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able fear that a statute designed to protect only innocent parties will result in unfounded suits forcing these parties to prove their innocence, the legislature in its wisdom may decide that the only way to effectuate its aims is to make the statute cover both the innocent and the guilty.[61] The question of the reasonableness of a statutory means to an end is, in the final analysis, a question of reasonable necessity; of this the legislature is primarily the judge.[62]

In the question of equal protection, as in the question of due process, many of the state courts have usurped the legislative function, and have utilized the fourteenth amendment in this endeavor. No court can invoke the fourteenth amendment to invalidate a legislative policy that it may deem unwise without exercising judicial censorship directed, not at the constitutionality of legislation, but at its wisdom. It is submitted that the decision in *Werner v. Southern Cal. Associated Newspapers,*[63] in upholding the California retraction statute, represents a healthy return to the earlier constitutional principle that the legislature has the power to act against injurious practices so long as their laws do not run afoul of some specific constitutional prohibition. Under this doctrine the fourteenth amendment is not to be so broadly construed that the state legislatures are put in a "strait jacket" when they attempt to suppress conditions which they in their legislative wisdom deem offensive to the public welfare.

THIRD PARTY BENEFICIARIES ON A CONTRACTOR'S SURETY BOND

THE NEW YORK LAW

When an owner of realty employs a contractor to construct a building thereon or, in the case of the state, to build a highway, he will ordinarily require that the contractor furnish a bond. Sometimes, if the owner is a governmental body, a bond may be required by statute. The bond usually will be "conditioned to be void" upon the contractor's faithful performance of the contract (performance bond). An additional bond may be furnished "conditioned to be void" upon payment by the contractor to his subcontractors, materialmen, and laborers (payment bond). It is possible that both conditions may be combined in a single performance-payment bond. The parties to the bond in each case are the principal (contractor), the obligee or promisee (owner), and the obligor or surety (bonding company).[1] Since materialmen, laborers, and subcontractors are not parties to the bond, their rights to sue

attempted commission of crime and . . . having resulted in the perpetration of frauds, it is hereby declared as the public policy of the state that the best interests of the people . . . will be served by the abolition of such remedies." N.Y. Civ. Prac. Act § 61-a.

61. Silver v. Silver, 280 U.S. 117 (1929).

62. Fearon v. Traenor, 272 N.Y. 268, 5 N.E.2d 815 (1936), appeal denied, 301 U.S. 667 (1937).

63. 35 Cal. 2d 121, 216 P.2d 825 (1950), appeal dismissed, 340 U.S. 910 (1951).

1. See Restatement, Security § 82, comment a (1941).

upon it depend, at least, upon whether they are intended beneficiaries of the surety's promise to the obligee.[2]

THE LAW PRIOR TO 1920

In 1859, in the familiar case of *Lawrence v. Fox*,[3] the New York Court of Appeals affirmed the general right of a third party to sue upon a contract made for his benefit. Ten years later, in *Turk v. Ridge*,[4] the court was called upon to decide a suit involving the rights of a third party on a surety bond. It was held that a surety bond, conditioned to be void on the payment by the principal of a debt owed by the obligee, was for the benefit of the obligee only. A third party, the obligee's creditor, who was named in the bond, was not permitted to recover upon it on the ground that there had to be an express promise (not merely a condition) in the bond to pay the third party.[5] "The decision was rendered at a time when the New York court was in a temporary period of reaction against the decision in *Lawrence v. Fox*."[6]

