THE AVAILABILITY OF A PRINCIPAL'S DEFENSE TO HIS UNCOMPENSATED SURETY

LIKE MANY familiar business practices based on usage rather than detailed contracts, uncompensated suretyship[1] is difficult to define accurately, and has erratic and often unpredictable consequences. The term surety will here be used broadly, to include any person who assumes responsibility for the debt of another,[2] whether as accommodation party on a negotiable instrument,[3] or as guarantor,[4] indemnitor,[5] indorser,[6] issuer of a letter of credit,[7] or surety on a separate contract.[8] While the quality and extent of the obligation assumed by the surety varies with the form and the terms of the bargain he has made, all such arrangements betray the general shape of suretyship: a contract between a promisor, the surety, and a creditor, the obligee, under-

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1. See Sturges, *Suretyship and Guaranty* (1934) 14 ENCYC. SOC. SCIENCES 482 and articles cited at 486. It is not proposed to discuss in this comment the problem of surety defenses as applied to the corporate compensated surety, where either the contract of suretyship expressly provides for the contingency of the principal's defense, or where the equities, except when defenses such as usury, fraud, or duress are involved, are clearly in favor of the equally innocent creditor. See 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1212A. Furthermore, there is a disposition to resolve ambiguities in the surety contract against the corporate compensated surety. See Comment (1936) 5 FORDHAM L. REV. 473. On the history of the corporate compensated surety, see HANNA, CASES ON SECURITY (1932) 337 and articles there cited.

2. See TEX. ANN. REV. CIV. STAT. (Vernon, 1925) art. 6252; RESTATEMENT, CONTRACTS (1932) § 92, Comment *a*; ROWLATT, PRINCIPAL AND SURETY (2d ed. 1926) 1; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1211; Merrill, *Nebraska Suretyship* (1930) 8 NEB. L. BULL. 267. But see ARNOLD, SURETYSHIP AND GUARANTY (1927) §§ 5–8, 10, 20.

3. See 1 BRANDT, SURETYSHIP AND GUARANTY (3d ed. 1905) § 1, n. 1; ROWLATT, *op. cit. supra* note 2, at 5; Sturges, *supra* note 1, at 485. This comment will be limited to those cases which fall outside the scope of the Negotiable Instruments Law.

4. See TEX. ANN. REV. CIV. STAT. (Vernon, 1925) art. 6252; RESTATEMENT, CONTRACTS (1932) § 92, Comment *a*; Radin, *Guaranty and Suretyship* (1929) 17 CALIF. L. REV. 605, 18 CALIF. L. REV. 21.

5. See Comment (1935) 44 YALE L. J. 1053.

6. Compare 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1211 with ARANT, SURETYSHIP (1931) § 16; see also Johnson v. Marshall, 4 Rob. 157, 160 (La. 1843); RESTATEMENT, CONTRACTS (1932) § 92, Comment *a*; GA. CODE (1933) § 3541; TEX. ANN. REV. CIV. STAT. (Vernon, 1925) art. 6252; Merrill, *supra* note 2, at 269.

7. The California Civil Code includes letters of credit within the chapter on suretyship. CAL. CIV. CODE (Deering, 1931) §§ 2858–2866; see also MONT. REV. CODES ANN. (Anderson & McFarland, 1935) §§ 8210–8218; N. D. COMP. LAWS ANN. (1913) §§ 6690–6698; S. D. COMP. LAWS (1929) §§ 1513–1521; Campbell, *Guaranties and the Suretyship Phases of Letters of Credit* (1936–37) 85 U. OF PA. L. REV. 175, 261. But see FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT (1930) 32.

8. See Radin, *Guaranty and Suretyship* (1929) 18 CALIF. L. REV. 21, 27. But see 1 BRANDT, *op. cit. supra* note 3, § 2; SPENCER, SURETYSHIP (1913) § 3.

taken in behalf of a third party, the principal obligor, that on certain conditions the surety will pay the creditor his principal's debt.

This comment will be concerned with one legal issue which recurs frequently in connection with the judicial analysis of suretyship transactions: the availability to a surety, in a suit by the creditor, of defenses which his principal could assert against the creditor. The ultimate issue affecting the solution of this problem is one both of usage and of business policy: is the function of the surety in the credit extension to relieve the creditor of all risks incident to the loan, or only of the risk of the principal's insolvency? While the cases in general profess to favor the uncompensated surety[9] — a point of view which would, if extended, permit the surety to assert all his principal's defenses, and give the creditor protection only against the principal's insolvency — the decisions do not indicate a clearly articulated policy. By allowing the surety to assert some defenses, and denying him the protection of others, the cases are delimiting the content of the uncompensated surety's largely inarticulate bargain in a haphazard manner: all that is clear is that the surety contract insures the creditor against many risks of nonpayment in addition to the insolvency of the principal. So far these risks can be classified only by enumeration.

Although it is frequently repeated that "whatever discharges the principal debtor also discharges the surety,"[10] certain defenses have been recognized as "personal"[11] to the principal, who alone may invoke them, while others are regarded as "inherent"[12] in the principal debt, and are available to the

9. Historically, the uncompensated surety is a "favorite of the law" and his contract *strictissimi juris*. See STEARNS, THE LAW OF SURETYSHIP (Feinsinger's 4th ed. 1934) 402; Sturges, *supra* note 1, at 484.

10. See Griffith v. Sitgreaves, 90 Pa. 161, 167 (1879); see also 1 POTHIER, OBLIGATIONS (Evans' ed. 1806) 235: STEARNS, *op. cit. supra* note 9, § 102.

11. 1 BRANDT, *op. cit. supra* note 3, § 163; Comment (1913) 13 COL. L. REV. 426. This exception was early incorporated into statutory provisions. See DIGEST OF CIVIL LAWS IN TERRITORY OF ORLEANS (1808) 428; see also CAL. CIV. CODE (Deering, 1931) § 2810; LA. CIV. CODE ANN. (Dart, 1932) art. 3060; S. D. COMP. LAWS (1929) § 1488; MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 8185; *cf.* GA. CODE (1933) § 3539; N. D. COMP. LAWS ANN. (1913) § 6674; OKLA. STAT. (Harlow, 1931) § 9623. The exception was invoked despite the fact that many of the "personal" defenses operated to make the principal contract "void." See *e. g.* Hicks v. Randolph, 3 Baxt. 352 (Tenn. 1874); Weed Sewing Machine Co. v. Maxwell, 63 Mo. 486, 488 (1876); Mitchell v. Hydraulic Bldg. Stone Co., 61 Tex. Civ. App. 131, 136, 129 S. W. 148, 150 (1910). But see Hovie v. Pleshek, 187 Wis. 55, 203 N. W. 910 (1925) (guarantor released where lease constituting homestead of landlord was void for want of wife's signature); Metz v. Warrick, 217 Mo. App. 504, 269 S. W. 626 (1925) (surety released where principal contract void because not in writing as required by statute). Compare Watterson v. Owens River Canal Co., 25 Cal. App. 247, 143 Pac. 90 (1914) (surety liable though principal contract void because unrecorded).

12. 1 BRANDT, *op. cit. supra*, note 3, § 163. The distinction is found in the civil law. LA. CIV. CODE ANN. (Dart, 1932) art. 3060; see Putnam v. Schuyler, 4 Hun. 166, 171

surety as well. Such pleas as payment,[13] illegality,[14] unconditional release of the principal debtor,[15] and failure of consideration[16] are among those defenses which may be invoked both by surety and principal. Although the list of "personal" defenses was restricted in the early cases to the pleas of infancy[17] and coverture,[18] insanity[19] and ultra vires[20] were later included by analogy, and other defenses have been added.[21] And the surety has generally not been permitted to avoid liability where the principal debtor is discharged in bankruptcy,[22] or where the principal has the defense of the statute of frauds.[23]

(N.Y. 1875). Pothier distinguishes between exceptions *in personam* and *in rem*. 1 POTHIER, *op. cit. supra*, note 10, at 237.

13. 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1219.

14. See Denison v. Gibson, 24 Mich. 187, 200 (1872); CAL. CIV. CODE (Deering, 1931) § 2810; MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 8185; S. D. COMP. LAWS (1929) § 1488; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1217.

15. ARANT, SURETYSHIP (1931) § 49; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1220.

16. ARANT, SURETYSHIP (1931) § 57; 1 BRANDT, *op. cit. supra*, note 3, § 465.

17. Hesser v. Steiner, 5 Watts & S. 476 (Pa. 1843); Parker v. Baker, 1 Clarke Ch. 136 (8th Cir. N. Y. 1839); Note (1923) 24 A.L.R. 838; ARANT, SURETYSHIP (1931) 170. See DIGEST OF CIVIL LAWS IN TERRITORY OF ORLEANS (1808) 428, which is now section 3036 of the Louisiana Civil Code, cited in Federal Schools, Inc. v. Kuntz, 16 La. App. 289, 134 So. 118 (1931). But *cf.* Baker v. Kennett, 54 Mo. 82 (1873); (1926) 43 A.L.R. 589.

