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Payments-Surety's Right to Direct Application

PAYMENTS—SURETY'S RIGHT TO DIRECT APPLICATION.—Defendant was surety for the Karstedt Construction Company on a contract requiring repairs on a school building. Plaintiff, a subcontractor, performed certain work for the Construction Company, and applied payments made out of proceeds of the secured contract on prior claims arising out of other contracts. Plaintiff brought the present action to recover from the surety the amount of the indebtedness arising out of the assured contract. Defendant contends that the payments from funds arising out of the present contract should be applied on debts arising out of the same contract. Held, in the absence of direction by the debtor, the creditor may apply the payments received to any claim due him from the debtor regardless of his knowledge of the source of the funds.[1]

In regard to the right of the surety to have the proceeds of the contract which he assures applied to the claims arising out of the contract, there are three distinct rules adopted by the courts: First, regardless of the knowledge of the source of the payments received, the creditor must apply them to the secured claims;[2] Second, if the creditor knows the source of the payments, he must apply them to the secured claims;[3] Third, regardless of knowledge, the creditor may apply the payments as he sees fit.[4] Before discussing the various rules, it is well to note some of the general rules as to the application of payments. In the first place, the debtor has the right to say how the payments which he makes shall be applied.[5] In the absence of direction by the

[18] Bryant v. School Town of Oakland City (1930), 202 Ind. 254, 171 N. E. 378.

[19] State ex. rel. Matthews v. Forsythe (1896), 147 Ind. 466, 473, 44 N. E. 593.

[20] Eddy Valve Co. v. Town Crown Point (1906), 166 Ind. 613.

[1] Western & Southern Indemnity Co. v. Cramer (1937), 10 N. E. (2d) 440, (Ind. App. Court).

[2] Columbia Digger Co. v. Sparks (1915), 227 F. 780; Crane Co. v. Pacific Heat Co. (1904), 36 Wash. 95, 78 P. 460.

[3] Maryland Casualty Co. v. Dupree (1931), 223 Ala. 420, 136 S. 811; Sturtevant Co. v. Fidelity & Deposit Co. (1916), 92 Wash. 52, 158 P. 740; Salt Lake City v. O'Connor (1926), 68 Utah 233, 249 P. 810.

[4] Grover v. Board of Education (1928), 102 N. J. Eq. 415, 141 A. 81; City of Marshfield v. United States Fidelity Co. (1929), 128 Ore. 547, 274 P. 503; Standard Oil v. Day (1924), 161 Minn. 281, 201 N. W. 410.

[5] Trentman v. Fletcher (1885), 100 Ind. 105.

debtor as to how the application should be made the creditor may apply the payments as he sees fit.[6] If neither the debtor nor the creditor has made any application and litigation arises, the courts will direct the application.[7] The problem in the present case arises when the funds with which the payments are made come from a source which, also, gave rise to a part, but not all of the claims.

The first rule which gives the surety the right to direct the application seems to base the decision on the idea that an equity in favor of the surety arises out of the fact relating to the source of the payments; that the debtor receives full credit for the payments regardless of the account on which it is applied; and that the creditor is not harmed, for in case of payment on either account he still has the claim for the other. However, this rationale really ignores the facts; for the surety is seldom called on to pay when the principal is not in financial difficulties. Furthermore, a reapplication might be a definite hardship, since the creditor may have released the security which he had for the other debt. For the surety, however, it may be said that he assures only payment of the claims arising out of the contract, or that the contract will not be a losing one, and that he does not assure the financial solvency of the contractor. To state the argument another way, the courts feel that each building contract should be self-supporting. Out of this arises the equity to which, under this view of the law, the courts give full protection.[8] The courts would not protect this equity, of course, if a superior equity in favor of the creditor should arise, as from the release of a lien.

According to the second view of the law under the present circumstances, the creditor's knowledge of the source of the funds from which he is paid will cause his rights to be subordinated to those of the surety.[9] The arguments in favor of the first rule apply with more force here; for before the creditor has made any application or released any securities, he knows of the source of the money. Under such circumstances it is less of a hardship to require a reapplication than in the case where the first application was made in ignorance of the source of the funds. Unless the first application was made in ignorance the courts adopting this view of the law do not consider it a hardship to require a reapplication. Here, of course, the burden is on the surety to show that payments applied to prior indebtedness were made with funds which the surety was entitled to have applied in discharge of his obligation;[10] the creditor has no duty to determine the source of the payments.[11]

There are a number of courts which state the rule as announced in the principal case to the effect that knowledge of the source of payments is immaterial, and that the creditor can apply them as he desires if the debtor

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[6] Crane Co. v. United States Fidelity Co. (1913), 74 Wash. 91, 132 P. 872.