Thereafter, in *Vrooman v. Turner*,[7] the class of third parties who could sue on contracts made for their benefit was, with certain exceptions, limited to creditor beneficiaries. The plaintiff had to show that the promisee was under some obligation to him (the plaintiff) when the contract was made, and that the performance of the contract was intended to discharge this obligation. It is true that there remained, as exceptions to the general rule, a right of action in favor of a donee beneficiary who could establish a close family relationship with the promisee[8] and in favor of a citizen of a municipality who could show that the municipality's contract with the defendant promisor was intended to protect the inhabitants individually.[9] Manifestly, however, unpaid laborers and materialmen did not fall within these narrow exceptions. Moreover, they were not usually creditors of the owner-promisee when the bond was given, before the actual construction work had begun. Even the subsequent accrual of a lien on materials in favor of these third parties did not change their status as donee beneficiaries.[10] Since, as a result of *Vrooman v. Turner*, the

2. Daniel-Morris Co. v. Glens Falls Indemnity Co., 283 App. Div. 504, 506, 128 N.Y.S.2d 760, 762 (1st Dep't 1954), aff'd, 308 N.Y. 464, 126 N.E.2d 750 (1955); accord, Skinner Bros. Mfg. Co. v. Shevlin Engineering Co., 231 App. Div. 656, 248 N.Y. Supp. 380 (1st Dep't), aff'd, 257 N.Y. 562, 178 N.E. 795 (1931); Restatement, Security § 165 (1941).

3. 20 N.Y. 268 (1859).

4. 41 N.Y. 201 (1869).

5. See also Simson v. Brown, 68 N.Y. 355 (1877); cf. Merrill v. Green, 55 N.Y. 270 (1873).

6. 4 Corbin, Contracts § 800 n.16 (1951).

7. 69 N.Y. 280 (1877).

8. Buchanan v. Tilden, 158 N.Y. 109, 52 N.E. 722 (1899) (wife-husband); Todd v. Weber, 95 N.Y. 181 (1884) (child-parent).

9. Pond v. New Rochelle Water Co., 183 N.Y. 330, 76 N.E. 211 (1906).

10. See Restatement, Contracts § 133, illustration 4 (1932); 2 Williston, Contracts § 372 (rev. ed. 1936). It has been suggested that the definition of creditor beneficiary should be broadened to include third persons who have the power to subject the promisee's property to a lien. 4 Corbin, Contracts § 802 (1951).

courts refused to recognize even an express promise in a bond to pay a third party donee beneficiary, unpaid laborers and materialmen were left without a cause of action on the contractor's bond.[11] This rule was almost immediately modified, however, to permit laborers and materialmen, even as donee beneficiaries, to recover on a surety bond where a statute, pursuant to which the bond was given, so provided.[12] Such remained the state of the law until 1920.

THE STATUS OF DONEE BENEFICIARIES AFTER 1920

In 1920, the New York Court of Appeals decided *Fosmire v. National Surety Co.*[13] The facts and holding of the case are discussed below. What is of immediate interest is the court's dictum to the effect that once there is revealed an intention to give to third parties the right to sue on a bond, "there is no legal obstacle in the way of its enforcement."[14] In support of this proposition, the court cited *Seaver v. Ransom,*[15] a case which indicated that New York was ready to recognize the right of a donee beneficiary to sue on a contract made for his intended benefit.

After the *Fosmire* and *Seaver* decisions, the trend of the lower court decisions was to allow recovery on a surety bond to a donee beneficiary if there was an express provision in the bond permitting such a recovery.[16] However, the court of appeals did not squarely meet the problem again until *McClare v. Massachusetts Bonding and Ins. Co.*[17] Although this case was decided on an estoppel theory, the climate of the opinion favored donee beneficiaries. "But for this [estoppel], the instant case would be a precedent in New York to sustain the right of a donee beneficiary on a contract made in his favor."[18]

The next and latest court of appeals case allowing recovery to a third party on a contractor's surety bond failed even to discuss the plaintiff's status as a

11. See Buffalo Cement Co. v. McNaughten, 90 Hun 74, 35 N.Y. Supp. 453 (N.Y. Sup. Ct., Gen. T. 1895); cf. French v. Vix, 143 N.Y. 90, 37 N.E. 612 (1894).

