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Gary L. Monserud

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ARTICLES

THE PRIVILEGES OF SURETYSHIP FOR DELEGATING PARTIES UNDER UCC SECTION 2-210 IN LIGHT OF THE NEW RESTATEMENT OF SURETYSHIP

GARY L. MONSERUD*

I. INTRODUCTION

Article 2 of the Uniform Commercial Code (UCC or the Code) is being revised.¹ The Restatement of the Law of Suretyship has recently been approved by the American Law Institute.² The

* Professor of Law, New England School of Law, Boston, Massachusetts; J.D. 1976, University of South Dakota; LL.M. 1985, New York University Law School. I have received enormous help and encouragement in writing this Article. The Trustees of New England School of Law provided a summer stipend. My colleagues, Professor Curt Nyquist, and Visiting Professor Richard G. Huber, Dean Emeritus, Boston College of Law (visiting at New England, 1995-1996), provided constructive criticism on an early draft. Brendan McDonough, my research assistant, labored long to find old cases on suretyship. Ann Jones, my wife, sought to curb my tendency toward verbosity. Ali R. Sharifahmadian of the *William & Mary Law Review* expertly and expeditiously edited a challenging manuscript. Finally, Neil B. Cohen, Professor of Law, Brooklyn Law School, Reporter for the Restatement (Third) of Suretyship & Guaranty, provided many insights on changes wrought by the new Restatement. However, if the Article contains any doctrinal error, it is mine alone.

1. The Drafting Committee is working under the auspices of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Professor Richard E. Speidel, Northwestern University School of Law, is the Reporter. Professor Raymond T. Nimmer, University of Houston Law Center, is the Reporter for technology issues. The drafts circulated to date have been for discussion purposes only. All excerpts from revised Article 2 in this Article are copyright 1996 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws and are reprinted with permission of the Permanent Editorial Board for the Uniform Commercial Code.

2. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. (1995). The Restatement of Suretyship was approved by the membership of the American Law Institute in 1995. The Reporter was Professor Neil B. Cohen, Brooklyn Law School. All excerpts from the Restatement contained in this Article are copyright 1995 by the American Law Institute and are reprinted with permission of the American Law Institute.

time is right to examine the application of suretyship principles to transactions covered by Article 2. One intersection of suretyship and Article 2 occurs when suretyship principles are applied to a delegation of obligations arising under a contract governed by Article 2. In such a delegation, the privileges of suretyship are conferred upon the delegating party by operation of law.

The UCC section most relevant to the delegation of obligations governed by Article 2 is section 2-210, which recognizes assignments and delegations as "normal and permissible incidents of a contract for the sale of goods."³ Section 2-210 does not mention suretyship, but, under section 1-103, unless displaced by the Code, "principles of law and equity shall supplement its provisions."⁴ Through section 1-103, suretyship principles can flow into legal relationships created by delegations governed by Article 2.

In its simplest sense, "suretyship" refers to a legal relationship "whereby one person engages to be answerable for the debt or default of another."⁵ The definition implies tripartite relation-

3. U.C.C. § 2-210 cmt. 1 (1994). See UCC § 2-210(1), which states:

A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

Id. § 2-210(1). Comment 1 to § 2-210 states: "Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods." *Id.* § 2-210 cmt. 1. Neither the statute's text nor the comment mentions suretyship.

4. *Id.* § 1-103. Section 1-103 states in its entirety: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." *Id.*

5. ARTHUR A. STEARNS, *THE LAW OF SURETYSHIP* § 1.1 (James L. Elder ed., 5th ed. 1951). Stearns's complete definition is: "Suretyship may be defined as a contractual relation whereby one person engages to be answerable for the debt or default of another." *Id.* The text makes a substitution for the words "contractual relation" because the sureties discussed in this Article do not voluntarily assume a suretyship status; hence, the general definition seems too narrow. Section 82 of the Restatement of the Law of Security defines suretyship in the following manner: "Suretyship is the relation which exists where one person has undertaken an obligation and another person is also under an obligation or other duty to the obligee, who is entitled to but one performance, and as between the two who are bound, one rather

ships—suretyship requires a principal obligor, a creditor, and a surety.⁶ The suretyship arising in the course of a delegation governed by section 2-210 is referred to as “nonconsensual”⁷ or “involuntary”⁸ suretyship or “suretyship by operation of law.”⁹ The term “nonconsensual” will be used most often in this Article, although the other terms also will appear from time to time as functional equivalents. Nonconsensual suretyship is a status arising from any delegation of an obligation of any nature without a novation.¹⁰ The term “nonconsensual suretyship,” as used

than the other should perform.” RESTATEMENT OF SEC. § 82 (1941). The latter is more exacting than the definition given by Stearns but also is harder to digest. In his treatise, Professor Simpson states:

A surety, in the broad sense, is one who is liable for the debt or obligation of another, whether primarily or secondarily, conditionally or unconditionally. In other words, the term surety includes anyone who is bound on an obligation which, as between himself and another person who is bound to the obligee for the same performance, the latter obligor should discharge.

LAWRENCE P. SIMPSON, HANDBOOK ON THE LAW OF SURETYSHIP § 4 (1950).

6. See RESTATEMENT OF SEC. § 82 cmts. a-d. Comment a notes the tripartite nature of suretyship relationships. *Id.* cmt. a. Comment b defines a “surety” as “the person who is bound on an obligation from which another, by the discharge of a duty, should relieve him.” *Id.* cmt. b. Comment c defines a principal as “the person who, in the solution of the rights and duties of the parties, should bear the ultimate burden unless excused for some reason personal to himself.” *Id.* cmt. c. Comment d defines a creditor as “the person to whom the surety is bound and to whom the principal is under an obligation or other duty.” *Id.* cmt. d.

7. The term “nonconsensual,” in relation to suretyship through delegation, is not in common use. The term is borrowed from an article by Professor Campbell. See Morton C. Campbell, *Non-Consensual Suretyship*, 45 YALE L.J. 69 (1935). Professor Campbell used the term “nonconsensual suretyship” to describe situations in which a person voluntarily consents to assume the obligations of a surety without the consent of one or more of the parties to the transaction. As described in the text, the term has a different meaning in this Article. See *infra* note 11 (discussing nonconsensual suretyship).

