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Victor Levine
University of Syracuse College of Law

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WHEN a buyer seeks to purchase goods on credit, the seller often refuses to make the sale unless the buyer procures some third person to become liable for the price; and the seller also exacts the privilege of suing either the buyer or the third person or both in the event that payment is not made on the date the price falls due. In a three-party transaction of this sort, the buyer, after the goods are delivered, is commonly called the principal, the seller the creditor, and the third person the surety.

Dean Arant has recently subjected to analysis the right of the surety to use defensively two types of claims which the buyer-principal may have against the seller-creditor.[1] The first type is a claim for damages based on the fact that the quality of the goods does not measure up to the warranty under which they were sold, and the second type is a debt or offset which the seller owes to the buyer on an independent transaction between themselves in which the surety played no part. Dean Arant has taken the position that the breach of warranty should discharge the surety from all liability for the price, though the buyer has decided to keep the goods notwithstanding their inferior quality. Dean Arant has also contended that the offset which the buyer has against the seller should be handled as if it were a payment made by the buyer to the seller and, hence, that the surety, sued alone, should be allowed to use this offset in reduction of the seller's claim.

An attempt will be made here to show that the breach of warranty ought not to work a complete release of the surety in those cases in which the seller was unaware before delivery that the goods did not conform to the warranty; and that the buyer's offset ought not to be allowed to the surety unless the buyer is brought in as a party to the action.

* Professor of Law, University of Syracuse College of Law. Subjects—Sales, Personal Property, Civil Procedure, New York Practice. A.B., LL.B., Harvard. Formerly Special Assistant to the United States Attorney General.

[1] 29 MICH. L. REV. 135 (Dec. 1930). This article has since been incorporated into a text by the same author. ARANT, SURETYSHIP, pt. 2, ch. 2, sec. 60.

I

CREDITOR'S BREACH OF WARRANTY AS COMPLETE DEFENSE TO SURETY

To avoid confusion, it is important to note at the threshold of our discussion that a breach of warranty gives the buyer who has received the goods a choice of remedies. One permits him to rescind the sale and to return or offer to return the goods, thereby relieving himself of all liability for the price.[2] When the buyer elects this remedy, it is easy to relieve the surety too. The seller can regain the goods, and his sole loss is the profit he might have made on his sales contract.

The buyer, however, has another remedy. He may keep the goods, and by so doing he remains liable for the price; but he has the right to counterclaim for the damage caused by the breach of warranty or to sue the seller therefor in a separate action.[3] This damage is, in the more common cases, the difference between the value of the goods had they been as warranted and their value as delivered.[4] To illustrate, we may assume the price of the goods to be $1,000; their worth had they been as warranted, $1,100; and their value as delivered, $900. The damage to the buyer would be the difference between $1,100 and $900, or $200, and the net practical result, whether the buyer counterclaims or brings a separate action, is that because of the breach of warranty the buyer's obligation to pay is reduced from $1,000 to $800. But this obligation is unsecured except for the presence of the surety. The seller has no right to retake the goods if the buyer fails to pay for them.[5] Therefore, should the buyer become totally insolvent, the only source from which the seller might obtain even the reduced price of $800 is the surety. By releasing him, the seller will have neither goods nor money.

When the buyer elects to keep the goods, the surety should, of course, be supplied with some remedy whereby his obligation, also, may be pared down to $800.[6] Dean Arant, however, is contending that the courts should give the surety more than the $200 reduction. An acquittance in full is advocated. He argues:[7]

[2] 2 WILLISTON, SALES, 2d ed., secs. 608-610 (1924).
[3] 2 WILLISTON, SALES, 2d ed., sec. 607 (1924).
[3] 2 WILLISTON, SALES, 2d ed., sec. 607 (1924).
[4] 2 WILLISTON, SALES, 2d ed., sec. 613 (1924).
[5] 2 WILLISTON, SALES, 2d ed., secs. 511 *et seq.* (1924).
[6] 2 WILLISTON, CONTRACTS, sec. 1251 (1920).
[7] 29 MICH. L. REV. at 137, 138, 139 (1930). ARANT, SURETYSHIP, n. 1 at 206, 207, 208.

"It is obvious that the creditor's breach of warranty, like his failure to perform a condition precedent, gives the principal a substantial reason not to perform in accordance with his promise and might even make him substantially less able to perform. It would doubtless be generally conceded, too, that none of the parties contemplate that the creditor shall give the principal any such reason not to perform his promise as he gives him when he breaks a warranty. . . . If this reasoning is sound, the creditor's breach of warranty should constitute a complete defense to the surety, because the creditor has produced a risk of non-performance by the principal that could not have been contemplated by the surety when he promised. . . . The degree to which the surety's risk is increased is unmeasurable in terms of money. It is none the less real, however, and, since it is caused by the creditor, the surety should be totally discharged."

In short, the suggestion is that the breach of warranty should be treated like a breach of condition, or like an alteration of the risk without the consent of the surety.

It may be conceded that if the creditor knew, before delivery, that the goods were defective, the case would be on all fours with one in which the buyer and the seller had modified the original agreement by substituting a different commodity at the reduced price of $800. The surety may with some show of propriety be totally discharged in such a case because the seller and the buyer have, as a practical matter, foisted a new contract on him. The risk has been altered.[8]

But it must be remembered that there may be a breach of warranty even though the seller had no knowledge whatsoever of the defects, and though he was not at fault.[9] For example, a jobber of canned goods was held liable for a breach of warranty despite the fact that he delivered to the buyer the precise articles received from the factory and did not know they were defective.[10] The problem, therefore, is whether the seller should lose his rights against the surety because of what may be called his unconscious modification of the contract.[11]

[8] See 2 WILLISTON, CONTRACTS, sec. 1239 *et seq.* (1920).

[9] 1 WILLISTON, SALES, 2d ed., sec. 237 (1924).

[10] J. Aron & Co. v. Sills, 211 App. Div. 21, 206 N. Y. S. 695 (First Dept. 1924), affirmed 240 N. Y. 588, 148 N.E. 717 (1925).

[11] When the value of the goods as delivered equals the balance of the price, and the seller by the terms of the sale has expressly reserved the right to retake the goods if the price is not paid, the release of the surety would be of slight consequence to the seller. He may realize his unpaid price by reselling the goods. Or if the damages

Dean Arant's premise and conclusion, may we repeat,[12] are:[13]

> ". . . [since] it would doubtless be generally conceded that none of the parties contemplate that the seller shall give the buyer such a reason not to perform as he gives him when he breaks a warranty, . . . the creditor's breach of warranty should constitute a complete defense."

This argument, obviously, is based on an unexpressed contemplation of the parties. No such explicit arrangement was made. And there will be no props under the syllogism, unless one accepts as a major premise that the parties would have expressly adopted such a term had their attention been called to the matter.

It is safe to say that in a large number of sales in which the price is guaranteed by a surety,[14] the buyer's financial responsibility is precarious, and the seller gives credit to the buyer relying almost entirely on the liability of the surety. Dean Arant's reasoning comes then to this: that the seller would have agreed to give the buyer credit under a contract which provided definitely that the responsible person, the surety, was to be absolved completely if the goods turned out to be defective, however blameless and ignorant of the defects the seller might be.

One hesitates to agree that this "would doubtless be generally conceded." One is even reluctant to grant that the question might properly be left to a jury. There is difficulty enough, when the variation of a contract is deliberate, to uphold the total discharge of a surety by this reasoning. It is, at best, conjectural whether the seller would have given the buyer credit under a contract expressly calling for the surety's release, despite the retention of the goods by the buyer, if the seller knew of the breach of warranty before delivery. When we go further and take as our hypothesis that the seller would have acquiesced in a term stipulating for the release of the surety upon the occurrence of any *unknown* breach, we come perilously close to the invocation of a fiction. The decisions freeing the surety after a change in a contract is made intentionally have the saving grace, such

resulting from the breach of warranty equal or exceed the unpaid price, the discharge of the surety would not affect the credit risk. The buyer in reality owes nothing. Our problem presents itself when the damages are less than the unpaid price.

[12] See quotation on page 199 supra.

[13] 29 MICH. L. REV. at 137 (1930). ARANT, SURETYSHIP, 206, n. 1.

[14] The difference between a surety and a guarantor (see ARNOLD, SURETYSHIP AND GUARANTY 95 *et seq.*) is of no moment in our discussion, and the terms will be used interchangeably.

as it is, of being based on the fact that the seller is aware of the step he is taking when he modifies voluntarily the buyer's agreement, and that thereby he is violating wittingly the commandment that "thou shalt not tamper with thy principal's contract." To extend the prohibition to include unintentional changes is to be unspeakably harsh on the creditor and to approach making a fetish of the doctrine that the surety's obligation is *strictissimi juris*. And if the surety were one who had received a premium from the creditor for guaranteeing the payment of the principal's debt, a decision releasing the surety would be nothing short of monstrous.[15]

Dean Arant has cited one case in support of his contention. In that case[16] a surety on a lease was being sued for rent by the lessor. The remaining facts and the decision relieving the surety are summed up in a few sentences of the opinion as follows:[17]

> "The lessor covenanted in the lease that he would furnish the hotel in all parts with good and suitable furniture, and put it in good repair by painting it outside and inside, papering, plumbing, and making all other necessary repairs. The defendant pleads a breach of this covenant in defense of the action. The fact that the lessee took possession of the hotel without its being repaired and furnished according to the covenant, and thereby waived the breach of it, did not bind his sureties."