18. St. Albans Bank v. Dillon, 30 Vt. 122 (1857); Stillwell v. Bertrand, 22 Ark. 375 (1860); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1214; LA. CIV. CODE ANN. (Dart., 1932) art. 3036; Notes (1909) 20 L.R.A. (N.S.) 1000, (1923) 24 A.L.R. 838, 841. See also Smyley v. Head, 2 Rich. L. 590, 591 (S. C. 1845) (analogy to law of principal and agent, surety being held "as a principal for engagement he has made in behalf of one who was incompetent to contract"). But see Goldfinger v. Doherty, 153 Misc. 826, 828, 276 N.Y. Supp. 289, 293 (Sup. Ct. 1934) (agent does not warrant principal's capacity).

19. Allen v. Berryhill, 27 Iowa 534 (1869); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1214; Note (1923) 24 A.L.R. 838, 846.

20. Maledon v. Leflore, 62 Ark. 387, 35 S.W. 1102 (1896); ARANT, SURETYSHIP (1931) 173; Note (1923) 24 A.L.R. 838, 847. The defenses of infancy, coverture, insanity and ultra vires have been said to involve the incapacity of the principal to contract. See ARNOLD, SURETYSHIP AND GUARANTY (1927) § 29. But see Levy v. Wise, 15 La. Ann. 38, 39 (1860) (no "personal" exception where incapacity of principal, a slave, to contract, was a rule of public policy, not for the principal's own protection or interest).

21. See, *e.g.*, Bean v. Chapman, 62 Ala. 58, 65 (1878) (defense of principal that he was enemy of creditor during Civil War held "personal" on analogy to bankruptcy and statute of limitations).

22. ARANT, SURETYSHIP (1931) § 53; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1215. This is clearly a risk against which it may be assumed the creditor sought to protect himself when he secured a surety.

23. First Presbyterian Church of Davenport v. Swanson, 100 Ill. App. 39 (1901); Backus v. Feeks, 71 Wash. 508, 129 Pac. 86, Ann. Cas. 1914C 553 (1913), Comment (1913) 13 COL. L. REV. 426. But *cf.* Metz v. Warrick, 217 Mo. App. 504, 269 S.W. 626 (1925).

Courts are in conflict, however, as to whether usury,[24] fraud,[25] duress,[26] forgery,[27] the statute of limitations,[28] or the fact that the instrument of indebtedness is not signed by the principal[29] or is signed by an agent without authority[30] are "inherent" or "personal" defenses.

Neither the nature of these defenses nor the differences between them help explain why they are classified as they are, or on what basis cases of first impression should be treated. Some courts have attempted to rationalize the distinctions between "inherent" and "personal" defenses. Thus it has been said that some defenses should be treated as "personal" because the creditor required the surety's promise as security against the contingency that the principal would raise them.[31] This view of the suretyship contract as expressly contemplating that the defense be regarded as "personal" is tenable only where the terms of the surety transaction and the circumstances accompanying it factually support such an analysis of the bargain.[32] A theory of this kind is too remote from the facts in these cases, since in practice uncompensated sureties incur their obligations without elaborate recitals of terms and conditions, especially as to "personal" defenses like the statute of limitations, which could hardly have been contemplated when the surety bargain was made.[33]

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24. See Note (1931) 70 A. L. R. 359; see also Note (1933) 82 A. L. R. 1018; *cf.* Note (1920) 6 A. L. R. 586 (right of surety of corporation to set up usury where corporation could not).

25. See ARANT, SURETYSHIP (1931) § 45; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1218; Ettlinger v. National Surety Co., 221 N. Y. 467, 117 N. E. 945, 3 A. L. R. 865 (1917), (1918) 27 YALE L. J. 566, (1918) 31 HARV. L. REV. 898, Comment (1918) 18 COL. L. REV. 158. It should be noted that the *Ettlinger* case involved a corporate compensated surety.

26. See HANNA, CASES ON SECURITY (1932) 430 (2); see also Arnold, *Availability of Duress and Fraud upon the Principal as Defenses to the Surety and Guarantor* (1928) 77 U. OF PA. L. REV. 23; (1926) 33 W. VA. L. Q. 123.

27. See ARANT, SURETYSHIP (1931) § 43. But see Florida School-Book Depository, Inc. v. Liddon, 114 Fla. 149, 153 So. 902 (1934).

28. See HANNA, CASES ON SECURITY (1932) 431; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1231; see also Gaffigan v. Lawton, 76 Cal. App. 157, 28 P. (2d) 375 (1934), (1934) 22 CALIF. L. REV. 454; Note (1927) 50 A. L. R. 1214.

29. See SPENCER, SURETYSHIP (1913) § 45; STURGES, CASES ON CREDIT TRANSACTIONS (1936) 107 and citations given at 108.

30. Compare Dole Bros. Co. v. Cosmopolitan Preserving Co., 167 Mass. 481, 46 N. E. 105 (1897) with Farmers' & Traders' Bank of Auxvasse v. Harrison, 321 Mo. 815, 12 S. W. (2d) 755 (1928). See HANNA, CASES ON SECURITY (1932) 432 (6).

31. See St. Albans Bank v. Dillon, 30 Vt. 122, 126 (1857); Kyger v. Sipe, 89 Va. 507, 510, 16 S. E. 627, 628 (1892); International Text-Book Co. v. Mabbott, 159 Wis. 423, 426, 150 N. W. 429, 430 (1915); Comment (1914) 2 CALIF. L. REV. 337.

32. The surety must be shown to have accepted the creditor's offer in the terms proposed. See HANNA, CASES ON SECURITY (1932) 429. But see Kimball v. Newell, 7 Hill 116, 117 (N. Y. 1845) (surety liable even if he had no knowledge of principal's coverture).

33. But see ARANT, SURETYSHIP (1931) 312.

A closely related theory of "personal" defenses relies on an estoppel against the surety to plead his principal's defense, based on the surety's, rather than the creditor's, knowledge of the existence of the defense at the time of his promise.[34] This approach involves the same difficulty which makes the first line of argument barren, of showing actual awareness of facts which were in all probability unknown or ignored;[35] and in addition it has the disadvantage of any estoppel argument in that it requires at least an allegation of elements of reliance[36] which are bound to be weak in the circumstances of these cases.

A third theory contends that the surety impliedly warrants the validity of the principal's obligation.[37] But the metaphor of an implied warranty conceals an attempt to formulate one possible interpretation of the generic content of the surety's contract. A contrary assumption, that the surety's liability was impliedly conditioned on the principal's being bound, would be equally plausible. The fiction of warranty itself makes no contribution to the analysis of the surety bargain.

It is urged as a fourth reason why the surety should not be allowed to assert a principal's "personal" defense that the creditor should not be deprived of the security of the surety contract since the loss of the creditor's rights against the principal does not result from his fault or neglect.[38] This reasoning fails to recognize, however, that the uncompensated surety may stand with the creditor, alike deceived, blameless or in fault.[39] In the absence of a more comprehensive analysis of the surety contract as a whole, and the peculiar equities accompanying it, there is no apparent reason to assess the loss to one party rather than the other.

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34. See Coffelt v. Wise, 62 Ind. 451, 458 (1878); Lee v. Yandell, 69 Tex. 34, 36, 6 S. W. 665, 667 (1887). Compare International Text-Book Co. v. Mabbott, 159 Wis. 423, 150 N. W. 429 (1915) (duty of surety to know) with Dole Bros. Co. v. Cosmopolitan Preserving Co., 167 Mass. 481, 46 N. E. 105 (1897) (reasonable cause to know doesn't deprive surety of principal's want of authority defense). It would seem more equitable to imply an evidentiary presumption of knowledge. Kimball v. Newell, 7 Hill 116 (N. Y. 1845) *semble*; Graham v. Marks Co., 98 Ga. 67, 70, 25 S. E. 931, 932 (1895) *semble*.

35. It is hardly likely, for example, that the surety was aware of the statute of limitations defense at the time of his contract with the creditor. See also HANNA, CASES ON SECURITY (1932) 430 (surety probably does not know at time of contracting that the act of his principal is ultra vires).

36. See Bloomfield v. Charter Oak Bank, 121 U. S. 121, 135 (1887); New York Life Ins. Co. v. Slocum, 177 Fed. 842, 846 (C. C. A. 3rd, 1910).

37. See Remsen v. Graves, 41 N. Y. 471, 475 (1869); Caldwell v. Ruddy, 2 Idaho 1, 11, 1 Pac. 339, 343 (1881); see also Comment (1913) 13 COL. L. REV. 426, 428.

