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CPLR 5232(a): Service of Execution Terminates Statutory Right of Setoff

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In practical effect, the *Ward* holding highlights the significance of preserving a party's testimony. Under *Ward,* a practitioner who has secured the testimony of his opposing party by deposition will have protected his own client's right to testify, notwithstanding the death of the opposing party. Conversely, by preserving his own client's testimony in a deposition, the practitioner may be "opening the door" for his opponent to testify in the future. In any event, by permitting the party with the most knowledge to testify before the court, the import of *Ward* should be to further the search for truth in those cases in which a decedent's testimony has been preserved.

ARTICLE 52—ENFORCEMENT OF MONEY JUDGMENTS

CPLR 5232(a): Service of execution terminates statutory right of setoff.

CPLR 5232(a) provides judgment creditors with a means for levying upon a debt owed a judgment debtor by a third party.[93] Once a copy of an execution is served upon the third party-garnishee, he must pay any mature debt owed the judgment debtor to the sheriff; the garnishee is prohibited from paying or otherwise disposing of the debt to any other person.[94] When the garnishee is also a creditor of the judgment debtor the situation becomes more complex. Under section 151 of the Debtor and Creditor Law, the garnishee may set off his indebtedness against debts owed him by the judgment debtor.[95] Thus, section 151 purports to allow the third party-

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same problem posed in *Ward* lend support to the *Ward* holding. *See, e.g.,* Coble v. McClintock, 10 Ind. App. 562, 38 N.E. 74 (1894); Coughlin v. Hauessler, 50 Mo. 126 (1872); Goehring v. Dillard, 145 Ohio St. 41, 60 N.E.2d 704 (1945). *But see* Levy v. Dwight, 12 Colo. 101, 20 P. 12 (1888). *See also* 3 B. JONES, LAW OF EVIDENCE § 20:43, at 692 (6th ed. 1972).

[93] CPLR 5232(a) provides for a levy upon debts owed a judgment debtor by serving a third party-garnishee with an execution. CPLR 105(i) defines garnishee as "a person who owes a debt to a judgment debtor, or a person other than the judgment debtor who has property in his possession or custody in which a judgment debtor has an interest." *See generally* 6 WK&M ¶ 5232.08.

[94] CPLR 5232(a) provides in pertinent part:

> The person served with the execution shall forthwith transfer all such property, and pay all such debts upon maturity, to the sheriff and execute any document necessary to effect the transfer or payment. . . . [T]he garnishee is forbidden to make or suffer any sale, assignment or transfer of, or any interference with, any such property, or pay over or otherwise dispose of any such debt, to any person other than the sheriff . . . .

[95] N.Y. DEBT. & CRED. LAW § 151 (McKinney Supp. 1977) provides in pertinent part:

> Every debtor shall have the right upon . . . the issuance of any *execution* against any of the property of . . . a creditor, to set off and apply against any indebtedness, whether matured or unmatured, of such creditor to such debtor, any amount owing from such debtor to such creditor, at or at any time after, the happening of . . .

garnishee to cancel or reduce the same debt that he is required to pay to the sheriff under CPLR 5232(a). Faced with this apparent conflict of statutory provisions, the Appellate Division, First Department, in *Industrial Commissioner v. South Shore Amusements, Inc.*,[96] held that service of an execution pursuant to CPLR 5232(a) immediately terminates the garnishee's statutory right of setoff.[97]

The Industrial Commissioner of the State of New York, seeking to collect unpaid unemployment insurance taxes, had issued warrants against defendant South Shore.[98] These warrants were returned unsatisfied and, according to statute, became enforceable as judgments entered against the defendant.[99] The Commissioner then served an execution upon the National Bank of North America, a bank in which South Shore maintained an account. At the time of service defendant was in default on a loan that previously had been granted it by this bank.[100] Consequently, the bank did not honor the levy, deciding instead to set off defendant's account against the outstanding loan pursuant to section 151 of the Debtor and Creditor Law.[101] The Supreme Court, New York County, resolved the dispute

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> the above mentioned [event], and the aforesaid right of set off may be exercised by such debtor against such creditor or against any . . . receiver or *execution*, judgment or attachment creditor of such creditor, . . . notwithstanding the fact that such right of set off shall not have been exercised by such debtor prior to the making, filing or issuance, or service upon such debtor of, or of notice of, any . . . *issuance of execution* . . . .