12. Wilson v. Whitmore, 92 Hun 466, 36 N.Y. Supp. 550 (N.Y. Sup. Ct., Gen. T. 1895), aff'd mem., 157 N.Y. 693, 51 N.E. 1094 (1898); accord, Eastern Steel Co. v. Globe Indemnity Co., 185 App. Div. 695, 174 N.Y. Supp. 98 (1st Dep't), aff'd mem., 227 N.Y. 586, 125 N.E. 917 (1919); Lyth v. Hingston, 14 App. Div. 11, 43 N.Y. Supp. 653 (4th Dep't 1897).

13. 229 N.Y. 44, 127 N.E. 472 (1920).

14. Id. at 48, 127 N.E. at 473 (dictum).

15. 224 N.Y. 233, 120 N.E. 639 (1918).

16. See Graybar Elec. Co. v. Seaboard Surety Co., 157 Misc. 275, 283 N.Y. Supp. 522 (Sup. Ct., App. T. 1935); International Time Recording Co. v. Southern Surety Co., 142 Misc. 501, 254 N.Y. Supp. 668 (Sup. Ct., App. T. 1932); Butts v. Randall, 145 Misc. 708, 230 N.Y. Supp. 713 (Sup. Ct. 1932); Maltby & Sons Co. v. Wade, 131 Misc. 143, 227 N.Y. Supp. 9 (Sup. Ct. 1928); Newark Concrete Pipe Co. v. National Surety Co., 131 Misc. 718, 228 N.Y. Supp. 569 (N.Y. City Ct. 1928); Knickerbocker Slate Corp. v. Union Indemnity Co., 141 Misc. 919, 253 N.Y. Supp. 569 (N.Y. Munic. Ct. 1931). But cf. Adirondack Core and Plug Co. v. New York Cent. R.R., 238 App. Div. 346, 264 N.Y. Supp. 484 (4th Dep't 1933), aff'd mem., 264 N.Y. 439, 191 N.E. 503 (1934); Rockaway Sash & Door Co. v. Soman, 146 Misc. 327, 261 N.Y. Supp. 106 (Sup. Ct. 1932).

17. 266 N.Y. 371, 195 N.E. 15 (1935).

18. 12 N.Y.U.L.Q. Rev. 668, 669 (1935).

donee beneficiary.[19] As a result, elaborate analysis of whether the plaintiff is in the position of a donee or creditor beneficiary "has become largely a waste of time."[20] As one court has observed, "after *Seaver v. Ransom* . . . there is little doubt that the essential requirement of the relationship is the *intent* of the contracting parties. To permit a third party beneficiary to enforce a contract against the promisor, it appears only necessary that the intention of the contracting parties was clearly to benefit the third party. Such a third party is, indeed, a donee beneficiary. . . ."[21]

In searching for the intent of the contracting parties in surety bond cases, different questions, deserving separate consideration, are presented when the payment bond is joined with a performance bond, and when it is separate therefrom. The joint performance-payment bond will be considered first.

Joint Performance-Payment Bonds

The case of *Fosmire v. National Surety Co.*, to which reference has already been made, brought squarely into focus the question of the intention of the contracting parties to benefit laborers and materialmen on a joint performance-payment bond. In this case, a contractor agreed to construct a highway for the State of New York. A statute required the contractor to furnish a performance bond[22] but the bond, which was ultimately furnished, was conditioned to be void not only upon the principal's faithful performance of the contract, but also upon his payment of the wages of his laborers. When one of the unpaid laborers brought suit upon the bond, the court observed that to allow recovery might so deplete the bond as to leave the state unprotected against possible nonperformance by the contractor. As a result, it was held that an intent to benefit third parties was inconsistent with the dominant purpose of the bond, namely the protection of the promisee.