It is evident there was no concealed defect, unknown to the creditor-lessor, which was made the basis of the decision. That the controlling feature was the knowledge of the creditor appears from the excerpt the court took out of an English case in commenting on another change made in the lease without the surety's consent:[18]

> ". . . it is a thoroughly sound and safe principle that, where the act is voluntary and deliberate, the creditor, altering the contract and rendering it impossible that it should be carried out in its original form, should suffer."

Of course, if one looks solely to the alteration of risk factor, or if, arguing in a circle, the rule is stated to be that any alteration releases the surety, there is no logical difference between a known and an

[15] See Arnold, "The Compensated Surety," 26 COL. L. REV. 171 (1926); ARNOLD, SURETYSHIP AND GUARANTY, ch. XII (1927); STEARNS, SURETYSHIP, ch. III (1922).

[16] Stern v. Sawyer, 78 Vt. 5, 61 Atl. 36 (1905).

[17] Stern v. Sawyer, 78 Vt. at p. 15, 61 Atl. at p. 39.

[18] Stern v. Sawyer, 78 Vt. at p. 13, 61 Atl. at p. 39.

unknown variation. A new contract has been thrust upon the surety in both instances. But when it is perceived that the element of knowledge on the part of the creditor has played a leading role in those decisions which have penalized him by releasing the surety, it becomes apparent that the latter's liability should not be reduced below that of the principal's, when the creditor has acted innocently. The surety should not be allowed to go scot-free.

There is an analogous distinction drawn by the authorities that fits snugly over the one we are suggesting. In building construction contracts it sometimes happens that a surety guarantees that the contractor, who is the principal, will perform the work, and the construction contract quite frequently calls for periodical payments to be made by the owner as the work progresses. Some courts have held that when the owner, who is the creditor, makes a premature payment to the contractor, the surety cannot be held on his guaranty for the failure of the contractor to complete the performance of his contract.[19] It is thought that by making the premature payment there has been in effect a modification of the contract, and also an alteration of the risk, since it may well have been that the contractor by virtue of the excess payment has been less disposed to continue with the work. Yet, if the over-payment was the result of forged or mistaken estimates of the work done, and the owner acted innocently, several courts have held that the surety is not discharged.[20]

[19] 2 WILLISTON, CONTRACTS, sec. 1243 (1920).

[20] 2 WILLISTON, CONTRACTS, sec. 1243 (1920). Another analogy can be found in those cases in which a creditor has given up to the principal certain collateral which the creditor had received as security. It is generally held that this discharges the surety to the extent of the value of the surrendered securities; but some courts refuse to discharge the surety if the creditor at the time he released the securities did not know of the relationship between the defendant and the alleged principal debtor. See Arant, "Why Release of Security Discharges a Surety," 14 MINN L. REV. 725 (1930), ARANT, SURETYSHIP, ch. 3 (1931).

A recent application of this distinction was made in Gorenberg v. Hunt, 107 N. J. Eq. 582, 153 Atl. 587 (1931) reviewed in 79 U. OF PA. L. REV. 1151 (1931). In this case the defendant executed a bond secured by a mortgage on his property, and then sold the property subject to the mortgage, the amount of the mortgage being credited on the purchase price. The mortgagee later gave the purchaser a binding extension of time. After the mortgage was foreclosed, there was a deficiency and the mortgagee sought to recover this from the defendant. It appeared that at the time the extension was given, the mortgagee did not know of the arrangement between the defendant and his grantee under which the property had been purchased. The court recognized that by crediting the amount of the mortgage on the purchase price, the land became the primary source from which the mortgage debt was to be paid and that the defendant became a surety. It also recognized that ordinarily a binding extension of time without the consent of the surety discharges him, but it

There appears to be no reason why a like distinction based on the seller's lack of intention to modify the contract should not be made in the breach of warranty cases, and that the creditor's knowledge of the breach before delivery be the *sine qua non* to the surety's discharge.[21]

nevertheless held that because of the mortgagee's lack of knowledge of this when the extension was granted, the defendant remained liable on his bond, at least until there was a showing that the property had depreciated during the interval covered by the extension of time.

In only one place does Dean Arant in his article refer to a seller's wilful breach, and that is in connection with the moral effect this might produce on the buyer. 29 MICH. L. REV. at p. 141 (1930). Some time ago the writer sent Dean Arant a draft of the article which is now before the reader. Subsequently Dean Arant incorporated his article into a text on suretyship (see note 1). In this book, Dean Arant has on p. 206, note 80, added the following which is not in his original article:

> "Throughout this discussion, when the creditor's breach of warranty or failure to perform his promise is mentioned, it will be assumed that the creditor's breach is wilful or substantial. Otherwise stated, it is not contended that mere technical breaches by the creditor should discharge the surety. But the contention is that such breaches as normally would decrease either the principal's inclination or his ability to perform should have this effect."

As so often happens when an author's views are stated in general terms, it is difficult to tell from the foregoing whether Dean Arant would discharge the surety in a case, such as we have assumed, in which the price was $1,000, the warranty damages $200, and the breach unknown before delivery. A breach causing damage of $200 in a $1,000 transaction is certainly substantial. But whether this breach "would decrease either the principal's inclination or his ability to perform" his obligation to pay the reduced price, is a query the answer to which we can only guess at in this case or in the average sales case. For that matter, even when the breach is wilful, we can only surmise that it has varied the risk beyond the amount of the damages recoverable by the buyer.

Of course, if the surety showed or it appeared from the nature of the transaction that the breach had in fact increased the risk beyond this point, there would then be a foundation for discharging him completely. It may perhaps be that Dean Arant is referring to this rare kind of a case. But we doubt that this is so, for he announces his view as a criticism of those decisions which involved the garden variety of case and which have held that the surety may not use the breach of warranty defensively. 29 MICH. L. REV. 135, 136 (1930); ARANT, SURETYSHIP 204, 205 (1931).

[21] The problem involved here is the one that arises in a multitude of cases in which the parties to a contract have failed to make express provision for certain contingencies. It will scarcely be questioned that a court would give effect to an unequivocal term in a contract of guaranty which explicitly provided that the surety was not to be released as a consequence of any breach of warranty, known or unknown, if the buyer-principal retained the goods. The obligation of the surety is based on his contract, and the express terms of this agreement would doubtless measure the extent of that obligation. By the same token, a clear expression to the contrary, namely that the surety was to be released if any warranty were broken, would also be enforced.

In the absence of an expressed intention, the traditional or orthodox technique used by the courts is to supplement the agreement by inserting the provision which the judge, or in doubtful cases the jury, considers would have been inserted had the

II

PRINCIPAL'S OFFSETS AGAINST CREDITOR AS PARTIAL DEFENSES TO SURETY

Dean Arant's other proposal is that a surety, *when sued alone*, should have the right to plead as a payment any independent offset which the principal may have against the creditor. Our opposition is based on the absence of the principal as a party to the creditor's action; and since this objection is procedural in character, we may assume a comparatively simple set of pleadings upon which to project our discussion. Abstract reasoning seldom lends itself to the solution of procedural difficulties.

In an action commenced on July 1 the plaintiff, the A Factory Corporation, sought to recover the price of goods sold and delivered to

matter been broached to the parties at the time the contract was made. This has frequently been described as the process of ascertaining the intention or contemplation of the parties, although it may readily be inferred from their failure to say anything about it, that the parties actually had no intention or contemplation concerning the consequences which should follow upon a breach of warranty. The character of the judicial process is perhaps more accurately described by saying that the court in this type of case is endeavoring to ascertain what fair-minded business men would have agreed upon.

Many critics of the administration of commercial law, especially the so-called juristic realists, have felt that this is unscientific, in that no comprehensive and thoroughgoing effort is made by the courts to discover what the average business man's judgment would be in a particular case and what the social and economic effects of its decisions will be. It is claimed that the rule permitting either party to show a trade custom or usage is not efficacious enough to bring the decisions of the courts into close harmony with the business world, and that often a judge resorts to a sort of boot-leg judicial notice by incorporating into his decision the results of his own fragmentary extra-judicial investigation among his business acquaintances. Accordingly, several research projects have been undertaken with a view towards determining "scientifically" whether the decisions of the courts on commercial law problems coincide with the judgments of the commercial fraternity; and the business man and the banker have been asked to answer questionnaires on what each has done or would do under certain circumstances. See, for example, Bogert and Fink, "Business Practice Regarding Warranties in the Sale of Goods," 25 ILL. L. REV. 400 (1930); Moore and Sussman, "Legal and Institutional Methods Applied to the Debiting of Direct Discounts," 40 YALE L. J. 381, 555, 752, 928, 1055, 1219 (1931); Hanna, "The Extension of Public Recordation," 31 COL. L. REV. 617, 635 (1931). See Llewellyn, "Some Realism about Realism," 44 HARV. L. REV. 1222 (1931), for a colorful inventory of a large portion of what is being done along these and related lines.