38. Compare Wagoner v. Watts, 44 N. J. L. 126, 130 (1882) with Mulvane v. Sedgley, 63 Kan. 105, 114, 64 Pac. 1038, 1041 (1901); see also Comment (1913) 13 COL. L. REV. 426, 428, n. 21. Obviously this argument does not apply to cases involving the defense of duress, fraud or usury.

39 See Dole Bros. Co. v. Cosmopolitan Preserving Co., 167 Mass. 481, 482, 46 N. E 105, 106 (1897).

The denial of defenses is justified as to some sureties by using the term technically to distinguish sureties from guarantors, indemnitors, or other parties secondarily liable on a debt, on the ground that the surety's obligation is "principal"[40] or "independent."[41] Although it is frequently said that a suretyship transaction involves a "direct undertaking" while a guaranty is "collateral,"[42] that a surety's promise is "primary" while the guarantor's is "secondary,"[43] and that a surety promises to pay only if the principal "does not" while the guarantor will pay only if the principal "cannot,"[44] such distinctions are almost entirely "verbal."[45] The terms "primary", "secondary," "collateral," and "independent," when applied to bargains of suretyship, are too inconclusive to be of service in determining whether a particular defense of a principal should be available to his surety.

In the final analysis, all of the arguments offered by the courts to justify a refusal to the surety of his principal's "personal" defense seem unpersuasive and of limited utility, and most of them apply with equal force to the "inherent" as well as the "personal" defenses. Since the surety probably does not have his right of reimbursement in any of these cases,[46] a decision that a particular defense is "personal" for the purpose of permitting the creditor to recover from the surety appears to dispose of the question of ultimate liability as between principal, creditor, and surety. And the historical title of the surety as the favorite of the law[47] might in fact warrant assumptions contrary to those which purport to justify the characterization of certain defenses as "personal" to the principal.

The imposition of liability upon the surety merely by labeling particular defenses "personal" rather than "inherent" makes judicial administration

40. See St. Albans Bank v. Dillon, 30 Vt. 122, 126 (1857); Weed Sewing Machine Co. v. Maxwell, 63 Mo. 486, 488 (1876).

41. See Hicks v. Randolph, 3 Baxt. 352 (Tenn. 1874) (surety had knowledge of principal's coverture); Winn v. Sanford, 145 Mass. 302, 303, 14 N. E. 119, 121 (1887); Comment (1913) 13 COL. L. REV. 426, 428; see also dissent in Auchampaugh v. Schmidt, 70 Iowa 642, 646, 27 N. W. 805, 807 (1886) (surety's promise "absolute"); Burner v. Nutter, 77 W. Va. 256, 258, 87 S. E. 359, 360 (1915) (surety "real sponsor").

42. SPENCER, THE GENERAL LAW OF SURETYSHIP (1913) § 3.

43. *Ibid.*

44. PINGREY, A TREATISE ON THE LAW OF SURETYSHIP AND GUARANTY (Joyce's 2d ed. 1913) § 4. But see STEARNS, *op. cit. supra* note 9, § 6 ("guarantor undertakes to pay if principal debtor does not or cannot"). See for another "clear and well defined" distinction, Cole Manufacturing Co. v. Morton, 24 Mont. 58, 62, 60 Pac. 587, 589 (1900) (surety contracts primarily for benefit of debtor while guarantor contracts mainly for his own benefit).

45. See Radin, *Guaranty and Suretyship* (1929) 18 CALIF. L. REV. 21, at 28; Sturges, *supra* note 1, at 484.

46. See note 54, *infra.*

47. STEARNS, *op. cit. supra* note 9, at 402. But see Sturges, *supra* note 1, at 484. It seems plausible, also, to presume that the surety relied on a binding contract between his principal and the creditor as well as a right of reimbursement. See Dole Bros. Co. v. Cosmopolitan Preserving Co., 167 Mass. 481, 482, 46 N. E. 105, 106 (1897).

easy, at least after all the labels have been attached.[48] It is, however, a superficial and deceptive simplicity, which makes no contribution to the analysis of new cases. Whatever certainty results from placing the primary emphasis upon the label of the defense pleaded diverts attention from the factual characteristics of the suretyship contract, and prevents a desirable flexibility which would enable the courts to consider the several equities of these situations.

Perhaps the most significant of these equities is the surety's right of reimbursement.[49] Although it might plausibly be urged that as a matter of business opinion the right of reimbursement is vital to a bargain of suretyship[50] so that a surety should not be held liable to the creditor unless that right remains unimpaired, the courts in characterizing defenses as "personal" or "inherent" have either overlooked the factor of reimbursement entirely or have been indefinite about its significance. The possibility that the surety could not assert this right induced a few courts in early cases to permit a surety to invoke his principal's defense,[51] while a determination that the right of reimbursement existed notwithstanding a defense available to the principal has sometimes been persuasive in imposing liability on the surety.[52] Despite such dicta, however, suits for reimbursement in cases involving "personal" defenses are rare, and one holding[53] and occasional dicta indicate that it would be "mockery"[54] to permit an indirect attack by the surety on a principal who could avoid liability when sued by the creditor.

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48. See, *e. g.*, Cozine v. Randolph, 71 Fla. 603, 72 So. 177 (1916).

49. It is necessary, of course, that the surety show the principal not to be a donee beneficiary before reimbursement will be allowed.

If the reimbursement right is recognized by a court, it would seem justifiable to deny the surety the particular defense sought to be invoked by him. This may not appear equitable, however, in every instance since the right of reimbursement is of small satisfaction where the principal is insolvent. The risk of insolvency, however, should be upon the surety.

50. See 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1211.

51. See Coffelt v. Wise, 62 Ind. 451, 458 (1878); Griffith v. Sitgreaves, 90 Pa. 161, 167 (1879); Russell v. Annable, 109 Mass. 72, 74 (1871); Auchampaugh v. Schmidt, 70 Iowa 642, 644, 27 N. W. 805, 806 (1886); Henry & Co. v. Fry, 78 Misc. 130, 131, 137 N. Y. Supp. 894, 895 (Sup. Ct. 1912); see also 1 PARSONS, NOTES AND BILLS (1863) 245. But see Wagoner v. Watts, 44 N. J. L. 126, 130 (1882) (surety's liability not to be tested by reimbursement right).

52. See The Star Grocery Co. v. Bradford, 70 W. Va. 496, 498, 74 S. E. 509, 510 (1912); ARNOLD, SURETYSHIP AND GUARANTY (1927) § 35.

53. Davis v. Board of Commissioners of Stokes County, 72 N. C. 441 (1875), *rehearing denied*, 74 N. C. 374 (1876).

54. See Coffelt v. Wise, 62 Ind. 451, 458 (1878); see also Griffith v. Sitgreaves, 90 Pa. 161, 167 (1879). Where the non-liability of the principal results from "want of capacity" it is generally stated that a surety who pays cannot receive reimbursement. See STEARNS, *op. cit. supra* note 9, at 515; ROWLATT, *op. cit. supra* note 2, at 180; ARANT, SURETYSHIP (1931) 325; see also Coffelt v. Wise, *supra* at 458 (in case of

Although it seems inconsistent, a surety is sometimes permitted to recover from his principal in the name of reimbursement, when the principal could defeat the creditor with a defense characterized as "personal." Thus, where the surety has paid the creditor in ignorance of a defense of usury available to his principal, the surety may be reimbursed.[55] Moreover, in a jurisdiction in which a statute classifies usury as a "personal" defense,[56] where a surety pays a debt without notice of the principal's intention to resist usury, he may obtain reimbursement whether or not he had knowledge of the defense of usury at the time of payment.[57] It has also been held that the defense of the statute of limitations which barred recovery by the creditor directly against the principal did not prevent the surety, against whom the statute has not yet run, from suing the principal for reimbursement, a cause of action which the court considered arose only after payment by the surety to the creditor.[58] And it has been suggested that where a surety pays the creditor in ignorance of his principal's defense of fraud or duress the surety's right of reimbursement remains unimpaired.[59]

A case which has been widely cited[60] as authority for the denial of reimbursement where the principal has a "personal" defense is *Davis v. Board of Commissioners of Stokes County*.[61] There reimbursement was refused to the surety for a county court on a loan authorized by statute to pay off a debt contracted in aid of the rebellion. The court held that the loan, although

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infancy, coverture, etc. surety is supposed to know of principal's disability so that he has no cause to complain of a loss of the reimbursement right); Griffith v. Sitgreaves, *supra*, at 167 *semble*. Compare Ayers v. Burns, 87 Ind. 245 (1882) with Conn. v. Coburn, 7 N. H. 368 (1834).