The *Fosmire* holding seems to favor a presumption that a performance-payment bond is not intended to inure to the benefit of third parties, payment of whom is one of the conditions of the bond, but rather that it is intended to protect the obligee only. This presumption is of course rebutted where there is an express stipulation in the bond that it is to be applied for the benefit of laborers and materialmen,[23] or where the bond is given pursuant to a statute

19. Daniel-Morris Co. v. Glens Falls Indemnity Co., 308 N.Y. 464, 126 N.E.2d 750 (1955).

20. Simpson, Contracts (Annual Survey of the American Law) 31 N.Y.U.L. Rev. 471, 474 (1956).

21. Ronzo v. Vernon Industries, Inc., 195 Misc. 873, 874, 91 N.Y.S.2d 52, 54 (Sup. Ct. 1949). (Emphasis added.)

22. N.Y. H'way Law § 38(7) which provides, "Unless a bond be dispensed with as hereinafter provided, each contractor, before entering into a contract for such construction or improvement, shall execute a bond . . . conditioned that he will perform the work in accordance with the terms of the contract, and with the plans and specifications, that he will commence the work within the time prescribed in the contract. . . ."

23. See Graybar Elec. Co. v. Seaboard Surety Co., 157 Misc. 275, 283 N.Y. Supp. 522 (Sup. Ct., App. T. 1935); Newark Concrete Pipe Co. v. National Surety Co., 131 Misc. 718, 228 N.Y. Supp. 569 (N.Y. City Ct. 1928).

which requires such a bond, and which permits suits by third parties thereon.[24] Even here, however, the third party is obliged to show that the obligee has received substantial performance[25] or that the bond is sufficient to cover both the plaintiff's and the obligee's claims.[26]

Thus, the New York rule is that where

> neither the performance-payment bond nor the statute, if any, pursuant to which it is exacted, contains any language clearly indicative of an intention on the part of the obligee to benefit the laborer and the materialman . . . the beneficiary has in his own right no cause of action on the bond.[27]

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24. See E. J. Eddy Inc. v. Fidelity and Deposit Co., 265 N.Y. 276, 192 N.E. 410 (1934); Merchants Mut. Cas. Co. v. United States Fidelity and Guaranty Co., 253 App. Div. 151, 2 N.Y.S.2d 370 (4th Dep't 1938); Samson Elec. Co. v. Buffalo Elec. Co., 234 App. Div. 521, 256 N.Y. Supp. 219 (4th Dep't 1932).

25. E. J. Eddy Inc. v. Fidelity and Deposit Co., supra note 24.

26. See Merchants Mut. Cas. Co. v. United States Fidelity and Guaranty Co., 253 App. Div. 151, 2 N.Y.S.2d 370 (4th Dep't 1938), wherein the court carefully noted at the beginning of its opinion that the bond was more than sufficient to cover the city's interest.

The case of Strong v. American Fence Constr. Co., 245 N.Y. 48, 156 N.E. 90 (1927), has been cited for the proposition that where a statute requires the bond, the Fosmire rule does not apply. See 2 Williston, Contracts § 372 n.5 (rev. ed. 1936). The implication seems to be that third parties then have an absolute right of recovery. But the Strong case involved a federal statute which, as the Supreme Court had already determined, gave a third party the right to sue on a bond given pursuant thereto. See Mankin v. United States for the Use of Ludowic:-Celadon Co., 215 U.S. 533 (1910). Actually, in the Strong case, the defendant general contractor had failed to furnish the bond required by statute. The plaintiff, an unpaid materialman of a subcontractor, sued the general contractor, claiming to be a third party beneficiary of the defendant's promise to furnish the bond. The Court decided in effect that the defendant's liability was coextensive with what would have been the liability of the surety had the bond actually been furnished. It is submitted that had not the Supreme Court already determined the surety's liability, the outcome might have been different.

The federal statute involved in the Strong case was the Hurd Act, 28 Stat. 278, 40 U.S.C. § 270 (1894). It was repealed in 1935, and the present § 270a was enacted. 49 Stat. 793, 40 U.S.C. 270a (1952). It provides for separate payment and performance bonds. For a discussion of the federal law on the question of third party rights on surety bonds, see Cushman, Surety Bonds on Federal Construction Contracts: Current Decisions Reviewed, 25 Fordham L. Rev. 241 (1956).