We would await with bated breath the results of such an investigation concerning the problem we have been discussing in the body of this paper. Our own miniature informal investigation among a fair-sized coterie of merchants shows that business men are unanimously opposed to releasing the surety *in toto*, when the breach of warranty was not known before the goods were delivered.

the defendants, the B Jobbers Company. The operative allegations of the complaint were: that on March 1 the defendants promised to pay the plaintiff the price of $1,000 for certain goods which the plaintiff on the same day delivered to the defendants; that the said price was agreed to be paid on June 1; and that there is now due and owing from the defendants to the plaintiff the sum of $1,000, no part of which has been paid.

The defendants, in their answer, admitted the allegations in the complaint, except that they denied that $1,000 was owing to the plaintiff-creditor, and that no part of it had been paid. They also pleaded as a partial defense the following facts: that the goods described in the complaint had been purchased by one Builder as principal and that the defendants were liable for the price thereof as sureties only; that the defendants became liable to the plaintiff for the said price at the request of the said Builder, who, for a valuable consideration, promised to indemnify and to save the defendants harmless against any liability which might accrue against them as a result of their promise to pay the said price;[22] that on May 1 the said Builder, the principal, at the request of the plaintiff, performed certain work for which the said plaintiff agreed to pay the said Builder $400 on June 1; that there is now due and owing from the plaintiff to the said Builder the sum of $400, no part of which has been paid; that because the plaintiff owes the said sum to the said Builder, the plaintiff has been paid the said sum on account of the claim set forth in the plaintiff's complaint and that, therefore, the defendants do not owe the plaintiff more than $600.

The plaintiff moved to strike out the partial defense on the ground that it was insufficient in law upon its face.

Arant's Theory That Offset Is a Payment

Dean Arant would deny this motion for the reason that the work done by the Builder, who is alleged to be the one primarily liable for the price of the goods, was equivalent to a part payment thereon, and thus the $1,000 debt has been reduced to $600. He contends:[23]

> "It would be reasonable to argue that the creditor's (the Factory's) need for protection determines the scope of the surety's

[22] This promise to indemnify may be implied from the fact that the principal has asked the surety to become liable to the creditor. 2 WILLISTON, CONTRACTS, sec. 1274 (1920).

[23] 29 MICH. L. REV. at 142, 143 (1930). ARANT, SURETYSHIP, n. 1 at 210, 211.

(the Jobbers') obligation . . . the debt of the principal (the Builder) to the creditor may be viewed as being in effect paid by the debt of the creditor to the principal, so that the difference is all that the principal owes the creditor. . . . The surety shows the creditor's liquidated debt to the principal merely to disclose the occurrence of circumstances that have narrowed the scope of his duty, as he would show a payment by the principal if the creditor sued him for the original amount of the principal's debt."

Creditor's Objections to Payment Theory

We shall accept, as most of the authorities seem to do,[24] the proposition that the Jobbers, provided they really are sureties, ought to have the benefit of the Builder's offset. There are, however, serious practical objections to looking upon it as a part payment. These will be revealed as we observe the payment theory in operation. When the Factory's motion to strike out the defense is denied and the case goes to trial, the defendants, the Jobbers, may prove the allegation in their answer that they are sureties, thereby establishing their right to use the offset; and the Factory's recovery for the goods would then be reduced from $1,000 to $600.

One difficulty will arise if the Builder, who has not been paid for his work, thereafter sues the Factory for the $400. The Factory, now a defendant, will no doubt plead as a total defense that this was paid by the reduction which it was forced to make in its action against the Jobbers, who proved themselves to be the Builder's sureties. But as Dean Arant states,[25] what happened in the proceeding against the Jobbers does not conclude the Builder, since he was not a party and, hence, had no opportunity to present his version of the facts. For this reason the determination in the Factory's action against the Jobbers that the Builder was principally liable for the goods would not be binding on him.[26] He would then be free in his action against the Factory to show that he was not in fact liable for the goods, either as principal or as surety, or in any capacity; and the jury in this action may so believe. In that event, there would be no defense to the Builder's claim to be paid for his work, and a judgment for $400 in

[24] The cases are collected in 2 WILLISTON, CONTRACTS, sec. 1251 (1920); STEARNS, SURETYSHIP, 3d ed., sec. 117 (1922).

[25] 29 MICH. L. REV. at 143 (1930). ARANT, SURETYSHIP, n. 1 at 212.

[26] Even if the Builder testified in favor of the Factory, the judgment would not conclude the Builder, for he has not had the necessary control over the proceedings. 1 FREEMAN, JUDGMENTS, 5th ed., sec. 434 (1925).

his favor would have to be entered against the Factory. Thus, the Factory's $1,000 claim will have dwindled to $200, for the recovery in its own action against the Jobbers was only $600. In other words, the Factory will have paid twice for the work represented by the amount of the offset.[27]

Strangely enough, this risk of double payment, to which the theory that the offset is a payment exposes the Factory, seems to have been overlooked by the text writers and by practically all the courts. Their concern is over another objection to the payment theory, one that arises out of the possibility that the offset may be greater than the $1,000 claim. If the offset should be $1,700, for example, the Jobbers, though they be sureties, would not be entitled to the $700 excess. So that by allowing the offset we would find ourselves in the dilemma of either depriving the Builder of this excess or allowing him to sue the Factory for it, thereby harassing the latter twice for the same claim.[28] And this objection may be raised even in those cases in which the Jobbers pleaded that the offset was either less, as in the case we have assumed, or equal to the Factory's $1,000 claim. The Builder, when he sues the Factory, may prove that he was entitled to more than $1,000 for his work.

[27] Double payment may result from the payment theory, although physical delivery of the goods was made to the Builder. He might claim he received them only as agent or as custodian for the Jobbers and that he did not agree to be liable for the price.

The extent to which the Factory may protect itself against double payment, and other instances in which the courts have subjected parties to the risk of double payment will be considered below, p. 215 *et seq.*

It may be noted here that it is immaterial whether the Builder's offset is pleaded by the Jobbers as a defense or as a counterclaim, or whether the Factory concedes or even pleads that the Builder is the principal. It is the absence of the Builder as a party that creates the risk of double payment.

[28] 2 WILLISTON, CONTRACTS, sec. 1251 (1920); STEARNS, SURETYSHIP, 3d ed., sec. 117 (1922); SPENCER, SURETYSHIP, sec. 194 (1913); BRANDT, SURETYSHIP AND GUARANTY, 3d ed., sec. 259 (1905); ARNOLD, SURETYSHIP AND GUARANTY, sec. 121 (1927); PINGREY, SURETYSHIP AND GUARANTY, sec. 144 (1901); CHILDS, SURETYSHIP AND GUARANTY 272 (1907). Compare, however, the cases allowing a bailee to recover the total damage to the bailed chattel. 25 HARV. L. REV. 655 (1912).

The double payment danger was noted in Jarratt v. Martin, 70 N. C. 459 (1874). In this case the principal had been made a party, but the action was discontinued as to him when he became bankrupt. The court said, ". . . the assignee in bankruptcy ought to be a party because the plaintiff ought not to be put to the risk of allowing the claims to the defendant (surety) and having to pay them to the assignee in bankruptcy."

There are statutes and decisions which allow the surety to use the offset with the consent of the principal. See the texts cited above and also POMEROY, CODE

A third objection, somewhat like the second, is that by allowing the Jobbers to plead the offset as a payment, the Factory might be compelled to litigate on two occasions the issue as to the Builder's liability for the price of the goods; once to meet the Jobbers' allegation that the Builder was principally liable, and again in the Builder's action to meet his contention that he was not liable at all.

Looked at from the Factory's angle, then, the argument in support of its motion to strike out the Jobbers' defense based on the Builder's offset is that a denial of the motion would subject the Factory to the risks of double payment and double vexation. These risks, plainly, justify us in contending that the Factory's motion should be granted unless it can resort to a remedy which will fend off these dangers, or unless the Jobbers can point to some substantial injury that they may suffer from the striking out of the defense.

Payment Theory Not Essential to Protection of Surety

We shall consider, first, the possible inconveniences to which the Jobbers as sureties may be subjected by a holding that the offset is not a payment. One consequence will be that the Jobbers will pay the Factory $1,000 instead of $600. But, if the Builder was in fact primarily liable for the price of the goods, the Jobbers as sureties will recover this $1,000 in a reimbursement action against the Builder based on the latter's promise to indemnify.[29] The prejudice to the Jobbers on this score, then, lies merely in the loss of the use of the $400 during the interval between the payment to the Factory and the recovery from the Builder.

It is only when the Builder is insolvent that the Jobbers have a real need for the offset. The reimbursement remedy is worthless against a Builder unable to pay. And if the payment theory were the only ground on which the Jobbers could reach the offset, much might be said in favor of permitting them to use it as a part payment, despite the Factory's objections, especially in view of the fact that there is always the chance that the Builder may become insolvent during the interim preceding the recovery of the reimbursement judgment.

