frick Co., 221 N. Y. 1, 116 N. E. 369 (1917); Amiesite Construction Corp. v. Luciano Contracting Co., 284 N. Y. 223, 30 N. E. (2d) 483 (1940).

to be unimportant.[22] It would seem to be equally unimportant whether the assignment is absolute or merely by way of security, for the purpose of determining the question here discussed.[23]

It was also argued in the principal case that a verdict for the respondent would result in a voidable preference under Section 60 of the Bankruptcy Act.[24] This argument was quickly disposed of, even though the moneys involved did not accrue until some time within the four months period prior to the filing of the debtor's petition in bankruptcy. Section 60 (a) of the Bankruptcy Act[25] provides that "a transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein." The assignment in question was so perfected on its execution and delivery.[26]

The final question decided by the court concerned itself with the necessity of filing the assignment under the provisions of Section 230 of the New York Lien Law.[27] On authority it was held that this statute had no application to the assignment of moneys to accrue under a contract.[28]

The transaction upheld by the court in this case is a common security device. Today it is of vital importance to industries engaged in the war effort and to the banks which finance their operations. The decision has a sufficiently sound legal basis and, moreover, gives recognition to the realities of everyday business life.

CRIMINAL LAW—STATUTORY INTERPRETATION—NATIONAL AND INSURED BANKS.—Defendant entered a national bank in Burlington, Vermont, for the purpose of borrowing $500.00. He obtained the loan and gave to the bank a note to which he had added a forged endorsement. A Vermont statute made it a felony to utter a forged promissory note. Defendant was convicted of violating a federal statute which declares it to be a crime to enter or attempt to enter a national or insured bank with intent to commit in such bank "any felony or larceny". The defendant appealed from the conviction on the ground that uttering a forged instrument was not a federal offense and hence not a felony within the meaning of the statute. *Held,* one judge dissenting, the federal statute includes not only federal felonies but also common law and state

22. Hooker v. Eagle Bank, 30 N. Y. 83 (1864).

23. RESTATEMENT, CONTRACTS (1932) § 150; Niles v. Mathusa, 162 N. Y. 546, 57 N. E. 184 (1900). The majority in the first opinion apparently thought that this was of some importance since they made an express finding that the assignment was by way of security.

24. 52 STAT. 869 (1938), 11 U. S. C. A. § 96 (Supp. 1942).

25. 52 STAT. 869 (1938), 11 U. S. C. A. § 96-a (Supp. 1942).

26. Salem Trust Co. v. Manufacturer's Finance Co., 264 U. S. 182 (1923); Superior Brassiere Co. v. Zimetbaum, 214 App. Div. 525, 212 N. Y. Supp. 473 (1st Dep't, 1925).

27. This statute renders void as against subsequent purchasers and creditors all unfiled mortgages on goods and chattels. By amendment in 1921 the coverage of the statute was extended to stocks and bonds.

28. *In re* Hub Carpet Co., 282 Fed. 12 (C. C. A. 2d, 1922); *In re* Bernard v. Katz, 38 F. (2d) 40 (C. C. A. 2d, 1930). See also Niles v. Mathusa, 162 N. Y. 546, 57 N. E. 184 (1900) decided prior to the amendment of 1921, holding that the section did not apply to a liquor license.

felonies. *United States v. Jerome,* 130 F. (2d) 514 (C. C. A. 2d, 1942). *Cert. granted,* 63 S. Ct. 62 (1942).

The strong and well-reasoned dissenting opinions of Judge Frank in this case and of Judge Huxman of the Tenth Circuit in a very similar case, *Hudspeth v. Melville,*[1] raise a serious question whether it was the intention of Congress to give to the statute[2] the broad application which has been accorded to it by the federal courts in these two cases.

The history of the statute is significant. Prior to 1934, while it was a federal offense for agents and employees of a national bank to embezzle funds from a national bank,[3] robbery or theft of its property was punishable only under state laws. In 1934 Attorney General Cummings, as part of his twelve-point program of federal crime control[4] recommended the passage of the Bank-Robbery Statute.[5] In 1935 the statute was extended to banks whose deposits are federally insured.[6] In 1937 the Attorney General also recommended passage of an amendment to extend this statute to include larceny and burglary. His letter accompanying the recommendation instances the case of a man who stole funds from a national bank but who could not be prosecuted under the statute because he had not used force or violence.[7] The resulting amendment is the statute,[8] the interpretation of which has given rise to the conflicting opinions discussed herein.

