Suretyship (1959-1967)

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6. Thompson was guardian in Virginia for Mary Smith, an infant. Thompson, as principal, and Kirk, as surety, executed a bond, under seal, bearing date November 1, 1945, in the principal sum of $5,000, conditioned upon the faithful performance of Thompson’s duties as guardian. Thompson used his ward’s funds for his own purposes, and shortly after his defalcation was discovered, he died of a heart attack. On June 1, 1952, shortly after Thompson’s death, Kirk paid the sum of $3,000, the amount of the defalcation, to the newly appointed guardian for Mary Smith. The bond was not assigned to Kirk upon the payment of the loss. At the time of the payment of the loss Kirk was advised that Thompson’s estate was hopelessly insolvent and he, therefore, made no attempt to collect the amount he had paid. Three years after Thompson’s death, Thompson’s Administrator discovered that Thompson owned some valuable personal property in Virginia which had been secreted by Thompson and that Thompson’s estate was solvent. On July 1, 1959, Thompson’s Administrator filed a suit in equity seeking the advice of the court in the administration of the estate. Kirk, upon learning that the estate was solvent, intervened in the chancery suit and sought therein to recover the sum of $3,000, with interest, the amount paid by him as surety on the guardianship bond. The Administrator promptly filed a plea of the three-year statute of limitations to Kirk’s claim.

How should the Court rule on this plea?

(SURETYSHIP) The plea of the three year statute should be disallowed. When Thompson died all of his creditors had an in rem right against whatever property he had at the time of his death to the end that it be applied to his debts. Since the new guardian of Mary Smith was such a creditor, since the obligation owed him was one under seal, and since he has been paid in full, Kirk is subrogated to his rights against Thompson’s estate on the sealed instrument. Note: Had Thompson’s administrator relied on Va. Code of 1878 which provides that no personal actions shall lie against the estate of a deceased person after five years from the qualification of his personal representative such a plea should have been sustained. See Lila’s Notes on Equity.

6. On Jan. 1, 1956, Joe Mendel was installed for a one-year term as the treasurer of Smithfield Hunt Lodge, and, pursuant to its by-laws, the Lodge obtained from Franklin Surety Co. its fidelity bond #163, payable to the Lodge and conditioned upon the faithful performance of Mendel’s duties as treasurer. This bond, in the penalty of $1,000, was executed on Jan. 1, 1956, for one year. Mendel paid the $25 bond premium from the Lodge’s funds. Because of his zeal for the job, Mendel was re-elected treasurer of the Lodge for succeeding years, but on April 6, 1960, he died in office, and it was soon discovered that he had misappropriated more than $1,000 of the Lodge’s funds in each of the years 1956 through 1959. The Lodge found among its papers bond #163 dated Jan. 1, 1956, and also three receipts from Franklin Surety Co. dated Jan. 1, 1957, 1958, and 1959, respectively, each of which state the following: "Received of Smithfield Hunt Lodge $25.00 premium for one year from date, for bond. /s/ FRANKLIN SURETY COMPANY"

The Lodge made demand on Surety Co. for $4,000, and Surety Co. promptly paid $1,000, but it denied that it owed any further obligation to the Lodge, inasmuch as no bonds had actually been written for the years 1957, 1958, and 1959. Surety Co. further tendered refund of the premium for those years.

The Lodge instituted suit by bill in chancery against Franklin Surety Co. in the Circuit Court of Isle of Wight County, alleging the above facts, and seeking recovery against Surety Co. for $3,000. How should the court rule?

(SURETYSHIP) The court should rule in favor of Lodge. Equity regards that as done which ought to have been done. Surety Co. should not be allowed to profit by its own wrong. The requirement of an actual bond was for the benefit of Lodge and could be waived by it. The signed receipts are a sufficient compliance with the statute of frauds. See 180 Va. 37.
Bank, Inc., of Roanoke, Va., solicited the deposit of Mammoth Corp. After some
negotiation, it was agreed that if Bonding Company would execute a bond guaranteeing
the deposit to the extent of $100,000, Mammoth would use the Bank as its depository.
The Bank and Bonding Company entered into an agreement by which Bank deposited with
Bonding Company U.S. Bonds in the amount of $75,000 to secure Bonding Company against
loss, and Bonding Company executed and delivered to Mammoth its bond guaranteeing
the deposit in the amount of $100,000.