27. Leg. Doc. No. 65(L), Report N.Y. Law Rev. Comm'n 461 (1945). In United States ex rel. Matthews v. Massachusetts Bonding and Ins. Co., 207 App. Div. 619, 202 N.Y. Supp. 867 (2d Dep't 1924), the appellate division allowed a third party to recover on a performance bond where the danger of loss to the promisee was so remote as to indicate that the real intent of the parties to the bond was to protect third parties. The case was, however, reversed on other grounds in the court of appeals. 238 N.Y. 334, 144 N.E. 631 (1924). One court commented on the case as follows, "The rule in New York holds the liability strictly . . . and yet the Appellate Division . . . allowed an owner to recover upon this very bond. While this judgment was reversed for errors in the conduct of the trial, the Court of Appeals . . . said . . . that 'the bonding company would be liable at least upon the record in this case.' How far this was intended as a deliberate holding . . . may indeed be doubted. . . . " United States ex rel. Brimberg Bros. Inc. v. Globe Indemnity Co., 26 F.2d

However, it may be that the *obligee* has a cause of action on behalf of the laborers and materialmen.

THE TRUST DOCTRINE AS APPLIED TO PERFORMANCE-PAYMENT BONDS

The *Fosmire* court deliberately left unanswered the question of "what defendant's [surety's] liability [to a third party] would be if the action were prosecuted by the people [the obligee]. . . . "[28] The question, thus reserved, came up for decision in *Johnson Serv. Co. v. E. H. Monin Co.*[29] In this case, the owner (Board of Education) exacted from the contractor a bond, conditioned among other things, upon the latter's payment for all materials used and services rendered in connection with the work. The contractor defaulted and the Board of Education was made a party in an action to foreclose a mechanics lien, whereupon it *voluntarily* joined in the prayer that the surety be made to pay according to its contract. The court allowed the suit and held that the Board of Education received the proceeds of its suit on the bond in trust for the plaintiff-materialman. It must be noted, however, that the third party is without remedy in such a case unless the obligee elects to bring an action for his benefit or at any rate, if made a defendant, elects to join in the beneficiary's prayer for judgment against the obligor.[30] Moreover, the beneficiary, himself, should the obligee be unwilling to pursue the suit, may not maintain a representative action against the surety and the obligee for judgment in favor of the obligee and for the imposition of a trust on the proceeds.[31] Thus the *Johnson* case, while it alleviates the harshness of the *Fosmire* rule, places the third party at the mercy of the obligee. Should the latter arbitrarily decide not to proceed against the surety, the third party is without remedy on the bond. Essentially, therefore, the *Fosmire* rule remains the law governing the right of laborers and materialmen to recover on a performance-payment bond.

SEPARATE PAYMENT BONDS

Intent to Benefit Third Parties

In the *Fosmire* case, the court had observed, "a different question would be here if the bond had been conditioned for the payment of wages and nothing else,"[32] *i.e.*, if the payment bond had been separate from the performance bond. Under such circumstances, whatever recourse a third party would have to the payment bond would in no way interfere with or prejudice the rights of the promisee to indemnification for nonperformance. Hence, where the promisee

191, 192 (2d Cir. 1928). The "doubtful holding" in the Matthews case should not be considered significant, especially in view of the continued adherence of the New York courts to the Fosmire rule. See, e.g., J. P. Duffy Co. v. Board of Educ., 280 N.Y. 773, 21 N.E.2d 527 (1939); Daniel-Morris Co. v. Glens Falls Indemnity Co., 308 N.Y. 464, 126 N.E.2d 750 (1955) (dictum).

28. 229 N.Y. at 49, 127 N.E. at 473.

29. 253 N.Y. 417, 171 N.E. 692 (1930).

