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## Commercial Law (1958)

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# COMMERCIAL LAW

FREDERICK M. HART

**D**URING the past year only one case directly involving commercial law reached the Court of Appeals. The major activity in this field took place in the lower courts and in the legislature. Principal developments include numerous statutes amending the State Banking Law, legislation and cases affecting a non-banking corporation's power to discount notes, judicial interpretation of the nature of a bank draft, and several cases examining warranty actions in the sale of foodstuffs.

## I

### LEGISLATION

The last general revision of the New York Banking Law was completed in 1914.<sup>1</sup> The phenomenal growth of the industry during the intervening forty-four years has been accompanied by marked changes in the banking structure. Bank mergers, branch banking, chain banking and, more recently, a move toward the holding company form are the most spectacular symbols of this metamorphosis. Of equal importance is the growth of savings banks, of savings and loan associations, and of the influence which insurance companies have exerted through their investments. In 1955 the Joint Legislative Committee to Review the Banking Law was established by the legislature.<sup>2</sup> Emanating from this committee's work are some sixty-seven bills passed during the year. The more important of these are noted below.<sup>3</sup>

Unfortunately, one of the most serious questions before the committee was left unanswered when attempts to formulate a policy on bank holding companies were unsuccessful.<sup>4</sup> Efforts to alter boundaries of the banking districts so as to enlarge the New York City District to include Westchester also failed.<sup>5</sup>

*Bank and Trust Companies.*—The organization of bank and trust companies was affected by legislation which increased the required amount of capital for their establishment,<sup>6</sup> required at least seven, instead of five, directors for institutions having a capital stock in excess

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<sup>1</sup> N.Y. Sess. Laws 1914, ch. 369.

<sup>2</sup> N.Y. Sess. Laws 1955, ch. 307, at 871.

<sup>3</sup> For a comprehensive summary of all laws enacted during the survey period affecting banking, see N.Y. State Banking Dep't, Legislative Summary (1958).

<sup>4</sup> Report of the Joint Legislative Committee to Revise the Banking Law, Leg. Doc. No. 18, at 12 (1958).

<sup>5</sup> S. Int. 2542 (1958).

<sup>6</sup> N.Y. Banking Law § 90(3) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 754.

of two million dollars,<sup>7</sup> and provided that not more than one-third of the directors be active officers or employees.<sup>8</sup>

Legislation modifying their business activities includes measures: (1) allowing the purchase, as well as the discounting, of certain negotiable instruments and evidences of debt;<sup>9</sup> (2) permitting the exercise through foreign branches of whatever powers as are usual in the place where the foreign branch is located;<sup>10</sup> (3) repealing a former prohibition forbidding the purchase of a bank or trust company's own obligations at less than face value;<sup>11</sup> (4) authorizing loans to bank officers and employees;<sup>12</sup> (5) restricting investments in bank premises;<sup>13</sup> (6) limiting the holding as security of another bank's stock to no more than twenty-five per cent of the total capital stock of the debtor bank;<sup>14</sup> and (7) revising lending limitations.<sup>15</sup>

*Savings Banks.*—Probably the most significant change involving savings banks enables them to lend funds secured by a first lien mortgage upon real estate to the amount of twenty-five thousand dollars, or to ninety per cent of the appraised valuation of the property, whichever is less. The property must be in New York State, within fifty miles of the bank's principal office, and improved by a one-family residence.<sup>16</sup> Investments by savings banks were also authorized in slum clearance projects,<sup>17</sup> and authorizations for FHA and VA bonds and mortgages,<sup>18</sup> leaseholds,<sup>19</sup> bankers acceptances and bills of exchanges,<sup>20</sup> and promissory notes were extended.<sup>21</sup>

<sup>7</sup> N.Y. Banking Law § 116(1) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 430.

<sup>8</sup> N.Y. Banking Law § 116(6) (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 430.

<sup>9</sup> N.Y. Banking Law § 96(1) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 780.

<sup>10</sup> N.Y. Banking Law § 96(10) (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 79.

<sup>11</sup> N.Y. Sess. Laws 1958, ch. 236 [Repealing N.Y. Banking Law § 103(5) (1950)].

<sup>12</sup> N.Y. Banking Law § 103(8) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 827. This chapter also repealed N.Y. Banking Law § 130(3) (1950).

<sup>13</sup> N.Y. Banking Law § 98(1), (2) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 62.

<sup>14</sup> N.Y. Banking Law § 103(2) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 98.