REMEDIES, 5th ed., sec. 626 (1929). Here, no doubt, the principal's consent can be used as a basis for having the judgment bind him.

Of course, when the creditor sues the principal and the surety together, and the principal as a party to the action pleads the set-off, it is then available to the surety. Any judgment will bind the principal. The cases on this point are also collected in the above texts.

[29] 2 WILLISTON, CONTRACTS, sec. 1274 (1920).

The Jobbers, however, have a remedy which affords them the same advantages that the payment theory does and yet shields the Factory against the double payment and double vexation hazards. The Jobbers may bring an action in which both the Builder and the Factory are named as defendants. In their complaint the Jobbers may allege that the Factory is claiming $1,000; that the present plaintiffs, the Jobbers, are liable therefor only as sureties; that the Builder is liable as principal; and that the Builder agreed to save the Jobbers harmless. Then, after setting forth the facts showing that $400 is due from the Factory to the Builder, the complaint would ask that it be decreed that $400 is due to the Builder from the Factory; that the Jobbers have the right to use this in reduction of the Factory's claim for the price of the goods, and that, pending the determination of this action, no further steps be taken in the Factory's suit against the Jobbers except to sever the action and to enter judgment for the $600 concededly due.[30]

This remedy we may call subrogation.[31] By resorting to it the

[30] Authorities directly or by way of dictum in support of this remedy are Scholze v. Steiner, 100 Ala. 148, 14 So. 552, (1893); St. Croix Timber Co. v. Joseph, 142 Wis. 55, 124 N.W. 1049, (1910); Downer v. Dana, 17 Vt. 518 (1845); Armstrong v. Warner, 49 Ohio St. 376, 31 N.E. 877, 17 L. R. A. 466, (1892); Becker v. Northway, 44 Minn. 61, 46 N.W. 210, 20 Am. St. Rep. 543, (1890); Gillespie v. Torrance, 25 N. Y. 306, 311, 82 Am. Dec. 355, 357 (1862); Rumery v. Merrill Trust Co., 127 Me. 298, 143 Atl. 54 (1928). In some of the above cases the statement was made that the relief would be dependent upon the principal being insolvent.

[31] There may be some question as to whether the remedy should properly be called subrogation. It savors of subrogation in that the set-off is in a real sense security to the Factory just as if the Builder, if he were the principal, had put up the $400 worth of work as collateral. The credit risk on the goods has been reduced to $600. By allowing the set-off, the Jobbers, as sureties, appear to be succeeding to security rights. 2 WILLISTON, CONTRACTS, sec. 1251; STEARNS, SURETYSHIP, 3d ed., sec. 258; ARNOLD, SURETYSHIP AND GUARANTY, sec. 121 (1927); Mahurin v. Pearson, 8 N. H. 539 (1837). Yet, as Dean Arant states, the surety is usually not entitled to subrogation before he pays the creditor, for the creditor himself needs the security until he is paid. 29 MICH. L. REV. at 142 (1930). ARANT, SURETYSHIP, n. 1 at 211.

The remedy smacks of exoneration, because the Builder as principal is ordered, in effect, to relieve the Jobbers to the extent of the set-off by prosecuting it against the Factory. See St. Croix Timber Co. v. Joseph, 142 Wis. 55, 124 N.W. 1049, 1052 (1910).

We need not, however, quarrel over the proper nomenclature. Our energy and ingenuity can perhaps be more profitably devoted to the development of the remedy into a sound and sturdy member of the legal family, although, in keeping with a modern vogue, we might christen it with the grotesque name of "subroneration."

It will be seen that when the remedy we have described is used, there is no danger of the Jobbers obtaining something the Factory still needs. The moment the Jobbers obtain the reduction, the Factory is discharged from its obligation to pay the

Jobbers, as is evident, will procure the advantage they seek, namely, the reduction of the $1,000 debt to $600.[32] At the same time the Factory will be relieved of the fear that the Builder, notwithstanding the reduction, may exact payment for the work, inasmuch as he is made a party to the subrogation suit and has a chance to have his day in court. Therefore, any findings on the issues as to his liability for the price of the goods will be binding on him in any subsequent action he brings against the Factory.

The Jobbers have another device by which to reach the offset and yet bind the Builder. They may make the Builder a party to the Factory's action. This can be done by the Jobbers averring in a counterclaim the same allegations they would make in a complaint seeking subrogation; and the Builder can be brought in as a party by serving a copy of the answer on him. There is common law authority that a court may empower a surety to bring in the principal;[33] and this procedure appears to be expressly sanctioned by the provisions in some codes which have enacted that a defendant may set up

> "any counterclaim which raises questions between himself and the plaintiff along with any other persons . . . who, if such counterclaim were to be enforced by cross action, would be defendants to such cross action. Where any such person is not a party to the action, he shall be summoned to appear by being served with a copy of the answer. A person not a party to the action who is so served with an answer becomes a defendant in the action as if he had been served with the summons." [34]

Since the Jobbers' claim to the offset raises questions between them and the Factory (the plaintiff) along with the Builder, and since also the latter two would be defendants if the counterclaim were to be enforced by cross-action, it seems clear that this code provision countenances the bringing in of the Builder without starting another suit.

Thus it appears that the Jobbers, as sureties, do not need the payment theory in order to utilize the offset. The subrogation remedy,

$400 to the Builder. The Jobbers do not actually receive the $400, as happens in the ordinary subrogation action in which a surety is seeking to reach securities held by the creditor. See 29 MICH. L. REV. 753 (1931).

[32] There may be some peculiar arrangement between the Jobbers and the Builder by virtue of which the Jobbers are not to have the benefit of the offset at all. This of course would prevent the Jobbers from resorting to it either as a defense or by a subrogation suit.

[33] Hiner v. Newton, 30 Wis. 640 (1872); 2 WILLISTON, CONTRACTS, sec. 1251 (1920).

[34] N. Y. Civil Practice Act, sec. 271; CLARK, CODE PLEADING 468 (1928).

invoked by way of a separate action or as a counterclaim, is ample for their purposes. Ordinarily, we might be prodigal with our remedies and bestow on the Jobbers another one, that of relying on the offset as a defense. But in view of the fact that, by so doing, we may be responsible for the Factory paying the same debt and being vexed by the same issue twice, we cannot be reproached for niggardliness when we confine the Jobbers to the subrogation remedy.

Subrogation Against Nonresident Principals

Before we consider the steps which the Factory may take in its own behalf to fend off the threat of double payment and double vexation, we ought to examine further the subrogation remedy to see whether it can be used effectively in all cases.

It may be that the Builder is a nonresident of the state in which the Factory has sued the Jobbers for the price of the goods and in which the Factory may be sued. Let us assume that the Builder is a resident of California, and the Factory and the Jobbers residents of New York and that the Factory's action is pending in New York. Even in these circumstances the subrogation remedy is adequate to serve the Jobbers' purposes and to protect the Factory against paying the $400 twice. There appears to be no obstacle in the way of permitting the Jobbers in their subrogation action to serve the Builder personally in California or by publication, and to obtain a judgment in New York that will foreclose him from recovering the $400 from the Factory.

The decision in *Pennington v. Fourth National Bank*[35] discloses that the Supreme Court will insist that full faith and credit be given to any judgment entered against the nonresident Builder in a subrogation action, despite the fact that before the Jobbers pay the Factory, the Builder's obligation to indemnify the Jobbers is inchoate and not a debt. In the *Pennington* case, a divorce action was brought in Ohio by a wife against her husband who was a nonresident of the state. The wife, in addition to the divorce, asked for alimony, and in order to insure its payment she joined as a party defendant the bank in which the husband had a deposit, and she obtained a preliminary order restraining the bank from paying out any part of it. The husband was served by publication and, pursuant to later orders, the bank paid the wife the whole of the deposit. The husband then sued the bank therefor, claiming that the divorce court's orders were in violation of

[35] 243 U. S. 269, 37 Sup. Ct. 282, 61 L. ed. 713 (1917).

the Fourteenth Amendment since he was a nonresident of Ohio and had neither been served personally in Ohio nor had he appeared in the divorce action; all of which the bank knew. His action was nevertheless dismissed, and he brought the case to the Supreme Court of the United States. The dismissal was affirmed, the court saying:[36]

"The Fourteenth Amendment did not, in guaranteeing due process of law, abridge the jurisdiction which a State possessed over property within its borders, regardless of the residence or presence of the owner. That jurisdiction extends alike to tangible and to intangible property. Indebtedness due from a resident to a non-resident — of which bank deposits are an example — is property within the State. *Chicago, Rock Island & Pacific Ry. Co. v. Sturm*, 174 U. S. 710. It is, indeed, the species of property which courts of the several States have most frequently applied in satisfaction of the obligations of absent debtors. *Harris v. Balk*, 198 U. S. 215. Substituted service on a non-resident by publication furnishes no legal basis for a judgment *in personam*. *Pennoyer v. Neff*, 95 U. S. 714. But garnishment or foreign attachment is a proceeding *quasi in rem*. *Freeman v. Alderson*, 119 U. S. 185, 187. The thing belonging to the absent defendant is seized and applied to the satisfaction of his obligation. The Federal Constitution presents no obstacle to the full exercise of this power.[37]

"It is asserted that these settled principles of law cannot be applied to enforce the obligation of an absent husband to pay alimony, without violating the constitutional guaranty of due process of law. The main ground for the contention is this: In ordinary garnishment proceedings the obligation enforced is a debt existing at the commencement of the action, whereas the obligation to pay alimony arises only as a result of the suit. The distinction is, in this connection, without legal significance. The power of the State to proceed against the property of an absent defendant is the same whether the obligation sought to be enforced is an admitted indebtedness or a contested claim. It is the same whether the claim is liquidated or is unliquidated, like a claim for damages in contract or in tort. It is likewise immaterial that

[36] 243 U. S. at 271, 37 Sup. Ct. at 282, 61 L. ed. at 714 (1917).