8. For a definition of the term “involuntary,” as used to describe suretyship status attained through delegation, see STEARNS, *supra* note 5, § 2.3.

9. *E.g.*, 74 AM. JUR. 2D *Suretyship* § 8 (1974).

10. Farnsworth defines “novation” as follows:

The term *novation* is used to describe a substituted contract that discharges a duty by adding a party who was neither the obligor nor the obligee of that duty. The party added may be an obligor, as when a creditor takes a third party's promise to pay in satisfaction of the debt. Since the promise is that of a third party, it differs from the existing duty and is consideration for the discharge of that duty, even if the promised performance is only part of that owed by the original debtor.

in this Article, thus does not include situations in which a person voluntarily assumes the obligations of a surety without the principal's consent, even though such usage can be justified by the Restatement of Security¹¹

As an illustration of nonconsensual suretyship, consider the following hypothetical situation. Ella, an old lawyer, sells Portia, a young lawyer, a collection of law books for \$12,000, to be paid at \$500 per month over twenty-four months.¹² Ella delivers the books. After one year (and twelve \$500 payments) Portia leaves law for politics. She sells the books to Sonya, who agrees to pay \$6000 cash and to assume Portia's remaining obligation to Ella. When Portia delivers the books, she notifies Ella of the sale and of Sonya's assumption of her outstanding \$6000 debt. In this situation, the law impresses suretyship status upon Portia. The sale to Sonya caused Sonya to become a principal obligor, Portia to become a surety, and Ella to become a creditor or obligee.¹³ These imposed suretyship relationships significantly alter the

The party added may instead be an obligee, as when the original creditor takes the debtor's promise to pay a third party in satisfaction of the debt.

E. ALLAN FARNSWORTH, *CONTRACTS* § 4.24, at 301 (2d ed. 1990) (footnotes omitted). For a discussion of "assignment" and "delegation" and related terms, see *infra* part IV

11. The Restatement of Security recognizes that "[t]he surety may have undertaken his obligation as a result of direct dealings with the creditor without the consent of the principal or even without his knowledge." *RESTATEMENT OF SEC.* § 82 cmt. f (1941). This situation is sometimes referred to as "nonconsensual suretyship." See, e.g., Campbell, *supra* note 7, at 69. Professor Neil Cohen also recognizes that the term "nonconsensual suretyship" can be used in this way. See *RESTATEMENT OF SURETYSHIP & GUAR.* § 1 reporter's note, cmt. m (1995). Such a surety's rights to reimbursement and exoneration were considered separately in the Restatement of Security. See *RESTATEMENT OF SEC.* § 104(2) & illus. 4 (reimbursement); *id.* § 112 cmt. f (exoneration). Thus, there has been some use of the term "nonconsensual suretyship" to designate a status different from suretyship through delegation. This Article does not hesitate to use the term with a new meaning because the combination of the words "nonconsensual" and "suretyship" seem to capture the sense of the situation this Article discusses, and any older meanings seem not to have gained widespread usage.

12. The hypothetical situation assumes that there is no interest owed on the outstanding debt and that Ella did not reserve title, which would complicate matters by creating an Article 9 security interest. See U.C.C. § 2-401(1) (1994).

13. *RESTATEMENT OF SEC.*, § 82 cmts. a-d. Sometimes the creditor is referred to as the "obligee."

rights and obligations of the parties in ways that cannot be understood solely by attending to the text of Article 2.¹⁴

The potential influx of suretyship law into delegations of obligations arising under Article 2 contracts seems seldom noticed in case law¹⁵ or treatises.¹⁶ Nonetheless, one can easily construct illustrations blending delegation and suretyship law.¹⁷ In cases in which Article 2 has *not* been recognized as controlling, a few appellate courts have woven together strands of suretyship law and delegation, albeit somewhat unevenly.¹⁸

The paucity of such explicatory material led to this Article, the objective of which is twofold. First, the Article will demonstrate the inextricable entwinement of Article 2 delegations and suretyship principles. Second, it will explore the ways in which the new Restatement of Suretyship will change the results of applying suretyship law to Article 2 delegations from what those results would have been under either the common law¹⁹ or the 1941 Restatement of Security.²⁰ This Article is thus descriptive

14. For example, a time extension that Ella and Sonya might agree on without Portia's consent likely would discharge Portia. If Ella and Sonya agreed on interest without Portia's consent, there having been no interest under the original agreement, Portia would be discharged. Moreover, if Ella decided to release Sonya for less than full payment with the intention of looking to Portia for payment under the original agreement, Portia probably would be released. These conclusions assume the applicability of the 1941 Restatement of Security. The results of nonconsensual suretyship status are explored in greater detail in Parts II-VI of this Article.

15. Delegation cases citing UCC § 2-210 are discussed in Part IV of this Article. To date, the only case in which an appellate court has cited § 2-210 in conjunction with a discussion of nonconsensual suretyship has been *Rosenberg v. Son, Inc.*, 491 N.W.2d 71 (N.D. 1992).

16. *E.g.*, RONALD A. ANDERSON, *UNIFORM COMMERCIAL CODE* (3d ed. 1995); WILLIAM H. HENNING & GEORGE I. WALLACH, *THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE* (2d ed. 1992); JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* (4th ed. 1995). White and Summers cite § 2-210 only three times, each time in a footnote. See WHITE & SUMMERS, *supra*, § 3-10 nn.2, 11 (mentioning § 2-210 in connection with a discussion about the protection of third parties); *id.* § 19-9 n.5 (mentioning only the applicability of assignment and delegation law to letters of credit). Henning and Wallach do not cite § 2-210. Anderson devotes more than forty pages to § 2-210 but makes no mention of suretyship principles as bearing on delegation.