Judge Clark, who wrote the majority opinion, in support of his conclusion that the statute was intended to include state and common law, as well as federal, felonies argued that a restriction of its scope to federal felonies would defeat the intention of Congress to make burglary of a bank a federal crime since there is no other federal crime of bank burglary. He said: "It will then be dangerous for federal officers to seize a man while he is breaking into a bank; they must wait and see what his ultimate plans are."[9] Judge Frank, however, seems to have furnished a sufficient answer to this point, by construing the statute as a burglary statute: "That it covers more than 'burglary' obviously does not prevent it from including 'burglary'."[10] He construes

1. 127 F. (2d) 373 (C. C. A. 10th, 1941). Judge Huxam delivered a similar dissent in Hudspeth v. Tornello, 128 F. (2d) 172 (C. C. A. 10th, 1942).

2. 54 STAT. 695 (1940), 12 U. S. C. A. § 588b (a) (Supp. 1942). It provides in part: "Whoever, . . . shall enter or attempt to enter any bank, or any building used in whole or in part as a bank, with intent to commit in such bank or building, or part thereof, so used, any felony or larceny, shall be fined not more than $5,000 or imprisoned not more than twenty years, or both; . . ."

3. 49 STAT. 704, 12 U. S. C. A. § 592.

4. Ann. Rep., Atty. Gen. U. S., 1933, p. 1; 1934, pp. 1, 61-64; 1935, pp. 1, 56; Proceedings Atty. Gen.'s Conf. on Crime, 1934, 302, 332.

5. 48 STAT. 783 (1934), 12 U. S. C. A. § 588a-d; as amended by 54 STAT. 695 (1940), 12 U. S. C. A. 588b (Supp. 1942).

6. 49 STAT. 720 (1935), 12 U. S. C. A. 588a.

7. His letter is quoted in Hudspeth v. Melville, 127 F. (2d) 373, 376 (C. C. A. 10th, 1941).

8. See *supra* note 2.

9. 130 F. (2d) 514, 517 (C. C. A. 2d, 1942).

10. 130 F. (2d) 514, 520 (C. C. A. 2d, 1942). *Accord,* Alford v. U. S., 113 F. (2d) 885, 887 (C. C. A. 10th, 1940). According to the position taken by the majority in the principal case, the statute does not directly cover burglary. The only way in which burglary can be reached under the statute as construed by the majority is by indicting for entry of

the statute as making it an offense to enter or attempt to enter a bank with intent to commit one of the federal felonies or larcenies set forth in the statute.[11]

Another argument advanced by the majority for their construction of the statute, is that the expression "larceny" used in the statute is not defined therein and reference must be made to the state and common law for its definition; that therefore, the same must be true of the expression "felony".[12] Here again the answer of the dissenting judge seems to deprive this argument of any force. He points out[13] that the federal criminal code[14] defines a felony and also that the statute itself sufficiently defines the two crimes, robbery and larceny; moreover, that where recourse is had to the common law for a definition of a term used by the Constitution or a federal statute, it is not necessary to import into the federal law the law of any particular state.

The fact that the statute permits the state courts to prosecute offenses under the statute[15] is relied upon by the majority as evidence of a congressional intent that the word "felony" is intended to include a state felony.[16] But as stated in the dissent,[17] jurisdiction existed in the state courts before the 1937 amendment; and besides, the fact that state courts may entertain suits under a federal statute (for example, The Employer's Liability Act)[18] does not mean that state law applies.

The history of the statute,[19] together with whatever internal evidence of intention is furnished by the statute itself, seems to support the view taken by the minority. The Attorney General stated that the purpose of the bill was to add "the crimes *of* burglary and larceny *of* a bank".[20] Where Congress has intended to incorporate

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a bank with intent to commit a state felony of burglary. If burglary be considered an inchoate crime, this would be a case of attempting to commit an attempt. It is true that the offense might be characterized as unlawful entry since it lacks the element of breaking which usually accompanies burglary. However, modern burglary statutes sometimes dispense with the element of breaking; see CALIF. PENAL CODE (1941) § 459; McCreary v. State, 25 Ariz. 1, 212 Pac. 336 (1923).

11. 54 STAT. 695 (1940), 12 U. S. C. A. § 588b (Supp. 1942). Judge Frank recognizes that such a construction will permit a conviction for a burglary where the intent is less than felonious, but this is not unusual under modern burglary statutes. See the definition of burglary in N. Y. PENAL LAW, § 402.

12. 130 F. (2d) 514, 517 (C. C. A. 2d, 1942).

13. 130 F. (2d) 514, 523, 524 (C. C. A. 2d, 1942).

14. 46 STAT. 1029 (1930), 18 U. S. C. A. § 541 (Supp. 1942).

15. 48 STAT. 783 (1934), 12 U. S. C. A. 588d.

16. 130 F. (2d) 514, 517 (C. C. A. 2d, 1942).