[37] See Beale, "Exercise of Jurisdiction in Rem to Compel Payment of a Debt," 27 HARV. L. REV. 107 (1913); Carpenter, "Jurisdiction over Debts," 31 HARV. L. REV. 909-918 (1918); "The Garnishment of a Debt in the Process of Foreign Attachment," 26 COL. L. REV. 605 (1926); Kennedy, "Garnishment of Intangible Debts in New York," 35 YALE L. J. 689 (1926); GOODRICH, CONFLICT OF LAWS 126-131 (1927).

the claim is at the commencement of the suit inchoate, to be perfected only by time or the action of the court. The only essentials to the exercise of the State's power are presence of the *res* within its borders, its seizure at the commencement of proceedings, and the opportunity of the owner to be heard. Where these essentials exist a decree for alimony against an absent defendant will be valid under the same circumstances and to the same extent as if the judgment were on a debt — that is, it will be valid not *in personam*, but as a charge to be satisfied out of the property seized.

"The objection that this proceeding was void, because there was no seizure of the *res* at the commencement of the suit, is also unfounded. The injunction which issued against the bank was as effective a seizure as the customary garnishment or taking on trustee process. Such equitable process is frequently resorted to in order to reach and apply property which cannot be attached at law."

A state case in point is *Morgan v. Mutual Benefit Life Ins. Co.*,[38] in which the plaintiff sought to foreclose an equitable lien on the proceeds of a life insurance policy. He claimed that he had paid the premiums at the request of the assured. The insurance company and the beneficiaries were made parties defendant, and the plaintiff obtained an order authorizing service to be made by publication on the beneficiaries who were nonresidents. The insurance company pleaded, in its answer, that the beneficiaries had sued it in California, and it moved to vacate the order on the ground that the beneficiaries would not be bound by the judgment. The court refused to vacate the order and held that process served by publication would give the court jurisdiction to enforce the lien on the insurance money debt.

The surety's interest in the principal's offset is also a lien, for when we take the stand that the Jobbers should have the offset not only despite, but because of, the Builder's possible insolvency,[39] we are thereby necessarily willing to give the Jobbers a lien on the offset to the extent that they need it for the purpose of reducing the main obligation. The subrogation action is, consequently, no more than a proceeding to enforce a lien on the offset, which is precisely what the court in the *Morgan* case held may properly take place notwithstanding the owner's absence. So, whether we depict the subrogation action as the enforcement of a lien or as the seizure of the offset and

[38] 189 N. Y. 447, 82 N.E. 438 (1907).

[39] See p. 208 supra.

its application to discharge the Builder's duty to indemnify, it appears quite certain that the courts in the United States will accord the Jobbers the power to reach the offset and, at the same time, to immunize the Factory against double payment.

In foreign countries, however, the subrogation remedy develops a possible flaw. A few countries may refuse to recognize some of our subrogation judgments when they are based merely on process served outside the state. For example, if the $400 debt due the Builder were payable in Germany and if, also, the Factory were doing business or could be sued there by the Builder, the German courts might not give effect to the subrogation judgment entered in New York in the Builder's absence and might compel the Factory to pay the $400 again.[40]

There may be a difference of opinion as to whether the Jobbers should be given the offset even in a subrogation action, whenever it appears that the debt is payable in a country that will not abide by the judgments we enter. This will be considered below.[41] Assuming that we allow the Jobbers to reach the offset in every subrogation action, this remedy with its blemish is much more acceptable than the payment theory. When the offset is allowed as a payment, in no case is the Builder bound by the judgment, for he is not a party to the Factory's suit;[42] whereas the subrogation remedy protects the Factory against an action by the Builder at least in the wide domain over which the Supreme Court of the United States holds sway, whatever be the fate of our judgments abroad. It does seem that we are not limiting the Jobbers too far when we insist as a condition to their using the Builder's offsets against the Factory that they call into play

[40] See Martin v. Nadel, [1906] 2 K. B. 26 discussed on page 225 infra. See also the cases referred to in note 75 infra. It is not quite clear whether, even when the offset debt is payable in a particular country, the refusal to hold that it has been discharged by the subrogation judgment will be limited to those cases in which the Builder was a citizen of that country.

For a general treatment of the reception our judgments will meet in foreign countries, see Lorenzen, "The Conflict of Laws of Germany," 39 YALE L. J. 804 (1930); "The Enforcement of American Judgments Abroad," 29 YALE L. J. 188, 268 (1920). As to the recognition of foreign judgments in this country, see Hilton v. Guyot, 159 U. S. 113, 16 Sup. Ct. 139, 40 L. ed. 95 (1895); Johnston v. Compagnie Generale Transatlantique, 242 N. Y. 381, 152 N.E. 121, 46 A. L. R. 435 (1926); Konitzky v. Meyer, 49 N. Y. 571 (1872); Holmes v. Remsen, 4 John. Ch. (N. Y.) 460, 8 Am. Dec. 581 (1820); Rapelje v. Emery, 2 Dall. (Pa.) 231, 1 L. ed. 361 (1795).

[41] See p. 225 infra.

[42] See p. 206 supra.

the subrogation remedy either by a new action or by a counterclaim, in order that the Factory may receive the substantial measure of protection which that remedy affords.

Creditor Unable to Protect Self Against Consequences of Payment Theory

This brings us to the question whether the Factory itself has a remedy with which to ward off the threat of double payment and double vexation. It is conceivable that the Factory, when faced with adverse claims by the Jobbers and the Builder, might bring an interpleader action against them and obtain an order directing them to litigate between themselves the issue whether the Builder was the principal. And, pending this action, further proceedings in the suit brought by the Factory against the Jobbers alone might be suspended except to enter a judgment for the $600 concededly due. Then, after it was found in the interpleader action that the Builder was the principal, and the Jobbers for that reason entitled to the $400 reduction, the Factory would be given no further judgment against the Jobbers.

We may admit that by employing this remedy the Factory would be protected against further litigation by the Builder. But it is exceedingly doubtful whether the remedy of interpleader, beset as it is with so many technicalities,[43] is flexible enough to be available to the Factory in this type of case. There would be a serious question as to whether the Factory or the Jobbers should make the deposit of the $400 in court in order that a *res* might be supplied for the interpleader action.[44] Moreover, unless the Jobbers did supply this $400, and thus lose the use of it pending the interpleader suit, the Factory might not be able to comply with the interpleader prerequisite of being a disinterested stakeholder.[45]

[43] 4 POMEROY, EQUITY JURISPRUDENCE, 4th ed., secs. 1319-1329 (1919); Chaffee, "Modernizing Interpleader," 30 YALE L. J. 814 (1921).

[44] 4 POMEROY, EQUITY JURISPRUDENCE, 4th ed., sec. 1328 (1919).

[45] 4 POMEROY, EQUITY JURISPRUDENCE, 4th ed., sec. 1325 (1919). If the $400 is not put up by the Jobbers, the Factory would be more desirous of having the Jobbers win. Should the Jobbers lose, the Factory would recover an unsecured judgment of $1,000 against them which it might not be able to collect, and it would be forced to pay $400 to the Builder. Whereas if the Jobbers win, the Factory need pay nothing to the Builder, though it recovers only $600 from the Jobbers. Obviously, the Factory would rather recover only $600 from the Jobbers and be released from a $400 debt due the Builder than have an unsecured judgment of $1,000 against the

We need not, however, stop to consider whether interpleader can be invoked by the Factory. Though a state does modernize the remedy to make it available to the Factory, the Supreme Court of the United States will still hold that the nonresident Builder cannot be bound by an interpleader judgment entered in his absence.