17. For illustrations blending delegation and suretyship law, see *infra* part IV

18. For a discussion of cases involving delegation and suretyship law, see *infra* parts III-IV

19. See *infra* part II.

20. See *infra* part III.

rather than prescriptive, except for a modest proposal that a revised Article 2 should explicitly recognize the importance of nonconsensual suretyship.

This Article is organized along the following plan. Part II discusses nonconsensual suretyship at common law. Part III examines nonconsensual suretyship under the 1941 Restatement of Security. Part IV blends selected delegation cases citing UCC section 2-210 with suretyship principles drawn from the 1941 Restatement of Security. Part V discusses several changes made in the new Restatement of Suretyship as they bear on nonconsensual sureties. Part VI uses three hypotheticals to compare the differences that result from applying the new Restatement of Suretyship rather than the 1941 Restatement of Security. Finally, Part VII discusses case law evidencing a recent trend toward expanding the scope of Article 2, an expansion that will make the blend of suretyship and delegation more important than it was in the early years of the Code.

II. NONCONSENSUAL SURETYSHIP: AN HISTORICAL PERSPECTIVE

A. *The Rights of Nonconsensual Sureties in Real Estate Sales*

Nonconsensual suretyship antedates attempts to systematize the privileges attached to it. The oldest reported cases arose from sales of real estate.²¹ One example is *Union Mutual Life Insurance Co. v. Hanford*,²² decided by the Supreme Court in 1892. Chase and Hanford had mortgaged land to Schureman as security for payment of three promissory notes on which they were signatories.²³ They paid the first note. Before the second and third notes were due, however, Schureman sold the notes,

21. Examples of cases recognizing the privileges of nonconsensual suretyship when a mortgagor transfers real property to a mortgagee and the latter assumes the mortgage include: *Seale v. Berryman*, 49 P.2d 997 (Ariz. 1935); *Wilcox v. Campbell*, 12 N.E. 823 (N.Y. 1887); *Walser v. Farmers' Trust Co.*, 185 N.E. 535 (Ohio 1933); *Hurst v. Merrifield*, 23 P.2d 124 (Or. 1933); *Zastrow v. Knight*, 229 N.W. 925 (S.D. 1930). *Hurst* and *Zastrow* contain many citations to further authorities.

22. 143 U.S. 187 (1892).

23. *Id.* at 187. The three notes were as follows: the first was for \$5000 due in one year at eight percent annual interest; the second was for \$5000 due in two years at eight percent annual interest; and the third was for \$6000 due in three years at 10% annual interest. *Id.*

along with the mortgage, to Union Mutual Life Insurance Company (Union Mutual).²⁴ Meanwhile, Chase and Hanford sold the mortgaged land to Fake, who *assumed* their obligations under the notes secured by the mortgage.²⁵ Chase advised Union Mutual of the sale and further advised that Fake would be making payments on the notes.²⁶ Unbeknownst to Chase or Hanford, however, Fake negotiated a binding agreement with Union Mutual to extend the due dates on both notes.²⁷ Subsequently, Fake defaulted.²⁸ Union Mutual foreclosed on the mortgaged property, which it sold for \$12,000—not enough to cover the balance owed on the notes.²⁹ As a result, Union Mutual sued Chase and Hanford for the deficiency.³⁰

The trial court denied recovery.³¹ The United States Supreme Court upheld the result based on suretyship principles.³² The grantee (Fake), by assumption of the debt secured by the mortgage, became primarily liable on the notes for which the mortgage was security. The grantors, Chase and Hanford, thereby attained the privileges of suretyship. As soon as the mortgagee (Union Mutual) knew of this transaction, it was bound to respect the rights of its nonconsensual sureties, Chase and Hanford.³³

According to the Court:

24. *Id.* at 188. The case report states that, in all relevant events, Union Mutual Life Insurance Co. acted through Boone, its authorized agent. In the recapitulation in the text, Boone's acts are all simply narrated as acts of his principal.

25. *Id.* The actual purchaser was Mrs. Fake, but her husband, as her agent, thereafter negotiated an extension. "Fake" herein refers to both the husband and the wife, even though the wife was the owner of record.

26. Though not essential to the legal analysis, Union Mutual, through its agent Boone, acknowledged the assumption. *Id.*

27. *Id.* Fake made the agreement to extend the time for payment binding by paying \$340 for the change. This fact was important because time extensions as a matter of grace were insufficient to justify discharge of the obligation; rather, the binding contractual modification was the justification for discharge.

28. *Id.* at 187.

29. *Id.* The sale was executed by the master, presumably on order of the circuit court. *Id.* at 188.

30. *Id.*

31. *Id.*

32. The trial court applied Illinois law. Choice of law was not an issue on appeal. The Supreme Court cited numerous cases from many jurisdictions that sustained its view of suretyship principles as principles of general application. *Id.* at 191.

33. *Id.*

[T]he consequence must follow that any subsequent agreement of the mortgagee with the grantee, without the assent of the grantor, extending the time of payment of the mortgage debt, *discharges the grantor from all personal liability for that debt.*³⁴

Hanford and Chase, therefore, were wholly discharged when Fake negotiated the binding extension agreement with Union Mutual without their consent. In the Supreme Court's opinion, this case turned on settled principles of law:

The case is thus brought within the well settled and familiar rule that if a creditor, by positive contract with the principal debtor, and without the consent of the surety, extends the time of payment by the principal debtor, he thereby discharges the surety; because the creditor, by so giving time to the principal, puts it out of the power of the surety to consider whether he will have recourse to his remedy against the principal, and because the surety cannot have the same remedy against the principal as he would have had under the original contract; and it is for the surety alone to judge whether his position is altered for the worse.³⁵

Unpacking this dense language in light of the facts, it becomes apparent that: Fake became the principal debtor upon his assumption of the debt secured by the mortgage; Hanford and Chase became nonconsensual sureties; and, in the language of suretyship, the mortgagee's assignee (Union Mutual) was the creditor. As nonconsensual sureties, Chase and Hanford had rights of subrogation and reimbursement if Fake defaulted and they paid the notes.³⁶ These rights could not arise until after

34. *Id.* (emphasis added).