17. 130 F. (2d) 514, 523 (C. C. A. 2d, 1942).

18. 53 STAT. 1404 (1939), 45 U. S. C. A. § 56 (Supp. 1942).

19. Especially two facts concerning the original bill sponsored in 1935 by the Attorney General. The proposed bill included the offense of breaking into a bank with intent to commit any felony under federal *or state law*. This proposal was rejected by Congress and the statute was limited to the crime of robbery. 130 F. (2d) 514, 516n. The proposed bill also made it a felony to obtain money from a bank through fraud, which under most state laws would be a felony. This provision was also rejected. *Id.* at 521. It is significant that when the Attorney General proposed the 1937 amendment there was no renewal of the suggestions that state felonies were to be included, or that the fraud provision be re-introduced. Yet the majority's interpretation has the effect of reviving both discarded clauses.

20. 130 F. (2d) 514, 521 (C. C. A. 2d, 1942). (Italics inserted.)

within its own legislation the criminal law of a state, it has done so in clear language, as in the case of the statute dealing with crimes committed in places under federal jurisdiction situated within the territory of a state.[21] The effect of the statute, as construed by the majority, would be to extend federal criminal jurisdiction over any felony committed within any national or federally insured bank, or in any building used in whole or in part as such a bank, provided the felonious intent was present when the building was entered. The tremendous expansion of federal criminal jurisdiction which results is apparent when one realizes that there are thousands of such banks throughout the country.[22] The power of Congress to enact the legislation in question is based upon its power to protect the fiscal institutions which handle the nation's currency[23] and if the legislation is construed as going beyond that area of power, there is a real question as to its constitutionality.

Two rules of construction are here applicable: not only should a criminal statute be strictly construed,[24] but it should be given a sensible construction and not one leading to absurd consequences, where the legislative purpose will be satisfied by a more limited interpretation.[25] The dissenting opinion of Judge Frank effectively points out some of the anomalies which result from the majority's interpretation of the statute. For instance forgery committed against a national bank is not a federal crime, so that a person who commits forgery outside the bank or even in such a bank after having entered it with innocent intentions, cannot be prosecuted. Likewise, a person who commits murder or rape in such a bank cannot be prosecuted, if he did not enter the bank with the intent to commit such crime, but he may be prosecuted if he entered with such intention but was prevented from committing the contemplated crime. In short the statute, if the majority are right, makes the mere attempt, and not the completed act, a crime. Judge Huxman in his dissenting opinion in *Hudspeth v. Tornello*[26] adverts to another incongruity resulting from the majority's interpretation. Although a federal statute should be uniform in its application, this statute would have a different application in each state, depending upon the particular criminal law in each state.

At best there is a serious question as to the true meaning of the statute. The Supreme Court may soon furnish a binding interpretation,[27] but if the present majority view does not correctly construe the intention of Congress, it would seem only proper that that body should immediately make clear its true intention in enacting the amendment.

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21. 54 STAT. 234 (1940), 18 U. S. C. A. § 468 (Supp. 1942).

22. Judge Frank says of the majority's interpretation of the statute: "In effect, it makes each one of the 13,427 banks covered by the Act, to a large extent, the equivalent of a territory within the jurisdiction of the United States, as if included within Title 18, Chapter 11 (Sec. 451 *et seq.*) which brings all state laws into play as to such territory." 130 F. (2d) 514, 522.

23. U. S. Const. Art. 1, § 8; United States v. Walter, 263 U. S. 15 (1923); Hudspeth v. Melville, 127 F. (2d) 373, 375 (C. C. A. 10th, 1941). In the latter case the majority said: "Congress also has power to enact legislation appropriate for the protection, preservation and regulation of such banks. . . ."

24. Prussian v. U. S., 282 U. S. 675 (1931); U. S. v. Reese, 92 U. S. 214 (1875).

25. U. S. v. Katz, 271 U. S. 354 (1926).

26. 128 F. (2d) 172, 173 (C. C. A. 10th, 1942).

27. *Certiorari* has already been granted. 63 S. Ct. 62 (1942).

INDEMNITY—GENERAL CONTRACTOR AND SUBCONTRACTOR—CONSTRUCTION OF INDEMNITY CONTRACT.—Plaintiff, a riveter working on the ground floor of a building at the New York World's Fair, was injured when a piece of pipe was dropped from the floor above by an employee of the defendant subcontractor. The pipe fell through a four inch opening around a column which the defendant general contractor had left unplanked in violation of a statute requiring all iron or steel floor beams to be thoroughly planked over. Plaintiff sued both the general contractor and the subcontractor. The general contractor cross-complained against the subcontractor upon the following contract: "Should any person . . . be injured by the subcontractor . . . in the course of performance by him of this agreement . . . said contractor shall alone be liable . . . therefor, and does hereby agree to and with said contractor to hold harmless and indemnify the contractor of and from all claims."