Id. (emphasis added). *See generally* Godfrey-Keeler Co. v. Regent Laundry & Dry Cleaning Corp., 9 N.Y.S.2d 840 (App. T. 1st Dep't 1939) (per curiam); Samuel v. Public Nat'l Bank & Trust Co., 151 Misc. 200, 270 N.Y.S. 112 (App. T. 1st Dep't 1932) (per curiam).

[96] 55 App. Div. 2d 141, 389 N.Y.S.2d 850 (1st Dep't 1976).

[97] *Id.* at 143, 389 N.Y.S.2d at 851.

[98] *Id.* at 141-42, 389 N.Y.S.2d at 850. The warrants were issued pursuant to N.Y LAB. LAW § 573(2) (McKinney 1965), which enables the State Industrial Commissioner to issue a warrant directed to any employee of the department of labor ordering the employee to levy upon property of an employer who has defaulted in the payment of unemployment insurance taxes. *See* 23 CARMODY-WAIT 2d § 143:8 (1968).

[99] *See* N.Y. LAB. LAW § 573(2) (McKinney 1965). The statute provides in pertinent part: "If a warrant is returned not satisfied in full, the commissioner shall have the same remedies to enforce the amount thereof as if the commissioner had recovered judgment for the same." *Id.*

[100] 55 App. Div. 2d at 142, 389 N.Y.S.2d at 850. After South Shore's default on its loan, the bank referred the debtor's account to an officer for collection. Surprisingly, no further action was taken until service of execution. Indeed, the bank, in the absence of any repayment by the judgment debtor, had renewed the loan twice. *Id.* at 142, 389 N.Y.S.2d at 850-51.

[101] *Id.* When a party deposits funds in a bank, the bank becomes a debtor of the depositor, *see* Brigham v. McCabe, 20 N.Y.2d 525, 232 N.E.2d 327, 285 N.Y.S.2d 294 (1967); His Majesty's Treasury v. Bankers Trust Co., 304 N.Y. 282, 107 N.E.2d 448 (1952); Sundail Constr. Co. v. Liberty Bank, 277 N.Y. 137, 13 N.E.2d 745 (1938), thus establishing the relationship required by § 151 of the Debtor and Creditor Law.

by ordering the bank to surrender the proceeds of the account to the Commissioner.[102]

A divided appellate division affirmed, ruling that any right of setoff the bank may otherwise have been entitled to under section 151 terminated upon service of execution.[103] The court reasoned that the express language of section 151 does not provide for the nullification of a CPLR 5232(a) levy.[104] Furthermore, the majority contended, the bank account ceased to be the property of the judgment debtor following service of the CPLR execution.[105] Thus, in the court's opinion the garnishee bank no longer held any property of the judgment debtor which was subject to setoff.[106] In support of its decision, the *South Shore* majority cited the opinion of the United States District Court for the Southern District of New York in *United States v. Sterling National Bank & Trust Co.*,[107] which it interpreted as holding that a garnishee-bank's right of setoff terminates upon service of an execution.[108]

Justice Lane, who authored the *South Shore* dissent, maintained that section 151 plainly permits the garnishee to effect the setoff subsequent to service of a CPLR 5232(a) execution.[109] A contrary interpretation, the dissent argued, nullifies effectiveness of the Debtor and Creditor Law,[110] "since the first effective notice of the

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[102] 55 App. Div. 2d at 141, 389 N.Y.S.2d at 850. The action was brought pursuant to CPLR 5227, which provides for a special proceeding to secure payment when a garnishee fails to comply with a CPLR 5232(a) levy. *See* Suffolk Auto Liquidators, Inc. v. Eastern Auto Auction, Inc., 74 Misc. 2d 411, 343 N.Y.S.2d 806 (Sup. Ct. Bronx County 1973); Michigan Assoc. v. Emigrant Sav. Bank, 74 Misc. 2d 495, 345 N.Y.S.2d 329 (N.Y.C. Civ. Ct. Queens County 1973); 6 WK&M ¶¶ 5227.08, 5232.13.