<sup>15</sup> N.Y. Banking Law § 103(1) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 374.

<sup>16</sup> N.Y. Banking Law § 235(6)(b-1) (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 949.

<sup>17</sup> N.Y. Banking Law § 235(28) (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 564.

<sup>18</sup> N.Y. Banking Law § 235(20) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 795.

<sup>19</sup> N.Y. Banking Law § 235(6) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 908.

<sup>20</sup> N.Y. Banking Law § 235(12) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 586.

<sup>21</sup> N.Y. Banking Law § 235(8) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 695.

*Savings and Loan Associations.*—Abandonment of the rotation system of withdrawals in favor of an arrangement expected to serve as a model for other states<sup>22</sup> is the most important change in the regulation of savings and loan associations. Previously, an association could limit withdrawals to one thousand dollars, and require a member wishing more to file a new request which would not be honored until previous applications, up to one thousand dollars, were paid.<sup>23</sup> Under the new system an association may demand a notice of sixty days before paying withdrawals. If such notice is made mandatory, then no payments may be made on any request until sixty days have passed.<sup>24</sup> At the end of sixty days the withdrawal application must be paid in full or the Superintendent of Banking is authorized to take possession.<sup>25</sup> To insure sufficient liquidity for the operation of this system, investments in conventional mortgages are now limited to eighty-five per cent, except where the Superintendent of Banking authorizes additional amounts.<sup>26</sup> Mortgages insured by the FHA and VA, as well as those made pursuant to Title I of the Bankhead-Jones Farm Tenant Act,<sup>27</sup> are not considered in computing the amount of investments for the purposes of these sections.

Saving and loan associations were also affected by acts which: (1) authorize the making of loans up to twenty-five thousand dollars or ninety per cent of the appraised value of land improved by a single family residence, whichever figure is lesser;<sup>28</sup> (2) allow them to service mortgages for others;<sup>29</sup> and (3) permit participation with other banking institutions in the making of mortgage investments.<sup>30</sup>

*Industrial Banks.*—The legislation of the past year increased the minimum number of directors for an industrial bank from five to seven,<sup>31</sup> and provided that no more than one-third of the directors could be active as officers or employees.<sup>32</sup> In addition, the power

<sup>22</sup> 75 Banking L.J. 632 (1958).

<sup>23</sup> *Ibid.*

<sup>24</sup> N.Y. Banking Law § 390(1), (2) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 880, §§ 2, 3.

<sup>25</sup> N.Y. Banking Law § 606(1) (f) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 880, § 5.

<sup>26</sup> N.Y. Banking Law § 380-d (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 880, § 1.

<sup>27</sup> 50 Stat. 522 (1937), as amended, 7 U.S.C. §§ 1000-25 (1952).

<sup>28</sup> N.Y. Banking Law § 380(1) (a) (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 948.

<sup>29</sup> N.Y. Banking Law § 383(6) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 227.

<sup>30</sup> N.Y. Banking Law § 380-c (Supp. 1958), added by N.Y. Sess. Laws 1958, ch. 362.

<sup>31</sup> N.Y. Banking Law § 290(6) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 553, § 1.

<sup>32</sup> N.Y. Banking Law § 303 (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch.

of an industrial bank to purchase and hold stock of the FDIC was discontinued.<sup>33</sup>

*Safe Deposit Business.*—Laws which regulate the operation of safe deposit business are now codified in article VIII-A of the Banking Law.<sup>34</sup>

*Discounting of Notes by Non-banking Corporations.*—One of the most significant legislative developments to the commercial community is an act<sup>35</sup> authorizing non-banking corporations to discount notes. This practice, long followed by factoring and finance companies, had been threatened by the Court of Appeals decision in *Miller v. Discount Factors, Inc.*,<sup>36</sup> which held that section 131 of the Banking Law prohibited discounting except by banking institutions. Although the *Miller* case has been subsequently limited by allowing foreclosure of a mortgage given as security for a discounted note,<sup>37</sup> the present legislation was necessary to provide a means of recovering on unsecured notes.

*Installment Sales of Automobiles.*—Six bills<sup>38</sup> amending the recently adopted Motor Vehicle Retail Installment Sales Act<sup>39</sup> were passed during the year. Two of these relate to insurance issued in connection with such sales requiring that the type of coverage be described<sup>40</sup> and that credit be given the purchaser for unearned premiums if the insurance is cancelled.<sup>41</sup> Total credit charges for insurance are now limited to seven dollars per hundred per annum regardless of the age of the vehicle,<sup>42</sup> and additional protection to the consumer

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553, § 8. This provision does not effect present directors who are serving as officers or employees, even though by doing so the one-third figure is exceeded.