This arrangement continued for several years and as Mammoth's business increased
so did its bank deposits until as of Dec. 31, 1959, its deposit amounted to $250,000.
Bank became insolvent as did Bonding Company. Mammoth, even if it had been paid the
entire $100,000, would still have lost $85,000 of its deposit. A chancery suit was
brought to wind up Bank's affairs to which both Mammoth and Bonding Company were

4. Joe Burns operated a cleaning and pressing shop in the City of Danville. Although
his business had not prospered as expected, Burns believed that bettering
the appearance of the front of the building and the installation of more modern
equipment would increase his volume of business. Burns went to the First Bank of
Commerce and requested a loan of $5,000 to be used in making the desired improve­
ments. The loan officer at the Bank, expressing doubt that such improvements would
be worth the investment, agreed to lend Burns the $5,000 on the condition that he
secure the guarantees of two other persons. Burns then contacted his friend Thomas
Potts, who was a wealthy and respected citizen of Danville, and told him of his
plans and of the Bank's requirement. Potts thought Burns' plan for improvement a
good one and agreed to guarantee the loan. However, when Burns was unable to find
another guarantor, Potts agreed to seek one for him. Potts then went to see his
friend George Duke who, being doubtful of the soundness of Burns' plan, showed a
reluctance to serve as a guarantor. Potts thereupon said to Duke, "Come ahead and
join me as a guarantor of the loan. You have no need to worry as I think Burns' idea is a good one. Even if Burns fails you will never have to pay a dollar on the
loan as long as I have any money of my own." On being told this, Duke, along with
Potts, signed as guarantor Burns' note to the Bank for $5,000.

Burns received the money and made the improvements to his establishment. However,
the improvements did not benefit the business of Burns who became insolvent and de­
faulted on the note held by the Bank. Potts then being out of the City on an extend­ed
vacation, the Bank brought an action against Duke and recovered from him the full
$4,500 then owing on the note. On Potts' return to the City, Duke brought an action
against him to recover the entire $4,500. Potts pleaded the statute of frauds as a
defense. Was this a good defense?

(SURETYSHIP) No. Since Potts was answerable for the debt independently of his promise
to Duke, when he undertook that Duke should not be compelled to pay it, this was
Potts' direct obligation to Duke and not a promise to answer for the debt of another
so held in 115 Va.J441, 79 S.E.1029(1913).
8. McDaniels holds a non-negotiable bond of Powers, for the sum of $5,000, payable November 1, 1961. This bond is signed by Sergeant as surety. Powers did not pay the bond on its maturity date, whereupon McDaniels made demand upon Sergeant for payment. Upon Sergeant's refusal to pay the bond, McDaniels sued Powers and Sergeant. In his defense to the action Sergeant contends: (a) That McDaniels made no demand upon Powers for payment on the maturity date of the bond. (b) That Powers is solvent and has unencumbered assets in the State of Virginia, the State in which McDaniels and Powers are resident. Are these contentions sound? (SURETYSHIP) No. In 112 Va. 384 the Court said, "In general, the liability of the surety to the creditor is the same as that of the principal. The responsibility of both is primary; and, at law the creditor rests under no obligation to look to the principal or to his property, or to exhaust his remedies against him before resorting to the surety. He may collect his debt out of either."

4. John Thomas was the holder of the following instrument:

"Richmond, Va.
July 2, 1962

$1,000
Thirty days after date I promise to pay to John Thomas, One Thousand Dollars.

Carl Black"

This instrument bore the accommodation endorsement of William Austin as surety. On July 29, 1962, Black, in good faith, told Thomas: "I am expecting to get some money shortly; I will pay you $300 now if you will give me ten days more in which to pay the balance of that note." Thomas agreed to this, and Black paid him the $300 which was credited on the note. The ten days expired and Black didn't pay the balance, and Thomas demanded payment from Austin. The facts are that Black, unknown to himself, had been insolvent for several months and that if Thomas hadn't accepted the $300 at the time it was offered him, Black would not have been able to pay anything on the debt. Austin consults you, telling you that he knew nothing about the $300 transaction until August 11, 1962, when Thomas demanded payment from him of the balance of $700 due on the note. On the above facts, has Austin any defense to the demand?

(SURETYSHIP) No. There has been a binding extension of time for a definite period without the consent of the surety. The payment of $300 before anything was due was a legal detriment to the principal debtor. It is immaterial that the Surety was not actually damaged. He went surety on the original contract and not on the changed contract, and the surety's remedies against the principal debtor have been impaired. See 18 M.J., Suretyship #15.