The jury rendered a verdict against both defendants, and the trial court thereafter dismissed the cross-complaint. On appeal from an order of the Appellate Division reversing the trial court's dismissal of the cross-complaint, held, three judges dissenting, that the cross-complaint was properly dismissed. *Walters v. Rao Electrical Equipment Co. et al.*, 289 N. Y. 57, 43 N. E. (2d) 810 (1942).

Four judges, constituting the majority, after pointing out that the failure of the general contractor thoroughly to plank over the steel beams, as required by the Labor Law,[1] was a breach of a primary non-delegable duty (citing *Employers' Liability Assur. Corp. v. Post & McCord, Inc.*),[2] held that any intention to extend the liability of the subcontractor beyond the limit of the acts of his employees would have to be unequivocally expressed, and that no such intention was revealed in the agreement under consideration. The effect of the indemnity contract was that, if both contractors were concurrently negligent, the general contractor could not secure indemnity from the subcontractor. The dissenting judges apparently were of the opinion that since the liability of the general contractor to the plaintiff resulted merely from its omission of a secondary duty, and since the subcontractor was the actual wrongdoer then, as between the two, the latter was principally liable; and that in construing the indemnity agreement it must be assumed that it was the intention of the parties that the more guilty one ultimately bear the loss.

An agreement to indemnify a person from the consequences of an illegal act is generally held to be void, because of its tendency to encourage the performance of such an act.[3] However, it is generally held that an agreement to indemnify a person against loss resulting from his own negligence is valid.[4] Even though such an agree-

1. N. Y. LABOR LAW § 241 (4).

2. 286 N. Y. 254, 264, 36 N. E. (2d) 135, 140 (1941). In this case the court approved the charge to the jury that it was the active duty of the general contractor, if the space required covering, to cover over the floors, and held that the violation of the statute, if a proximate cause of the accident, was actionable negligence.

3. Municipal Metallic Bed Manufacturing Corporation v. Dobbs, 253 N. Y. 313, 171 N. E. 75 (1930); RESTATEMENT, CONTRACTS (1932) § 572. Also see Delafield v. Barrett, 270 N. Y. 43, 200 N. E. 67 (1936).

4. Messersmith v. American Fidelity Co., 232 N. Y. 161, 133 N. E. 432 (1921); Westinghouse, C., K. & Co. v. Long Island R.R. Co., 160 App. Div. 200, 203; 145 N. Y. Supp. 201, 203 *aff'd*, 216 N. Y. 69, 110 N. E. 1051 (1914). A contract of indemnity should be distinguished from a contract *exempting* a person from liability to another as a result of that person's negligent conduct. In the former case the injured person is not denied redress; in the latter he is left without redress. The latter type of contract has been declared void,

ment may be viewed as placing a premium on negligence, the policy in favor of freedom of contract is considered sufficient to uphold its validity,[5] at least where the negligent act involved "is only an undesired possibility in the performance of the bargain and the bargain does not tend to induce the act."[6] Therefore, it is well settled that an undertaking by a building contractor to assume liability for all damages incurred in the prosecution of the work is valid.[7]

The failure of the general contractor in the principal case to thoroughly plank over the beams was not only a violation of the Labor Law,[8] but might also constitute a misdemeanor under the Penal Law.[9] Under the general principles stated immediately above, it might be argued that the indemnity agreement is illegal if construed to save harmless the general contractor from claims resulting through its violation of the provisions of the Labor Law and the Penal Law. However, in none of the cases dealing with the subject have the courts held that the indemnity agreement was void for this reason.[10] It may be that the distinction between acts *mala prohibita* (into which class this violation undoubtedly falls) and those *mala in se* applies here, and the public policy of the state would not require the condemnation of the agreement thus construed.[11]

Probably the case most frequently cited in New York within recent years dealing with the interpretation of an agreement by a subcontractor to indemnify a general contractor is *Thompson-Starrett Co. v. Otis Elevator Co.*[12] In that case a workman was injured solely by reason of the negligence of the general contractor. The court construed the agreement indemnifying the general contractor "against all claims for damages to persons growing out of the execution of the work" as one not intended to indemnify the general contractor against its own negligence.[13] The opinion made reference to the case of *Dudar v. Milef Realty Corp.*[14] in which an indemnity agree-

as violating public policy, in certain cases: for instance, when the promise is given by a passenger to a common carrier or by an employee to an employer. RESTATEMENT, CONTRACTS (1932) § 575; Straus v. Canadian Pacific R.R. Co., 254 N. Y. 407, 173 N. E. 564 (1930); Johnson v. Fargo, 184 N. Y. 379, 77 N. E. 388 (1906).