<sup>33</sup> N.Y. Banking Law § 292(11) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 553, § 2.

<sup>34</sup> N.Y. Sess. Laws 1958, ch. 879, § 17.

<sup>35</sup> N.Y. Gen. Corp. Law § 18 (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 991. The Banking Law was also amended to bring it into conformity with the General Corporation Law. N.Y. Banking Law § 131(1) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 990.

<sup>36</sup> 1 N.Y.2d 275, 135 N.E.2d 33, 152 N.Y.S.2d 273 (1956). See Kupfer, *Prohibited Discounts Under the Banking and General Corporation Laws: The Impacts of Miller v. Discount Factors, Inc.*, 12 Record of N.Y.C.B.A. 30 (1957).

<sup>37</sup> *Amherst Factors, Inc. v. Kochenburger*, 4 N.Y.2d 203, 149 N.E.2d 863, 173 N.Y.S. 2d 570 (1958). For a federal case which comes to the same result when a chattel mortgage is involved, see *New York Credit Men's Adjustment Bureau, Inc. v. Samuel Breiter & Co.*, 253 F.2d 675 (2d Cir. 1958). These two cases are discussed at pp. 1150-51 *infra*.

<sup>38</sup> N.Y. Sess. Laws 1958, chs. 681-86. See also McKinney's N.Y. Sess. Laws 1958, at 1836.

<sup>39</sup> N.Y. Pers. Prop. Law art. 9 (Supp. 1958).

<sup>40</sup> N.Y. Pers. Prop. Law § 302(5) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 681.

<sup>41</sup> N.Y. Pers. Prop. Law § 302(6) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 681.

<sup>42</sup> N.Y. Pers. Prop. Law § 303 (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 682.

is provided by requiring that he be informed of his rights when his contract is assigned to a third party.<sup>43</sup>

*Installment Sale of "Merchandise Certificates."*—The installment sale of merchandise certificates which are redeemable for goods and services was sanctioned by an amendment to the Retail Installment Sales Act.<sup>44</sup> These are now considered as a form of retail installment credit agreement for the purposes of regulation.<sup>45</sup>

## II

### CASES

*Discounting by Non-banking Corporations.*—The legislative overruling of *Miller v. Discount Factors, Inc.*<sup>46</sup> was accompanied by a significant limitation of that decision by the courts. Although the action of the legislature diminishes the importance of these holdings, they cannot go unnoted in this year's *Survey*.

The *Miller* case, decided in 1956, held that no action could be brought on unsecured notes which had been discounted by a non-banking corporation. The decision was based upon the statutory prohibition against discounting, except by banking institutions, found in section 131 of the Banking Law. Since the court considered only the narrow issue of whether an action brought on the notes themselves was maintainable, it did not foreclose a remedy for money had and received to recoup the amount actually paid to the borrower. Such an action had been allowed prior to the *Miller* case,<sup>47</sup> and the court gave no indication of any intention to reverse its previous rulings.

Foreclosure of a mortgage given as security for discounted notes offered another possibility of relief. Prior to the *Miller* case the court had held such mortgages enforceable even where the secured notes were void.<sup>48</sup> Subsequent to the *Miller* decision, however, the argument was raised that discounting in contravention of section 131 rendered not only the notes void, but also all mortgages given as security. Lower courts uniformly refused to adopt this position, whether the mortgage was of real property or of chattels.<sup>49</sup>

<sup>43</sup> N.Y. Pers. Prop. Law § 302(9) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 684.

<sup>44</sup> N.Y. Pers. Prop. Law art. 10 (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 687.

<sup>45</sup> N.Y. Pers. Prop. Law § 401(8) (Supp. 1958), as amended, N.Y. Sess. Laws 1958, ch. 687.

<sup>46</sup> 1 N.Y.2d 275, 135 N.E.2d 33, 152 N.Y.S.2d 273 (1956).

<sup>47</sup> *Pratt v. Short*, 79 N.Y. 437 (1880).

<sup>48</sup> *Williams-Dexter Co. v. Dowland Realty Corp.*, 259 N.Y. 581, 182 N.E. 189 (1932); *Pratt v. Eaton*, 79 N.Y. 449 (1880).