Q. 4 on p.577(Suretyship) Due to misconception as to how the question was asked I put down "No" when I should have answered, "Yes, Austin has a defense." The rest of the answer stands as it is.
3. Martin Manufacturing Co., an Illinois corporation engaged in the manufacture of cosmetics, contracted with John Erdman to sell him its products. As a condition precedent to any extension of credit, Erdman was required by Martin Manufacturing Co. to secure a guaranty of future indebtedness from one substantial citizen. Erdman approached his neighbor, Wilkes, a successful but illiterate businessman, to obtain his execution of the guaranty. Erdman falsely told Wilkes that the paper tendered him was simply a statement approving Erdman's character. Wilkes thereupon signed the paper which was in fact a non-negotiable guaranty promising unconditionally to pay each item of indebtedness of Erdman to Martin Manufacturing Co. as it became due. Martin Manufacturing Co. received the guaranty agreement in due course, and proceeded to extend credit to Erdman. Subsequently, Erdman became insolvent, and indebted to Martin Manufacturing Co. for $750. Thereupon Martin Manufacturing Co. brought an action in the Lee County Court against Wilkes for the $750.

In defense of the action, Wilkes did not question the debt, but sought to avoid the obligation by pleading fraud on the part of Erdman. Was this a good defense? (SURETYSHIP) Wilkes is liable. Where the loss must fall on one of two innocent parties it will be placed on the one who made the loss possible. Martin Mfg. Co. is not liable for the fraudulent representations since they were made without its knowledge or consent by one not its agent. See 153 Va. 514.

6. John Peters, a retail hardware merchant of Alexandria, was indebted to Tom Crisp for a total of $5,000 arising from two separate sales of household appliances made to Peters by Crisp. The first such sale was for a price of $2,000 and was made by Crisp on credit in January of 1963. In August of 1963 Peters made the second purchase from Crisp for a price of $3,000, but Crisp having some misgivings about the financial ability of Peters, required Peters to execute a promissory note for $3,000 payable to Crisp on November 15, 1963. At the insistence of Crisp, Peters' uncle Alfred Spang also executed the note but as accommodation maker. At the same time, Peters endorsed and delivered to Crisp corporate securities of Peters of a value of $8,000 in pledge to secure payment of the total indebtedness of $5,000. On November 15th Peters, being in financial straits, failed to pay any part of the $5,000 owed Crisp and, on the demand of the latter, Spang paid Crisp the $3,000 due on the promissory note.

Spang now consults you and says that although he has asked Crisp to transfer to him that portion of the pledged securities necessary to enable him to recoup the $3,000 he has paid Crisp, that Crisp has stated that he will not make any transfer of the securities until Peters has paid him the balance due of $2,000. Spang then asks whether he can proceed in equity to compel Crisp to transfer to him that portion of the pledged securities having a value of $3,000. How should you advise him?

(SURETYSHIP) No. There can be no subrogation until the whole debt is paid, or, stated figuratively, Surety cannot stand in Creditor's shoes until Creditor is through with his shoes. The securities might later go down in value to such an extent that Creditor will need all of them. 160 Va. 351.
Peter, just turned nineteen years of age, but with an appearance of maturity beyond his years, entered into a written contract with Owen to deliver a quantity of bootleg whiskey to Owen in Halifax County for resale, for which delivery he was to receive one-half the expected profit of $2,000. As part of the contract, Owen required Peter to guarantee that if Peter failed to make the delivery for any reason, then Peter would pay Owen $1,000 and required Peter to obtain a surety for this obligation. Sam, for a $10 consideration from Peter, agreed in writing that he would pay to Owen the sum of $1,000 if Peter failed to deliver the whiskey and defaulted in the payment of the $1,000.

Peter purchased a panel truck from Calvin, paying him one-half the purchase price with an agreement in writing that the remainder would be paid in sixty days. Calvin, who neither knew nor had reason to suspect the purpose for which the truck would be used, required a surety; and Sam, for a consideration of $10 from Peter, in writing guaranteed to Calvin this payment if Peter should default.

None of the parties knew how old Peter was and, because of his appearance, had made no inquiry in regard to same. Before he picked up the whiskey, Peter wrecked the truck and totally demolished it and, consequently, could not deliver the whiskey to Owen, or make any payments to Owen or Calvin. Owen and Calvin immediately brought actions against Peter and Sam for recovery on their respective agreements.