30. Leg. Doc. No. 65(L), Report N.Y. Law Rev. Comm'n 463 (1945).

31. William S. Van Clief & Sons Inc. v. City of New York, 141 Misc. 216, 252 N.Y. Supp. 402 (Sup. Ct. 1931). See Note, 31 Colum. L. Rev. 1365 (1931).

32. 229 N.Y. at 48, 127 N.E. at 473.

exacts a separate payment bond, must not his intent necessarily be to benefit third parties? Certainly, such an argument has validity, and third parties will recover, where a statute, pursuant to which the bond is given, provides for a right of action for laborers and materialmen,[33] or where the bond itself contains an express provision that it is for the benefit of third parties.[34] However, in the absence of such a statute or stipulation in the bond, several other questions arise. For instance, was not the promisee's intent in exacting the payment bond actually to protect himself against mechanics' liens which might accrue in favor of unpaid laborers and materialmen?[35] And, if such were the promisee's intent, could he really have meant to benefit, other than incidentally, these third parties? The answer to these questions lies in the relatively recent case of *Daniel-Morris Co. v. Glens Falls Indemnity Co.*[36]

Lien Creditors as Intended Beneficiaries of a Payment Bond

In the *Daniel-Morris* case, a general contractor had sublet certain work to a subcontractor on condition that the latter furnish materials and labor "free of the lien of any third party" and "indemnify and save harmless the contractor, the owners . . . against loss damages or expense," to secure which the subcontractor agreed to furnish a twenty per cent payment bond and a twenty per cent performance bond, the premiums on both bonds to be paid by the general contractor. The payment bond was conditioned that "if the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract . . . then this obligation is to be void. . . . " The subcontractor defaulted, and his materialman sued on the bond.

The question was solely one of intent. The trial court ruled that the plaintiff had no right to sue as a third party beneficiary under the payment bond for the reason that it was given for the sole benefit of the general contractor, to protect against "the risk of mechanics' liens, retaking of material delivered

33. See Chittenden Lumber Co. v. Silberblatt & Lasker, Inc., 288 N.Y. 396, 43 N.E.2d 459 (1942) (involving N.Y. State Fin. Law § 137). The plaintiff must be careful to comply with the provisions of the statute upon which he relies. See Triple Cities Constr. Co. v. Dan-Bar Contracting Co., 309 N.Y. 665, 128 N.E.2d 318 (1955), where the plaintiff's complaint was dismissed because he had failed to file a notice of lien pursuant to N.Y. State Fin. Law § 137.

34. See cases cited note 16 supra. Many of these cases concern performance-payment bonds. However, where the intent to benefit third parties is expressed in the bond, this intent should govern, whether the bond is of the performance-payment or separate payment type.

35. "A contractor, subcontractor, laborer, material man, who performs labor or furnishes materials for the improvement of real property . . . shall have a lien for the principal and interest, of the value, or the agreed price, of such labor or materials upon the real property improved. . . ." N.Y. Lien Law § 3.

"If labor is performed for, or materials furnished to, a contractor or subcontractor for an improvement, the lien shall not be for a sum greater than the sum earned and unpaid on the contract at the time of filing the notice of lien, and any sum subsequently earned thereon." N.Y. Lien Law § 4.

36. 308 N.Y. 464, 126 N.E.2d 750 (1955).

to the site, and related litigation by the materialmen."[37] Having once established the promisee's motive for exacting the bond, the court held, "in the light of the authorities in this state we may not go further."[38]

The appellate division went further, and found that "the bond was obtained by the general contractor primarily for its own protection, but we think that this supplies the motive in securing the undertaking rather than the intent as to who shall be benefited."[39] In other words, the *intent* of the promisee was that the bond should be available to laborers and materialmen; the motive of the promisee in formulating this intent was self-protection against lienors. The court of appeals concurred in the distinction between motive and intent, and found that "the inference is irresistible that the parties intended to benefit unpaid materialmen."[40]