55. See Moncure v. Dermott, 13 Peters 345, 357 (U. S. 1839); *cf.* Ford v. Keith, 1 Mass. 139, 142 (1804).

56. GA. CODE (1933) § 3428. But see Vaughan v. Farmers' & Merchants' Bank, 146 Ga. 51, 90 S. E. 478 (1916); Weldon v. Ayers, 116 Ga. 181, 42 S. E. 473 (1902).

57. GA. CODE (1933) § 3554; see also Ford v. Keith, 1 Mass. 139, 142 (1804); Jones v. Moore, 212 Ala. 248, 252, 102 So. 200, 204 (1924); Polhill v. Brown, 84 Ga. 338, 343, 10 S. E. 921, 922 (1890). But see Boren v. Boren, 29 Tex. Civ. App. 221, 223. 68 S. W. 184, 185 (1902).

58. ARANT, SURETYSHIP (1931) 324; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1286; Notes L. R. A. 1917F 1074, (1934) 22 CALIF. L. REV. 454. But see Auchampaugh v. Schmidt, 70 Iowa 642, 644, 27 N. W. 805 (1886). The surety's right of action is said to be based on his implied contract with the principal, not on the original debt itself. See Willis v. Chowning, 90 Tex. 617, 622, 40 S. W. 395, 396 (1897). By such reasoning the principal's incapacity to contract at the time the surety pays would seem to be the only defense in an action for reimbursement.

59. No cases are given, however, to support this view, the cases cited including, as far as can be determined, only the defense of failure of consideration or usury. ARANT, SURETYSHIP (1931) 325, n. 20. But see Owens v. Mynatt, 1 Heisk. 675, 677 (Tenn. 1870). *Cf.* Griffith v. Sitgreaves, 90 Pa. 161, 167 (1879).

60. ARANT, SURETYSHIP (1931) 325; ARNOLD, SURETYSHIP AND GUARANTY (1927) § 157; STEARNS, *op. cit. supra* note 9, § 284.

61. 72 N. C. 441 (1875).

not tainted with illegality, was beyond the "power" of the county court.[62] Neither in this suit nor in an earlier one in which the creditor recovered against the surety[63] was reference made to the surety's knowledge of the purpose of the loan or of the trial court's charge to disregard the question of the creditor's knowledge.[64] But if the creditor was aware of the object of the loan and knew that the surety was not, he should have been estopped from pursuing the surety,[65] who apparently relied on his equity of reimbursement, unless it was assumed that the surety could still sue for reimbursement.

Ratification is another neglected factor[66] in these cases involving "personal" defenses, a factor which might be invoked to preserve the surety's equity of reimbursement and which may be illustrated from the facts of the *Davis* case. It is nowhere indicated in the *Davis* case that the money borrowed by the people of the county has been returned nor that there was any offer by them to return it, but on the contrary, the decision intimates that the loan has been used for a public purpose without the people's objection, and presumably at least with their consent.[67] Under these facts the surety should be permitted a pro tanto reimbursement in quantum meruit,[68] either as if by subrogation to the creditor's claim against the principal or on the ground that ratification by the county supported not only an obligation on the loan, but further, an implied promise to reimburse the surety.[69] If the Court in the *Davis* case had called the principal obligation voidable instead of void, full reimbursement might have been urged on these grounds.[70] Since contracts which include the "personal" defenses are now generally labeled voidable,[71] a duty of election may be imposed upon a principal so that his ratification, either express or by the receipt of benefits under the contract, might be held

62. *Id.* at 444.

63. Poindexter v. Davis, 67 N. C. 112 (1872).

64. *Id.* at 113.

65. See 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1214.

66. *Cf. id.* at § 1218.

67. See Davis v. Board of Commissioners of Stokes County, 74 N. C. 374, 376 (1876).

68. The money was not loaned for an illegal purpose. See *id.* at 377; Poindexter v. Davis, 67 N. C. 112, 114 (1872). But see PINGREY, *op. cit. supra* note 44, § 190.

69. But see Davis v. Commissioners of Stokes County, 74 N. C. 374, 376 (1876). The court apparently thought an implied contract of reimbursement would be as much ultra vires as the principal obligation. But see 1 WILLISTON, CONTRACTS (rev. ed. 1936) § 271, n. 3.

70. A ratification by the principal who has the defense of fraud has been held sufficient to impose liability on the surety. See Evans and Arrington v. Keeland, 9 Ala. 42, 47 (1846).

71. *E.g.*, 1 WILLISTON, CONTRACTS (rev. ed. 1936) § 226 (infancy); *id.* § 251 (insanity); *id.* § 271 (ultra vires act of corporation).

to imply a promise of reimbursement,[72] while an effective avoidance may release the surety[73] or at least diminish his liability.[74]

A third factor bearing on the equity of denying defenses to a surety is his equitable right of exoneration.[75] The importance of this equity is best illustrated where the surety seeks to set off a liquidated debt owing from the creditor to the principal on an independent transaction.[76] Where principal and surety are sued jointly, the surety may usually set off the principal's claim against the creditor.[77] In some jurisdictions, the surety when sued alone is permitted by statute to invoke the principal's claim, provided the consent of the principal has been obtained.[78] The assertion of the defense by the surety in both these instances is, of course, largely fortuitous; for the creditor will probably sue the surety alone if he is aware of the principal's claim, while in those jurisdictions which permit the set-off with the consent of the principal, the availability of that plea to the surety depends on the election of the principal.

It is generally said, however, that when the surety is sued alone by the creditor, he cannot set off a claim of his principal whether liquidated or unliquidated.[79] Several grounds have been advanced to justify this result: (1) that as a matter of procedure the independence of the debt sought to be set off should make it unavailable to the surety;[80] (2) that to make this defense

72. In most instances where the principal ratifies, the surety should in a suit for exoneration compel the creditor to proceed first against the principal. See note 75, *infra*. Where the principal has the defense of infancy, however, the principal's ratification will be postponed until he attains majority. See note 110, *infra*.

73. This would be true if the creditor assumed the risk of avoidance by the principal. *Cf.* 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1218.

74. See note 143, *infra*.

75. ARANT, SURETYSHIP (1931) § 72; STEARNS, *op. cit. supra* note 9, § 281; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1275; ROWLATT, *op. cit. supra* note 2, at 184. The right is statutory in some jurisdictions. CAL. CIV. CODE (Deering, 1931) § 2846; MINN. STAT., (Mason, 1927) § 9175; MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 8204; N. D. COMP. LAWS (1913) § 6684; OKLA. STAT. (Harlow 1931) § 9633.

76. See ARANT, SURETYSHIP (1931) 211; STEARNS, *op. cit. supra* note 9, § 117; Levine, *The Principal's Warranty and Offset Claims Against the Creditor as Defenses to the Surety* (1931) 30 MICH. L. REV. 197.

77. ARANT, SURETYSHIP (1931) 215, n. 6. The right is also statutory in some jurisdictions. GA. CODE (1933) § 4341; IND. STAT. ANN. (Burns, 1926) § 372; MICH. COMP. LAWS (1929) § 16038(10); W. VA. CODE (1932) ch. 56, art. 5, § 4.

78. ALA. CODE ANN. (Michie, 1928) § 10176; IOWA CODE (1935) § 11153; TENN. CODE ANN. (Williams, 1934) § 8770; see also Graff v. Kahn, 18 Ill. App. 485 (1886).

79. ARANT, SURETYSHIP (1931) 204; ARNOLD, SURETYSHIP AND GUARANTY (1927) § 121; CHILDS, SURETYSHIP AND GUARANTY (1907) § 148. But *cf.* Murphy v. Glass, L. R. 2 P. C. 408 (1869); Bechervaise v. Lewis, L. R. 7 C. P. 372 (1872) (claim arising out of same transaction); See Meeker v. Halsey, C. C. A. 2d, Jan. 11, 1937.

80. See East River Bank v. Rogers, 7 Bosw. 493, 497 (N. Y. City Super. Ct., 1860); Lasher v. Williamson, 55 N. Y. 619, 620 (1874); Thalheimer v. Crow, 13 Colo. 397, 403, 22 Pac. 779, 780 (1889); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1251.

available to the surety would deprive the principal of his right of election whether to use his claim against the creditor defensively or offensively;[81] (3) that where the creditor's debt to the principal exceeds the surety's obligation to the creditor it may be better, since the surety's set-off cannot include the excess, to protect the larger debt due the principal at the expense of denying to the surety his principal's claim;[82] and finally (4) that to permit the surety to set off his principal's debt may subject the creditor to the risk of "double payment" for the same claim; for if the principal is not a party to the suit in which the creditor sues the surety and the surety is allowed to set off the principal's claim, the principal, conceptually not bound by the adjudication, may at least attack the result collaterally by suing the creditor for the claim which was set off.[83]

Although courts have described this defense of set-off of an independent liquidated claim as "personal,"[84] various remedies have been proposed in order that the surety may be permitted the set-off plea to avoid circuity of action.[85] While it may not be possible to accomplish this result directly, the surety could achieve substantially that end by a suit in equity for exoneration.[86] In exoneration the surety sues the principal and creditor jointly at the maturity of the principal obligation to compel the principal to pay his debt to the creditor.[87] Where the principal is solvent and pays his obligation, the effect of the exoneration decree will be to discharge the surety completely.[88] If, however, the principal does not or cannot satisfy the debt, the

81. See Graff v. Kahn, 18 Ill. App. 485, 487 (1886); Gillespie v. Torrance, 25 N. Y. 306, 310 (1862); Phoenix Iron-Works Co. v. Rhea, 98 Tenn. 461, 465, 40 S. W. 482, 483 (1897); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1251.