35. *Id.*

36. Stearns discusses the surety's right to reimbursement:

The third great equitable right of a surety is his right, on payment of the principal's debt, to be indemnified by the principal for the loss sustained by the surety in making payment of the debt. This right, sometimes also described as a right to reimbursement or exoneration, is universally recognized.

STEARNS, *supra* note 5, § 11.35; see SIMPSON, *supra* note 5, § 48. The surety's right to reimbursement depends on payment to the creditor of a debt owed. One also

the due date on the notes because they were contingent on the sureties being liable to, and paying, the creditor. By negotiating an extension of the due dates, Fake necessarily extended the time in which Hanford and Chase could pay the notes and seek reimbursement from Fake or assert any rights by subrogation against Fake.³⁷ The extension could have prejudiced their rights. For example, if Fake's financial situation had deteriorated between the original due dates and the later due dates, the chances of collecting reimbursement would have been diminished. This possibility of prejudice, according to the Court, was enough to justify discharge. Actual provable prejudice was not the question. Rather, the Court stated that "it is for the surety alone to judge whether his position is altered for the worse."³⁸ By virtue of their suretyship status, which was impressed upon them by law, Hanford and Chase received a complete discharge upon proof of the unconsented-to alteration of the contract by the binding agreement between their grantee and their creditor.

The result of *Union Mutual* is consistent with the ancient rule of *strictissimi juris*.³⁹ When *Union Mutual* was decided, well-established principles of law strictly held a surety to the principal's obligation as it existed when suretyship status was attained. An agreement to extend the time of payment without the surety's consent operated as an automatic and immediate discharge.⁴⁰ A single day's change without the surety's consent

should note that Hanford and Chase would have been subrogated to Union Mutual's rights to the mortgaged property had they paid off the notes before foreclosure and sale. Stearns states, in relevant part:

Subrogation in suretyship is "a mode which equity adopts to compel the ultimate discharge of the debt by him who in good conscience ought to pay it, and to relieve him whom none but the creditor could ask to pay." The scope of the right of subrogation consists in the immediate transfer, by operation of law, to the promisor in suretyship of all the rights of the creditor against the principal whenever the promisor pays the debt or satisfies the obligation.

STEARNS, *supra* note 5, § 11.1 (footnotes omitted); see 4 JOHN N. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1206 (Spencer W. Symons ed., 5th ed. 1941); SIMPSON, *supra* note 5, § 47.

37. *Hanford*, 143 U.S. at 188.

38. *Id.* at 191.

39. "*Strictissimi juris*" means "[o]f the strictest right or law." BLACK'S LAW DICTIONARY 1422 (6th ed. 1990).

40. See ARTHUR A. STEARNS, THE LAW OF SURETYSHIP § 81 (Clinton Dewitt ed.,

caused discharge *in toto*, unless there was a waiver or a reservation of rights.⁴¹

It bears repeating that, in property transfers, as in the *Union Mutual* case, suretyship status is not sought or bargained for. Chase and Hanford may not have been aware of their suretyship status until litigation commenced. Their knowledge of their status was irrelevant to ascertaining their rights; they attained their privileged status, wittingly or unwittingly, when Fake assumed their debt. The assumption of the debt secured by the mortgage and the disclosure of this fact to the creditor triggered events by which the law bestowed on them the privileges of nonconsensual suretyship.⁴²

2d ed. 1915). In a later edition, Stearns articulated the reasons for the discharge as follows:

There are three reasons usually given for this rule of discharge: (1) the giving of time operates to substitute a new contract for the old, to which new contract the surety is not a party; (2) the extension impairs the surety's right of subrogation, *i.e.*, his right to bring a suit in the creditor's name to obtain reimbursement from the principal; and (3) the agreement to extend time of payment or performance increases the risk of the surety, who had considered the principal's probability of payment or performance on the due date but had not calculated the principal's responsibility beyond that date.

STEARNS, *supra* note 5, § 6.16.

41. The peculiar doctrine known as "reservation of rights" allows a creditor to accommodate a principal's request for a time extension without *ipso facto* discharging the surety, even though the surety may not agree to or even be aware of the extension and reservation. Regarding the reservation-of-rights doctrine, Stearns states:

An extension of time granted to the principal does not discharge the surety where the creditor expressly reserves his rights against the surety. Such a reservation qualifies the extension of time in that, although the creditor has bound himself not to proceed against the debtor until the maturity of the extension, he has not changed his relations with the surety, since he has specifically reserved his right to sue him at once. This reservation of rights against the surety being a condition of the contract for extension entered into with the debtor, the latter impliedly assents that the surety may have all his original rights preserved against him as principal debtor. Although the creditor must forbear suit against the principal, yet the surety, if he pays the debt, may sue the principal at once. Accordingly, there is said to be no alteration of the surety's contract and no equitable reason for urging his discharge.

STEARNS, *supra* note 5, § 6.34 (footnotes omitted); see *Gholson v. Savin*, 31 N.E.2d 858 (Ohio 1941); SIMPSON, *supra* note 5, § 73, at 362-63; J.W. Oler, Annotation, *Creditor's Reservation of Rights Against Surety in Releasing or Extending Time to Principal Debtor*, 139 A.L.R. 85 (1942).

42. See H.D.W., Annotation, *Release of Mortgagor (or Intermediate Grantee Who*

B. The Rights of Nonconsensual Sureties in Sales of Goods

In the nineteenth and early twentieth century, the principles pertaining to nonconsensual suretyship, illustrated in *Union Mutual*, were applied mainly to real estate cases.⁴³ Occasionally, courts applied these principles to sales of goods, specifically when goods (inventory or equipment) were sold as part of a going concern. One example is *Malanaphy v. Fuller & Johnson Manufacturing Co.*,⁴⁴ decided by the Iowa Supreme Court in 1904. In *Malanaphy*, the court sustained a lower court's decree that prevented execution against sellers who had become sureties by operation of law and had a claim for discharge *in toto* because of dealings between their creditor and their buyers, who had assumed payment obligations to their creditor.⁴⁵

Malanaphy & Daly was a partnership that sold farm implements in Decorah, Iowa.⁴⁶ In 1889, the partners owed Fuller & Johnson Manufacturing Co. (Fuller & Johnson) \$179 for merchandise acquired on credit.⁴⁷ The partners had signed a prom-

Has Assumed the Mortgage) by *Subsequent Dealings Between His Grantee and Mortgagee*, 112 A.L.R. 1324 (1938).