<sup>49</sup> *Amherst Factors, Inc. v. Kochenburger*, 4 App. Div. 2d 745, 164 N.Y.S.2d 815 (2d Dep't 1957), *aff'd*, 4 N.Y.2d 203, 149 N.E.2d 863, 173 N.Y.S.2d 570 (1958); *Anti-*

In *Amherst Factors, Inc. v. Kochenburger*,<sup>50</sup> the Court of Appeals was faced with the question of whether a mortgage on real estate, given as security for a note discounted by a non-banking corporation, was enforceable through a foreclosure action. In reaffirming the pre-*Miller* cases, the court held that the New York General Corporation Law specifically authorized non-banking corporations to lend money on notes secured by mortgages.<sup>51</sup> Where the notes had been discounted, section 131 of the Banking Law affected the transaction by voiding the notes but not the accompanying security. The same result was reached by the United States Court of Appeals for the Second Circuit in a case involving a chattel mortgage.<sup>52</sup>

Thus, the *Miller* case, which had "staggered the financial and commercial mechanism,"<sup>53</sup> survived only two years. Criticised as failing to effectuate "the common understanding and reasonable expectations of laymen in the conduct of their daily affairs,"<sup>54</sup> its holding was quickly limited by the courts. What remained was destroyed by the legislature. It is unlikely that its demise will engender much grief among either the legal or business communities. Although the *Miller* decision was fully in accord with sound principles of statutory construction, its holding resulted more as a hindrance to legitimate business practices than to effectuate the purposes of the statute.

*Bank Drafts.*—The right of a drawer bank to raise the defense that a successor in interest to the payee of a bank draft lacked good title was affirmed by *International Firearms Co. v. Kingston Trust Co.*<sup>55</sup> The purchaser of the draft, which was drawn by Kingston on another local bank, sent the instrument to a stakeholder in Canada with instructions that it should not be delivered to the payee until certain goods cleared customs. This condition was never met, and the purchaser demanded return of the draft. The stakeholder refused, and payee's successor in interest obtained possession as a result of an in rem action brought in Canada. Concurrently, the purchaser and the drawer bank agreed to have payment stopped, and the purchase price of the instrument was returned to the purchaser. Payee's successor in

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pyros Co. v. Samuel Breiter & Co., 165 N.Y.S.2d 976 (Sup. Ct., N.Y. Co. 1957); County Indus. Corp. v. Francia, 5 Misc. 2d 602, 164 N.Y.S.2d 415 (Sup. Ct., Westch. Co. 1957). See also New York Credit Men's Adjustment Bureau, Inc. v. Samuel Breiter & Co., 253 F.2d 675 (2d Cir. 1958).

<sup>50</sup> 4 N.Y.2d 203, 149 N.E.2d 863, 173 N.Y.S.2d 570 (1958).

<sup>51</sup> N.Y. Gen. Corp. Law § 18 (Supp. 1958).

<sup>52</sup> New York Credit Men's Adjustment Bureau, Inc. v. Samuel Breiter & Co., 253 F.2d 675 (2d Cir. 1958).

<sup>53</sup> Kupfer, supra note 36, at 30.

<sup>54</sup> Id. at 47. See also Kripke, *Illegal "Discounts" by Non-Banking Corporations in New York*, 56 Colum. L. Rev. 1183 (1956).

<sup>55</sup> 6 App. Div. 2d 171, 175 N.Y.S.2d 794 (3d Dep't 1958).

interest brought this action against the drawer bank for payment of the draft. Plaintiff's title was found to be defective by the trial court, and judgment was rendered for the defendant. The appellate division affirmed with two justices dissenting.

The majority and minority opinions differ on the right of the purchaser and drawer bank to revoke their contract by mutual consent and to stop payment of a bank draft. The majority, in finding a bank draft analogous to a personal check, held that where payment was stopped, the drawer bank would not incur liability if the title of the payee, or his successor in interest, was defective. Relying on *Kerr S.S. Co. v. Chartered Bank of India, Australia & China*,<sup>56</sup> the dissenting justices considered the transfer of the draft to the purchaser in exchange for money an executed contract which may not be revoked. The dissenters would hold the drawer absolutely liable on the instrument where payment had been stopped.

The *Kerr* case, itself a minority view,<sup>57</sup> does hold that a purchaser may not unilaterally rescind his agreement with the drawer bank even where he is in possession of the draft and it is impossible for him to transmit it to the payee. It is clearly distinguishable from the instant case, however, in which there is no disagreement between the purchaser and the drawer bank, both agreeing to have payment stopped. The holding of the *Kerr* case does not deal with the right of a drawer bank to stop payment where there has been a mutual rescission of the agreement between it and the purchaser of the draft, nor does it touch upon the defenses available to the drawer bank when this results in suit on the instrument.