82. See Gillespie v. Torrance, 25 N. Y. 306, 311 (1862); Henry v. Daley, 17 Hun. 210, 212 (N. Y. 1879); Gruff v. Kahn, 18 Ill. App. 485, 488 (1886); STEARNS, *op. cit. supra* note 9, 179, n. 212.

83. Levine, *supra* note 76, at 206.

84. See cases cited in Note (1909) 18 L. R. A. (N.S.) 600, at 602.

85. See ARANT, SURETYSHIP (1931) 211 (theory of payment); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1251; Levine, *supra* note 76, at 209 ("subrogation"). It would seem that where the claim is unliquidated the principal ought to be made a party to determine the amount of the claim. But this appears unnecessary where the debt is liquidated. But see ROWLATT, *op. cit. supra* note 2, at 138.

86. Compare Levine, *supra* note 76, at 209; see also Rubey v. Watson, 22 Mo. App. 428, 434 (1886) cited in Gray v. School Dist. of Borough of Brownsville, 67 F. (2d) 141, 144 (C. C. A. 3rd, 1933).

87. For dicta which apparently recognizes the exoneration action in set-off cases see Flagg v. Locke, 74 Vt. 320, 52 Atl. 424, 425 (1902); Becker v. Northway, 44 Minn. 61, 64, 46 N. W. 210, 211 (1890); St. Croix Timber Co. v. Joseph, 142 Wis. 55, 62, 124 N. W. 1049, 1052 (1910); Bechervaise v. Lewis, L. R. 7 C. P. 372, 377 (1872). But *cf.* Harrison v. Nettleship, 2 Myl. & K. 423 (1833). Notice should also be taken of an unusual statute, MINN. STAT. (Mason, 1927) § 9175 ("An action may be brought against two or more persons for the purpose of compelling one to satisfy a debt due to the other, for which the plaintiff is bound as surety.").

88. 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1275.

surety may at least obtain a reduction of his own liability to the creditor by an equitable garnishment in the exoneration proceedings of any obligation due the principal, including his claim against the creditor.[89] Where the principal's claim against the creditor exceeds the surety's obligation to the creditor, an equitable garnishment by the surety of the creditor's debt to the principal should not bar a subsequent recovery by the principal of the balance due from the creditor.[90] While it would be advisable to seek the exoneration decree prior to judgment in the creditor's action against the surety, where the creditor has already brought action against the surety, the latter might, pending the exoneration suit, seek a temporary injunction restraining the creditor's action against him.[91] Although courts are generally unwilling to permit a surety when sued alone to invoke his principal's claim against the creditor, in a few jurisdictions this equity is allowed where the principal is insolvent.[92] And even in these few jurisdictions a set-off of the principal's claim has been available to the surety only when invoked defensively.[93] But there are no persuasive reasons why, even in the jurisdictions in which the defense of set-off is denied when the principal is insolvent, the courts should not permit the surety to reach the same result as set-off by way of a bill for exoneration coupled with a request for equitable garnishment.

A variation in the technique of exoneration to permit a surety to set off his principal's claim against the creditor is suggested by *Pain v. Packard*.[94] In the jurisdictions where that case is followed,[95] a surety may, under certain circumstances,[96] request the creditor to sue the principal at maturity and thereby require him to do so, on pain of losing his rights against the surety

89. On attachment and garnishment, see ARNOLD AND JAMES, CASES ON TRIALS, JUDGMENTS AND APPEALS (1936) 455 ff. *Cf.* McConnell v. Scott, 15 Ohio 401 (1846) where equitable exoneration was employed by the surety before payment to get at the principal's credits where the principal was insolvent.

90. The amount of the principal's claim will, of course, have been determined in the exoneration suit.

91. See Becker v. Northway, 44 Minn. 61, 64, 46 N. W. 210, 211 (1890); Levine, *supra* note 76, at 206; see also Keach v. Hamilton, 84 Ill. App. 413 (1899). Compare 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1218.

92. This may be said to be in effect a pro tanto exoneration. Clark Co. v. Clark, 48 F. (2d) 169 (C. C. A. 3d, 1931), (1932) 16 MINN. L. REV. 217; Note (1913) 43 L. R. A. (N.S.) 977, 980; see STEARNS, *op. cit. supra* note 9, at 180.

93. *Cf.* POMEROY, CODE REMEDIES (5th ed. 1929) § 626. There may be a danger, however, that the claim will be privately collected and spent by the principal before the creditor's suit against the surety. Proof of the principal's defense may, also, be lost before the creditor's suit. But *cf.* Allerton v. Belden, 49 N. Y. 373, 378 (1872) *rev'g* 3 Lans. 492 (N. Y. Sup. Ct. 1871).

94. 13 Johns. 174 (N. Y. Sup. Ct. 1816).

95. See Comments (1928) 37 YALE L. J. 971, (1930) 34 DICK. L. REV. 119, (1929) 1 ROCKY MT. L. REV. 232; Notes (1911) 21 Ann. Cas. 1367, L. R. A. 1918C 10.

96. The limitations on the doctrine are set out in Comment (1928) 37 YALE L. J. 971, 974.

to the extent that the surety has been prejudiced by the creditor's failure to sue. Although a theoretical weakness of this procedure, and the suit for exoneration as well, is that it does not appear that the surety can compel the principal to assert his claim in the suit by the creditor against the principal, in most instances the principal will probably not forego his defense.[97]

Considerations which warrant the suit for exoneration where a surety when sued alone seeks to invoke a liquidated claim of his principal against the creditor apply with equal force to the cases where the surety attempts to assert his principal's unliquidated claim resulting from the fact that the property sold in the principal transaction does not conform to the creditor's warranty.[98] Although this plea too has generally been considered "personal,"[99] this conclusion seems difficult to justify even in terms of the rules supposed to control the classification of defenses. It does not appear plausible, for example, to assume that the creditor sought the surety for the principal's obligation in anticipation of defective performance, or that the surety was aware of the breach at the time of his bargain with the creditor.[100] Some courts, therefore, have permitted a breach of warranty defense to the surety when sued alone to the extent of the damages caused the principal,[101] while legal commentators have given this plea even broader implications.[102]

Notwithstanding the fact that in a suit for exoneration brought by a surety who knows of the creditor's breach of warranty there can be no equitable garnishment of the principal's unliquidated claim unless the principal elects to invoke his defense, other considerations serve to make the remedy of exoneration a useful one in these instances where the surety and principal are not joined as defendants.[103] Where the creditor's breach is material, the court may require in the suit for exoneration that the principal

97. Doubtless, if collusion between the principal and creditor is shown, the surety will not be made to suffer by the fraud. See Evans and Arrington v. Keeland, 9 Ala. 42, 47 (1846).

98. See the defendant's argument in Graham v. Middleby, 213 Mass. 437, 442, 100 N. E. 750, 751 (1913).

99. See Notes (1909) 18 L. R. A. (N.S.) 600, 602, (1932) 16 MINN. L. REV. 217, 218; see also ARANT, SURETYSHIP (1931) § 60; Levine, *supra* note 76 at 207, n. 28; Note (1893) 21 L. R. A. 406.

100. *Cf.* ARANT, SURETYSHIP (1931) at 206.

101. Mitchum v. Richardson, 3 Strob. 254 (S. C. 1848); Scroggin v. Holland, 16 Mo. 419 (1852); Meyer & Stratman v. Stookey, 3 Ill. App. 336 (1879). But see ARANT, SURETYSHIP (1931) 207.

102. Dean Arant suggest that a substantial or willful breach is an uncontemplated risk for the surety and should release him from all obligation. ARANT, SURETYSHIP (1931) § 60; see also Levine, *supra* note 76, at 203 (creditor's knowledge of the breach before delivery is *sine qua non* to surety's discharge).