[103] 55 App. Div. 2d at 142-43, 389 N.Y.S.2d at 851.

[104] *Id.* at 143, 389 N.Y.S.2d at 851. The court maintained that the "issuance of execution" provision found in § 151 of the Debtor and Creditor Law did not preserve the bank's right of setoff after levy. For a discussion of the legislative intent underlying this provision, see note 118 and accompanying text *infra*.

[105] 55 App. Div. 2d at 143, 389 N.Y.S.2d at 851.

[106] *Id.*

[107] 360 F. Supp. 917 (S.D.N.Y. 1973), *aff'd in relevant part*, 494 F.2d 919 (2d Cir. 1974).

[108] *See* 55 App. Div. 2d at 143-44, 389 N.Y.S.2d at 851-52. *Sterling* involved an action brought by the IRS against a garnishee-bank for its failure to honor a levy on the checking account of a delinquent taxpayer. The financial institution had insisted on its right to set off the checking account funds against the outstanding balance of the debtor-taxpayer's loan. 360 F. Supp. at 919. It should be noted that the IRS levy which precipitated the *Sterling* litigation presumably was treated as a post-judgment levy. *See* I.R.C. § 6331; Treas. Reg. § 301.633-1 (1974). *See also* 6 WK&M ¶ 5202.05, .05(a). Aside from the fact that the account was levied upon pursuant to federal law, the situation in *Sterling* was similar to the *South Shore* situation.

[109] 55 App. Div. 2d at 145-46, 389 N.Y.S.2d at 853 (Lane, J., dissenting).

[110] *Id.* at 146, 389 N.Y.S.2d at 853.

issuance of an execution is by service of that execution upon the garnishee . . . ."[111]

The result reached by the *South Shore* majority appears questionable. Indeed, the court's reliance upon *Sterling* seems misplaced. The *Sterling* court held that under federal income tax law a bank has no right to assert a setoff after a tax levy is served.[112] By virtue of the supremacy clause,[113] therefore, section 151 is not applicable when a levy is effected pursuant to federal tax law. In *South Shore,* since plaintiff levied pursuant to state law rather than federal law, section 151 should have been applied.[114] In following the *Sterling* decision, the *South Shore* majority may have contravened the legislative intent underlying the state statutory scheme. Levy by service of execution first became possible in 1952 with the enactment of CPA 687-a, the predecessor of CPLR 5232(a).[115] To ensure that the garnishee's rights would be safeguarded, the legislature simultaneously amended section 151 of the Debtor and Creditor Law to state that a garnishee may raise against a judgment creditor, even after "issuance of execution,"[116] any setoff which the garnishee possessed against his creditor.[117] This statutory language, when read in conjunction with the applicable legislative history, seems to evince an intent to preclude the result reached in *South Shore.*[118]

Hence, there appears to be no basis for the majority's conclusion that section 151 "does *not* provide for such right [of setoff] after levy."[119] The effect of such a narrow construction is to render

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[111] *Id.* (citation omitted).

[112] *See* 360 F. Supp. at 920-22.

[113] U.S. CONST. art. VI, cl. 2.

[114] *See* N.Y. DEBT. & CRED. LAW § 151 (McKinney Supp. 1977), *quoted in* note 95 *supra.*

[115] CPA 687-a was enacted to expand a creditor's remedies in situations where there were "obligations owing a judgment debtor by others." N.Y. LAW REVISION COMM'N, 1952 REPORT, N.Y. LEG. DOC. No. 65, at 363.

[116] N.Y. DEBT. & CRED. LAW § 151 (McKinney Supp. 1977).

[117] N.Y. LAW REVISION COMM'N, 1952 REPORT, N.Y. LEG. DOC. No. 65, at 365.