The distinction was by no means clear to the dissenting justice in the appellate division. He thought that, "motive often illuminates intent, and I believe that in this case an intent to benefit itself must be spelled out of the general contractor's conceded desire to protect itself. . . . "[41] The position of the dissent evidently results from a belief that the requisite "intent to benefit" must be a benevolent intent, born of altruistic motives. The basic premise is unrealistic. The intent to benefit, except where the promisee is making a gift to the beneficiary, will nearly always be motivated by the promisee's self-interest.[42] After all, were Holly's motives entirely unselfish when he instructed Fox to pay Lawrence?

A positive test of intent to benefit, which implicitly recognizes the distinction between motive and intent, has been proposed by Professor Simpson. "If by the terms of the promise for which the promisee bargained the promisor is to render a performance directly to the third party, in nearly every case the third party who is to receive performance will be the person intended by the promisee to be benfited thereby."[43] Where the bond does not expressly state that performance is to be rendered directly to the beneficiary, the *Daniel-Morris* case nevertheless raises a presumption in his favor. Such a presumption is in accord with the current of authority that "the contract of a compensated surety is to be interpreted liberally in the interest of the promisee and beneficiaries, rather than strictly in favor of the surety."[44]

Under the proposed test, not every beneficiary would recover on the bond.

> [I]f by the promise the promisor is to render his performance to the promisee, the contract is for the benefit alone of the parties thereto; and any third party who along with the promisee might derive benefit from the performance is an incidental beneficiary not entitled to sue.[45]

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37. 101 N.Y.S.2d 535, 537 (Sup. Ct. 1950).
38. Ibid.
39. 283 App. Div. 504, 507, 128 N.Y.S.2d 760, 763 (1st Dep't 1954).
40. 308 N.Y. at 468-69, 126 N.E.2d at 752.
41. 283 App. Div. at 511, 128 N.Y.S.2d at 766 (dissenting opinion).
42. See the detailed discussion of intent to benefit in Corbin, Third Parties as Beneficiaries of Contractor's Surety Bonds, 28 Yale L.J. 1, 3-8 (1928).
43. Simpson, Contracts § 82 (1954).
44. 4 Corbin, Contracts § 800 (1951).
45. Simpson, Contracts § 82 (1954).

Thus, in *McGrath v. American Surety Co.*,[46] a contractor was required by federal statute to furnish separate payment and performance bonds. The same statute imposed personal liability upon the contractor for claims of unpaid laborers and materialmen. To mitigate the risk of this liability, the contractor, in turn, required his subcontractor to furnish separate performance and payment bonds. When an unpaid materialman of the subcontractor sued on this last bond, the court held that since the plaintiff was adequately protected by the contractor's statutory payment bond, he must not have been the intended beneficiary of the subcontractor's payment bond. Rather, this bond was intended solely to protect the contractor against his statutory liability to unpaid materialmen.

The *McGrath* case has been criticized as creating a circuity of action. In other words, "if the plaintiff had sued the prime contractor and his surety first, they would have had a remedy over against the subcontractor and his surety (the defendant) for exoneration and indemnity,"[47] so that the ultimate outcome would be the same as if recovery were allowed directly against the subcontractor's surety. But the very circuity of the proceedings emphasizes that the plaintiff was merely an incidental beneficiary of the subcontractor's bond, and also militates against a presumption that the surety's performance was to be rendered directly to the plaintiff. Under these circumstances, the plaintiff had no rights on the subcontractor's bond.