103. *Cf.* Hiner v. Newton, 30 Wis. 640, at 642 (1872). But see Levine, *supra* note 76, at 227, n. 76 (although the remedy of "subrogation" is a convenient one where the surety sets off his principal's liquidated claim, "the setting is somewhat different" in breach of warranty cases).

debtor elect, perhaps sooner than he had intended, whether or not to return or offer to return the consideration delivered by the creditor. A determination by the principal to avoid might release the surety[104] or at least diminish his liability.[105] If, however, the principal retains the defective article and elects to invoke the creditor's breach by way of counterclaim for damages, the amount of the claim arising from the breach should be determined so that it may be deducted from the contract price in the exoneration decree ordering the principal to pay the creditor what he owes. If the principal is insolvent, or does not pay as ordered, the surety will obtain at least the benefit of the set-off; for recovery by the creditor against him will be limited to the amount set in the exoneration decree. But if the insolvent principal in the suit for exoneration declines to invoke the defense of breach of warranty, either to avoid the contract entirely or to claim damages by way of counterclaim, the surety would have no defense in the subsequent action by the creditor against him.[106]

No persuasive grounds appear to preclude the use of the suit for exoneration by the surety in many of the cases in which defenses said to be "personal" arise, some of which are thought to render the contract between the principal and the creditor voidable rather than void. Where, for example, such defenses as the statute of frauds or duress[107] are involved, considerations similar to those discussed with reference to the defense of breach of warranty seem to be equally applicable in respect to the issue of whether or not the principal will assert the defense. Of course, even if the principal avoids, the surety may still be held liable to the creditor on the ground that the defense is "personal" to the principal;[108] but when the issue is presented in the creditor's suit subsequent to the exoneration decree, some courts, in view of the probable loss of the surety's right of reimbursement, may be willing to face the question of allocating losses directly and without retreating to illusory distinctions between "inherent" and "personal" defenses.

It should not be overlooked, however, that the suit by the surety against the creditor and the principal for exoneration may not be available in all

104. See SPENCER, SURETYSHIP (1913) § 194. This should be true only where the creditor has assumed the risk of the principal's avoidance.

105. The surety would be entitled to the consideration returned if the risk of avoidance is upon him. See note 143, *infra*.

106. Dean Arant suggests, "If the surety paid the creditor and sued the principal in his name, it would doubtless be held that the principal would have a defense in such an action to the extent of the damage resulting from the breach of warranty," but no cases are given to support this statement. See ARANT, SURETYSHIP (1931) 208; *cf.* 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1251.

107. *Cf.* 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1218; (1927) 21 ILL. L. REV. 637.

108. But see Henry v. Daley, 17 Hun. 210, 211 (N. Y. 1879) (where there was no evidence of avoidance by the principal who had the defense of fraud, that defense was held personal); see also Evans v. Keeland, 9 Ala. 42, 47 (1846); 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1218.

instances.[109] In cases where the defense of infancy is invoked by the principal, it is likely that the exoneration decree will be denied; for courts are usually reluctant to require an infant principal to elect before he has attained majority.[110] In such instances the surety, after having been held liable to the creditor, may be obliged to wait until the minor becomes of age before a ratification can create a right of reimbursement[111] or an effective avoidance[112] might persuade a court to permit a surety to take possession of the consideration thus returned. Exoneration may likewise be refused where the consideration for the promise of the surety is a usurious loan. In jurisdictions where the exaction of usurious interest renders a transaction wholly void, barring recovery from the principal debtor of both the principal amount and the interest,[113] the surety has usually been similarly released where the usurious contract is the only consideration for the surety's promise.[114] Under some statutes, however, usury operates to render void only the interest involved,[115] or that part which exceeds the lawful rate;[116] while penalties, fixed at a multiple of the interest demanded, are often superimposed.[117] In these latter jurisdictions the question arises whether or not the surety can avail himself of his principal's liquidated claim of usurious payments made to the creditor along with perhaps the statutory penalty.[118] Both with respect to a general statutory set-off or counterclaim provision and a specific usury set-off statute[119] the holdings are in conflict as to whether

109. The principal must of course be shown not to be a donee beneficiary.

110. An infant cannot effectively ratify a contract until he attains majority. 1 WILLISTON, CONTRACTS (rev. ed. 1936) § 239. A court might, however, require an infant to elect whether or not to disaffirm.

111. See Kuns's Executor v. Young, 34 Pa. 60 (1859) (surety held where infant ratified on attaining majority). The surety should have sought the remedy of exoneration in that case, although since the infant's contract was deemed void the surety might be exonerated only to the extent of quantum meruit.

112. The courts should require the infant to restore what he has received before he may effectively avoid a fair contract. See 1 WILLISTON, CONTRACTS (rev. ed. 1936) § 238.

113. See *e.g.*, N. Y. GENERAL BUSINESS LAW § 373; UTAH REV. STAT. ANN. (1933) § 3324. The statutes as of 1921 are abstracted in RYAN, USURY AND USURY LAWS (1924) 205-216.

114. Henry & Co. v. Fry, 78 Misc. 130, 137 N. Y. Supp. 894 (1912); Note (1931) 70 A. L. R. 359; *cf.* Drew v. Skeena Lumber Co., Ltd., 180 Minn. 358, 230 N. W. 819 (1930) (compensated surety).

115. *E.g.*, TEX. ANN. REV. CIV. STAT. (Vernon, 1925) art. 5071; MICH. COMP. LAWS (1929) § 9241; see RYAN, *loc. cit. supra* note 113.

116. *E.g.*, OHIO GEN. CODE ANN. (Page, 1926) § 8306; PA. STAT. ANN. (Purdon, 1930) tit. 41, § 4; see RYAN, *loc. cit. supra* note 113.

117. *E.g.*, CAL. GEN. LAWS (Deering, 1931) Act 3757, § 3; MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 7727; see RYAN, *loc. cit. supra* note 113.

118. See ARANT, SURETYSHIP (1931) 211, n. 91; SPENCER, SURETYSHIP (1913) § 58; Notes (1931) 70 A. L. R. 359, (1933) 82 A. L. R. 1018.

119. *E.g.*, GA. CODE (1933) § 3439; N. C. CODE ANN. (Michie, 1935) § 2306.

or not the surety falls within their purview.[120] In this situation, it would seem that the surety might get the advantage of the set-off by means of a suit for exoneration with an equitable garnishment of the principal's claim against the creditor, due under the usury statute. Since it is generally required, however, that a party who seeks affirmative relief in equity against the exactor of usury must do equity, *i. e.,* pay the principal amount, and perhaps, the legal rate of interest,[121] the suit for exoneration may prove little comfort to a surety seeking to reduce his liability by invoking his principal's set-off. Moreover, where a contract tainted by usury is not rendered wholly void,[122] an insolvent principal who is not able to release his surety by a tender of the amount lawfully due the creditor, even though he is willing to allow his surety to invoke the set-off, can do nothing to decrease his surety's liability except in those few jurisdictions where by statute the surety may with consent plead the principal's claim against the creditor,[123] or where equity permits the surety a set-off in the special circumstance of the principal's insolvency.[124] In view of existing equities,[125] however, it might be urged that the exoneration decree, as a flexible device, should be granted upon tender or offer of tender by the surety of the amount necessary to satisfy the equity requirement. The actual recovery by the creditor against the surety would then be limited to the amount lawfully owed by the principal, since the principal's statutory claim, garnished by the surety in the exoneration suit, would be applied in reduction of the surety's liability.

Since most of the cases where a surety seeks to invoke a defense of his principal in the suit of the creditor turn on the classification of defenses as "inherent" or "personal," the law in this field, by requiring a uniform decision as to the availability of a particular defense, has become too rigid. The transactions described as suretyship transactions occur in so many business contexts that any one rule fixing terms for the liability of the

120. Compare People's Bank v. Loven, 172 N. C. 666, 90 S.E. 948 (1916) and Stockton v. Coleman, 39 Ind. 106 (1872) with Lazear v. National Union Bank of Maryland, 52 Md. 78 (1879) and Roberts v. Coffin, 22 Tex. Civ. App. 127, 53 S.W. 597 (1899); see also Notes (1931) 70 A.L.R. 359, (1933) 80 A.L.R. 1018.

121. See Note (1922) 17 A.L.R. 123. In Arkansas, Minnesota and New York, however, a borrower is entitled to equitable relief against the usurious contract without payment of either principal or legal interest. *Id.* at 128. That a surety is not a borrower, see Allerton v. Belden, 49 N. Y. 373 (1872) *rev'g* 3 Lans. 492 (N. Y. Sup. Ct. 1871).

122. See notes 115, 116, *supra.*

123. See note 78, *supra.*

124. See note 92 *supra.* It may be possible, however, for the surety to give the money owed by the principal to him in order that the amount lawfully due may be tendered.