5. Note, (1935) 20 CORN. L. Q. 352.

6. RESTATEMENT, CONTRACTS (1932) § 572.

7. National Transit Co. v. Davis (C. C. A. 3d, 1925) 6 F. (2d) 729, *cert. denied*, 269 U. S. 579.

8. N. Y. LABOR LAW § 241 (4).

9. N. Y. PENAL LAW § 1277.

10. An examination of the briefs in Turner Construction Co. v. Rockwood Sprinkler Co., 275 N. Y. 635, 11 N. E. (2d) 793 (1937) discloses that such an agreement was enforced despite the fact that the indemnitor urged the illegality of the agreement upon the court.

11. See Messersmith v. American Fidelity Co., 232 N. Y. 161, 133 N. E. 432 (1921) in which the court upheld the validity of an insurance contract where the loss resulted from performance of an illegal act. Also see Hartford Fire Insurance Co. v. Chicago, M. & St. P. Ry. Co., 175 U. S. 91 (1899) and Griffiths & Son Co. v. National Fireproofing Co., 310 Ill. 331, 141 N. E. 739 (1923).

12. 271 N. Y. 36, 2 N. E. (2d) 35 (1936), noted in (1936) 23 VA. L. REV. 85.

13. *Id.* at 41, 2 N. E. (2d) 35, 37 (1936) in which the court said: "It is a general rule long established that contracts will not be construed to indemnify a person against his own negligence unless such intention is expressed in unequivocal terms." An earlier New York case is Manhattan Ry. Co. v. Cornell, 54 Hun. 292, *aff'd*, 130 N. Y. 637 (1892).

14. 258 N. Y. 415, 180 N. E. 102 (1932).

ment was given effect where the injury resulted from the negligence of the indemnitor, in which, as the court said, the indemnitee "did not participate". The instant case presents the in-between situation referred to in the two preceding cases, that is, one where both contractors are concurrently negligent, but where the negligence of the subcontractor is active and that of the general contractor merely passive.

Aside from agreement, indemnity against the principal wrongdoer has been granted to one less culpable, although both are equally liable to a person injured.[15] Recovery over in such a case does not offend the rule *in pari delicto potior est conditio defendentis* because they are not *in pari delicto*.[16] In the principal case, the majority opinion stressed the fact that the statute placed the duty of planking over the beams primarily on the general contractor. However, while this fact unquestionably makes the general contractor, along with the subcontractor, liable to the injured person, it does not altogether solve the problem whether the subcontractor should ultimately bear the whole loss. The answer to that problem should depend upon their relative culpability. While it is true that an act of omission may indicate as much fault as one of commission (and in some instances even greater fault), it would appear that the primary and efficient cause of the harm in the principal case was the affirmative act of the subcontractor's employee, and that, without the agreement, a basis for recovery over might be found. It must be admitted, however, that a contrary result was apparently reached in the case of *Employers' Liability Assurance Corp. v. Post & McCord, Inc.*[17]

But we must not lose sight of the very important fact that the case under discussion involved the interpretation of an agreement. At times judges seem to forget that fact and to determine the rights of the parties irrespective of their intention.[18] In close cases of interpretation it may be permissible to construe the agreement in the light of established principles of liability in order to arrive at the presumed intention of the parties. The rule of the *Thompson-Starrett* case[19] that a promise to indemnify a person against his own sole act of negligence must be expressed in unequivocal language seems a fair rule of presumption, since the liability of such indemnity is so extensive and the character of the indemnity so extraordinary. But the rule of the *Thompson-Starrett* case is only a rule of construction, and we know that business men, when drawing their agreements, often ignore relations and principles known to lawyers.[20] Unless their agreement violates public policy, it should be enforced as made.

15. Scott v. Curtis, 195 N. Y. 424, 88 N. E. 794 (1909); Union Stock Yards Co. v. Chicago, B. & Q. R.R. Co., 196 U. S. 217 (1905); Horrabin v. Des Moines, 198 Iowa 549, 199 N. W. 988 (1924). For a discussion of this point see (1925) 38 A. L. R. 566.

16. Phoenix Bridge Co. v. Creem, 102 App. Div. 354, 92 N. Y. Supp. 855 (2d Dep't 1905), *aff'd without opinion*, 185 N. Y. 580, 78 N. E. 1110 (1906). In this case the court cited the leading American case of Lowell v. Boston & L. R. Corp., 23 Pick. 24, 34 Am. Dec. 33 (Mass. 1839) for the principle that "where the offense is merely *malum prohibitum*, and does not involve any moral delinquency, it is not against the policy of the law to inquire into the relative delinquency, and to administer justice between them, although both parties are wrongdoers."

