Fordham Law Review

Volume 27 | Issue 1 Article 2

1958

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Cover Page Footnote

Member of the New York Bar. The author wishes to express his appreciation to Milton Kaplan, Esq., Administrative Assistant to the Counsel to the Governor, for his suggestions and criticism during the preparation of this article.

MUNICIPAL CONFLICTS OF INTEREST: RIGHTS AND REMEDIES UNDER AN INVALID CONTRACT

*RICHARD B. LILLICH**

THE New York common-law prohibition against conflicts of interest on the part of municipal officers and employees was evolved from public policy to prevent self-dealing municipal servants from profiting at public expense. During the past half century, a complex of inconsistent case law, patchwork statutory enactments and dogmatic administrative opinions has converted this relatively precise principle into one of the most confusing areas of New York law. Both lawyers and public servants have experienced difficulty in handling two of the major problems in this field of municipal law: (1) What public servants are covered by the existing rules? (2) What is the nature of the disqualifying interest?[1] A third problem, by nature more diffuse and often more difficult, is presented when a prohibited conflict of interest is found: What are the consequences flowing from such an invalid transaction?

The problem is well illustrated by the case of the city airport commissioner who, in his capacity as a funeral director, has buried city welfare recipients and has been partially paid for such services. This transaction has been held to violate section 3 of the General City Law,[2] the city provision against conflicts of interest, and the court of appeals has deemed such municipal contracts "not merely voidable, but void."[3] This does

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1. The above is discussed in Kaplan and Lillich, Municipal Conflicts of Interest: Inconsistencies and Patchwork Prohibitions, 58 Colum. L. Rev. 157 (1958).

2. N.Y. State Compt. Op. 57-744 (1957). The Comptroller of the State of New York issues advisory opinions at the request of municipal officials whose transactions are subject to post-audit by the Comptroller pursuant to N.Y. Gen. Munic. Law §§ 33-35. In addition, he makes determinations of an official nature when he performs his pre-audit duty of disallowing state aid sought in reimbursement of payments made to local officials. The opinions of the Comptroller are reported in the published annual Opinions of the Comptroller Relating to Municipal Government (hereinafter cited as N.Y. Ops. State Compt.). Opinions of the Comptroller not appearing in N.Y. Ops. State Compt. will be cited by their number and date.

3. Clarke v. Town of Russia, 283 N.Y. 272, 274, 28 N.E.2d 833, 835 (1940). Most conflicts of interest statutes in New York, with the exception of N.Y. County Law § 412(2), N.Y. Second Class Cities Law § 19, N.Y. Canal Law § 110, and N.Y. Opt. County Gov't Law §§ 314, 1020, do not expressly declare such contracts to be void, but administrative opinion has correctly interpreted them in such fashion. 11 N.Y. Ops. State Compt. 127 (1955) and 7 N.Y. Ops. State Compt. 15, 20 (1951). Early legislation declared the prohibited contracts voidable at the municipality's option. N.Y. Sess. Laws 1843, c. 57, p. 36. This type of statute proved ineffective, since the discretion as to the exercise of the option was usually

not mean, however, that no legal consequences are generated by the prohibited dealings, since "void" is a word that has undergone substantial legal surgery.[4] The airport commissioner may be compelled to bring suit against the city in an attempt to obtain his remaining payments. The city or its taxpayers, in turn, may seek to recover those payments already made. Innumerable third parties, especially other funeral directors, may bring actions grounded on the illegal transaction. Finally, the state itself may be concerned with the prohibited contract if the question of state aid to the city welfare district based upon payments made in violation of the General City Law should arise.

The rules that regulate the above ramifications of a city officer's contracting with his city will be discussed below. They will be shown to be confusing, conflicting and far from consistent. That remedial legislation, based upon the equitable principles behind the common-law prohibition against conflicts of interest, is needed in New York will be shown to be equally obvious.

I. Action by the Interested Public Servant

Little authority exists in New York on the question of whether an interested public servant or his business organization may recover in *quantum meruit* after the contract is declared illegal because of a conflict of interest. In *People ex rel. Schenectady Illuminating Co. v. Board of Supervisors,*[5] where recovery in an action on a contract was denied because the contract was invalid, the court stated by way of dictum: "Of course, if a large sum of money were involved so that a rejection of the bill would work great hardship and injury upon the relator, we might adhere to the principle but make an exception of this case to work out equity; but there is no occasion to do so here."[6] A recovery in such case would necessarily have been on a *quantum meruit* theory since the court had declared the contract itself void, excluding the possibility of a direct

placed in the hands of the very officials who had entered into the questioned contract. Nevertheless, many city charters contain such provisions. Batavia City Charter § 14.8.

4. 5 Williston, Contracts § 1630 (rev. ed. 1937). See also 6 Corbin, Contracts § 1534 (1951): "It is far from correct to say that an illegal bargain is necessarily 'void,' or that the law will grant no remedy and will always leave the parties to such a bargain where it finds them. Such general statements are indeed found in great number, faithfully reprinted in long columns of digest paragraphs; they render only a wearisome disservice when repeated with no reference to the facts of the cases in which they have been made. Before granting or refusing a remedy, the courts have always considered the degree by [sic] the offense, the extent of public harm that may be involved, and the moral quality of the conduct of the parties in the light of the prevailing mores and standards of the community."

5. 166 App. Div. 758, 151 N.Y. Supp. 1012 (3d Dep't 1915).