Whether payment can be stopped without casting absolute liability on the drawer depends upon the nature of a bank draft. It is profitable to compare it with other instruments used to transmit money, namely, personal checks, certified checks and cashiers' checks. There is no doubt that payment can be stopped on a personal check,<sup>58</sup> and this normally applies to a personal check certified at the request of a drawer.<sup>59</sup> Where the check is certified at the request of the payee or a holder, a contrary result is reached on the rationale that the certification is in effect an acceptance by the drawee bank.<sup>60</sup> New York has, by statute, denied the right to stop payment on all certified checks.<sup>61</sup> It is generally stated that payment cannot be stopped on a

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<sup>56</sup> 292 N.Y. 253, 54 N.E.2d 813 (1944).

<sup>57</sup> See 57 Harv. L. Rev. 918 (1944).

<sup>58</sup> *Florence Mining Co. v. Brown*, 124 U.S. 385 (1888); 7 Am. Jur. Banks § 602 (1937).

<sup>59</sup> *Britton, Bills and Notes* 837 (1943); 7 Am. Jur. Banks § 603 (1937).

<sup>60</sup> *Carnegie Trust Co. v. First Nat'l Bank*, 213 N.Y. 301, 107 N.E. 693 (1915).

<sup>61</sup> N.Y. Negotiable Instr. Law § 325-a (Supp. 1958). No similar provision is found in the Uniform Negotiable Instruments Act.



cashier's check.<sup>62</sup> Holdings to this effect have either allowed the payee or holder to treat the instrument as a promissory note<sup>63</sup> since the drawer and drawee are the same person, or have reasoned that the check is accepted by the act of issuance.<sup>64</sup>

The logical reasons for imposing absolute liability upon the drawer of a cashier's check and for refusing to allow a personal check certified at the holder's request to be stopped are not applicable to bank drafts. Although a bank draft is considered by some authorities to be identical with a cashier's check,<sup>65</sup> this fundamental difference exists: only in the cashier's check are the drawer and drawee merged in one person. As acceptance can be implied when a bank draws a draft upon another bank, there is no satisfactory rationale for considering it to be an absolute promise to pay.

The implication of Justice Herlihy's dissent in the *International Firearms* case that the majority's holding will leave the bank draft with little more significance than a personal check does not appear to be realistic. The essential difference between the two is that the bank draft is based upon the credit of the drawer bank, while a personal check relies upon the credit of an individual. The majority opinion does not refute this distinction. All that it says is that whoever demands payment must show good title. This position is in agreement with the majority of jurisdictions considering the question,<sup>66</sup> and is sound.

*Warranty of Wholesomeness: Privity.*—Antagonists of the requirement that a plaintiff must establish privity of contract with the defendant in order to maintain a cause of action in warranty should rally round the flag post and raise a banner to salute Justice George Starke. His opinion in *Conklin v. Hotel Waldorf Astoria Corp.*<sup>67</sup> revived the "assault on the citadel of privity" in New York. He followed this with an article<sup>68</sup> criticising the privity principle in which he characterized it as "just a 'bugaboo.'"<sup>69</sup> Finally, in June of this year,

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<sup>62</sup> Annot., 56 A.L.R. 532 (1928), 107 A.L.R. 1463 (1937). But note contrary cases discussed therein.

<sup>63</sup> *Cable & Wireless, Ltd. v. Yokohama Specie Bank, Ltd.*, 191 Misc. 567, 79 N.Y.S.2d 597 (Sup. Ct., N.Y. Co. 1948), aff'd sub nom. *Cable & Wireless, Ltd. v. Lyon*, 304 N.Y. 574, 107 N.E.2d 75 (1952) (mem.).

<sup>64</sup> *Matter of Bank of United States*, 243 App. Div. 287, 277 N.Y. Supp. 96 (1st Dep't 1935).

<sup>65</sup> 10 C.J.S. Bills and Notes § 5 (1938). See *Kohler v. First Nat'l Bank*, 157 Wash. 417, 289 Pac. 47 (1930).

<sup>66</sup> Annot., 107 A.L.R. 1463, 1465 (1937). See also *Hurley v. Union Trust Co.* 244 App. Div. 590, 280 N.Y. Supp. 474 (3d Dep't 1935).

