



4-1-1943

Liability of Sureties -- Extent to Which Liability Established Against Principal Determines the Liability of Surety

Robert R. Bond

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Robert R. Bond, *Liability of Sureties -- Extent to Which Liability Established Against Principal Determines the Liability of Surety*, 21 N.C. L. REV. 310 (1943).

Available at: <http://scholarship.law.unc.edu/nclr/vol21/iss3/13>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

W, it would seem that the provision for these payments was inserted in the judgment at least partly with the idea of having *H* pay off the part of the debt due by *W*. When considered in this light, it becomes plain that this provision was also one for the payment of debt, although it may, as the court suggested, have also contemplated providing the wife with a house in which to live.

It is submitted that the court erred in upholding the citation for contempt. Although *H* consented that failure to pay might subject him to contempt proceedings under the statute relating to alimony without divorce, his consent could not give a court jurisdiction to imprison him for debt. He might just as well, as Justice Seawell suggests, "have agreed that a default in the payment of the debt should subject him to punishment under any criminal statute which may be found in the books."¹⁶

JOEL DENTON.

Liability of Sureties—Extent to Which Liability Established Against Principal Determines the Liability of Surety

Action by creditor against both principal and surety. The principal had made a statement admitting liability but such statement was made after default and without the principal knowing of his rights. *Held*: The surety has the right to stand on his contract and the statement of the principal is not binding on the surety.¹

Assuming that the surety has no defenses of his own the extent to which he may use defenses of the debtor is extremely limited. Ordinarily any defense, not personal to the debtor, is available to the surety in an action on the surety bond² but some cases seem to hold that a surety cannot make use of a defense (of the debtor) which the principal waives or otherwise precludes himself from making.³ While this doctrine does not apply to cases involving fraud or collusion between debtor and creditor,⁴ it does seem to extend the liability of the surety, for if a

¹⁶ Seawell, J., dissenting in *Edmundson v. Edmundson*, 222 N. C. 181, 192, 22 S. E. (2d) 576, 584 (1942), cited *supra* note 1.

¹ *Chozen Confections, Inc. v. Johnson*, 221 N. C. 224, 19 S. E. (2d) 866 (1942).

² *The Peoples Bank v. Loven*, 172 N. C. 666, 90 S. E. 948 (1916); *United States Fidelity & Guaranty Co. v. Town of Dothan*, 174 Ala. 480, 56 So. 953 (1911); *Bear v. Duval Lumber Co.*, 112 Fla. 240, 150 So. 614 (1933); *Greenwood v. Greenwood*, 44 Ga. App. 848, 163 S. E. 318 (1932); *Benson v. Alleman*, 220 Iowa 731, 263 N. W. 305 (1935); *Iowa Bonding & Casualty Co. v. Wagner Co.*, 203 Iowa 179, 210 N. W. 775 (1926); *City National Bank of Columbus, Ohio v. Jordan*, 139 Iowa 499, 117 N. W. 758 (1908); *State v. Duggan*, 102 W. Va. 312, 135 S. E. 270 (1926).

³ *Burwell v. First National Bank*, 86 Ind. App. 581, 159 N. E. 15 (1928); *Union State Bank v. American Surety Co.*, 324 Mo. 438, 23 S. W. (2d) 1038 (1930); *M. S. Cohn Gravel Co. v. Southern Surety Co.*, 129 Okla. 171, 264 Pac. 206 (1928); *Rathgaber v. Horton*, 52 S. D. 436, 218 N. W. 148 (1928).

⁴ *City National Bank of Columbus, Ohio v. Jordan*, 139 Iowa 499, 117 N. W.