[118] The New York Law Revision Commission, which was responsible for recommending the amendment to § 151 and the enactment of CPA 687-a, stressed that:

> In order that it may be clear that the third party debtor is entitled to utilize (in defending a suit brought against him by the judgment creditor), all defenses and set-offs he might have had against the judgment debtor, appropriate amendments of section 151 of the Debtor and Creditor Law should be made.

Id.

[119] 55 App. Div. 2d at 143, 389 N.Y.S.2d 851 (emphasis in original). The *South Shore* tribunal placed considerable emphasis upon the bank's failure to react promptly to the judgment debtor's default. *See id.* at 142, 389 N.Y.S.2d at 851. It may be inferred, therefore, that the court's decision was at least partially influenced by the lending institution's lack of diligence. Since § 151 provides that the setoff may be applied "against any indebtedness, whether matured or unmatured, . . . at or at any time after" issuance of execution, N.Y.

the statute a virtual nullity in a situation which it expressly was intended to govern.[120] It is hoped that the legislative purpose underlying section 151 will be implemented by the courts in future decisions.

ESTATES, POWERS AND TRUSTS LAW

EPTL § 5-1.1(b)(1)(B): Totten trust established prior to August 31, 1966 and transferred to another depository subsequent to that date held to be a testamentary substitute.

Designed to prevent the disinheritance of a surviving spouse by use of the Totten trust device,[121] EPTL section 5-1.1(b)(1)(B) provides that money that has been deposited in a Totten trust by a decedent after August 31, 1966 and subsequent to his marriage to the surviving spouse is to be treated as a "testamentary substitute" and included in the net estate subject to the surviving spouse's right of election.[122] Although seemingly unambiguous on its face, this statute fails to expressly treat the question whether funds placed in a Totten trust prior to August 31, 1966 and transferred to another

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DEBT. & CRED. LAW § 151 (McKinney Supp. 1977), it would appear to be improper for the *South Shore* court to have considered adversely the bank's failure to react immediately.

[120] As was noted by the *South Shore* dissent, "the first effective notice of the issuance of an execution is by service of that execution upon the garnishee . . . ." 55 App. Div. 2d at 146, 389 N.Y.S.2d at 853 (Lane, J., dissenting) (citation omitted). Thus, it is clear that the majority's position, in demanding action by the garnishee prior to service of execution, greatly encroaches upon the garnishee's right of setoff.

[121] The term Totten trust is derived from the case *In re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904). The usual Totten trust is established when a person makes a deposit in a savings account in his own name in trust for another. The account is not an irrevocable trust; by making withdrawals the depositor can revoke, modify, or terminate the trust at any time during his lifetime. The beneficiary has no rights in the trust until the depositor dies, whereupon title to the funds automatically vests in the beneficiary. If the depositor survives the beneficiary, the trust is terminated. *See* EPTL § 7-5.2. *See generally* G. BOGERT & G. BOGERT, LAW OF TRUSTS § 20 (5th ed. 1973); 1 A. SCOTT, TRUSTS § 58 (3d ed. 1967).

[122] EPTL § 5-1.1(b)(1)(B) provides that the following transaction is to be treated as a testamentary substitute subject to the surviving spouse's right of election:

> Money deposited, after August thirty-first, nineteen hundred sixty-six, together with all dividends credited thereon, in a savings account in the name of the decedent in trust for another person, with a banking organization, savings and loan association, foreign banking corporation or organization or bank or savings and loan association organized under the laws of the United States, and remaining on deposit at the date of the decedent's death.

The surviving spouse's elective share is one-third of the net estate when the decedent is survived by one or more issue, and one-half of the net estate in all other cases. EPTL § 5-1.1(a)(1)(A). The net estate is computed by deducting debts, administration expenses, and reasonable funeral expenditures from the probate estate. *Id. See generally* 9A P. ROHAN, NEW YORK CIVIL PRACTICE ¶ 5-1.1[1]-[4] (1977) [hereinafter cited as ROHAN]; A. SAINER, THE SUBSTANTIVE LAW OF NEW YORK §§ 22-49 (1976).