125. If the surety may not set off the principal's statutory claim, and the reimbursement right is preserved [see notes 55, 57, *supra*], the creditor will of course avoid the statutory penalty.

surety is bound constantly to distort the bargains which were actually made. If there were a single accepted theory for all suretyship transactions, listing the risks which the surety was deemed to accept, the surety's claim to exoneration or reimbursement would be irrelevant to his liability, as it is in the clear cases where the principal is an infant or a married woman under common law disabilities. But there is no prevailing opinion among judges, legislators, or business men, as to what the surety's risk should be with respect to most of the defenses available to the principal. In such typically ambiguous cases the application of the traditional rules, whatever their virtues of simplicity and certainty, lack sufficient flexibility to permit courts to take cognizance of the equities of reimbursement and exoneration latent in these cases and to reach decisions which they regard as equitably allocating the losses in view of all the significant circumstances of each case.

As an alternative to mechanical and misleading distinctions between defenses, the cases might be disposed of in terms of a reasonably factual analysis of the transactions implicit in them. The process would consist of two steps: (1) a consideration of the actual bargains made by the surety and the creditor,[126] and (2) an addition to those bargains of conditions[127] regarded as reasonable in view of what the court thought were proper or habitual characteristics of the kind of surety relationship at issue and of the circumstances in particular cases. Thus, a defense may be denied where the surety is held to be absolutely or unconditionally liable and permitted where the surety's liability is viewed as conditional upon the enforceability of the principal's obligation by the creditor. The guaranty of collection would, of course, be included as one type of conditional contract, due diligence in securing a judgment against the principal with execution returned unsatisfied being regarded as conditions precedent to the surety's liability.[128] Because of these protective conditions precedent, the guarantor of collection automatically takes advantage of any defenses invoked by his principal.[129]

126. The courts have apparently lost sight of the fact that the most important characteristic of a surety transaction is its contractual basis. See 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1211; see also ARNOLD, SURETYSHIP AND GUARANTY (1927) § 26. It is possible to construe in various ways the consideration the surety has received for his promise to pay the debt. The consideration may be simply a paper arrangement between principal and creditor; or it may be found to be a contract between the principal and creditor, enforceable (a) by the creditor, (b) by the principal, (c) or by both.

127. *Cf.* ARANT, SURETYSHIP (1931) § 47; Comment (1918) 18 COL. L. REV. 158.

128. SPENCER, SURETYSHIP (1913) § 107; STEARNS, *op. cit. supra* note 9, § 62.

129. *Cf.* 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1231. A court can, of course, permit a surety to take advantage of all the defenses of his principal by construing an ambiguous surety bargain as a guaranty of collection. Some courts have in fact drawn nice distinctions between guaranties of collection and guaranties of payment. See Melvin, *Enforcement of Guaranty Contracts* (1932) 6 CONN. BAR J. 233; (1920) 20 COL. L. REV. 102.

Although in most cases, written contracts signed by a surety are inconclusive on the issue of whether the surety's liability was intended to be conditional upon the enforceability by the creditor of the principal's obligation, and although it is unlikely that the parties had any actual intent on this issue at the time the surety bargain was made, the process of implying conditions to the liability of the surety offers considerable scope for a flexible administration of cases of this sort. The superior flexibility of an analysis in terms of conditions implied in fact from the circumstances of the bargain over the results suggested by the traditional dichotomy of "inherent" and "personal" defenses is strikingly illustrated in the "failure to sign" cases,[130] where the problem is to assess the effect on a surety's liability of the principal's failure to sign the instrument evidencing the principal debt. Some courts have implied a presumption to the effect that the surety's liability is conditional upon the principal's signing the instrument of indebtedness;[131] other jurisdictions, perhaps less plausibly in terms of business experience, have presumed the surety's liability to be unconditional.[132] In either case, however, the presumption is evidentiary, and evidence is admissible to rebut it.[133] Reasoning in these terms enables a court to decide two cases involving the "failure to sign" defense differently, relying either upon what is shown to be the understanding of the parties or upon other special circumstances. Although no persuasive grounds appear to preclude the extension of this reasoning to cases involving analogous defenses,[134] the practice of implying conditions has hitherto been limited to few types of cases.

The courts have frequently found logical difficulty in escaping the rigor of the "inherent" and "personal" defense rationale. While infancy is normally considered a "personal" defense,[135] where an infant principal disaffirms a contract with his creditor and returns the consideration, the courts have usually held that the surety may escape liability,[136] on the ground of failure of the consideration for the entire transaction.[137] While such reasoning may

130. See ARANT, SURETYSHIP (1931) 156; Comment (1924) 12 CALIF. L. REV. 318.

131. SPENCER, SURETYSHIP (1913) § 45, n. 9.

132. *Id.* at § 45, n. 10.

133. See, *e. g.*, Johnston v. Township of Kimball, 39 Mich. 187, 188 (1878).

134. In cases where the principal has the defense of forgery, for example, an evidentiary presumption that the surety's liability was conditional on the validity of the principal's signature might be made in jurisdictions which favor the surety in the "failure to sign" cases.

135. See note 17, *supra*.

136. ARANT, SURETYSHIP (1931) 170, n. 47; STEARNS, *op. cit. supra* note 9, § 104, n. 138a. The surety is also said to be released "where the consideration has not yet passed to the infant." STEARNS, *supra*, § 104, n. 138b; see also Patterson v. Cave, 61 Mo. 439, 441 (1875) ("no consideration").

137. See the leading case of Baker v. Kennett, 54 Mo. 82, 93 (1873); see also Moore v. Leach, 14 S. W. (2d) 21, 23 (Mo. App. 1929). Payment by the creditor

be justifiable where a creditor agrees to rescind his contract with the infant principal,[138] it does not appear applicable to those cases where the creditor, who either has performed or is ready and willing to perform his promise to the infant principal, elects to treat the infant's disaffirmance as a breach of the contract;[139] for it does not seem tenable to assume that the creditor, as consideration for the obligation of the surety, promised not only his own performance but that of the infant as well.[140] The surety's liability might more reasonably have been avoided by presuming tentatively that the infant's non-disaffirmance was a condition precedent to the surety's liability.[141]

In suggesting this more convenient method of justifying the release of the surety, it is not urged that in all such cases the risk of avoidance by the infant principal should be placed upon the creditor; in fact, the contrary presumption, *i. e.*, that the surety's liability was not conditioned upon affirmance by the infant principal, could often be plausibly indulged. For the considerations which have motivated the courts in permitting the surety the defense of infancy in these circumstances do not appear to be persuasive. Some courts have stated that it is a "strange doctrine"[142] which permits the creditor to recover from the surety, since by the infant's avoidance of his contract with the creditor the latter would also receive the consideration returned by the infant. It has been widely insisted, however, that this assumption is erroneous; for "upon payment of the debt the surety would become subrogated to the rights of the creditor"[143] to the consideration returned. Moreover, it has been suggested that in cases where the surety is released on "failure of consideration" grounds, the surety should not completely escape liability; for a disaffirmance by the infant principal and the return of the consideration, while they do restore the status quo, deprive the creditor of the benefit of his bargain.[144] While this argument would be inapplicable where the presumption is made that non-disaffirmance by the infant principal is a condition precedent to the surety's liability, in a jurisdiction which imposes the risk of avoidance upon the surety, instead of

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to the surety of a small sum, perhaps even nominal, might prevent the failure of consideration defense.

138. Lagerquist v. Bankers' Bond & Mortgage Guaranty Co., 201 Iowa 430, 205 N. W. 977, 43 A. L. R. 585 (1925), Comment (1926) 11 IOWA L. REV. 394.

139. See ARANT, SURETYSHIP (1931) 172.

140. *Cf.* Evants v. Taylor, 18 N. M. 371, 376, 137 Pac. 583, 584 (1913).

141. *Cf.* ARANT, SURETYSHIP (1931) § 47.

142. See Baker v. Kennett, 54 Mo. 82, 93 (1873); Keokuk County State Bank v. Hall, 106 Iowa 540, 542, 76 N. W. 832 (1898).

143. See Comment (1914) 2 CALIF. L. REV. 337, at 338; see also Parker v. Baker, 1 Clarke Ch. 136, 139 (8th Cir., N. Y. 1839); McKee v. Harwood Automotive Co., 204 Ind. 233, 237, 183 N. E. 646, 648 (1932), (1933) 1 U. OF CHI. L. REV. 153, (1928) 4 IND. L. J. 206, (1933) 18 IOWA L. REV. 551.