17. 286 N. Y. 254, 36 N. E. (2d) 135 (1941).

18. The dissenting opinion delivered in a recently decided case, Coley v. Cohen, —— N. Y. ——, —— N. E. (2d) —— decided Dec. 11, 1942, refers to the "acts and neglects imputable to the indemnitees in accordance with the Thompson-Starrett rule."

19. *Supra*, note 12.

20. Hartigan v. Casualty Co. of America, 227 N. Y. 175, 124 N. E. 789 (1919).

The decision of the majority in the principal case comes close to re-writing what was apparently the contract of the parties.[21] The affirmative carelessness of the indemnitor's employee was undoubtedly just such an act as against which the indemnity agreement was designed to furnish protection. It would seem that the general contractor's insistence upon an indemnity agreement was meaningless unless it was understood that there would be some negligence on its part, such as that which occurred, which might also render it liable to the injured person.

SURETYSHIP—SUBROGATION—PRIORITY OF SURETY OVER ASSIGNEE.—A contractor executed a highway contract with the State, and in connection with the letting thereof furnished two bonds, one to insure completion of the contract, and the other for the satisfaction of labor and material claims. The contract provided that, if the work should be abandoned by the contractor, the State should have the right to complete the work, and that the contractor would be liable for an excess in the cost of its completion; also that, the State "may apply any moneys due or to become due under this contract to the completion of the work." Thereafter the contractor assigned his rights and interests in the proceeds of the contract in consideration of money advanced, apparently for use in connection with the contract. This assignment was duly filed in compliance with the provisions of the Lien Law. Before the contract was completed, the contractor defaulted and the State went on to complete the contract. Labor and material claims, which were outstanding at the time of the default, some having been reduced to mechanic's liens which were filed after the assignments, were then paid by the surety. The surety claims, by way of subrogation, the unexpended balance, above the cost of completion, remaining in the hands of the State; the assignee makes claim to the balance by virtue of its prior assignment. *Held,* two judges dissenting, the surety is entitled by subrogation to the fund as against the assignee. *Century Cement Manufacturing Company, Inc. v. Fiore,* 264 App. Div. 475, 36 N. Y. S. (2d) 332 (3d Dep't 1942).

The majority held that the surety was entitled to be subrogated to the rights of the State, upon the theory that in discharging the labor and material claims the surety was instrumental in completing the contract, pointing out that the State would have been justified in using the disputed fund for this purpose. *Scarsdale National Bank & Trust Co. v. U. S. Fidelity & Guaranty Co.*,[1] in which it was held that the equity in favor of the surety, which arose at the time the bond was given, became available when the surety completed the contract at a loss, was strongly relied on. The minority opinion gave effect to the provisions of the Lien Law[2] which give to an assignee of moneys due or to become due under a public contract, who has duly filed his assignment, priority over subsequent lienors to the extent of advances made before the subsequent liens are filed. In the opinion of the two judges who dissented, any right of subrogation which the surety possessed arose under its material and labor bond, and

21. Turner Construction Co. v. Rockwood Sprinkler Co., 275 N. Y. 635, 11 N. E. (2d) 793 (1937) contained an almost identical factual situation. The majority opinion in the principal case explains the enforcement of the indemnity agreement in that case on the basis of what it considered the broader language of the agreement in that case.

1. 264 N. Y. 159, 190 N. E. 330 (1934).

2. N. Y. LIEN LAW, § 25, subd. 1.

not under the completion bond, and the surety, as subrogee of the lienors, was in a position inferior to that of the assignee.

The right of subrogation is said to be equitable, since courts of equity first recognized and enforced it; also it is equitable in the sense that it is conferred in the absence of contract and out of considerations of fairness to the subrogee.[3] When the surety discharges the obligation of his principal, he is entitled to be substituted to the position of the creditor whom he pays, thereby acquiring the rights and remedies and any security possessed by the latter.[4] However, subrogation, being a creation of equity, is only applicable when, and to the extent that, its enforcement will not violate legal rights or superior equities of others.[5]

Although the right of subrogation will not be enforced until the surety fully discharges the principal's obligation, the equity in favor of the surety attaches when the surety becomes obligated, so that, by relation back, the surety acquires the security unencumbered by subsequent liens.[6] As to a fund in the hands of the creditor which represents a percentage of the contract price retained under the terms of a construction contract, it is well settled that a surety, who discharges his obligation under the bond, is entitled to this fund. It is in the nature of security. One claiming under an assignment from the contractor is assumed to know that this fund is retained as much for the surety's protection as well as for that of the obligee,[7] and, in fact, an unjustified prepayment of such fund will release the surety, at least *pro tanto*.[8] Therefore, if the fund in the principal case consisted of a retained percentage, there is ample authority to sustain the view taken by the majority. It does not appear whether the earned moneys in the principal case, which the State possessed at the time of the contractor's default, included such a retained percentage, but it would seem well settled in New York,[9] as in most jurisdictions,[10] that the surety should be entitled by subrogation to

3. Hodgson v. Shaw, 3 Mylne & K. 183, 190, 40 Eng. Rep. R. 70 (1834); Hidden v. Bishop, 5 R. I. 29, 31 (1857); ARANT, SURETYSHIP (1931) 224, 358.