43. The law of involuntary or nonconsensual suretyship in real estate sales has been covered in many treatises. See HERSCHEL W. ARANT, *HANDBOOK OF THE LAW OF SURETYSHIP AND GUARANTY* § 79 (1931); GEORGE W. BRANDT, *THE LAW OF SURETYSHIP AND GUARANTY* § 37 (Chicago, Callaghan & Co., 2d ed. 1891); SIMPSON, *supra* note 5, § 47; STEARNS, *supra* note 5, § 2.3. Each treatise cites real estate cases involving nonconsensual suretyship.

Illustrative cases are: *Hamlen v. Rednalloh Co.*, 197 N.E. 149 (Mass. 1935); *Zastrow v. Knight*, 229 N.W. 925 (S.D. 1930). Many cases are also cited in *American Law Reports* annotations. See, e.g., G.V.I., Annotation, *Lessee As Surety for Rent After Assignment; and Effect of Lessor's Dealings (Other Than Consent to Assignment or Mere Acceptance of Rent From Assignee) to Release Lessee*, 99 A.L.R. 1238 (1935); R.E.H., Annotation, *Release of Mortgagor (or Intermediate Grantee Who Has Assumed the Mortgage) by Subsequent Dealings Between His Grantee and the Mortgagee*, 72 A.L.R. 389 (1931).

For law review articles, see Note, *A Mortgagor As Surety for His Assignee*, 15 HARV. L. REV. 398 (1901-1902). A more recent discussion is found in B. Benjamin Beard, *Suretyship on the Fringe: Suretyship by Operation of Law and by Analogy*, 34 WM. & MARY L. REV. 1157, 1165 & nn.27-28 (1993) (citing several cases involving nonconsensual suretyship arising from real property transfers). Professor Beard's article has been an invaluable source for this Article.

44. 101 N.W. 640 (Iowa 1904).

45. *Id.* at 642.

46. *Id.* at 640.

47. *Id.*

issory note for this amount.⁴⁸ Malanaphy & Daly sold the implement business, including the stock in trade, to Christen and Gilbertson, who agreed to assume the note payable to Fuller & Johnson.⁴⁹ As in *Union Mutual*, the buyers acquiring title to the property assumed a debt in connection with the purchase, and the assumption was part of the purchase price.

Malanaphy & Daly asked Fuller & Johnson to approve the substitution of Christen and Gilbertson as debtors.⁵⁰ This would have effected a novation. Fuller & Johnson declined the request.⁵¹ Nonetheless, Malanaphy, Daly, Christen, and Gilbertson—all four—signed a new promissory note and sent this note to Fuller & Johnson, which, under the circumstances, was sufficient to advise Fuller & Johnson (the creditor) that Christen and Gilbertson had become the primary obligors on the debt for the farm implements.⁵²

Christen & Gilbertson, now a partnership operating in the implement business, obtained more goods from Fuller & Johnson on credit.⁵³ Christen & Gilbertson eventually fell upon hard times, failing to pay an account for goods received and defaulting on the note that they had signed for the debt originally incurred by Malanaphy & Daly.⁵⁴ Fuller & Johnson obtained a judgment for the account payable for goods received after the purchase of the business and, thereafter, sued all four signatories on the note given for the debt assumed when the business was sold.⁵⁵ On this latter debt, Fuller & Johnson obtained a default judgment against Christen, Malanaphy, and Daly and then negotiated a settlement with Christen.⁵⁶ Christen paid \$200, and in return for the \$200, Fuller & Johnson released him from

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* Had Fuller & Johnson agreed to the request, it would have extinguished any liability of Malanaphy & Daly, which was probably the purpose of the request.

52. The court noted that Christen & Gilbertson signed first, *id.*, perhaps indicating by position their status as principals. In any event, Fuller & Johnson had enough information to be on notice of the arrangement.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

any and all liability on the note judgment.⁵⁷ This proved to be a major mistake for Fuller & Johnson, who intended to pursue Malanaphy and Daly for the uncollected balance.

Fuller & Johnson settled with Christen without Malanaphy's or Daly's knowledge or acquiescence.⁵⁸ As a result, when Fuller & Johnson sought to enforce the judgment against them, Malanaphy and Daly brought suit to restrain enforcement.⁵⁹ The trial court restrained enforcement,⁶⁰ and the Iowa Supreme Court upheld the decree on the ground that Malanaphy and Daly were *completely discharged* when the creditors—Fuller & Johnson—released Christen in exchange for consideration.⁶¹ The court based the result on suretyship principles.

The court explained its rationale as follows:

Turning our attention to the principal parties to the contract, it is quite clear that [Christen & Gilbertson] became primarily liable for the debt. It assumed the relation of a principal, and, as to it, the obligation of [Malanaphy and Daly] became that of a surety only

. [T]he receipt and acceptance of the note had the effect to further apprise [Fuller & Johnson] of the relation existing between the two firms, and of its obligation to respect the same.