A somewhat lengthy statement of the case of *New York Life Insurance Co. v. Dunlevy*[46] must be made here. In that case a firm named Boggs and Buhl recovered a judgment in Pennsylvania against a Mrs. Dunlevy who was then a resident of the state. This was in 1907. Thereafter Mrs. Dunlevy became a resident of California, and still later she and her father, named Gould, made adverse claims to the surrender value of a life insurance policy; Gould as the beneficiary and Mrs. Dunlevy as the assignee. In November, 1909, Boggs and Buhl in Pennsylvania issued an execution attachment which was served on the insurance company and also on Gould as garnishees. In January, 1910, Mrs. Dunlevy started her own action in California against the insurance company and she, too, named Gould as a defendant. The insurance company then applied to the Pennsylvania court to turn its proceedings into an interpleader action between Mrs. Dunlevy and Gould, since the latter was claiming that the assignment to Mrs. Dunlevy was invalid. This application was granted, and the court also ordered Mrs. Dunlevy to be served with process in California. She was so served, but she failed to appear in the Pennsylvania action. Some time later the insurance company deposited the proceeds of the policy with the Pennsylvania court, and the issue as to whether Gould or Mrs. Dunlevy was entitled to the money was tried by a jury. It was found that the assignment to Mrs. Dunlevy was invalid, and the fund was paid to Gould. Thereupon the insurance company, as defendant in Mrs. Dunlevy's California action, pleaded the Pennsylvania interpleader judgment as a bar. But the California court refused to give full faith and credit to this Pensylvania judgment, and after a trial it found that the assignment to Mrs. Dunlevy was valid. Accordingly, judgment was entered in favor of Mrs. Dunlevy against the insurance company; with the result that the company

Jobbers and be obligated to pay the Builder $400 whether the Jobbers pay the $1,000 or not.

In many states also, interpleader could not be used if the Factory disputed that as much as $400 was due or the Builder claimed it was more. 4 POMEROY, EQUITY JURISPRUDENCE, 4th ed., sec. 1323 (1919).

[46] 241 U. S. 518, 36 Sup. Ct. 613, 60 L. ed. 1140 (1916).

was compelled to pay and litigate the claim twice. The Supreme Court of the United States affirmed this judgment, saying:[47]

> "Beyond doubt, without the necessity of further personal service of process upon Mrs. Dunlevy, the Court of Common Pleas at Pittsburgh had ample power through garnishment proceedings to inquire whether she held a valid claim against the insurance company and if found to exist then to condemn and appropriate it so far as necessary to discharge the original judgment. Although herself outside the limits of the state such disposition of the property would have been binding on her. *Chicago, R. I. & P. Ry. v. Sturm*, 174 U. S. 710; *Harris v. Balk*, 198 U. S. 215, 226, 227; *Louis. & Nash. R. R. v. Deer*, 200 U. S. 176; *Baltimore & Ohio R. R. v. Hostetter*, 240 U. S. 620; Shinn on Attachment and Garnishment sec. 707. See *Brigham v. Fayerweather*, 140 Mass. 411, 413. But the interpleader initiated by the company was an altogether different matter. This was an attempt to bring about a final and conclusive adjudication of her personal rights, not merely to discover property and apply it to debts." [48]

[47] 241 U. S. at 520, 36 Sup. Ct. at 613, 60 L. ed. at 1142 (1916).

[48] For other cases to the same effect see 3 FREEMAN, JUDGMENTS, 5th ed., sec. 1522, n. 11 (1925). It has also been held that a court has no jurisdiction to enjoin a defendant served within the state from paying money to a nonresident claimant who was served outside the state. Mahr v. Norwich Union Fire Ins. Co., 127 N. Y. 452, 28 N.E. 391 (1891); Kelly v. Norwich Union Fire Ins. Co., 82 Iowa 137, 47 N.W. 986 (1890).

Mention should be made here of the likelihood that the subrogation remedy will not wholly relieve the Factory from the peril of double vexation, if it questions the existence of the offset. In proceedings under the garnishment statutes, it frequently happens that the garnishee denies that he owes the defendant anything. The practice in such cases is to frame an issue between the garnishee and the plaintiff-garnishor as to whether there is anything due from the garnishee to the defendant. When this issue is resolved, after a trial, in favor of the garnishee, he is discharged. But, if later, the defendant, who took no part in these proceedings, brings his own action against the garnishee for the alleged debt, it has been held for a number of reasons, that the judgment in favor of the garnishee which was rendered in the garnishment proceeding is not binding on the present plaintiff, who was the defendant in the garnishment action; and the garnishee is compelled to relitigate the merits of the alleged garnished debt. 2 FREEMAN, JUDGMENTS, 5th ed., sec. 841 (1925); New York Life Insurance Co. v. Dunlevy, 241 U. S. 518, 522, 36 Sup. Ct. 615, 617, 60 L. ed. 1140, 1142 (1916).

In the Jobbers' subrogation action, the Factory may controvert the allegation that it owes the Builder $400 or any other amount, and at the trial in the absence of the Builder, the Factory may show that there is no such thing as an offset. The Factory, it is true, would thereupon recover $1,000 from the Jobber. But, relying upon the garnishment cases, the courts may hold that the Builder, when he subsequently sues

The Supreme Court evidently draws a sharp distinction between a proceeding by a debtor to adjudicate the disputed right of a claimant to the debt and an action to sieze and apply it to the satisfaction of a disputed claim against the claimant. The court has informed us that no state can give the Factory the power effectively to interplead the absent nonresident Builder and to bind him by any declaration as to his rights in the offset;[49] while every state may permit the Jobbers to seize the offset by whatever legal or equitable process is at hand in a particular jurisdiction, to appropriate it to the discharge of the Builder's alleged obligation to indemnify, and to preclude him from thereafter recovering its amount from the Factory.[50]

Whether there is a sufficient foundation for this distinction is not within the province of this paper.[51] We are quite willing to admit that, if the interpleader remedy were adequate to protect the Factory, the problem whether the Jobber or the Factory should bring in the Builder would hardly be worth discussing. What is abhorrent to our sense of justice is that any court should subject the Factory to the risk of paying the same debt twice at the instigation of the Jobbers who may so easily avert the judicial tragedy that is enacted when a debtor is ordered to pay the same debt a second time. One must nurture a doting solicitude for sureties when one refuses to put them to the slight inconvenience of making the principal a party to a subrogation action or a cross action in order that the utterly helpless creditor, having an offset against him, be delivered from the spectre of double payment.

The retort may be made that the Factory might join the Builder as a party defendant in its action against the Jobbers. This overlooks the circumstance that the Factory is not claiming that the Builder is liable for the goods, and further, that the Factory cannot effectively bring in as a party the nonresident Builder.[52] And if we go to the length of insisting that the Factory sue the Builder, wherever he is,

the Factory for the $400, is entitled to reopen the question whether the Factory owed him anything.

If the courts do so, it will mean that in this respect the subrogation action is no better than the payment theory. The all-important advantage that the subrogation remedy does afford is that when the offset is once established and the Factory recovers only $600 from the Jobbers, the Factory is safe from further molestation by the Builder.

[49] Whether the Factory does have a remedy when it claims that the Builder is liable to it will be considered in note 52 infra.

[50] See page 210 *et seq.* supra.

[51] See WALSH, EQUITY 57-62 (1930) for a jeremiad against the distinction. See also Chaffee, "Interstate Interpleader," 33 YALE L. J. 685 (1924).

[52] If the Factory was contending that the Builder was also liable for the goods, its claim would be merely a personal one for the $1,000 price, and no valid judgment

before suing the Jobbers,[53] the Factory would be unable to proceed in those cases in which the Builder could not be located. The Jobbers, in their subrogation action, on the other hand, can serve the Builder by publication and thus bind him by the judgment to the extent of the $400, whether he can be located or not.[54]

Other Cases of Threatened Double Payment and Vexation Distinguished

The remaining question is whether the suretyship cases can be distinguished from others in which the courts have exposed a person to the risk of double payment and double vexation. A recent instance is *Petrogradsky M. K. Bank v. National City Bank.*[55] In this case a Russian corporation sued to recover a deposit in a New York bank. The defense was that certain Soviet decrees deprived the corporation of its interest in the deposit and that there was a possibility that the defendant might have to pay the deposit again, since the Soviet Republic's claim to the fund might be upheld in other countries in which the bank might be sued. The court, after refusing to consider the Soviet decrees because the Soviet government had not been recognized

could be entered against the Builder unless he was served personally in the state. 3 FREEMAN, JUDGMENTS, sec. 1367 (1925).

There is a possibility in some states that the Factory could sue the nonresident Builder for this $1,000 and garnish or attach its own debt of $400 due to the Builder. The cases are collected in 26 MICH. L. REV. 518 (1928); 11 MINN. L. REV. 470 (1927); 31 A. L. R. 712 (1924). By so doing the $1,000 debt would be cut to $600 and the Builder probably precluded from recovering the $400 in a later action. The Supreme Court of the United States does not seem to have passed on this question.

To make applicable the cases allowing a plaintiff to garnish his own debt, it would not only have to appear that the Factory was claiming that the Builder was liable for the goods, it would also be necessary that the Factory admit it owes the $400 to the Builder. Otherwise we would be driving the Factory into the anomalous position of trying to show that it was liable to the Builder for a debt the existence of which it denied.

[53] Though there are states which require a creditor to sue the principal first when the surety so demands, no state seems to have gone as far as to repose this power in the surety if the principal is outside the jurisdiction in which the creditor resides. 2 WILLISTON, CONTRACTS, secs. 1236, 1278 (1920).

It will be noted that in an action by the Factory against the Builder there would not necessarily be a determination of the relationship between the Builder and the Jobbers. The Factory would be suing merely for goods sold and delivered and the Builder could not be forced to counterclaim for his debt. 2 FREEMAN, JUDGMENTS, 5th ed., sec. 786 (1925).