State what defense, if any, could be raised(1) by Peter to each action and (2) by Sam to each action, and how the court should rule in each instance. (SURETYSHIP)(1) As against Owen, Peter has the defenses of illegality and infancy. As against Calvin, Peter has the defense of infancy. (2) As against Owen, Sam has the defense of illegality since Owen knew about the illegality. As against Calvin, Sam has no defense. Sam cannot take advantage of his principal's infancy as that is a personal defense, nor of the illegality because Calvin was ignorant thereof and the purchase of a panel truck was apparently a perfectly proper transaction.

The Cattlemen's National Bank of Louisa County, Virginia, held as payee three bonds of Happy Holstein, all maturing on the same date, secured by deed of trust lien on improved real estate in that county. Bond No. 1 was endorsed by Angus Hereford as surety. Holstein defaulted in payment of the bonds on the maturity date and, upon demand by the bank, Hereford paid Bond No.1 upon which he was surety. Thereafter, the bank instituted a suit to foreclose under the deed of trust and the property was sold. Angus Hereford was permitted to intervene in the foreclosure suit, and he thereupon filed a proper pleading in which he claimed that he was subrogated to the rights of the bank as to Bond No.1, and that he was entitled to reimbursement of the sum paid by him in satisfying the bond. After the payment of suit costs and costs of the sale of the property, the balance remaining was barely sufficient to pay bonds Nos.2 and 3.

Is Angus Hereford entitled to be repaid the amount of Bond No.1 in whole or in part? (SURETYSHIP) No. A surety cannot claim against his creditor until his creditor has been paid in full, or, stated figuratively, he cannot stand in his creditor's shoes by way of subrogation until his creditor is through with his shoes. If subrogation were allowed here Bank would not be paid in full and Hereford would recover a portion of what he has paid to the injury of Bank all in conflict with the principles stated above. See Lile's Notes on Equity Jurisprudence at p.176.
The claim of XYZ Motor Corp. was based upon the following written guaranty agreement given to it by John Doe and Richard Roe on July 15, 1965:

"In consideration of your supplying Automotive Parts Corporation with goods in your line on credit, we, John Doe and Richard Roe, do guarantee you the payment of, and we, John Doe and Richard Roe, promise to pay such sum or sums of money as Automotive Parts Corporation shall owe XYZ Motor Corp. for goods purchased at any time provided that at no time shall the total indebtedness of Automotive Parts Corporation to XYZ exceed the sum of $5,000.

Witness our hands and seals this 15th day of July, 1965.

(Signed) John Doe (Seal)
(Signed) Richard Roe (Seal)"

Doe and Roe owned all the stock of Automotive Parts Corporation.

Between July 15th and August 10th, 1965, XYZ Motor Corp. sold Automotive Parts Corporation automotive parts at a price aggregating $5,100. No payment was made on the account until August 16th, 1965, when $2,100 was paid. When Automotive Parts Corporation refused to pay the balance of the account, XYZ Motor Corp. instituted an action against Doe and Roe jointly for $3,000 on the guaranty agreement. They request you to advise them as to their liability on said agreement.

How would you advise them?

(SURETYSHIP) I would advise them that they were not liable. When credit to the extent of $5,100 was given a condition of their liability was broken.

Acme Construction Co. contracted to construct an apartment house in the City of Richmond for the Highrise Corporation for $985,000. The contract contained the following provision for payments to be made to Acme Construction Company:

"On the first day of each month hereafter, Highrise shall pay to Acme 85% of the cost of labor and materials incorporated in the work during the previous month. The supervising architect is to be the sole judge of the cost of labor and materials incorporated into the work during each month, and payments shall be based upon the amount determined by the architect. Highrise shall retain 15% of the cost of said labor and materials, as determined by the architect, until construction of the building is completed according to the contract."

Acme Construction Co. gave Highrise Corporation a bond for faithful performance of the contract. Reliable Guaranty Co. executed the bond as guarantor and agreed to reimburse Highrise for any construction costs incurred in excess of the contract price. Subsequently, but without the knowledge of the Reliable Guaranty Co., Highrise paid each month to Acme the full cost of labor and materials, instead of 85% of this amount as provided in the contract. When construction of the building was three-fourths completed, Acme defaulted. Thereupon, Highrise, after proper notice to Reliable, proceeded to complete construction of the building through the services of another contractor. After such completion, Highrise called upon Reliable to pay $32,000, that being the amount by which the cost of construction of the building exceeded the contract price. Reliable declined to make payment. Highrise now asks you whether it may recover from Reliable. What should you advise?