6. Id. at 761, 151 N.Y. Supp. at 1014.

action on the contract. No subsequent New York decision can be found squarely dealing with the allowance or denial of *quantum meruit* in such situations.[7] While some writers[8] contend that *Smith v. Albany*[9] stands for the proposition that *quantum meruit* will be denied in New York in an action brought by the interested public servant against his municipality, an examination of the record on appeal indicates that the action was grounded on contract and that the court of appeals in denying Smith recovery was so doing because it considered the contract in question invalid.[10]

Although many popular textwriters state that relief is denied the interested party in the majority of states,[11] it is more accurate to say that there is an even split of authority on the point.[12] Thus, where the municipality has received articles or services of value, many cases hold that, although the contract itself cannot be enforced, nevertheless a recovery will be permitted on the basis of *quantum meruit* for the services or materials actually rendered or furnished.[13] Professor Antieau has concluded:

"Many cases refuse [quasi-contractual relief], most on the ground that such a contract was prohibited by statute and relief would circumvent the statute. On the other hand, many well-reasoned cases permit quasi-contract relief, and it is suggested that this should be the rule at least where no statute makes void the attempted contract. Removal of all profits from the undertaking is usually enough of a deterrent to one who would take advantage of the municipality."[14]

While the above analysis of the problem is essentially sound, there is no basis for the suggested distinction between situations where the contract is declared "void" by statute and where it is deemed invalid under

7. 7 N.Y. Ops. State Compt. 15, 26 (1951).

8. E.g., 1 Antieau, Municipal Corporation Law § 10.07 (1955).

9. 61 N.Y. 444 (1875).

10. Transcript of Record, pp. 19, 25-26, Smith v. Albany, 61 N.Y. 444 (1875).

11. Annot. 84 A.L.R. 936, 969-70 (1933), supplemented by Annot. 110 A.L.R. 153, 164 (1937), Annot. 154 A.L.R. 356, 375 (1945); 27 L.R.A. (n.s.) 1123-24 (1910); 63 C.J.S., Municipal Corporations §§ 975-88 (1950); Note, 16 Va. L. Rev. 628, 636 (1930). Cf. 6 Williston Contracts § 1786A (rev. ed. 1938); Note, 20 Minn. L. Rev. 564 (1936).

12. 2 Dillon, Municipal Corporations § 773 (5th ed. 1911); Elliott, Municipal Corporations § 212 (3d ed. 1925); 10 McQuillin, Municipal Corporations § 29.113 (3d ed. 1950); Woodward, The Law of Quasi Contracts § 260 (1913); Antieau, The Contractual and Quasi-Contractual Responsibilities of Municipal Corporations, 2 St. Louis L. Rev. 230, 246 (1953); Note, 17 Minn. L. Rev. 101 (1932); 37 Am. Jur., Municipal Corporations § 274 (1941). Cf. 6 Corbin, Contracts § 1534 (1951).

13. Abbott, Public Corporations § 156 (1908); 2 Dillon, Municipal Corporations § 773 (5th ed. 1911). Leading cases permitting quantum meruit are Spearman v. Texarkana, 58 Ark. 348, 24 S.W. 883 (1894); and Macon v. Huff, 60 Ga. 221 (1878). The last case cited Smith v. Albany, 61 N.Y. 444 (1875). Cf. p. 32 supra.

14. 1 Antieau, Municipal Corporation Law § 10.07 (1955).

the common law.[15] Why should a self-dealing fire district officer[16] be allowed *quantum meruit* recovery and a similar city officer[17] be denied such relief?[18] In addition to this unjustified distinction, Professor Antieau is incorrect in stating categorically that profits are removed when quasi-contractual relief is granted, since such remedy permits the recovery of reasonable value, which often includes profits.[19] To avoid the temptation for public servants to avoid the rules, profits should be denied, but this is done by allowing an *actual cost* rather than *quantum meruit* recovery.[20]

The rationale behind allowing the interested public servant to recover if he has innocently performed in good faith is further illustrated by an early Kansas case, *Concordia v. Hagaman*:[21]

"When it [the contract] has been executed without objection, and actual benefits have been received under it, all parties acting in entire good faith, the law is maintained and the ends of justice subserved by . . . allowing compensation merely for the reasonable value of the benefits received under it. Considerations of public policy do not require the doing of less than this . . . . No rule which is applied for the prevention of wrong should be used to work injustice to either of two parties who have both been equally innocent of intentional illegality or wrong-doing. Principles based upon public policy fail in their object when used as instruments of wrong."[22]

The contrary view is represented by a California case of the same vintage. "To say that implied contracts were not prohibited," wrote the court in *Berka v. Woodward*,[23] "would be to destroy the purpose and efficiency of the laws, and leave the people at the mercy of careless or unscrupulous officers."[24] The decision is in harmony with those opinions,

15. Rhyne analyzes the cases in a similar fashion. "When a contract is void because . . . contrary to express prohibition of a charter or statute, no recovery thereon can be had against the municipality . . . But if a contract is not within an express prohibition but is merely voidable under common law or equitable principles, the contracting officer may sometimes receive payment for the reasonable value of benefits accepted by the city." Rhyne, Municipal Law 261 (1957). While some cases make the distinction, they are relatively sparse. See Tallman v. Lewis, 124 Ark. 6, 186 S.W. 296 (1916).

16. A contract of a fire district officer would be covered by the common law. 7 N.Y. Ops. State Compt. 209 (1951).

17. A contract of a city officer would be covered by N.Y. Gen. City Law § 3.

18. Arkansas, which first allowed quantum meruit in all situations and then adopted the common law-statute distinction, now makes a distinction between the type of statutory prohibition. Quantum meruit is allowed if the statute merely prohibits the transaction, but it is denied if the statute makes it "null and void."