<sup>67</sup> 5 Misc. 2d 496, 161 N.Y.S.2d 205 (N.Y. City Ct., N.Y. Co. 1957).

<sup>68</sup> Starke, *Implied Warranties of Quality and Wholesomeness in the Sale of Food*, 137 N.Y.L.J. Nos. 67-69, p. 4, col. 1 (1957).

<sup>69</sup> *Id.* at No. 67, p. 4, col. 2.

when another action for breach of warranty came before him, he found the law so totally confused that it required a thirty-four page opinion to explain adequately his reasons for deciding a city court case.<sup>70</sup> In the course of this opinion, which reads more like an appellate brief, the learned Justice invites the higher courts to "clarify the legal atmosphere clouding the subject."<sup>71</sup> Although he is quick to note the handful of opinions which have relied upon his reasoning in the *Conklin* case and his subsequent article, he cautiously refrains from pointing out that whatever clouds hang over the problem are a result of his own efforts.

The importance of the recent decisions involving the privity question, only one of which reached an appellate court, lies principally in the possibility that they will lead to a re-examination of the problem by the Court of Appeals. So far, New York has refused to follow the nation-wide trend away from the privity requirement,<sup>72</sup> and a renouncement in this jurisdiction of the established maxim "no privity—no warranty" would be significant. The purpose of this survey would be perverted by a full discussion of the numerous questions which must be answered if the broad criticisms leveled by the lower courts are accepted, but some note of the year's cases is justified.

The facts of the *Conklin* case, noted in last year's *Survey*,<sup>73</sup> were ideal for the purpose of attacking the privity concept. Two women were served lunch in one of defendant's dining rooms. One was injured by the food; the other paid the bill. A holding that the injured party lacked a cause of action in warranty simply because payment by her companion left her with no contractual relationship with the defendant would appear wholly unjust. However, it was possible to allow recovery in warranty without departing from the established privity rules. The court held that the contract between restaurateur and patron commenced at the time the order was placed and accepted, and that as soon as this contractual relationship existed, a warranty ran to the defendant that the food was wholesome. Although this was apparently the rationale of the decision, the court also pointed out the possibility of finding an agency relationship between the patrons, or of construing the contract between the paying party and the defendant as a third party beneficiary contract. As resting upon the holding that a contractual relationship did in fact exist, the decision is wholly in harmony with prior New York law.

The article by Justice Starke which followed had a far wider

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<sup>70</sup> *Parish v. Great Atl. & Pac. Tea Co.*, 177 N.Y.S.2d 7 (N.Y.C. Munic. Ct., Manhattan 1958).

<sup>71</sup> *Id.* at 11.

<sup>72</sup> Cf. Prosser, *Torts* 507 (2d ed. 1955).

<sup>73</sup> 1957 *Survey of N.Y. Law*, 32 N.Y.U.L. Rev. 1405.

scope, advocating complete abandonment of the privity requirement. Less than two months after its publication, a judge sitting in the Municipal Court of the City of New York allowed recovery against a manufacturer of a chocolate bar although the plaintiff had purchased the candy from a local retailer.<sup>74</sup> The report of the case leaves some doubt as to the rationale of the decision. It states:

The Judge charged the contract was between the manufacturer and the jobber, and then by the jobber and the retailer; and such contracts were made knowingly for the benefit of the public.

Reliance has been placed on the manufacturer of the sealed product rather than on the jobber or retailer. The manufacturer in placing sealed products upon the market, especially by his advertising and printed labels has intentionally brought himself into direct relationship with the ultimate purchaser or consumer. The Judge charged that there was an implied warranty of quality and wholesomeness that went along with the peanut bar from the manufacturer to the ultimate consumer.<sup>75</sup>

Six months later special term decided the case of *Welch v. Schiebelhuth*.<sup>76</sup> Mrs. Welch had purchased a cake from the defendant-retailer. Suit was instituted by her husband and two guests who allegedly became ill after having ingested the cake. Plaintiffs' motion to amend their complaint to allege for each of them an additional cause of action for breach of warranty was opposed on the grounds that no privity existed. The court briefly reviewed legislation and judicial decisions in other states which have overturned the privity principle. It then indulged in the novelty of citing legislation, recommended in New York but never adopted, which would extend the liability of a vendor to the buyer's employees and to members of his household. Although it would seem that failure of a recommended bill would indicate, if anything, that it did not represent the desires of the legislators, the court here considered the discarded bill as an indication that it was what the legislature advocated. Going on to cite cases in which privity had been held to exist on an agency relationship, the court notes that New York "has chipped away, eroded and streamlined the privity rule *and its demise, without elegy, is in view.*"<sup>77</sup> Concluding that it "is . . . evident as long as we are incumbered with the privity rule, no matter how it may be disguised, progress towards the full protection of the consumer will be slow and tedious,"<sup>78</sup> the court granted plaintiffs' motion.