144. See ARANT, SURETYSHIP (1931) 171; Comment (1926) 11 IOWA L. REV. 394; (1933) 1 U. OF CHI. L. REV. 153.

permitting the creditor to recover the full amount of the principal's debt, the creditor might be required to give the surety credit to the extent of the market value of the consideration which the infant principal has returned, so that the surety's liability would be limited to the balance of the contract price.[145]

Another consideration that might well be given weight under a flexible technique of making evidentiary presumptions of conditions precedent to the liability of the surety, a factor which has not been sufficiently stressed under the traditional rationale of "inherent" and "personal" defenses, is the surety's knowledge at the time of contracting of facts upon which a defense is predicated.[146] Under traditional doctrines knowledge of the surety is considered significant only where the principal's defense is duress,[147] or, according to occasional dicta, insanity,[148] or infancy.[149] In other cases liability is automatically imposed upon the surety if the defense he seeks to invoke falls within the category "personal."[150] If the technique of making evidentiary presumptions as to conditions precedent to the liability of the surety is followed, however, the factor of knowledge of the surety will be given the weight it deserves in all these cases; for it may be introduced to support the presumption that the liability of the surety is unconditional or to rebut the contrary presumption.

The emphasis upon the category into which a particular defense is said to fall has directed attention away from the one consideration which should be of primary importance in these cases: the actual bargain made by the surety,[151] with particular reference to any provision made in it for the surety's obligation when the principal debt cannot be enforced by the creditor against the principal. The equities of reimbursement and exoneration and

145. See ARANT, SURETYSHIP (1931) 171; HANNA, CASES ON SECURITY (1932) 429; (1933) 1 U. OF CHI. L. REV. 153.

146. See, *e.g.*, 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1214 (any defense should be available to surety if creditor was aware at time of contract of principal's defense, and also knew surety didn't know of it). Dean Arant adds, "but if neither promisee nor surety knows that the contract is ultra vires, the surety should be held." ARANT, SURETYSHIP (1931) 173.

147. See note 26, *supra*.

148. See Allen v. Berryhill, 27 Iowa 534, 539 (1869); Lee v. Yandell, 69 Tex. 34, 36, 6 S. W. 665, 667 (1887).

149. See International Text-Book Co. v. Mabbott, 159 Wis. 423, 426, 150 N. W. 429, 430 (1915).

150. But see GA. CODE (1933) § 3539 (surety's obligation accessorial; but if "original contract of the principal was invalid from a disability to contract, and this disability was known to the surety, he shall still be bound."); see also Patterson v. Gibson, 81 Ga. 802, 805, 10 S. E. 9, 10 (1888) (citing this statute as "equivalent to declaring that if the principal was under a disability to contract, and this was unknown to the surety, he would not be bound.")

151. See ARANT, SURETYSHIP (1931) § 44; 4 WILLISTON, CONTRACTS (rev. ed. 1936) § 1211; Sturges, *supra* note 1, at 484; (1934) 43 YALE L. J. 494.

the implication of conditions to the surety's obligation, which have been considered at length, are secondary to the actual terms of the contract by virtue of which liability is sought to be imposed upon the surety; and those indirect considerations should be used to measure the equities of the situation only when the bargain of the surety is inconclusive on the issue. Unfortunately, however, surety bargains tend to become stereotyped; and the promise of the surety rarely provides expressly for the contingency of the invalidity of the principal's obligation. Furthermore, courts do not closely study the bargains in these cases where the surety seeks to invoke a defense of his principal,[152] nor do the cases indicate that litigants attempt to build persuasive records on the issue of whether the surety anticipated a particular defense or whether, in view of the circumstances of the bargain, the surety indicated that his liability was conditioned upon the validity of his principal's obligation. The parol evidence rule may make it difficult to introduce any evidence bearing upon such conditions not made explicit in the written contract of suretyship;[153] but that rule apparently excludes only evidence as to conditions subsequent,[154] so that it should not prove an obstacle in those cases where the validity of the principal's obligation[155] or his affirmance of the principal contract[156] may be construed as a condition precedent to the surety's liability. Moreover, evidence as to the parties' intention might be said to explain rather than alter the written contract.[157]

152. Where the courts are confronted with an unusual defense which is traditionally neither "personal" nor "inherent," they are apparently more apt to use a contract analysis. See, *e.g.*, Kiessig v. Allspaugh, 99 Cal. 452, 34 Pac. 106 (1893).

153. See Weare v. Sawyer, 44 N. H. 198, 204 (1862); ROWLATT, *op. cit. supra* note 2, at 149; STEARNS, *op. cit. supra* note 9, §§ 111, 112; see also an extended annotation in (1922) 20 A. L. R. 421. Parol evidence is admissible to show that the apparent principal was a surety. SPENCER, SURETYSHIP (1913) § 2.

154. See STEARNS, *op. cit. supra* note 9, § 111; see also Moore v. Leach, 14 S. W. (2d) 21, 23 (Mo. App. 1929); Note (1922) 20 A. L. R. 421, 427. But see CAL. CIV. CODE (Deering, 1931) § 2806 ("a guaranty is to be deemed unconditional unless its terms import some condition precedent to the liability of the guarantor."). See also MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 8181; N. D. COMP. LAWS ANN. (1913) § 6661; OKLA. STAT. (Harlow, 1931) § 9610; S. D. COMP. LAWS (1929) § 1484.

155. But see Weare v. Sawyer, 44 N. H. 198, 204 (1862) (parol evidence inadmissible to show surety insured only such performance as had been "legally" entered into by school district whose agent signed without authority); *cf.* Neil v. Board of Trustees of the Ohio Agricultural and Mechanical College, 31 Ohio 15 (1876) (parol evidence inadmissible to show written guaranty of payment was understood to operate as guaranty of collection).

156. *Cf.* Moore v. Leach, 14 S. W. (2d) 21 (Mo. App. 1929) (oral evidence admissible to indicate infant principal's entrance into college was condition precedent to surety's liability on note given for college tuition). It should be noted that failure of consideration may be shown by parol. STEARNS, *op. cit. supra* note 9, § 112.

157. Where the promisor merely signs as surety it is manifest that the precise meaning of this generic term of reference should be made clear. But see Davenport

Although the surety has been called "a favorite of the law,"[158] this title does not seem justified in those cases involving defenses held "personal," where the courts settle cases on the basis of what a defense is called rather than of the bargain made by the surety and the equities of his position. Apart from the doctrinal remedies suggested,[159] legislation may provide a method to redress the balance in favor of the surety in these cases. It has been indicated[160] that there is a possibility in New York that the surety in the suit by the creditor against him may compel the creditor to join the principal as defendant. A statute in that jurisdiction permits a party to an action to bring in a third person who is or will be liable to such party wholly or in part for the claim made against such party in the action.[161] Although this provision seems to permit a surety when sued alone to join his principal in the creditor's action, a single case has held to the contrary.[162] It is difficult, however, either to justify or to understand the court's reasoning that since the surety's cause of action for reimbursement does not arise until he makes payment to the creditor, the principal may not be joined since "there might be presented the anomaly of two judgments, one of which would be conditional upon payment of the other."[163] There should also be noted the unique Vermont statute which permits the surety "on a note or other obligation by indorsement or otherwise" to take advantage "of any defense that the principal might have availed himself of in an action brought against him thereon."[164] The statute is apparently restricted, however, to the defenses of set-off and counterclaim.[165] Its application to these defenses has been upheld against constitutional attack, since it allows the surety no more than could be accomplished in equity,[166] the available equitable remedy apparently being the suit for exoneration.

& Harris Undertaking Co. v. Roberson, 219 Ala. 203, 121 So. 733 (1929); HANNA, CASES ON SECURITY (1932) 345.

158. See note 9, *supra*.

159. See also 4 WILLISTON, CONTRACTS (rev. ed. 1936) §§ 1218, 1251; Levine, *op. cit. supra* note 76, at 210; (1929) 42 HARV. L. REV. 443.

160. See STURGES, CASES ON CREDIT TRANSACTIONS (1936) 18.

161. N. Y. CIVIL PRACTICE ACT, § 193, subdiv. 2.

162. Scripture v. Buckley, 137 Misc. 155, 241 N. Y. Supp. 635 (City Ct. of N. Y., 1930).

163. *Id.* at 156, 241 N. Y. Supp. at 636. Such reasoning might also prevent the surety from making the principal, as has been suggested (see note 159, *supra*), a party to the creditor's action under ordinary code provisions.

164. VT. GEN. LAWS (1917) § 2856; see also an ambiguous Mississippi statute in MISS. CODE ANN. (1930) § 2960. The Vermont statute appears, however, to be superseded by the Negotiable Instruments Act. See Vt. Pub. Laws (1933) 1563 (Disposition Tables). General Law § 2856 does not by its terms, however, seem limited to negotiable instruments. See Strait & Son v. U. S. Fidelity & Guaranty Co., 82 Vt. 103 (1909).

165. Flagg v. Locke, 74 Vt. 320, 52 Atl. 424 (1902); Strait & Son v. U. S. Fidelity & Guaranty Co., 82 Vt. 103 (1909).

166. Flagg v. Locke, 74 Vt. 320, 322, 52 Atl. 424, 425 (1902).