Accepting of the situation as we find it, our conclusion is that the release of Christen operated to release his principals, Malanaphy and Daly, who, as to him, and with knowledge on the part of [Fuller & Johnson], were secondarily bound only for the payment of the judgment.⁶²

As in *Union Mutual*, the buyers who assumed a debt for the sellers became principal obligors. The sellers remained liable to the creditor but were accorded suretyship status. When the creditor was apprised of the facts giving rise to nonconsensual suretyship, the creditor became legally obligated to respect that relationship. Respecting the relationship meant making no deals

57. *Id.*

58. *Id.* at 641.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

with the principal obligors without each surety's consent or, in the case of time extensions, a reservation of rights.⁶³ When Fuller & Johnson (the creditor) released Christen (a principal obligor), the sureties' obligations (accessory by nature) were extinguished.⁶⁴

To have held the sureties liable when their rights of reimbursement and subrogation had been compromised would have been unfair.⁶⁵ That the persons involved may not have known of their suretyship status until after the fact was of no consequence because the privileges of nonconsensual suretyship did not arise from the parties' intent. Rather, the privileges of suretyship attached when the sale and assumption of the debt occurred and the creditor was advised of the debt assumption. The status of nonconsensual suretyship thus was important at common law in cases arising from sales of goods as well as from sales of real estate.⁶⁶

Applying the rules discerned in the foregoing cases to the hypothetical in the introduction requires little imagination. According to the holding of *Union Mutual*, if Sonya made a deal with Ella to extend her time for payment of the \$6000 obligation assumed from Portia and neither got Portia's consent nor made

63. For a discussion of reservation of rights, see *supra* note 41.

64. See STEARNS, *supra* note 5, § 6.42. Stearns states:

[I]f the principal has been released by the creditor, the surety will be discharged also. This follows from the elementary proposition of suretyship that the surety's obligation is accessory to the main obligation and can have no force when the main obligation has been performed. Furthermore, the release of the principal eliminates the surety's right to be indemnified or reimbursed by the principal and, for that reason, it would be manifestly unjust to require the surety to pay the debt after the principal has been discharged.

Id. (footnote omitted); see SIMPSON, *supra* note 5, § 63.

65. See STEARNS, *supra* note 5, § 6.42.

66. Cases involving sales of goods in which nonconsensual suretyship is discussed in any manner admittedly are rare. Generally, such cases involve the sale of chattels as a part of a business. In addition to *Malanaphy*, see *McKey-Fansher Co. v. Rowen*, 5 N.W.2d 911 (Iowa 1942) (involving sale of a beauty parlor and barber shop); *Harvey's Rubber & Supply Co. v. Kilbane*, 8 Ohio L. Abs. 297 (Ohio Ct. App. 1930) (involving sale of a business). For a discussion of more recent cases involving sales of goods and nonconsensual suretyship, see *infra* part IV, in which the applicability of the Restatement of Security is explained. Nonconsensual suretyship has also turned up in stock sales. *E.g.*, *Sauder v. Dittmar*, 118 F.2d 524 (10th Cir. 1941).

a reservation of rights, the extension would discharge Portia's surety obligation. According to the holding of *Malanaphy*, if Ella agreed to discharge Sonya for less than full payment, intending to hold Portia liable for the balance, the agreement would discharge Portia's surety obligation. The law of delegation is incomplete without considering the influx of suretyship principles as they apply to all of the parties to the transaction.

C. The Extension of Nonconsensual Suretyship from Real Estate to Sales of Goods and Beyond: Perspective Through a Survey of the Treatises

Providing a history of nonconsensual suretyship is not the objective of this Article. An examination of the historical background will, however, be helpful to provide an overview of developments by which suretyship and delegation became intertwined in scholarly thinking. Scholars, starting at the end of the 1800s, incorporated nonconsensual suretyship into their doctrinal systems of suretyship law and contract law. An overview of nonconsensual suretyship as it evolved in the twentieth century thus can easily be garnered by a brief survey of the major treatises, which should make the Restatements that followed more comprehensible.

George W. Brandt's classic work, *The Law of Suretyship and Guaranty*, demonstrates an early recognition of nonconsensual suretyship.⁶⁷ Brandt discussed nonconsensual suretyship only in the context of real estate sales and gave the following example:

If a party owning land, incumbered by mortgage to secure his debt, sells it, and the vendee, as part of the purchase price, agrees to pay the mortgage debt, the vendor, as between themselves at least, becomes the surety of the vendee for the mortgage debt, and the vendee becomes the principal, and the vendor will, as to such debt, be entitled to the same rights and remedies against the vendee that any surety has against his principal. Whether the vendor in such case would be entitled to all the rights of a surety as against the creditor, who had knowledge of the facts, is not quite so clear

67. BRANDT, *supra* note 43.

upon authority⁶⁸

In this embryonic stage, the law of nonconsensual suretyship was clear as between the principal and surety (vendor and vendee)—apparently, the nonconsensual surety had rights of reimbursement and subrogation. The risks imposed upon the creditor, however, which were so well illustrated in *Malanaphy* and *Union Mutual*, had not yet been clarified. Because the vendor's rights as a surety were granted by law and not by consent of the parties, it is appropriate to describe this kind of suretyship as nonconsensual. Brandt, however, recognized nonconsensual suretyship exclusively in connection with real estate transfers.

Later treatises recognized that the creditor was indeed affected by the status of nonconsensual suretyship⁶⁹ and extended the legally imposed privileges that the status implied to transactions other than real estate sales. The foremost example is Arthur Stearns's *The Law of Suretyship*.⁷⁰ The following summation from the 1915 edition captures the growth of the law:

An obligation in suretyship will not be implied, and never arises by act of the parties except by express contract. Yet the law will sometimes place persons in the situation of a Surety or Guarantor, not by imposing the liabilities of these undertakings without their assent, but by extending to persons already bound upon some other contract, the privileges of these relations. Thus, where a partnership is dissolved, one partner assuming the debts or taking the assets or continuing the business, the retiring partner is placed in the situation of a Surety for the partnership debts, and can claim the privileges of that relation as against the creditors of the firm who have notice of this arrangement. While this obligation to treat another as a promisor in suretyship is imposed upon the creditor without his assent, yet it is founded upon the highest equity, and is an enforcement of a principle of good faith in commercial transactions. Also the vendor of land

68. *Id.* § 37 (footnote omitted).

69. This recognition was not necessarily found in later cases. *See, e.g.,* *Rosenberg v. Son, Inc.*, 491 N.W.2d 71 (N.D. 1992), discussed *infra* part IV.B. In *Rosenberg*, the court found a delegating party to be a surety, but only in relation to the delegate, not in relation to the creditor. *See infra* part IV.B.