debtor has a defense and takes advantage of it then in many instances the surety will be discharged. Whether or not a waiver of defense is to be binding on the surety should depend on the nature of the defense. There are defenses which go to the validity of the principal contract, *e.g.*, no consideration, illegality. If there is a failure of consideration the surety may take advantage of this fact as a defense⁵ even though the principal has not set it up first. To permit a waiver of this defense by the principal to bind the surety will in effect change the surety's contract upon which he has a right to stand. It will deprive the principal of the use of the property from which it was contemplated that the principal would secure funds with which to pay his debt. The surety's liability would be for a contract which either never existed in the case of total failure of consideration or only partially existed in the case of partial failure of consideration. Where the defense is illegality the courts will refuse to grant a plaintiff their aid.⁶ And to permit a waiver of such defense would in effect allow a plaintiff to recover upon a contract in violation of law. Some defenses arise, not from the nature of the bargain, but from the nature of the parties, *e.g.*, infancy. This defense, if the debtor is the infant, is not available to the surety even after the principal sets it up,⁷ and rightly so, for this may be the very reason the creditor secured a surety before parting with his goods. However, there is an exception to this rule where the infant both renounces the contract and returns the consideration so that the creditor is placed in status quo;⁸ but proof on this issue is on the surety and is in the end a failure of consideration. Then there are cases which present defenses arising because of wrongs perpetrated on one of the parties, *e.g.*, fraud or duress. It is not within the scope of this note to deal with defenses which accrue to the surety in his own right such as where the fraud is on him. Where there is fraud on the principal the surety may not avail himself of the defense unless the principal first sets it up.⁹ If, then, this defense is waived by the principal it will not be available to the surety. The reasoning of the court is that the defense of fraud is personal to the principal and he may waive the fraud and insist on enforcement of the contract and the surety may not make this election to set up the defense for the principal. But this reasoning seems to be fallacious for the surety has

758 (1908); *Taylor-Fichter Steel Const. Co. v. Fidelity & Casualty Co. of N. Y.*, 258 App. Div. 235, 16 N. Y. S. (2d) 218 (1940).

⁵ *Forsythe v. United States Fidelity & Guaranty Co.*, 130 Misc. Rep. 569, 224 N. Y. Supp. 330 (1927).

⁶ *Walker v. Graham*, 228 Ala. 574, 154 So. 806 (1934); *Schur v. Johnson*, 2 Cal. App. (2d) 680, 38 P. (2d) 844 (1935).

⁷ *McKee v. Harwood Automobile Co.*, 204 Ind. 233, 183 N. E. 646 (1933).

⁸ *Lagerquist v. Bankers' Bond & Mortgage Guaranty Co.*, 201 Iowa 430, 205 N. W. 977, 43 A. L. R. 585 (1933).

⁹ *Burwell v. First Nat. Bank*, 86 Ind. App. 581, 159 N. E. 15 (1928); *Rathgeber v. Horton*, 52 S. D. 436, 218 N. W. 148 (1928).

the right to stand on his contract.¹⁰ This would include the right to have the contract on which he became surety as it was when he became surety which would include the defense of fraud available to the principal. The defense of duress should likewise be treated. Any other view allows the creditor to profit by his own wrong. And even if the principal is willing to waive defenses of fraud or duress as to himself and insist on enforcement of the contract the creditor should not be allowed to retain the additional security of the surety.

Assuming again that the surety has no defenses of his own, and assuming further (1) that there are admissions by the principal of his liability under a contract, (2) that the creditor has secured a judgment against the debtor, then to what extent are these binding on the surety?

First, as to admissions of liability by the principal. The availability of an admission of the principal against the surety should be determined by the nature of the admission. If the admission is urged merely as a waiver of defense, then the above discussion of waiver should be applied. But, if the admission be urged as proof that there never was any defense or that it does not now exist, a different doctrine should be applicable. While the surety may not object to the principal remaining bound,¹¹ he has a right to stand on his own contract.¹² In other words a surety is not bound by what a principal says he has or has not done but on the contrary he is bound by what the principal actually does.¹³ The outcome of a case involving liability of surety, then will be determined by proof or disproof of the alleged liability of the principal. In this connection the competency of evidence will go a long way toward controlling the outcome of the case, and it is at once apparent how much influence an admission of liability by the principal will have if such admissions are competent. It is common to find a court saying that admissions of indebtedness by a debtor are admissible against his surety,¹⁴ and there are cases which contain general statements that admissions of the principal are not admissible against the surety.¹⁵ But from an examination of the

¹⁰ *Randall v. Gunter*, 181 Miss. 332, 179 So. 362 (1938); *Cohen v. Hurwitz*, 142 N. Y. Supp. 305 (1913); *State v. Duggan*, 102 W. Va. 312, 135 S. E. 270 (1926).

¹¹ *United States v. Shea-Adamson Co.*, 21 F. Supp. 831 (D. Minn. 1937); *Van Kirk v. Adler*, 111 Ala. 113, 20 So. 336 (1896); *M. S. Cohn Gravel Co. v. Southern Surety Co.*, 129 Okla. 171, 264 Pac. 206 (1928).