[54] 1 FREEMAN, JUDGMENTS, 5th ed., sec. 347 *et seq.* (1925).

[55] 253 N. Y. 23, 170 N.E. 479 (1930).

by the United States, gave judgment for the defendant, though the Soviet was not made a party. The court said:[56]

> "The case comes down to this: A fund is in this State with title vested in the plaintiff at the time of the deposit. Nothing to divest that title has ever happened here or elsewhere. The directors who made the deposit in the name of the corporation or continued it in that name now ask to get it back. Either it must be paid to the depositor, acting by them, or it must be kept here indefinitely. Either they must control the custody, or for the present and the indefinite future it is not controllable by any one."

It will be seen that the alternatives between which the court had to choose were either to withhold indefinitely from the plaintiff the money to which it showed itself entitled in its own behalf, or to subject the defendant to the risk of double payment. Throwing this risk on the defendant was perhaps choosing the lesser of two evils.

In the suretyship cases, however, the choice is between remitting the surety to the simple remedy of subrogation or exposing the creditor to the double payment risk. No argument should be needed to demonstrate that a person ought not to be subjected to double liability on a single obligation, if this can be easily and satisfactorily avoided. In the *Petrogradsky* case double liability could be avoided only at the expense of depriving the plaintiff of its money for an indefinite period. In the suretyship cases, as we have pointed out, double liability may be avoided by putting the surety to the negligible expense of bringing in the principal as a party. This is by far the less objectionable alternative.

The New York court of appeals, in another case, tells us that every effort should be made to refrain from visiting on a party the risk of double payment. In *Russian Reinsurance Co. v. Stoddard*[57] a Russian corporation was seeking to recover a fund deposited in a New York bank to be held in trust for the corporation, its stockholders, and creditors. The claim of the plaintiff was that the trust was at an end because its purposes had failed when the Soviet government nationalized the plaintiff. But there was a possibility that the bank might have to pay the fund again to the Soviet government. The court refused to allow the plaintiff to recover, saying:[58]

[56] 253 N. Y. at 40, 170 N.E. at 486 (1930).
[57] 240 N. Y. 149, 147 N.E. 703 (1925).
[58] 240 N. Y. at p. 165, 147 N.E. at p. 708.

". . . The company cannot do business in Russia because it is excluded therefrom; it cannot do business under the management of the directors who here claim to represent it in any country which gives full force and effect to the decrees of the Soviet government; it cannot do business in this jurisdiction after it has withdrawn these moneys from the depositary and it makes no claim that it intends or in fact could make use of the property as working capital in doing business elsewhere . . . (p. 166). We do not assume that these directors would not safely keep this property, if delivered to them; we do not now decide that any public policy forbids us, after the claims of domestic creditors are secured, to order the delivery of the property to the directors of the corporation merely because of these considerations. At least, however, they point to the conclusion that there is no impelling reason why the court should take jurisdiction; they become cogent arguments why the court should *not* take jurisdiction if it also appears that injustice might be done to this defendant if judgment is granted against it . . . (p. 168). Our inability to protect by our judgment this defendant against a second recovery upon the same cause of action presents a strong consideration against assuming jurisdiction of this action." (Italics the court's).

It is interesting to note how the New York court distinguished this case in the later one, the *Petrogradsky* case.[59] It said:[60]

"The defendant cites our decision in *Russian Reinsurance Co. v. Stoddard*, 240 N. Y. 149 (1925), as supporting its defense. . . . we held that in a suit in equity there is discretion if not duty to refuse a decree whereby a trustee will be directed to make payment of the subject of the trust to one of two claimants, unless there is power also by force of the same decree to protect against the rival. *Mahr v. Norwich Union Fire Insurance Co.*, 127 N. Y. 452. The rule is different altogether in actions at law. *Chapman v. Forbes*, 123 N. Y. 532; *Bauer v. Dewey*, 166 N. Y. 402. Here in the case before us the subject of the controversy is not property burdened with a trust to be administered in equity. The subject is an ordinary deposit in a bank to be sued for, if at all, in an action founded on the debt. In actions of that order, a refusal to pay when due is not sustained without more by the presence of an adverse claim. The defendant, if unable to interplead, must respond to the challenge and defend as best it can."

[59] Petrogradsky M. K. Bank v. National City Bank, 253 N. Y. 23, 170 N. E. 479 (1930).

[60] 253 N. Y. at p. 38, 170 N.E. at p. 485 (1930).

If a court should be inclined to promulgate a fixed rule that the danger of double liability is to be considered only in equity actions, this would still permit the creditor to prevent the surety from relying on the principal's offset when the principal is not a party to the action. Whatever rights the surety has to the offset are of equitable origin.[61]

But we are not primarily interested in historical grounds for distinguishing the cases. Neither was the New York court. Our first quotation from the *Petrogradsky* case[62] shows that it went on to consider in the best judicial manner the alternatives it faced. What we are eager to emphasize is that the spectacle of a court ordering a person to pay the same debt twice appears to the layman to be a manifestation of egregious judicial incompetency. In the *Petrogradsky* case there was, perhaps, no satisfactory means of escape from the possibility of such a result. In the suretyship cases, however, the subrogation remedy, as we have seen, does furnish a simple way out.[63]

Another and more common situation in which a party is subjected to possible double liability was involved in *Scheffer v. Erie Co. Savings Bank.*[64] In this case the plaintiff claimed to be the donee of a savings bank deposit. The defense to his action against the bank was that the gift was invalid, and that in an action by the donor or his representatives the invalidity of the gift might be proven and the bank

[61] The rights of the surety against the principal or the principal's property were originally equitable. The only action at law which the surety could bring was one for reimbursement when the principal had expressly promised to indemnify. Ames, "The History of Assumpsit," 2 HARV. L. REV. 53-59 (1888); 3 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 259, 287 (1909). 4 POMEROY, EQUITY JURISPRUDENCE, 4th ed., secs. 1417, 1419. 5 *ibid.*, secs 2342, 2343 (1919).

Compare Steinbach v. Prudential Ins. Co., 172 N. Y. 471, 65 N.E. 281 (1902), in which the court refused to reform a policy by inserting the plaintiff's name as the beneficiary unless the beneficiary entitled to the proceeds by the terms of the policy was made a party. The court said on p. 477: "A court of equity always seeks to do complete justice and to make its judgments so full and comprehensive as to quiet the controversy in all its aspects and as to all persons. Thus every one who is compelled to obey its decrees is protected, further litigation is prevented, and the unseemly spectacle of inconsistent judgments rendered by the same court, is avoided."

[62] See p. 220, supra.

[63] Other cases in which the New York court continued to consider the element of possible double liability before disposing of funds owned by Russian corporations are: First Russian Ins. Co. v. Beha, 240 N. Y. 601, 148 N.E. 722 (1925); Severnoe Securities Corp. v. London and Lancashire Ins. Co., 255 N. Y. 120, 174 N.E. 299 (1931); Matter of Russian Reinsurance Co., 255 N. Y. 415, 175 N.E. 114 (1931). See also Tennant, "Recognition Cases in American Courts," 29 MICH. L. REV. 708, 729 (1931).

[64] 229 N. Y. 50, 127 N.E. 474 (1920).

compelled to pay again. The court, after deciding that the gift was valid, ordered judgment for the plaintiff, although the donor was not a party to the action.

The soundness of this decision is to be determined by considering what the plaintiff could have done in order to protect the bank against the double liability danger. The plaintiff obviously had no right to sue his donor on any promise or obligation to the discharge of which the deposit might be appropriated. So that, if the donor was a non-resident, the plaintiff could not have made him a party to a New York action in which the plaintiff's right to the deposit might have been established.[65] And in the state of the donor's residence or presence, the plaintiff probably would not have been able to obtain an injunction restraining the donor from making a claim to the deposit, for most courts do not seem to be willing to remove a cloud on the title to personal property.[66] It is possible that in some states the plaintiff might have been able to obtain a judgment against the donor, declaring that the plaintiff was entitled to the deposit.[67] But there are jurisdictions in which such a declaratory judgment could not be obtained; and if the donor were a resident or could be served in one of these latter jurisdictions only, this possibility would be non-existent. Moreover, if the donee were required to sue his donor and establish the validity of the gift before suing the bank, it would delay the donee in obtaining the money to which he claims to be entitled in his own right.

That is to say, there was probably no satisfactory remedy to which the donee could have been forced to resort in order to avoid throwing on the bank the risk of double payment. But in the suretyship cases, the surety by means of the subrogation remedy can reach the offset and at the same time protect the creditor against double payment. And the surety can do this without leaving the state and without being delayed in the recovery of any money to which he is entitled, since

[65] See New York Life Ins. Co. v. Dunlevy, 241 U. S. 518, 36 Sup. Ct. 613, 60 L. ed. 1140 (1916), supra, p. 216; Schoenholz v. New York Life Ins. Co., 197 App. Div. 91, 188 N. Y. S. 596 (1921), affirmed on other grounds in 234 N. Y. 24, 136 N.E. 227 (1922).