(SURETYSHIP) Highrise may not recover from Reliable as it was the owner's duty to retain the 15% as an incentive for the contractor to complete the contract. Failure to do so was a complete release of Reliable as it increased the likelihood of loss on the part of the surety.
3. William Halo signed and delivered to James Hearty a promissory note in the amount of $10,000, payable six months after date. This note was secured by a deed of trust on Halo's farm, having a market value of $12,000 and constituted a first lien thereon. Shortly thereafter Halo, by a written contract, agreed to sell his farm to Thomas Spike for $12,000, who agreed to pay to Halo $2000 and to assume the payment of the $10,000 debt evidenced by Halo's note. Pursuant to the terms of the contract, the agreed $2,000, was paid Halo and a deed of conveyance was delivered to Spike. At maturity of the note Halo, upon the demand of Hearty, paid the note. Shortly thereafter in a judgment creditor's suit against Spike the judgment creditors claimed that Halo's payment of the debt, evidenced by the note, effected a discharge of the debt and a release of the lien of the deed of trust. Halo, having been permitted to intervene, claimed that he was entitled to be subrogated to Hearty's rights to enforce the deed of trust and that he was entitled to receive payment of the $10,000, evidenced by the note from the proceeds of the sale of the property described in the deed of trust. How should the court rule? (Suretyship)

The court should rule in favor of Halo under the theory he has put forth. Spike, by assuming the debt, became the principal debtor, and Halo became only secondarily liable as a surety. Therefore, after Halo paid the debt to Hearty, he became subrogated to Hearty's rights under the deed of trust. While subrogation is not an absolute right, it will be granted where equity may require its application. The creditors know of the deed of trust, therefore they had no equities superior to those of Halo. (195 Va 513).

3. Dilton Motel Corporation needed $60,000 to complete the Dilton-Winchester Motel, which it was building and which was to be completed in one year, and it applied for a loan from Credit Loan Corporation. Pursuant to the requirements of Credit, Dilton applied to Surety Company to write a bond for it. After negotiations, it was agreed between Dilton and Credit that the loan of $60,000 would be made, calling for 6% interest, but that Credit would retain $1,500 as a "commission" and that another $10,000 would be retained by Credit and applied to another debt previously incurred. Credit prepared the bond which it wanted executed and which Dilton executed and presented to Surety, which bond provided, in part, "...Whereas Credit Loan Corporation has agreed to lend Dilton Motel Corporation $60,000, payable 18 months from date with interest at the rate of 6% per annum for construction of the Dilton-Winchester Motel, and whereas one of the conditions of the said loan is that the motel building will be completed one year from date at an approximate cost of $80,000, free from all liens; now, therefore, if the Dilton-Winchester is completed by said date at this cost and free from all liens, then this obligation shall be void. Otherwise, Surety Company guarantees to Credit Loan Corporation a repayment of the said loan in the event of default by Dilton Motel Corporation." Surety Company had no knowledge of any agreement other than that stated in the bond and properly executed the bond for a consideration.

Dilton was unable to complete the motel and defaulted on the debt. Credit, having sustained a loss of $30,000, sued Surety on the bond for this amount.

Is Surety liable to Credit for all or any part of the loss? (Suretyship) Surety not liable for any part of the loss. Where, with the knowledge or consent of the creditor there is a misrepresentation to the surety with regard to any material fact which, if he had known, he might not have entered into the undertaking of suretyship, it will thereby be rendered invalid and the surety discharged from his liabilities. The effect of the retention of the $1,500 and the $10,000 was to reduce the fund which the surety might reasonably suppose would go to the completion of the building and the removal of the liens for which the surety had made himself responsible.
Hines was an endorser on a bond made by Isom for $3,000, payable to and owned by Jobin. At the maturity of the bond Isom wrote to Jobin: "I am hard pressed right now, and if you will hold that debt a little longer I can pay it without inconvenience." Jobin made no reply to this letter and did nothing about collecting the note until a year later when he sued both Isom and Hines on it. At the maturity of the bond and for several months thereafter, Isom had sufficient assets to satisfy the bond, but due to some unforeseen reverses, he became insolvent before the suit was brought. If suit had been brought earlier, the bond could have been collected from Isom.

Hines consults you as to his liability on the above state of facts. How ought you to advise him?

(SURETYSHIP) Hines is still liable on his endorsement. A creditor may refrain from prosecuting his claim against the principal, and remain inactive, without impairing his right to resort to the surety, particularly when his forbearance amounts to mere inaction. 50 Am. Jur. 960.