¹² *Randall v. Gunter*, 181 Miss. 332, 179 So. 362 (1938); *Cohen v. Hurwitz*, 142 N. Y. Supp. 305 (1913); *State v. Duggan*, 102 W. Va. 312, 135 S. E. 270 (1926).

¹³ *Chelmsford Co. v. Demerest*, 7 Gray (Mass.) 1 (1856); *Kellum v. Clark*, 97 N. Y. 390 (1884); *Hatch v. Elkins*, 65 N. Y. 489 (1875).

¹⁴ *Graves v. Aetna Insurance Co. of Hartford, Conn.*, 215 Ala. 250, 110 So. 390 (1927); *Smith v. Republic Underwriters*, 152 Kan. 305, 103 P. (2d) 858 (1940); *Atlas Shoe Co. v. Bloom*, 209 Mass. 563, 95 N. E. 952 (1911); *Cook County Liquor Co. v. Brown*, 31 Okla. 614, 122 Pac. 167 (1912); *W. T. Rawleigh Co. v. Graham*, 4 Wash. (2d) 407, 103 P. (2d) 1076 (1940).

¹⁵ *United States v. American Surety Co. of New York*, 56 F. (2d) 734 (C. C. A. 2d, 1932); *Chicago Portrait Co. v. O'Neane*, 6 Ga. App. 425, 65 S. E. 161 (1909);

cases admissibility seems to be determined with reference to the time the statement was made, *i.e.*, if the statement was made after a breach or default by the debtor such admissions are not competent evidence,¹⁶ while if the statement was made during the life of the contract it is admissible.¹⁷ The admissions after default are, in a sense, treated as hearsay,¹⁸ and the admissions made during the formation of the contract as part of the *res gestae*.¹⁹ The distinction between admissions after default and those made during the formation of the contract is understandable under the *res gestae* doctrine. But the reason for admitting statements made between the time of completion of the transaction and the time of default is less clear, for there appears no reason to make such statements binding on the surety since the principal is not the agent of the surety. And also there should be a rule that the principal may not act to the prejudice of his surety. Courts seem to follow the reasoning that a principal is less likely to make a statement admitting liability before default than after. But it would seem to be the reverse, for why would a person admit that he is liable as of the time of such statement more quickly than he would admit liability that is to become absolute in the future? A creditor should have to prove that a debt is owing from the principal by original evidence excluding statements of the principal made after the transacting of the business.²⁰

Great Western Life Assurance Co. v. Shumway, 25 N. D. 268, 141 N. W. 479 (1913); *Armstrong v. Goldberg*, 190 Wash. 210, 67 P. (2d) 328 (1937).

¹⁶ *Graves v. Aetna Insurance Co. of Hartford, Conn.*, 215 Ala. 250, 110 So. 390 (1927) (Admissions of indebtedness by principal after being declared in default held not binding on surety); *Atlanta Journal Co. v. Knowles*, 24 Ga. App. 745, 102 S. E. 191 (1920) (An admission of a principal that an account was correct, due, and unpaid held not admissible in a suit against the surety, where made after the principal had been dismissed as the plaintiff's agent); *Citizen's National Bank of Leighton v. Kupres*, 106 Pa. Super. 164, 161 Atl. 466 (1932) (In action on note wherein defendant obtained rule to open judgment by confession, defendant's declarations, in absence of guarantor on day after alleged fraud, held properly excluded).

¹⁷ *United States v. American Surety Co. of New York*, 56 F. (2d) 734 (C. C. A. 2d, 1932) (Admissions made by principal in transacting business for which surety is bound are competent evidence against surety); *Scovill Mfg. Co. v. Cassidy*, 275 Ill. 462, 114 N. E. 181 (1916) (Admissions made in regular course of the guaranteed business by the president and general manager of a corporation as to the amount of its indebtedness to a guarantee held competent against guarantors in suit on guaranty, although made shortly before bankruptcy).

¹⁸ *Padavic v. Vanderboom*, 207 Ill. App. 600 (1917) (A statement made by the maker of a note to a collector for the payee, out of the presence of the surety, at the time of presentation of the note for payment, that he would fix the matter with the payee, is purely hearsay as to the surety). However, notice that Illinois holds admissions by the principal made in regular course of business to be admissible. *Scovill Mfg. Co. v. Cassidy*, 275 Ill. 462, 114 N. E. 181 (1916), cited *supra* note 17.