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<sup>74</sup> *Lardaro v. MBS Cigar Corp.*, 10 Misc. 2d 873, 177 N.Y.S.2d 6 (N.Y.C. Munic. Ct., Queens 1957).

<sup>75</sup> *Id.* at 873-74, 177 N.Y.S.2d at 6.

<sup>76</sup> 11 Misc. 2d 312, 169 N.Y.S.2d 309 (Sup. Ct., Kings Co. 1957).

<sup>77</sup> *Id.* at 316, 169 N.Y.S.2d at 313.

<sup>78</sup> *Ibid.*

Two cases<sup>79</sup> followed which considered the privity question in connection with a husband's action for loss of consortium. In both of these a wife recovered for breach of warranty, but the husband's action for medical expenses and loss of services was defeated because he failed to establish that he was in privity with the defendant. The possibility that the wife acted as his agent in making the purchase was considered by one court,<sup>80</sup> implying that the existence of an agency relationship would be sufficient to hurdle the privity obstacle. It was found, however, that the evidence failed to establish that he was the principal in the sale.

In *Parish v. Great Atl. & Pac. Tea Co.*,<sup>81</sup> the last of this year's reported cases involving privity decided by trial courts, plaintiff purchased a sealed jar of jam from a retailer. She and her infant children were injured after having consumed it, and she brought suit on her own behalf and as guardian ad litem of her two children. Defendant's motion to dismiss the cause of action in warranty as to the two infants on the ground that no privity of contract existed between them and the defendant was denied by the court. The court could have justified its decision either by construing the contract between the purchaser and the defendant as a third party beneficiary contract for the benefit of the infants, or by holding the purchaser to be the agent of her children. Admittedly, both of these theories involve rationalizations not wholly acceptable to the legal purist, but they do have the advantage of being supported, at least in part, by prior New York cases. Justice Starke chose instead to hold that "the archaic notion that privity is an essential to recovery in a breach of warranty action is cardinal error. It requires the acceptance of the artificial and the shutting of our eyes to the realities of life."<sup>82</sup> Thus, he tells us that the Court of Appeals has been wrong in requiring privity of contract in warranty cases, and supports his refusal to follow their erroneous decisions by a strong and lengthy argument attacking privity from every corner.

The opinion is commendable for its forthright approach. Clearly stating that the privity requirement should be totally abandoned, it avoids the confusion which often results where the principle has been retained, but twisted and distorted to fit "hard" cases. However, it is

<sup>79</sup> *Zampino v. Colgate-Palmolive Co.*, 10 Misc. 2d 686, 173 N.Y.S.2d 117. (Sup. Ct., Montgomery Co. 1958); *Lore v. De Simone Bros.*, 172 N.Y.S.2d 829 (Sup. Ct., Richmond Co. 1958).

<sup>80</sup> *Zampino v. Colgate-Palmolive Co.*, supra note 79, at 690, 173 N.Y.S.2d at 121. Prior to these cases the city court, Bronx County, allowed recovery by a fourteen year old girl for damages suffered while eating a can of salmon bought by her father. *Greenberg v. Lorenz* (Dec. 13, 1957) in 138 N.Y.L.J. No. 115, p. 9, col. 7. The appellate term decision in this case is discussed at p. 1157 infra.

<sup>81</sup> 177 N.Y.S.2d 7 (N.Y.C. Munic. Ct., Manhattan 1958).

<sup>82</sup> *Id.* at 38.

difficult to defend the court's assumption of the duty to correct the mistakes of an appellate court. The need for stability in the law, as well as the right of lawyers and litigants to know the status of their rights, seems to demand, at least, that inferior courts follow established precedents. Although it is unquestionably true that courts "must correct errors in the law and . . . must make . . . changes with the times which are substantiated by reason and experience,"<sup>83</sup> this is a function of the Court of Appeals, not of the city courts.