19. Shaddock v. Schwartz, 246 N.Y. 288, 158 N.E. 872 (1927); Black, Law Dictionary 1408 (4th ed. 1951).

20. Town of Hartley v. Floete Lumber Co., 185 Iowa 861, 171 N.W. 183 (1919).

21. 1 Kan. App. 35, 41 Pac. 133 (1895).

22. Id. at 40, 41, 41 Pac. at 134.

23. 125 Cal. 119, 57 Pac. 777 (1899).

24. Id. at 128, 57 Pac. at 780.

evidently based upon the assumption that the public servant must either be granted the original contract price or denied relief entirely, that refuse recovery on the theory that to permit it would be to deprive the municipality of the protection of a safeguard against the possible corruption of its officials.[25] Remove the assumption, however, and this theory would seem of doubtful validity, for few public servants would be good enough samaritans to contract with their municipality knowing that they would have to stand the expense of litigation merely to recover their out-of-pocket costs. Nevertheless, many courts adhere to the assumption in denying relief, relying on the tired formula that recovery should be denied, "otherwise a means would be thereby furnished for the undoing of the law itself."[26]

As intimated, the state of New York law on the subject well bears out one writer's observation that "the liability of municipal corporations in quasi-contracts . . . has never been satisfactorily worked out by our courts."[27] Several New York decisions, while not deciding this exact point, apply similar principles to analogous situations, giving us some insight into judicial thinking on the matter. *Brady v. The Mayor,*[28] decided a century ago, held that where a contract was void because made in violation of a charter provision requiring competitive bidding, no recovery would be allowed either on the contract itself or upon *quantum meruit.* Judge Denio, in denying *quantum meruit,* was affirming the general term, which had written:

"It may sometimes seem a hardship upon a contractor that all compensation for work done, etc., should be denied him; but it should be remembered that he, no less than the officers of the corporation . . . is bound to see to it that the charter is complied with. If he should neglect this, or choose to take the hazard, he is a mere volunteer and suffers only what he ought to have anticipated. If the statute forbids the contract which he has made, he knows it, or ought to know, before he places his money or services at hazard."[29]

This argument has far less validity in conflicts cases, where often there is no statute to put the public servant on guard or, if such a statute exists, it is so unreasonably broad that no one should be charged with knowledge of its scope. While a contractor should expect bidding requirements, a city airport commissioner, in no way connected with the making or performance of welfare contracts, should not be deemed to know that he

25. Woodward, The Law of Quasi Contracts 261 (1913). See Note, 26 Mich. L. Rev. 335, 336 (1928).

26. Norbeck and Nicholson Co. v. State, 32 S.D. 189, 198, 142 N.W. 847, 849 (1913). See Note, 17 Minn. L. Rev. 101 (1932).

27. Tooke, Quasi-Contractual Liability of Municipal Corporations, 47 Harv. L. Rev. 1143 (1934).

28. 20 N.Y. 312 (1859).

29. 16 How. Pr. 432, 446 (N.Y. 1857).

is violating the city conflicts of interest statute, even though no actual conflict exists, when he buries welfare recipients.

The rationale behind the *Brady* case was adopted by the court of appeals in *McDonald v. The Mayor*,[30] which has become the leading case in New York for the proposition that *quantum meruit* recovery will be denied in actions against municipal corporations grounded on invalid contracts. The latter was an action for the value of gravel and stone sold and delivered to New York City and used to repair its streets. Since plaintiff offered no proof that the expenditure had been approved by the common council or that the contract had been awarded properly to the low bidder, the contract was declared invalid. Neither, stated the court, could it support a claim for *quantum meruit*. "Where a person makes a contract with the city of New York for supplies to it, without the requirements of the charter being observed, he may not recover the value thereof upon an implied liability."[31]

The *McDonald* decision, in turn, was followed by the court of appeals in its most recent pronouncement on the question. In *Seif v. Long Beach*,[32] the mayor, without authority, retained special counsel to perform legal services for the city. These services were successfully performed, but when the assignee of the counsel sought to collect the attorney's fee he was forced to sue the city, its council having denied liability on the ground that the employment was illegal. The court held for the city.

"Where the Legislature provides that valid contracts may be made only by specified officers or boards and in specified manner, no implied contract to pay for benefits furnished by a person under an agreement which is invalid because it fails to comply with statutory restrictions and inhibitions can create an obligation or liability of the city. In [a] similar case this court has given emphatic warning that equitable powers of the courts may not be invoked to sanction disregard of statutory safeguards and restrictions [citing *McDonald v. The Mayor*]."[33]

Recent New York lower court cases have been evenly split, some allowing[34] and some denying[35] *quantum meruit* relief. The latest holding, *Cassella v. Schenectady*,[36] denied recovery to a city fire surgeon who had

30. 68 N.Y. 23 (1876).

31. Id. at 29.

32. 286 N.Y. 382, 36 N.E.2d 630 (1941).

33. Id. at 387-88, 36 N.E.2d at 632.

34. Ellis v. New York, 180 Misc. 968, 46 N.Y.S.2d 363 (Sup. Ct. 1943); Barry v. New York, 175 Misc. 712, 25 N.Y.S.2d 27 (Sup. Ct. 1941), aff'd without opinion, 261 App. Div. 957, 27 N.Y.S.2d 425 (1st Dep't 1941).

35. Cassella v. Schenectady, 281 App. Div. 428, 120 N.Y.S.2d 436 (3d Dep't 1953); Brown v. Mount Vernon Housing Authority, 279 App. Div. 794, 109 N.Y.S.2d 392 (2d Dep't 1952).