¹⁹ *Dietrich v. Dr. Koch Vegetable Tea Co.*, 56 Okla. 636, 156 Pac. 188 (1916) (Declarations and conduct of the principal become a part of the *res gestae* and admissible against surety, where they were made during the transaction of the business for which the surety is bound, but not otherwise).

²⁰ See *Hatch v. Elkins*, 65 N. Y. 489, 496 (1875).

Second, as to the effect of a judgment against the principal in an action against the surety. Here too, there is an apparent division of authority. Some courts seem to hold that judgment against the principal is not binding on the surety²¹ while other cases hold it to be only prima facie evidence of a breach by the principal,²² and still others hold that the judgment is conclusive as to the liability of the surety.²³ An analysis of these cases will reveal that judgment is binding on the surety if he is surety on a bond such as a replevin bond, while if the suretyship contract is for the faithful performance of a contract, *i.e.*, business deal, then judgment against the principal is only prima facie evidence of a breach of the principal contract. This distinction is justified, for where a person is surety on a replevin bond usually breach of the bond depends simply on the existence of a judgment against the principal. Judgments rendered on business deals are determined only on evidence produced in court by the parties. Those cases which hold that a judgment against the principal is not binding on the surety deal with exceptions to the two rules above, such as where the defense is payment,²⁴ where the surety is entitled to defend in his own right,²⁵ or where the surety obligation is for less than the judgment.²⁶

While set-offs and counterclaims are not defenses it may be well to point out here that a surety, when used alone, may not avail himself of a set-off or counterclaim that a principal might use.²⁷ This doctrine seems to be based upon the fact that a counterclaim is an independent right of action belonging to the principal which he may or may not wish to invoke. The doctrine, however, has been extended to prohibit the surety from counterclaiming for usurious payments by the debtor²⁸ but North Carolina allows a surety to set-off such usurious payments.²⁹ It was also extended, in what appears to be a very poor decision, to a case where the defendant was surety for the return of the purchase price and the buyer had not exercised reasonable care in handling the purchased

²¹ Speight Box & Panel Co. v. Ipock, 217 N. C. 375, 8 S. E. (2d) 243 (1940); J. E. McCoy & Son v. Atkins, 172 Ark. 365, 288 S. W. 886 (1927); Randall v. Gunter, 181 Miss. 332, 179 So. 362 (1938).

²² Moses v. United States, 166 U. S. 571, 600, 17 S. Ct. 682, 693, 41 L. ed. 1119, 1129 (1896); Sauer v. Detroit Fidelity & Surety Co., 237 Mich. 697, 213 N. W. 98 (1927); see United States v. American Surety Co. of New York, 56 F. (2d) 734, 735 (C. C. A. 2d, 1932).

²³ Brewer v. Kirk, 256 Ky. 822, 77 S. W. (2d) 34 (1935); Giatas v. Demoulas, 271 Mass. 51, 170 N. E. 921 (1930).

²⁴ Randall v. Gunter, 181 Miss. 332, 179 So. 362 (1938); see Merrill v. Equitable Surety Co. of N. Y., 131 Misc. 541, 227 N. Y. Supp. 266, 273 (1928).

²⁵ Speight Box & Panel Co. v. Ipock, 217 N. C. 375, 8 S. E. (2d) 243 (1940).

²⁶ Moses v. United States, 166 U. S. 571, 600, 17 S. Ct. 682, 693, 41 L. ed. 1119, 1129 (1896); J. E. McCoy & Sons v. Atkins, 172 Ark. 365, 288 S. W. 886 (1927).

²⁷ National Surety Co. v. George E. Breece Lumber Co., 60 F. (2d) 847 (C. C. A. 10th, 1932).

²⁸ Savage v. Fox, 60 N. H. 17 (1880). *Contra*: Cole v. Hills, 44 N. H. 227 (1862).

²⁹ Peoples Bank v. Loven, 172 N. C. 666, 90 S. E. 948 (1916).

goods,³⁰ the court holding that the surety could not set off the amount of damage to the goods caused by such negligent handling.

In *Chozen Confections, Inc. v. Johnson*³¹ where the admission was made by the principal after default and also without the principal having knowledge of his rights, it is submitted that the North Carolina Supreme Court has reached the only proper and just conclusion.

ROBERT R. BOND.

³⁰ *Graham v. Middleby*, 213 Mass. 437, 100 N. E. 750, 43 L. R. A. (N.S.) 977 (1913).

³¹ 221 N. C. 224, 19 S. E. (2d) 866 (1942).