4. Subrogation is a species of assignment by operation of law, this view having been borrowed from the Roman law. Lumpkin v. Mills, 4 Ga. 343, 345, 349 (1848); Nelson v. Webster, 72 Neb. 332, 100 N. W. 411 (1904); Comment (1926) 35 YALE L. J. 484.

5. STEARNS, LAW OF SURETYSHIP (4th ed. 1934) § 246; POMEROY, EQUITY JURISPRUDENCE (4th ed. 1919 § 1419n.

6. Smith v. Bloxam, 2 H. & M. 457, 26 Digest 118 (1865); Hill v. King, 48 Ohio St. 75, 26 N. E. 988 (1891); Drew v. Lockett, 32 Beav. 499, 55 Eng. Rep. R. 196 (1863).

7. Prairie State Bank v. United States, 164 U. S. 227 (1896); Wasco County v. New England Equitable Ins. Co., 88 Or. 465, 172 Pac. 126 (1918); Southern Surety Co. v. Merchants' & Farmers' Bank (Ind.) 176 N. E. 846 (1931); State of Ohio *ex rel.* Southern Surety Co. v. Schlesinger, 114 Ohio 323, 151 N. E. 177 (1926).

8. Calvert v. London Dock Co., 2 Keen 639, 48 Eng. Rep. R. 774; Kiessig v. Allspaugh, 91 Cal. 231, 27 Pac. 655 (1891); National Surety Co. v. Lincoln County, 238 Fed. 705 (C. C. A. 9th, 1917).

9. Scarsdale National Bank & Trust Co. v. U. S. Fidelity & Guaranty Co., *supra*, note 1. In Arrow Iron Works, Inc. v. Greene, 260 N. Y. 330, 183 N. E. 515 (1934), the court admitted the logic of permitting the surety to be subrogated to all earned funds in the hands of the creditors but refused to decide the question.

10. Lacy v. Maryland Casualty Co., 32 F. (2d) 48 (C. C. A. 4th, 1929); Standard Accident Insurance Co. v. Federal National Bank, 112 F. (2d) 692 (C. C. A. 10, 1940), and cases cited therein. *Contra:* Dowling v. City of Seattle, 22 Wash. 592, 61 Pac. 709 (1900).

all unpaid moneys in the hands of the obligee, whether they represent retained percentages or not.

However, where the funds obtained from the assignee are used to pay labor and material claims,[11] there are some cases which consider the equity of the assignee superior to that of the surety.[12] A New York decision which seems to lend some color of support to this view is *Laski v. State*.[13] In that case one who claimed under a mechanics lien, a surety and an assignee of the contractor made claim to earned moneys in the hands of the State. The court held that the surety's rights were superior to that of the assignee since the latter had not advanced any money which went into the construction. However, it was also held that the lienor should be paid before the surety, since the lienor had furnished materials which had gone into the construction and to that extent diminished the amount which the surety would have had to pay. "For the surety to receive equity it should do equity to the lienor for lightening the burden of the surety."[14] In *Arrow Iron Works v. Greene*,[15] where the contest was between a lienor and an assignee, who had loaned to the contractor money, which the latter had employed to furnish labor or materials, the court found for the assignee on the ground that, under the decisions and the Lien Law, an assignee of moneys due or to become due under a public contract, has priority over all lienors whose liens are subsequently filed. One might draw the conclusion from these two cases that the assignee, whose money went into performance of the contract, should prevail over the surety. However, such a conclusion does not necessarily follow. There is some apparent justice in subordinating the surety's equitable claim to that of a lienor who has made a direct contribution to the work and whom the State would be justified in paying in order to complete the contract, even though, in the language of Judge Cardozo, lienors are described as "statutory assignees" of the contractor.[16] Priority in filing should determine the rights between such a statutory assignee and an actual one; legally they are in the same position. But in the case of adverse claims between surety and assignee, the assignment is defeated by the surety's equity which by relation back, antedates the assignment. The assignee takes its assignment subject to the State's right to apply the earned moneys to completion of the contract, and the surety who completes the contract succeeds to this right and "it is no answer to say as against the State that the money of the bank went into the work and thus reduced the cost of completion."[17] Any possible claim by the assignee that it too is entitled

11. In the principal case the majority opinion presumes this fact; the dissenting opinion states it to be a fact. Sec. 25, subd. 5 and 6, of the Lien Law makes it a crime to use funds received from the assignee, for any other purpose until first applied to these claims.