36. See note 35 supra.

rendered medical services to his municipality without proper civil service procedure being followed.

"The fact that the city accepted the benefit of the plaintiff's services does not entitle him to recover in quasi contract. Recovery may be allowed against a municipality in quasi contract for benefits received under an unenforceable contract where the invalidity of the contract was due to a mere irregularity or a technical violation . . . but where the making of the contract flouted a firm public policy or violated a fundamental statutory restriction upon the powers of the municipality or its officers, recovery in quasi contract is uniformly denied."[37]

Since the prohibition against conflicts of interest on the part of municipal servants was embedded in the common law, and is now often found in the form of statutory restrictions, this case offers little aid to the interested public servant.

Some help may be obtained, however, from a court of appeals case not in the field of municipal law, *Rosasco Creameries, Inc. v. Cohen.*[38] A recovery was allowed in that case when the prohibited transaction was found to be *malum prohibitum* and not *malum in se.*[39] Judge Finch made this distinction:

"Illegal contracts are generally unenforceable. Where contracts which violate statutory prohibitions are merely malum prohibitum, the general rule does not always apply. *If the statute does not provide expressly that its violation will deprive the parties of their right to sue on the contract,* and denial of relief is wholly out of proportion to the requirements of public policy or appropriate individual punishment, the right to recover will not be denied."[40]

Since contracts prohibited by conflicts of interest rules are inherently *malum prohibitum,* the above approach, if applied to such an invalid transaction, would certainly grant at least an actual cost recovery to the interested public servant.

In determining an equitable standard[41] for deciding cases of this nature, it is to be hoped that the New York courts avoid the ". . . danger of jumping to a conclusion, either refusing all remedy in the belief that the 'illegal' [contract] is bad and that no 'bad' man deserves relief, or granting a remedy without sufficient regard for what the public interest requires."[42] In the effort to avoid such extremes, some strange middle grounds have been taken. Minnesota, for instance, has held that the

37. 281 App. Div. at 432, 120 N.Y.S.2d at 440-41.

38. 276 N.Y. 274, 11 N.E.2d 908 (1937).

39. Cf. Tracy v. Talmage, 14 N.Y. 162, 179-80 (1856).

40. 276 N.Y. at 278, 11 N.E.2d at 909. (Emphasis added.)

41. Such an equitable standard is already found in § 20(5) of the N.Y. Gen. City Law, which specifically authorizes cities "to pay or compromise claims equitably payable by the city, though not constituting obligations legally binding on it." See Shaddock v. Schwartz, 246 N.Y. 288, 158 N.E. 872 (1927).

42. 6 Corbin, Contracts § 1534 (1951).

interested public servant may recover in *quantum meruit* where he loaned money or sold merchandise to his municipality, but not where he rendered services to it.[43] The reason for such a distinction is elusive. On the other hand, one authority contended:

"If the contract is made directly with the trustee upon a matter in which he alone is interested it would be against public policy to permit him to collect; but if he is an official or stockholder of a corporation doing business with the city, the corporation should not be precluded from recovering on the common counts because of this relationship."[44]

This distinction has some superficial plausibility, primarily because it represents one of the tests used to determine whether a sufficient disqualifying interest is present to taint the contract in the first place. After the contract is found invalid, however, the distinction loses its validity, for the rights rising from the prohibited transaction should be uniform rather than dependent on either the subject matter of the contract or the type of disqualifying interest which made it illegal.

Certainly it would seem that, viewing the complex New York conflicts of interest rules which often promote innocent transgressions, *quantum meruit* relief, or at least the allowance of an *actual cost* recovery as suggested above, should be permitted. Good faith, the condition precedent for such a recovery, plus perhaps the removal of profits as an additional safeguard, would combine to serve as an adequate watchdog of the public interest. In addition, section 1868 of the Penal Law makes many conflicts of interest situations misdemeanors, and no public servant would risk criminal sanctions merely for the opportunity of a quasi-contractual or actual profit recovery.

The latter approach was utilized by the Iowa Supreme Court in *Town of Hartley v. Floete Lumber Co.*,[45] where a stockholder, director and manager of a corporation voted, in his capacity as city official, to contract with the corporation. The contract was deemed bad, but since good faith had been shown the corporation was allowed to recover the actual value of property received and retained by the city. "The temptation to violate this rule of public policy," noted the court, "lies in the profit which may come to the individual from its violation. Remove all hope of profit, and you remove at once the temptation."[46] No fault can be found with this solution. The New York courts, so inconsistent in analogous situations, would be well advised to give it their serious consideration.

43. Currie v. School District, 35 Minn. 163, 164-65, 27 N.W. 922, 923 (1886). See Note, 34 Minn. L. Rev. 46, 51 (1949).

44. Weiss, Law or Justice? 6 Fla. State Bar Assoc. J. 284, 286 (1932).

45. 185 Iowa 861, 171 N.W. 183 (1919).

46. Id. at 865, 171 N.W. at 185.

II. Action by the Municipality or by Taxpayers[47]

Considerable authority can be found in other states for permitting municipalities[48] and often taxpayers[49] to restrain further payments and recover past payments made to an interested public servant under a contract deemed illegal because of a conflict of interests, in many instances despite the public servant's having performed in whole or in part.[50] In New York, both municipalities and certain taxpayers[51] have the capacity to bring such actions, the only question being the extent of the relief accorded. No New York case can be found in which a municipality brought such an action, but three supreme court cases have considered suits brought by taxpayers.