70. STEARNS, *supra* note 40, § 23.

subject to a mortgage, which the vendee agrees to pay, occupies the same relation to the mortgagee, and may insist that the rights of a surety be observed as to him.⁷¹

Three things are noteworthy in this excerpt. First, creditors having notice of nonconsensual suretyship status were obliged to respect the status or suffer the consequences. Stearns left no doubt about the delegate's suretyship status in relation to creditors, as had Brandt. Second, the equitable nature of the imposed arrangement was explicit. Stearns recognized the law of nonconsensual suretyship as an attempt to play fairly with a delegating party, whether that party be a seller or a withdrawing partner. Third, the law of nonconsensual suretyship, as discussed by Stearns, was not confined to real estate sales; rather, real estate sales were simply one concrete situation illustrating a delegation in which suretyship principles were deemed applicable.

Herschel Arant's treatise,⁷² published in 1931, also recognized the applicability of nonconsensual suretyship law to situations other than real estate transactions, particularly withdrawals from partnerships.⁷³ This broader applicability also was recognized generally in secondary authorities.⁷⁴ The stage thus

71. *Id.*

72. ARANT, *supra* note 43, § 79.

73. Arant stated:

A mortgagor who sells the property mortgaged to a grantee, who assumes payment of the mortgage debt, becomes a surety, and is entitled to the security of the mortgage if he pays. The same is true of a retiring partner to whom the remaining partners promise that they will pay the partnership indebtedness.

Id. (footnotes omitted).

74. The following statement is an example of those authorities:

A common instance of involuntary suretyship, at least as between the principal and surety themselves, occurs where one party to a contract, as a part of the agreement, assumes an indebtedness owing by the other to a third person, the one assuming the indebtedness becoming the principal, and the former debtor a surety. For example, where a purchaser of mortgaged land assumes and agrees to pay the mortgage debt, he becomes the principal debtor, and the mortgagor or grantor occupies the position of a surety; or where, upon the dissolution of a firm or a change in the membership, the continuing partners or new firm assumes the firm debts, those who assume the debts are, as among themselves, the principal debtor and the retiring partners are regarded as sureties.

was set for the Restatement of Security, published in 1941.⁷⁵ The 1951 edition of Stearns's treatise⁷⁶ recognized several common situations, including sales of mortgaged chattels, as grounds for imposing nonconsensual suretyship. The treatise stated in relevant part:

Whenever a party promises another to pay his debt or perform his obligation to a third person, as between promisor and promisee, the former becomes the principal obligor and the latter acquires the privileges of a surety

The transactions which may give rise to a suretyship by operation of law are varied. Thus, where a partnership is dissolved and a continuing partner assumes the firm's debts, or a partner pledges his individual property to secure a firm debt, or an assignee of a lease covenants to pay the rent, or a *purchaser of mortgaged personalty or realty assumes payment of the mortgage* a relation in the nature of suretyship is considered to have arisen.⁷⁷

The reference to mortgaged personalty is significant, and this recognition of nonconsensual suretyship in sales of goods spread to contract treatises. Professor Corbin, in his famous treatise on contract law, briefly touched upon nonconsensual suretyship in the course of discussing assignment and delegation.⁷⁸ He stressed that a delegating party is not relieved of an obligation by a mere delegation, but he acknowledged that such a party "occupies substantially the position of surety"⁷⁹ His treatment of the subject explicitly included delegations in sales-of-goods contracts as well as contracts for the sale of real estate.

Professor Corbin used the following illustration:

The buyer can assign his right to the goods or land and can delegate performance of his duty to pay the price. He himself remains bound as before by his duty to pay that price. But observe that he remains bound "as before"; the assignee and

50 C.J. *Principal and Surety* § 34 (1936).

75. See *infra* part III.

76. STEARNS, *supra* note 5.

77. *Id.* § 2.3 (emphasis added) (footnotes omitted).

78. 4 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 866, at 458-59 (1951).

79. *Id.* § 866, at 459.

the seller cannot, by agreement or by waiver, make it the assignor's duty to pay a different price or on different conditions. If the seller is willing to make such a change, he must trust to the assignee alone.⁸⁰

This language may seem confusing because assignments and delegations were treated together. In context, "trust to the assignee alone" means looking only to the delegate (principal obligor) and not to the delegating party (surety) for performance of the obligation that went along with the assignment. Professor Corbin recognized that changes made in the delegated obligation without the delegating party's consent discharged the delegating party. Suretyship principles thus wormed their way into the midst of the doctrine of delegation but required only a passing reference.

The third edition of Professor Williston's treatise on contract law⁸¹ contained references to involuntary or nonconsensual suretyship, although these terms were not used. In discussing successive purchases of mortgaged real property, the treatise stated summarily: "As between the grantor and grantee, the latter becomes principal debtor and the former a surety."⁸² Accordingly, the author concluded that a mortgagee's grant of further time for payment to the grantee (principal) would result in forfeiture of the mortgagee's rights against the grantor (surety).⁸³ In a discussion of assumption of liabilities of a withdrawing partner, the treatise concluded: "Questions of suretyship may arise, analogous to those in mortgage cases where the party assuming the debt is regarded as the principal debtor."⁸⁴ As did Professor Corbin's treatise, Professor Williston's treatise recognized the importation of suretyship principles into delegation doctrine as significant but did not consider it at any great length.

Nonconsensual suretyship, with its origin in equitable considerations arising from real estate transactions, thus entered into

80. *Id.* § 866, at 458 (footnote omitted).

81. 2 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS (Walter H.E. Jaeger ed., 3d ed. 1959).

82. *Id.* § 386.

83. *See id.*

84. *Id.* § 388.

suretyship law whenever duties were delegated, including sales of goods and other situations, especially partnership dissolutions. The great contract-law treatises also recognized nonconsensual suretyship in conjunction with the law of delegation. The privileges of nonconsensual suretyship were not given a central place either in suretyship treatises or contract-law treatises; rather, they existed on the fringes of both fields of law. For more than a century, however, the impact of applying suretyship principles to delegations has constantly created minor disturbances in the shadows of contract and suretyship law.