The opinion itself is open to criticism. Although numerous arguments are made to show why the privity requirement should be discarded, and these are amply fortified with citations and extensive quotations, the heart of the privity question is never explored. The effects of allowing a consumer who has been injured by a product to bring a warranty action against anyone who took part in the manufacture or distribution of the goods are quickly by-passed. For instance, the court says that, "the only distinction [between a negligence and a warranty action] is that the negligence action requires proof of failure to use due care, whereas breach of warranty is liability (without negligence) for the fitness of the product."<sup>84</sup> For the litigant and his attorney this is a tremendous distinction, completely changing the burden of proof and imposing upon those engaged in putting the product on the market an entirely different duty. It would have been more profitable if Justice Starke had spent less time in arguing his position and exerted more effort in investigating the significance of the change which he advocates. He might also have considered whether the cases involving foods and drugs present a different problem from those concerning other articles, a difference founded upon the community's greater solicitude over products which they will ingest.

The final reported case in this area, *Greenberg v. Lorenz*,<sup>85</sup> was the only one to reach an appellate court. The trial court had allowed recovery by a fourteen year old girl for injuries suffered as a result of eating the contents of a can of salmon purchased by her father, holding that the implied warranty of wholesomeness extended to the girl as a matter of law.<sup>86</sup> The appellate term, with one justice dissenting, affirmed.

Endorsing the view that the privity concept is anachronistic, the majority explains its apparent failure to follow established precedents requiring privity in breach of warranty actions by noting several cases<sup>87</sup> which, it is claimed, establish a new trend and render it clear

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<sup>83</sup> *Id.* at 37.

<sup>84</sup> *Id.* at 20.

<sup>85</sup> 178 N.Y.S.2d 407 (Sup. Ct., App. T., 1st Dep't 1958).

<sup>86</sup> 178 N.Y.S.2d 404 (N.Y. City Ct., Bronx Co. 1957).

<sup>87</sup> *Blessington v. McCrory Stores Corp.*, 305 N.Y. 140, 111 N.E.2d 421 (1953);

that when this question again reaches the higher appellate courts they will overrule previous decisions. Once having discerned this trend, the majority feels that it is "the right, nay the duty, of an intermediate court, to take cognizance of it,"<sup>88</sup> and to extend "the trend already set in motion by superior authority."<sup>89</sup> There is no convincing support, however, from higher appellate courts showing such a trend. None of the cases cited have indicated that the privity requirement is to be abandoned. To the contrary, where recovery has been allowed by a non-purchaser, the courts have specifically found privity to exist by virtue of an agency relationship between the purchaser and the injured plaintiff.<sup>90</sup>

The opinion is also interesting because of the novel interpretation placed upon the legislature's failure to adopt proposed bills which would abolish the privity requirement. It disposes of the contention that the duty to reverse a long line of cases for what is essentially a public policy reason lies more within the province of the legislature than of the courts, and that the failure of the legislature to act might indicate a desire to retain the requirement, with the following ratiocination:

Doubtlessly the Legislature has refrained from intruding amendatory legislation in the area we have been considering, because it has had these considerations in mind—it believes that a change in a principle originated by a judicial decision can safely be left to and effected by decisional law to achieve the most salutary advance.<sup>91</sup>

Not only is it more difficult to detect the legislature's reasons for not acting than the court believes, but also the court begs the question by accepting as a premise the conclusion that this principle originated by a judicial decision. A well reasoned dissent was written by Justice Steuer. He would refuse recovery on the ground that a breach of warranty action is based solely on the sale. Since sales are specifically covered by statute, and the statute has been construed to require a showing of privity between the parties in warranty actions, there can be no recovery in such cases until the legislature amends the law.

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Ryan v. Progressive Grocery Stores, Inc., 255 N.Y. 388, 175 N.E. 105 (1931); Bowman v. Great Atl. & Pac. Tea Co., 284 App. Div. 663, 133 N.Y.S.2d 904 (4th Dep't 1954), aff'd, 308 N.Y. 780, 125 N.E.2d 165 (1955); Visusil v. W. T. Grant Co., 253 App. Div. 736, 300 N.Y. Supp. 652 (2d Dep't 1937).

<sup>88</sup> 178 N.Y.S.2d at 411.

<sup>89</sup> Ibid.

<sup>90</sup> Ryan v. Progressive Stores, Inc., 266 N.Y. 388, 175 N.E. 105 (1931); Bowman v. Great Atl. & Pac. Tea Co., 284 App. Div. 663, 133 N.Y.S.2d 904 (4th Dep't 1954), aff'd, 308 N.Y. 780, 125 N.E.2d 165 (1955).

<sup>91</sup> 140 N.Y.L.J. No. 73, at p. 2, col. 2.