47. Since the scope of this article is limited to actions of a restitutionary nature, it does not directly touch on the removal from office of municipal servants who have violated conflicts of interest provisions. N.Y. Pub. Officers Law § 36 provides that any town, village, improvement district or fire district officer, except a justice of the peace, may be removed from office by the Supreme Court for misconduct in office. City, county and school district officers are not covered by the above section, nor are employees of the municipalities mentioned covered. Barber v. Lampman, 198 Misc. 135, 100 N.Y.S.2d 668 (Sup. Ct. 1950), aff'd, 278 App. Div. 600, 101 N.Y.S.2d 924 (3d Dep't 1951). The main point of contention under the statute concerns whether the removal is discretionary or mandatory with the court. Three early decisions held it to be mandatory in conflicts cases, despite good faith on the part of the public servant. Matter of Jackson, 231 App. Div. 838, 246 N.Y. Supp. 903 (2d Dep't 1930); Matter of Moran, 145 App. Div. 642, 130 N.Y. Supp. 432 (2d Dep't 1911); Matter of Smith, 48 App. Div. 634, 63 N.Y. Supp. 1018 (4th Dep't 1900). Three later decisions have held it to be discretionary. Wolfe v. Trask, 249 App. Div. 11, 290 N.Y. Supp. 970 (4th Dep't 1936); Village of Lake George v. Mayor, 242 App. Div. 723, 273 N.Y. Supp. 10 (3d Dep't 1934); Matter of Slack, 234 App. Div. 7, 254 N.Y. Supp. 669 (3d Dep't 1931). The Comptroller has followed the lead of the more recent cases. See 9 N.Y. Ops. State Compt. 380 (1953).

48. 6 Williston, Contracts § 1735 (rev. ed. 1937); 2 Dillon, Municipal Corporations § 773 (5th ed. 1911); 1 Antieau, Municipal Corporation Law § 10.07 (1955); 10 McQuillin, Municipal Corporations § 29.132 (3d ed. 1950).

49. "[T]axpayers can recover if the officials of the municipality refuse to sue." 1 Antieau, Municipal Corporation Law § 10.07 (1955); 18 McQuillin, Municipal Corporations § 52.18 (3d ed. 1950).

50. "When there is such a statute, it has been held that even though the bargain has been carried out, the municipality may recover what it has paid." 6 Williston, Contracts § 1735 (rev. ed. 1938). Williston cites only one New York case for this proposition, Engel v. Garner, 116 Misc. 289, 190 N.Y. Supp. 344 (Sup. Ct. 1921), discussed at pp. 41-42 infra. And see Antieau, The Contractual and Quasi-Contractual Responsibilities of Municipal Corporations, 2 St. Louis L. Rev. 230, 244 (1953). Equitable considerations frequently mitigate this harsh rule. "[E]quity courts have at times in suits by municipal corporations and taxpayers ordered the city to do equity by returning benefits." 1 Antieau, Municipal Corporation Law § 10.07 (1955). See also 2 Dillon, Municipal Corporations § 773 (5th ed. 1911).

51. N.Y. Gen. Munic. Law § 51 permits taxpayers of any county, village, town or municipal corporation to bring such actions. N.Y. Gen. Munic. Law § 2 defines the term "municipal corporation" to include a city. Thus, only school and fire district taxpayers have no remedy. Schnepel v. Board of Education, 302 N.Y. 94, 80 N.E.2d 617 (1951); Blackburn

Engel v. Garner[52] was the first of these cases. The taxpayers of the Town of Ghent brought an action against a former town superintendent of highways for the restitution of moneys received by him for furnishing materials and supplying labor on orders of the supervisor, a contract illegal both under the common law and section 1868 of the Penal Law. The superintendent had acted in good faith, the town had been substantially benefited and the payments had been audited and approved by the town board. Nevertheless, the superintendent was required to disgorge all he had been paid. Perhaps to ease its judicial conscience, the court added:

"I am not unmindful, in arriving at the conclusion in this case which I have arrived at, that it is requiring the defendant to refund to the town moneys for labor and materials which the town itself has received and enjoyed the benefit of; but this is one of that class of cases which cannot be decided upon the individual circumstances and incidents, but must be decided upon the general principles of law applicable to the official relation of individuals to their employer, especially where the employer is a municipality."[53]

The decision in the *Engel* case was so harsh that it was not followed in either of the two subsequent decisions dealing with the question. In the first of these, *Sebring v. Starner*,[54] a taxpayer of the City of Corning sued for the restitution of money allegedly illegally paid to the city superintendent of public works and to enjoin further payments. The superintendent, it seems, had been guilty of receiving $10 weekly for the hire of his car for official business. By stretching section 3 of the General City Law to its broadest, the court held that it prevented the public officer from contracting with the city for the use of the car.[55] Nevertheless the court, noting that he had acted in complete good faith, denied restitution.[56]

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v. Clements, 297 N.Y. 971, 80 N.E.2d 358 (1948). Originally taxpayers had no remedy, the courts holding that only the municipality concerned could bring an action. Roosevelt v. Draper, 23 N.Y. 318 (1861); People v. Ingersoll, 58 N.Y. 1 (1874). This, of course, was a hollow shell of a remedy, since in the usual case the municipality was being administered by the very individuals who should have been sued for violation of the conflicts of interests rules. Statutes were then passed giving the taxpayers a right of action. See N.Y. Sess. Laws 1875, c. 49, § 1; People v. Tweed, 63 N.Y. 202 (1875). Compare the latter case with People v. Ingersoll, supra.