The *McGrath* rule is in accord with the holding in the *Daniel-Morris* case. This latter decision remains the basis for recovery in New York by a laborer or materialman on a separate payment bond.[48]

Public vs. Private Payment Bonds

As a corollary to the confusion between intent and motive, some jurisdictions have acknowledged the rights of laborers and materialmen on a payment bond exacted by a public corporation while denying such rights on a payment bond exacted by a private owner.[49] The rationalization for the distinction is that since no lien accrues in favor of third parties against the promisee-public corporation, the only reason for exacting the payment bond is to compensate these third parties for the lack of lien protection; but on the other hand, when a private owner exacts a payment bond, it is for his own protection against lienors, and not for the protection of third parties.[50] Of course this latter assumption falls into the error of the appellate division dissent in the *Daniel-Morris* case. But the fundamental fallacy is to be found in the very distinction between public and private bonds. To ascribe to the public corporation wholly unselfish motives in exacting the payment bond, is to ignore commercial realities. The possibility of a lien may be only one of the *motives* for exacting

46. 307 N.Y. 552, 122 N.E.2d 1906 (1954).

47. 4 Corbin, Contracts § 799 (Supp. 1957).

48. See, e.g., W. A. Case & Son Mfg. Co. v. H. K. Ferguson & Co., 155 N.Y.S.2d 652 (Sup. Ct. 1956); Neill Supply Co. v. Fidelity and Deposit Co., 152 N.Y.S.2d 157 (Sup. Ct. 1956).

49. See Annot. 77 A.L.R. 21 (1932); 118 A.L.R. 57 (1939).

50. See Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 125 So. 55 (1929).

a payment bond. There are other motives, common both to a private party and to a governmental unit. First, the reduction in expense for credit investigation and bad debt losses, not only making it possible for the subcontractor or materialman to charge a lower price, but also inducing competition by subcontractors and materialmen who might not otherwise wish to compete with a consequent lower bid by the contractor. Second, the assurance of steady progress of the work in case of default by the contractor, since unpaid laborers and materialmen can look to the bond for compensation. Third, the avoidance of the annoyance and risk of withholding payments to the contractor in favor of unpaid laborers and materialmen should the contractor default.[51] Even without the possibility of a lien, these commercial advantages seem motive enough for the owner to insist on a payment bond from the contractor.

Fortunately, the distinction between public and private bonds does not seem to have prevailed in New York. Furthermore, any future tendency to make the distinction should be discouraged by the *Daniel-Morris* decision. Selfish motive no longer excludes intent to benefit.

CONCLUSION

The *Fosmire* and *Daniel-Morris* decisions—the basic New York cases controlling the rights of laborers and materialmen on the contractor's surety bond—represent contrasting attitudes on the part of the court of appeals. While the effect of the *Daniel-Morris* case was to create a presumption in favor of the rights of third parties on a separate payment bond, the effect of the *Fosmire* case was to create a presumption against the rights of third parties on a joint performance-payment bond. Yet the difference in the function of the two types of bonds fails to justify this difference in attitude. It is submitted that the *Fosmire* rule thwarts the intention of the contracting parties.

Implicit in the *Fosmire* court's recognition that the *dominant* purpose of a performance-payment bond is the protection of the promisee against possible nonperformance, is the recognition of the *subservient* purpose of protecting laborers and materialmen against possible nonpayment. In other words, the contracting parties intend that these third parties shall have the benefit of the bond provided the promisee remains adequately protected. Protecting the promisee's interests in a suit by the beneficiary on the bond would be relatively simple. The beneficiary would merely be obliged to make the promisee a party defendant to the action and to allege either that the promisee has no claim or that a balance of the penal sum of the bond will remain after satisfaction of the promisee's claim, if any.[52] Both the dominant and subservient purposes of the bond would be given effect by this procedure, and the rights of all parties would be protected with proper regard for priority.

Unfortunately, the chances for the adoption by the courts of any procedure which will modify the *Fosmire* rule are at best uncertain. Even the *Daniel-Morris* court, which so favored the rights of third parties, gave at least lip service to the *Fosmire* rule.

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51. Leg. Doc. No. 65(L), Report, N.Y. Law Rev. Comm'n 450 (1945).
52. Id. at 468; see Restatement, Security § 167 (1941).