[7] Bell v. Bell (1911), 174 Ala. 446, 56 S. 926; Cain v. Vogt (1908), 138 Iowa 631, 116 N. W. 786.

[8] Columbia Digger Co. v. Sparks (1915), 227 F. 780; Sioux City Foundry Co. v. Merten (1916), 174 Iowa 332, 156 N. W. 367; Thompson v. Commercial Union Co. (1904), 20 Colo. App. 331, 78 P. 1073.

[9] Salt Lake City v. O'Connor (1926), 68 Utah 233, 249 P. 810; Chicago Lumber Co. v. Douglas (1913), 89 Kan. 308, 131 P. 563; Wanamaker v. Powers (1905), 102 App. Div. 485, 93 N. Y. S. 19.

[10] Merchants Ins. Co. v. Herbert (1897), 68 Minn. 420, 71 N. W. 624; Fulton Grain Co. v. Anghim (1899), 44 App. Div. 488, 69 N. Y. S. 957.

[11] Salt Lake City v. O'Connor (1926), 68 Utah 233, 249 P. 810.

gives no direction.[12] The courts following this view recognize the hardship of requiring a reapplication and a revival of a debt which was once considered discharged. Futhermore, this view is consistent with the idea that the money is the property of the contractor and he could have used it in payment of other creditors unconnected with the assured contract.[13] Thus, this view of the law is consistent with idea of the negotiability of money and is commercially desirable, inasmuch as the other views tend to place restrictions on the use of the money used in making the payments.

The third view, which gives the surety no right to regulate the application of the payments, seems to be the view which is gaining the most support. It is not unfair to the surety, because he could refuse to assure a contractor who was already heavily in debt. Furthermore, the surety could provide in the agreement just how the funds should be applied and could secure ample protection in this way, since if such agreement were known to the creditor he would have to respect it.[14] R. E. M.

NORRIS-LAGUARDIA ANTI-INJUNCTION ACT—EXISTENCE OF A LABOR DISPUTE.—Plaintiff, a Delaware corporation, maintained several meat markets in Milwaukee, Wis., employing a total of some thirty persons, none of whom were union members. Defendants, members of a labor union, after a fruitless demand that plaintiff require its employees to become members of the union, picketed plaintiff's place of business to force unionization. On a bill in the Federal courts for an injunction, Held, a labor dispute existed within the meaning of both the Federal[1] and the state[2] anti-injunction acts, and an injunction could not issue except in accordance with those acts.[3]

In surprisingly few words,[4] the Supreme Court has cast aside doubts as to the constitutionality of the Norris-Laguardia Act—doubts that have persisted during the six years that have elapsed since its adoption.[5] In equally brief fashion, the Court has laid down its first authoritative construction of the Act.

[12] Western & Southern Indemnity Co. v. Cramer (1937), 10 N. E. (2d) 440; (Ind. App. Court); Hirth v. Powers (1896), 108 Mich. 339, 66 N. W. 215; Grace Harbor Lumber Co. v. Ortman (1916), 190 Mich. 429, 157 N. W. 96; Radichel v. Federal Security Co. (1927), 170 Minn. 92, 212 N. W. 171; Standard Oil v. Day (1924), 161 Minn. 281, 201 N. W. 410; City of Marshfield v. United States Fidelity Co. (1929), 128 Ore. 547, 274 P. 503.

[13] Fidelity and Deposit Co. v. Union State Bank (1927), 21 F. (2d) 102.

[14] White v. Beem (1881), 80 Ind. 239.

[1] 47 Stat. 70 (1932), 29 U. S. C. §§ 101-115.

[2] State statutes similar to the Federal Act have been adopted in Indiana (Burns Ind. Stat. Ann., 1933, §§ 40-501ff), Colorado, Idaho, Louisiana, Maryland, Massachusetts, Minnesota, New York, North Dakota, Oregon, Utah, Washington, and Wisconsin. Several other states have restrictive statutes of narrower scope.

[3] Lauf et al v. E. G. Shinner & Co. (1938), — S. Ct. —.

[4] The majority opinion found it necessary to cite only one authority for its result, simply stating, "There can be no question of the power of Congress thus to define and limit the jurisdiction of the inferior courts of the United States."

[5] Recent indications had pointed to this result. The Supreme Court had upheld the Wisconsin statute in Senn v. Tile Layers Protective Union (1937), 301 U. S. 468, 57 S. Ct. 857. The lower Federal courts had consistently upheld the Act, as had the majority of state courts in passing upon the validity of their statutes. See, for example, Levering & Garrigues Co. v. Morrin (CCA,