52. 116 Misc. 289, 190 N.Y. Supp. 344 (Sup. Ct. 1921).

53. Id. at 298, 190 N.Y. Supp. at 349.

54. 119 Misc. 651, 197 N.Y. Supp. 201 (Sup. Ct. 1922).

55. Such a transaction is now permitted by a statutory exception, N.Y. Gen. City Law § 20(33), another example of the many exceptions spawned by the broad blanket-coverage prohibitions like § 3. See N.Y. State Compt. Op. 58-73 (1958).

56. The court also restrained future payments for the future use of the car. This holding is to be distinguished, however, from the case where the public servant has fully performed and has been only partially paid. In such a case, further payments will not be restrained. See pp. 41-42 infra.

"When an action for the restitution of public moneys is brought jointly against the officials who paid or authorized the payment and the official who received it, if there were no intentional wrongdoing or collusion, restitution cannot be enforced, even though there were a technical illegality in making the payment."[57]

Ryszka v. Board of Education,[58] the second decision subsequent to the *Engel* case, sprang from an unusual fact situation. Board of Education member Bromley was delegated the power to contract for repairs to a school. The Buck Lumber Company agreed to do the job if labor was supplied, so Bromley was employed to obtain and supervise the labor at $1 an hour. After the work was completed and partially paid for, a taxpayer brought an action for the restitution of moneys paid under the contract and restraint of further payments, claiming the employment of the board member violated the rule that a public servant may not assume a private duty in conflict with his obligations to the public. The court stated that it would have dismissed any action brought by the interested person for the contract price, but that since it was faced with a suit in equity brought by a taxpayer, and the entire transaction had been in good faith with a fine job done, the relief requested by the taxpayer should be denied. Here we see both restitution and restraint of further payments refused.[59]

Thus, two out of three lower court decisions deny taxpayers, and presumably the holdings would also apply to actions by municipalities, a recovery in a suit for restitution of payments made under an invalid contract. Any prognostication as to what position the court of appeals would take if presented with the problem is edged with uncertainty, and speculation on the question should be made in the light of William Blake's purported observation that "to generalize is to be an idiot." Still, in view of the weight of the lower court authority, it is not too much to hope that the court, rather than summarily granting relief, would fully consider the equities of the individual case and the facts surrounding the making and performance of the particular contract before arriving at its decision.[60]

Such an approach offers no pat slide rule formula, but it is consistent with the theory behind the conflicts of interest rules. These rules are merely the application to public servants of a broad principle of equity requiring all fiduciaries to act in scrupulous good faith and candor for the

57. 119 Misc. at 658, 197 N.Y. Supp. at 207.

58. 126 Misc. 622, 214 N.Y. Supp. 264 (Sup. Ct. 1926).

59. See Weiss, supra note 44, at 284, 286.

60. This may be wishful thinking in view of the rigid approach of the court in Clarke v. Town of Russia, 283 N.Y. 272, 28 N.E.2d 833 (1940). See also discussion of Seif v. Long Beach, and Rosasco Creameries v. Cohen, at pp. 36-38 supra.

benefit of those whose affairs are in their care.[61] Applying this equitable principle to the post-contract problem, Judge Dillon concluded:

"If the prohibited or void contract has been executed, the officer interested therein becomes a trustee for the municipality and is bound to account for *any profits* which he derived from the transaction."[62]

Such a solution is the logical as well as equitable procedure. If the interested public servant is allowed an actual cost recovery, to be conversely consistent the municipality or taxpayers should be allowed to recover to the extent of the actual profit received. In each instance both parties would be made whole, with the public servant or his business organization being penalized only to the extent of losing contemplated profit. Granted good faith, the public policy behind the law will not be circumvented by allowing the interested public servant to retain or receive only what he has expended from his own pocket.

III. Actions by Third Parties

The rights of a variety of third parties may depend on the validity of a municipal contract in which a public servant has an interest. The possibilities for actions brought by third parties stemming from invalid contracts are innumerable. Four situations have occurred in New York.

The first of these is presented when one of several interested parties seeks to obtain a division of the resulting profits or otherwise enforce what turns out to be an invalid contract. In such cases the courts generally refuse all relief and leave the parties where it finds them.[63] Thus, in *Woodworth v. Bennett*,[64] where a statute prohibited engineers on state canals from becoming interested in any contract with the canal systems, a partnership to bid for canal work of which a state engineer was a member was deemed illegal and one partner was denied recovery of his share of the profits from a fellow partner.

The second situation, similar to the above, occurs when one of several

61. 1 Abbott, Municipal Corporations § 255 (1905); Lenhoff, The Constructive Trust as a Remedy for Corruption in Public Office, 54 Colum. L. Rev. 214 (1954); Antieau, The Municipality and Its Employees, 14 Det. L. Rev. 171, 173-74 (1951). Antieau states: "A municipal officer or employee occupies a fiduciary relationship to the city. He is accordingly accountable to the municipal corporation for every violation of good faith in dealings with and for the city."

62. 2 Dillon, Municipal Corporations § 773 (5th ed. 1911). (Emphasis added.) Although it is not clear from Rhyne's writings whether he would permit the municipality a complete recovery or only a recoupment of profits, it appears that he, like Judge Dillon, leans toward the latter. Rhyne, The Law of Municipal Contracts 34-35 (1952). An old Canadian case, decided under the common law, takes a similar stand. See Toronto v. Bowes, 4 Grant 489, aff'd, 6 Grant 1, aff'd, 11 Moore 463 (Can. 1854).