[66] 5 POMEROY, EQUITY JURISPRUDENCE, 4th ed., sec. 2151 (1919); 26 MICH. L. REV. 426 (1928); 12 MICH. L. REV. 139 (1913); 5 COL. L. REV. 609 (1905).

[67] Sunderland, "A Modern Evolution in Remedial Rights — The Declaratory Judgment," 16 MICH. L. REV. 69 (1917); CLARK, CODE PLEADING 230 (1928); Borchard, "The Constitutionality of Declaratory Judgments," 31 COL. L. REV. 561 (1931). In The Manar, [1903] P. 95, an English court rendered a declaratory judgment which was to be used in France.

the surety in no case may have a money judgment against the creditor, whatever the amount of the offset may be.[68] It is a far cry, then, from the decision in the *Scheffer* case to a contention that the surety, when sued alone, should, regardless of the double payment possibilities, be permitted to plead the alleged principal's offsets without bringing in the principal.

The last type of case involving the double payment risk which we shall discuss is the one in which the surety is relying on a payment made by the principal.[69] The courts would probably permit the Jobbers, when sued alone, to plead as a partial defense a $400 cash payment alleged to have been made by the Builder to the Factory.[70] This, too, has its double payment potentialities. When the Jobbers prove themselves to be sureties, and that the payment was in fact made, the Factory's claim will be reduced to $600. But the Builder may in a later action, allege and prove that the $400 he gave to the Factory was a loan to it, and, in addition, show that he was not liable for the goods. He would, in that case, recover a judgment of $400 against the Factory, and thus whittle the Factory's original claim down to $200.

This result, also, can be justified, if at all, only on the ground that there is no remedy to which the Jobbers can be remitted that will give them the benefit of the payment and afford the Factory the requisite protection. The alleged payment is clearly not a debt owing to the Builder which may be applied in satisfaction of the Builder's promise to indemnify. Hence, there is nothing upon which a subrogation action can operate, and there is no step that the Jobbers can take to guard the Factory against the Builder.[71] In deciding whether the surety can plead the payment, the court must choose

[68] See p. 207 supra.

[69] Other cases are those like N. Y. Life Ins. Co. v. Dunlevy, 241 U. S. 518, 36 Sup. Ct. 614, 60 L. ed. 1140 (1916), p. 216 supra, in which a defendant is unable to interplead several claimants to a debt when they are not residents of or present in the same state. These raise the same problems which we considered on p. 222 supra, under the case of Scheffer v. Erie Co. Savings Bank, 229 N. Y. 50, 127 N.E. 474 (1920).

[70] 2 WILLISTON, CONTRACTS, sec. 1219 (1920).

[71] True it is that the Jobbers for their own protection may vouch in the Builder by notifying him to take over the defense of the Factory's action. So that, if the Jobbers should fail to establish that the $400 payment was made, and if they later sued the Builder for reimbursement, the Jobbers could use the Factory's judgment against them as conclusive evidence against the Builder that the payment was not made. 1 FREEMAN, JUDGMENTS, 5th ed., sec. 447 (1920). And this would be so although the Builder was a nonresident and was served with the notice outside of the state in which the Factory sued the Jobbers. Konitzky v. Meyer, 49 N. Y. 571

between depriving him of it or throwing the risk of double payment on the creditor. It may be that the latter choice, which the courts seem to have made, is the better one. But where the surety pleads an independent offset belonging to the principal, we do have a remedy by which the surety can gain access to it and yet afford the creditor the protection he needs. We are not, in such a case, in the quandary of either taking the offset from the surety or placing the double payment risk upon the creditor. The task that confronts us is the light one of forcing the surety to use the subrogation remedy if he would gratify his desire to reach the offset.

Should Surety Have the Offset When Creditor Cannot Be Protected?

Lest we be misunderstood, we state before closing this paper that we are by no means ready to subscribe to a rule of law providing that whenever the choice does lie between withholding the principal's offset from the surety and having the creditor assume the double payment risk, the surety's right to the offset should prevail. This perplexity rears its ugly head when, in the subrogation action, it appears that the principal is a nonresident and the offset debt is payable in a country which will not give effect to our subrogation judgments and in which the creditor may be sued.[72]

A cognate problem has presented itself under the garnishment statutes which permit a plaintiff to sue a nonresident defendant and to garnish or attach a debt due the defendant from someone amenable to process in the state in which the action is brought. In *Martin v. Nadel*,[73] the garnishee was the Dresdner Bank of Berlin, Germany, with a branch office in London. It was indebted to one Nadel, a resident of Germany, who had deposited money in the Berlin office of the bank. Nadel, in turn, was indebted to certain Englishmen who obtained a garnishee order to be served on the London branch of the

(1872); MacArthur Brothers Co. v. Kerr, 213 N. Y. 360, 364, 107 N.E. 572, 573 (1915).

But the courts hold that a judgment based on a notice vouching in a person is not conclusive on him as to the issue whether he was the principal; and even when the Jobbers seek reimbursement, the Builder is free to show that he was not principally liable for the goods. 1 FREEMAN, JUDGMENTS, 5th ed., sec. 448 (1920). Unless the courts hold that the Builder will be bound by the determination in the Factory's action that the Builder, as principal, made the payment, the Factory would derive little benefit from a requirement that the Jobbers vouch in the Builders as a condition to their relying upon an alleged payment by him.

[72] See note 40 supra.

[73] [1906] 2 K. B. 26.

bank. Objection was made by the bank on the ground that, according to German law, a payment to the English creditors of Nadel pursuant to an English judgment would be no defense to an action by Nadel against the bank in Germany. The court, for this reason, held that the garnishee order should not have been issued, saying:[74]

> "On the facts of this case the debt of the bank to Nadel would be properly recoverable in Germany. That being so, it must be taken that the order of this court would not protect the bank from being called on to pay the debt a second time. That is a good reason why the order should not be made, for to make it would be inequitable and contrary to natural justice."

This case has been followed in later English decisions and in this country.[75] A strong argument may be built upon these authorities for the proposition that, in the subrogation action, the creditor should have the right to defeat the surety in his demand for the offset by showing that it is payable in a country which will not recognize the judgment. Nevertheless, there would be a fairly substantial justification for a court impaling itself on the other horn of the dilemma and asking the creditor to take the chance of paying twice. There is the more or less impelling reason that the surety will otherwise lose the offset.

But in the action that the creditor brings against the surety alone there is only the most tenuous ground to support a decision refusing to strike out the surety's defense based on the principal's offset. The surety has been relieved thereby from the trifling inconvenience of making the principal a party to a subrogation action or cross action. It is this mite which is to be weighed against saving the creditor from the apprehension of double payment in those cases in which the subrogation judgment would be effective.

What a commentary might be written on the dullness of the courts' sense of justice if they favored the surety in these circumstances. We should, therefore, rejoice that the courts almost universally have refused to add the suretyship-offset cases to the roster of those in which they subject a party to the risk of double payment; and our

[74] [1906] 2 K. B. 26, at p. 31.

[75] Swiss Bank Corp. v. Boehmische Industrial Bank, [1923] 1 K. B. 673; Employers' Liability Assurance Corp. v. Sedgwick Collins and Co., [1927] A. C. 95; Richardson v. Richardson, [1927] P. 228; Weitzel v. Weitzel, 27 Ariz. 117, 230 Pac. 1106 (1924); Parker, Peebles & Knox v. National Fire Insurance Co., 111 Conn. 383, 150 Atl. 313, 69 A. L. R. 599 (1930); 29 MICH. L. REV. 114 (1930); 40 YALE L. J. 139 (1930).

exultation need not be much abated by the fact that most of the decisions have been in the form of stating merely that the law does not allow the surety, when sued alone, to plead his principal's offset unless the principal is a party to the action.[76]

[76] The cases are collected in the texts referred to in note 28 supra. See also 18 L. R. A. (N.S.) 600 (1909); 43 L. R. A. (N.S.) 977 (1913).

For the sake of simplifying a necessarily complicated discussion we have based our double payment argument on but one possibility, namely, that the Builder, who is alleged by the Jobbers to be the principal, might show, when he sued the Factory for the work, that he was not liable at all for the price of the goods. One can easily conceive of other contingencies that might cause the Factory to pay twice. We mention only a few. The Builder in his own action against the Factory might prove that he had bought the goods from one one else and that he was still liable to that person; or that even before the suit against the Jobbers was commenced, the Builder had paid the Factory for the goods or had for some valid reason rescinded the sale or compromised the Factory's claim and obtained a release.

There is no need to multiply the instances. The inconvenience to which we put a surety when we confine him to the subrogation remedy is so slight and the injustice to a creditor, when we compel him to pay the offset twice, is so flagrant that we would be fully warranted in denying the surety the use of the offset in the absence of the principal, if by so doing we avoided double payment in but a single instance.

It may be added here that the setting is somewhat different when the surety pleads an offset arising out of the contract set forth in the complaint, such as a counterclaim for breach of warranty damages pleaded against a claim for the price of the same goods. The authorities do not generally give the surety this offset in the absence of the principal. See texts cited in note 28. This problem is beyond the scope of the present article.