12. Fidelity & Deposit Co. v. City of Stafford, 93 Kan. 539, 144 Pac. 852 (1914); New Amsterdam Casualty Co. v. Wurtz, 145 Minn. 438, 177 N. W. 664 (1920).

13. 217 App. Div. 420, 217 N. Y. Supp. 48 (3d Dep't 1926), *aff'd, mem.* 246 N. Y. 569 (1927). *Contra:* St. Peter's Catholic Church v. Vannote, 66 N. J. Eq. 78, 56 Atl. 1037 (1904); Tuttle v. Independent School District, 62 Iowa 422, 17 N. W. 603 (1883); Maryland Casualty Co. v. Board of Water Commissioners, 66 F. (2d) 730 (C. C. A. 2d, 1933).

14. Laski v. State, *supra*, note 13.

15. 260 N. Y. 330, 183 N. E. 515 (1932).

16. Anderson v. Hayes Construction Co., 243 N. Y. 140, 150, 153 N. E. 28 (1926).

17. Scarsdale National Bank & Trust Co. v. U. S. Fidelity & Guaranty Co., *supra*, note 1, at p. 163. Might not the same statement be applied to the lienor in Laski v. State, *supra*, note 13?

to subrogation, since it has in effect enabled the contractor to discharge its obligation, would be defeated by the fact that the assignee, unlike the surety, is a volunteer, and equity will not aid a volunteer.[18]

In the above discussion it has been assumed that the surety had completed the contract. The fact in the principal case, which was the chief cause of the dissent, was that the surety had not been required to fulfill its obligation under its completion bond, but merely under its labor and material bond. Under a technical application of the rule of subrogation the surety should succeed only to the rights of the lienors (the creditors whom it paid) and, as the dissent pointed out, it is established that the lienor's right is inferior to that of the assignee.[19] But the majority opinion seems to have proceeded upon the theory that the surety in paying the labor and material claims was instrumental in completing the contract. Of course, the same is true of the assignee in a more remote and indirect way. It has been held that, if in discharging the obligation of his principal a surety incidentally discharges another's obligation, it is subrogated to the rights of that other.[20] But that is not the case here, because the State was under no obligation to pay the labor or material claims, although it would, under the contract, have been justified in doing so, and to that extent have relieved the surety. Nevertheless the fact remains that the State required the labor and material bond and was named as obligee therein. While not under any legal compulsion to pay the labormen and materialmen, its requirement of this type of bond showed the State's concern that these claims be paid,[21] and the surety did discharge this governmental responsibility. On the other hand there is something to be said in favor of the assignee's position. Those who finance builders of public improvements, especially banks, perform a useful and important function. Assignments of moneys due or to become due under contracts for such public construction constitute the best, if not the only, form of security for such loans, and they should be given protection. If the assignee directly pays the laborer or materialman his position is closely akin to that of the surety, and perhaps he should not be called a mere volunteer.[22] In the instant case, the assignee is merely one step removed.

On its facts, the decision of the majority seems to extend somewhat the holding in *Scarsdale National Bank & Trust Co. v. U. S. Fidelity & Guaranty Co.*,[23] but the same result has been reached in another decision.[24] While technical considerations make the choice a close and difficult one, substitution of the surety to the rights of the State and not solely to those of the lienor, seems an equitable extension of the doctrine of subrogation, which like most equitable doctrines, should be elastic in its application.

There is left an interesting inquiry. Suppose there had been a separate surety on the completion bond? As between the assignee and the surety who paid the labor and material claims (admitting the soundness of the court's decision) the result should

18. Gadsen v. Brown, Speers' Eq. (1843 S. C.) 37, 41 Prairie State Bank v. United States, 164 U. S. 227 (1896); Hennigsen v. U. S. Fidelity & Casualty Co., 208 U. S. 404 (1908).

19. Arrow Iron Works v. Greene, *supra,* note 14.

20. Brinson v. Thomas, 2 Jones Eq. 414 (N. C. 1856).

21. McClare v. Massachusetts Bonding & Ins. Co., 266 N. Y. 371, 195 N. E. 15 (1935).

22. See cases cited *supra,* note 12.

23. *Supra,* note 1.

24. Riverview State Bank v. Wentz, 34 F. (2d) 419 (C. C. A. 8th, 1929), in which there was a dissenting opinion similar to that in the principal case.