63. 2 Dillon, Municipal Corporations § 773 (5th ed. 1911).

64. 43 N.Y. 273 (1870).

interested parties assigns his interest in the proceeds of an invalid contract to a third party, who subsequently sues the other interested parties for the share. This was the situation in *Bell v. Quin*,[65] where a city officer and a contractor were interested in a contract for the supplying of coal to New York City's almshouse in violation of the city charter.[66] The contractor's note to the officer, made for a share of the resulting profits, was indorsed to a third party. Since the note grew out of an invalid transaction, the court denied the third party recovery.[67]

The third class of actions, and the most prevalent, are those brought by disappointed contractors against municipal officials, alleging that the award of a contract by the municipality to another contractor was invalid because of a conflict of interest. In *Matter of Clamp*,[68] the second lowest bidder sought a writ of mandamus directing that the bid of the low bidder, which had been accepted by the city, be rejected for the above reason. In *People ex rel. Crowe v. Peck*,[69] the plaintiff, individually and as partner in a disappointed publishing company, sought a writ of mandamus to compel the supervisors to cancel the designation of an official newspaper, claiming that a supervisor was interested in the paper. And in *Yonkers Bus Inc. v. Maltbie*,[70] after the Suburban Bus Company had obtained a certificate of convenience and necessity from the Public Service Commission to extend its bus lines, the Yonkers Bus Company brought a proceeding to contest the award of such certificate, on the ground that an alderman acting on the award was an officer of the Suburban Bus Company. Under the facts of all three of the above cases[71] the plaintiffs were unsuccessful, but the decisions clearly indicate that, if a prohibited conflict of interest had been present, a remedy would have been available.

The fourth and final variety of cases are those where a third party seeks to enforce a collateral right based upon a contract found to be invalid. In *Clarke v. Town of Russia*,[72] the wife of a town laborer sought workmen's compensation for her husband's death. To be entitled to such an award she was required to show an employee-employer relation be-

65. 2 Sand. (4 N.Y. Super. Ct.) 146 (1848).

66. N.Y. Sess. Laws 1830, c. 122, § 11.

67. This is similar to the rule in the law of negotiable instruments that the illegality of a note making it void is a real defense which rides with the paper and can be set up even against a holder in due course. See Sabine v. Paine, 223 N.Y. 401, 119 N.E. 849 (1918), where a holder in due course was denied recovery on a note void at its inception for usury.

68. 33 Misc. 250, 68 N.Y. Supp. 345 (Sup. Ct. 1900).

69. 88 Misc. 230, 151 N.Y. Supp. 835 (Sup. Ct. 1914).

70. 23 N.Y.S.2d 87 (Sup. Ct. 1940), aff'd, 260 App. Div. 893, 23 N.Y.S.2d 91 (3d Dep't 1940).

71. The facts were assumed in the Yonkers Bus case, which was decided on motion.

72. 283 N.Y. 272, 28 N.E.2d 833 (1940).

tween her hubsand and the town at the time of his fatal injury. The town contested the claim on the ground that the husband was also a justice of the peace and member of the town board, that his employment contract was hence void because of a conflict of interest, and that as a result no employee-employer relation existed on which the widow could base her claim for a compensation award. The court held for the town, denying the widow her $4.16 weekly award.

From the above it can be seen that the problems presented by third party actions are so diversified that it is no wonder they remain free of statutory supervision. With the exception of actions brought by disappointed contractors to set aside tainted transactions, third party situations do not lend themselves to legislative codification. At common law in New York, disappointed contractors have been given a remedy; California, by statute, has permitted not only contractors but also the entire general public to set aside contracts invalid because of a conflict of interest.[73] This statute gives the public greater protection against the possible corruption of public servants by placing a right of action in more hands and in the lawbooks for all to see. New York would do well to adopt a similar provision.

Where an interested party or his assignee seeks a division of the proceeds from an invalid transaction, however, the question is more complex. Equitable bias toward the innocent third party is mitigated by the realization that New York courts, in analogous situations,[74] have acted as though there were little equity in the law.[75] Professor Corbin to the contrary,[76] New York has been rigid in denying relief to third parties, even when the relief sought is the enforcement of an entirely collateral right.

Where a third party assignee sues a second interested party, a balancing-of-the-equities approach, with the scales tipped in favor of the innocent assignee, would be consistent with the standards advocated in Parts I and II.[77] There is even less reason for denying an innocent third party relief when he seeks to enforce a collateral right. The conflicts of interest rules are to prevent self-dealing, and it is hard to see how the likelihood of self-dealing would have been increased had Mrs. Jay Clarke been granted compensation. Where interested parties are suing each other, Professor Corbin's test would serve well.

Such an approach, it must be emphasized, would *not* be in accord with

73. Cal. Gov't, Code Ann. § 1092 (West 1956).

74. See pp. 43-44 supra.

75. Cf. Stevens, A Plea for the Extension of Equitable Principles and Remedies, 41 Corn. L.Q. 351 (1956).

76. See note 4 supra.

77. See pp. 32-42 supra.

the substantial weight of New York case law. It is hoped, nevertheless, that New York courts will adopt such a case-by-case standard when next presented with the problem, since effective legislation in this area is not envisaged.

IV. State Aid

While many parties are affected by illegal contracts, one party often producing an effect is the State of New York.[78] This stems from the position of the State Comptroller, taken in 1943, of refusing to audit a municipality's claim for state aid which is based on an expenditure made by the municipality under a contract in which a public servant has a disqualifying interest.[79] In the absence of a clearcut constitutional or statutory provision expressly authorizing such action,[80] it would seem that the Comptroller would be on firmer ground to deny state aid only to the extent of the profit made by the interested public servant. The current position, as shown by the introductory illustration of the airport commissioner who buried welfare recipients, can often produce extreme hardship.

Such a contract would be illegal under the broad blanket-coverage provisions of section 3 of the General City Law. If the city completely paid the funeral director's bill, which it well might since no actual conflict of interest is present and hence the parties might not realize that the transaction was bad, it presumably would be unable to secure complete restitution from the man.[81] Yet the state would deny all aid. Thus the city would be unexpectedly forced to stand the entire cost of burying the welfare recipients, which, in the last analysis, would mean that the city taxpayers would be taxed again locally for the same services, with the state in effect pocketing the initial levy. In many cities, and in other smaller municipalities, this would represent a substantial burden on the taxpayers, especially if the payments to the funeral director had gone unnoticed for several years. This is a remarkable paradox, as the conflicts of interest rules were designed with the thought of protecting these very taxpayers.[82]

78. One of the effects, not within the scope of this article, is the penal prosecutions under § 1868 of the N.Y. Pen. Law.

79. 1 N.Y. Ops. State Compt. 340 (1945); 4 N.Y. Ops. State Compt. 471 (1948); N.Y. Ops. Att'y Gen. 182, 183 (1943); N.Y. Ops. Att'y Gen. 144 (1944); N.Y. Ops. Att'y Gen. 168 (1944).

80. Cf. N.Y. Const. art. V, § 1; N.Y. State Fin. Law §§ 8(7), 54-a; N.Y. Soc. Welfare Law § 160(3); N.Y. Educ. Law § 273 (10).

81. See pp. 40-42 supra. Even if the city were held to have a right to full restitution, a statute of limitations might have run or the public servant might be judgment proof.

82. Of course, the same taxpayers are state taxpayers whom the Comptroller is required to protect. This Peter-Paul argument is relatively weak, though, since the city taxpayers would pay far more in additional local taxes than they would save from a theoretical reduction in their state taxes.

If, however, the Comptroller would deny state aid only to the extent of its proportionate share of the profit actually received by the funeral director, the state and its taxpayers could not conceivably be paying for local wrong-doing. The latter is the major argument advanced by those who now support the total withholding of state aid, and it is negated if the city is allowed reimbursement for only actual cost. The city, in turn, would not be penalized since it would receive a substantial portion of the state aid it was planning upon, and thus the purpose behind state aid would be fulfilled. Since the city might well recover the profit made by the airport commissioner, it could conceivably be made whole and its taxpayers escape double local taxation.[83] The funeral director would be penalized to the extent of losing his anticipated profit, and the state would be ahead to the extent of that portion of state aid, its proportionate share of the funeral director's profit, which it would retain.

While it may be argued that until the courts adopt the theory urged in Part II[84] of limiting the municipality's recovery to profits the Comptroller can not do otherwise than withhold the full amount of state aid, such an argument is of the chicken-egg variety. Should the Comptroller adopt the "actual profit" standard in withholding state aid, the New York courts, which have been ambivalent on the point, would undoubtedly utilize the same approach. At the same time, the necessarily painful evolution of case law would be avoided.

V. Conclusion

The ramifications of a municipal contract declared invalid as a result of New York conflicts of interest rules are almost as hard to ascertain as the rules themselves. Statutes are of no help; administrative opinion is confined to the question of state aid; judicial precedent, although relatively plentiful, is either slightly off-point or of uneven depth. While the courts may be moving in the right direction, both the certainty and the symmetry of the law require legislative action.

Equitable principles have historically dominated the conflicts of interest field. As Judge Dillon noted,[85] the municipal servant is a recipient of the public trust, and if he violates that trust, whether intentionally or unintentionally, he should not be allowed to profit at the municipality's expense. Yet he should not be required to suffer severe hardship because of what is all too often an innocent violation of the complex conflicts rules. New York, like most other states,[86] has made no attempt to pro-

83. Except, perhaps, to the extent the state withheld the part of the state aid representing its portion of the profit and the city did not recover the profit.

84. See pp. 41-42 supra.

85. See p. 42 supra.

86. A few states have statutes covering part of the problems presented in this article.

vide a statutory pattern to regulate the consequences of these violations, which are inevitable in municipal life and especially prevalent under New York's harsh and confusing rules. Hence a statute, which would protect the public interest and yet not unduly penalize the interested municipal servant, is urgently needed.

While such a statute would be novel in nature, it should not be hard to formulate, since the groundwork exists at the present time. If the interested public servant has performed in good faith and not been paid, he should be allowed an actual cost recovery. If he has been paid, his municipality should be allowed to recover back to the extent of the actual profit which he has made. The Comptroller, in cases of state aid, should be required to reimburse the municipality to the extent of its proportionate share of the actual cost of the services or materials furnished the municipality. Such a statute, it is believed, would amply protect the public interest and yet eliminate the existing uncertainties and inequities in this unsettled area of New York municipal law.

Pennsylvania and Colorado allow the municipality to recover only the profits made by the interested public servants. Colo. Rev. Stat. Ann. tit. 3, c. 40, art. 19, § 5; Pa. Stat. Ann. tit. 35, § 1548 (1949). Tennessee, however, allows the municipality to recover all it has paid out and at 6% interest! Tenn. Code Ann. § 12-404 (195). Pennsylvania is not consistent, refusing to allow the public servant even an actual cost recovery if he has performed and not been paid. Pa. Stat. Ann. tit. 18, § 4683 (1949).