III. NONCONSENSUAL SURETYSHIP UNDER THE 1941 RESTATEMENT OF SECURITY

A. *The Recognition of Nonconsensual Suretyship*

In 1941, the American Law Institute promulgated the Restatement of the Law of Security⁸⁵ Sections 82 through 211 covered the subject of suretyship. Section 83, entitled "Creation of Suretyship," recognized nonconsensual suretyship in clause c: "The suretyship relation is created where the surety having been a principal obligor, his obligation, without a novation, has been assumed by another or his property has been transferred under such circumstances as to place the property under the primary burden of the obligation."⁸⁶

Comment e to section 83, which comments on clause c, illustrates the applicability of clause c to assumptions of real estate mortgages in which the vendee is the principal obligor, the vendor (mortgagor) is the surety, and the mortgagee is the creditor.⁸⁷ Comment e further advises a creditor to be aware of the

85. RESTATEMENT OF SEC. (1941).

86. *Id.* § 83(c).

87. Comment e states:

Two important situations under Clause (c) arise within the field of mortgages. Where a mortgagor transfers mortgaged land, the grantee usually assumes the mortgage or agrees to take the land subject to the mortgage. Whatever his agreement, the land remains subject to the mortgage unless some action is taken by the mortgagee which releases it. Where the grantee assumes the mortgage the grantee becomes the principal obligor and the mortgagor a surety. Where the grantee takes subject to the mortgage, but without assuming the debt it secures, the land is

danger of "discharging the surety by dealings with the new principal which alter the principal obligation, as by an extension of time without the surety's consent."⁸⁸ Comment e thus links nonconsensual suretyship to the Restatement's rules regarding a surety's rights to discharge.⁸⁹ The parenthetical cross-references in comment e likewise tie section 83 to the Restatement's rules for discharge.⁹⁰ Hence, the 1941 Restatement incorporates the privileges of nonconsensual suretyship.

The language of section 83(c) is broad enough to encompass transactions in goods; however, none of the illustrations following the comments to section 83 cover nonconsensual suretyship situations involving sales of goods. Consequently, a lawyer or judge using the 1941 Restatement has been required to link the general terms of section 83(c) to delegations of obligations in sales-of-goods contracts. Several reported cases demonstrate this linkage.⁹¹ Before examining these cases, however, one should explore sections 122, 128, and 129, which are cross-referenced in section 83(c), because these cross-referenced sections contain the specific discharge rules that can be applicable to nonconsensual sureties.

B. The Restatement of Security: Three Rules for Discharge

1. Section 122: The Creditor's Release of the Principal Discharges the Surety

Section 122 of the Restatement of Security states a general rule that, when the creditor releases the principal, the surety also is discharged.⁹² This section of the Restatement and its

regarded as bearing the principal burden of the mortgage, and the mortgagor is a surety to the extent of the value of the land.

Id. § 83 cmt. e (cross-referencing § 114).

88. *Id.* (cross-referencing §§ 122, 128, 129).

89. This was also the situation in the cases discussed in part II, *supra*.

90. See RESTATEMENT OF SEC. § 83 cmt. e (cross-referencing §§ 122, 128, 129).

91. See *infra* part III.C.

92. Section 122 states: "Where the creditor releases a principal, the surety is discharged, unless (a) the surety consents to remain liable notwithstanding the release, or (b) the creditor in the release reserves his rights against the surety." RESTATEMENT OF SEC. § 122. Comment b to section 122 states a rationale for the rule: "If the principal has no longer a duty as a result of the creditor's act, the surety should

accompanying comment could have been derived from *Malanaphy v. Fuller & Johnson Manufacturing Co.*,⁹³ in which the creditor's release of a vendee-principal released the vendors-sureties. *Malanaphy* clearly demonstrated the common-law rule that, when a principal obligor's debt was extinguished by agreement with the creditor, the surety's obligation was extinguished. Section 122 of the 1941 Restatement thus contains a long-established common-law rule for discharge, which is linked to nonconsensual sureties by cross-reference in section 83(c).

In relevant part, comment b to section 122 states a rationale for the rule:

If the principal has no longer a duty as a result of the creditor's act, the surety should not be held to an obligation to answer for a default of that duty. Furthermore, if the surety could be compelled to pay after the principal's release, he would be entitled to reimbursement if he had become a surety at the principal's request or with his consent. Such an outcome would be unfair to the principal after a release because it would afford the creditor a means of attacking the principal indirectly through the surety.⁹⁴

Illustrations 1 and 2 following section 122 further clarify the rule.⁹⁵ Section 122 details two exceptions to the general release rule. The surety remains liable upon discharge of the principal if: (1) the surety consents to remain liable or (2) the creditor in the release reserves rights against the surety.⁹⁶ One need not inquire into the creditor's intent in granting a release. In fact, the creditor's intent is immaterial. Maintaining rights against the surety requires something more than intent. For a creditor to release a principal without discharging the surety, he must have the surety's consent or an explicit reservation of rights by

not be held to an obligation to answer for a default of that duty." *Id.* § 122 cmt. b.

93. 101 N.W. 640 (Iowa 1904); see *supra* part II.B.

94. RESTATEMENT OF SEC. § 122 cmt. b.

95. Illustration 1 states: "S at P's request becomes surety to C on an obligation of P to C. Both S and P are bound jointly on the same instrument. C releases P. S is not liable to C." *Id.* § 122 illus. 1.

Illustration 2 states: "Same facts as Illustration 1, except that S and P are not bound jointly. S is not liable to C." *Id.* § 122 illus. 2.

96. See *id.* § 122; *supra* note 41 (discussing the reservation-of-rights doctrine).

the principal.⁹⁷

2. Section 128: Any Modification Agreed Upon by the Creditor and the Principal Without the Surety's Consent Discharges the Surety

Section 128 of the 1941 Restatement provides a general rule that any modification made by agreement between the principal and the creditor without the surety's consent discharges the surety *unless* the modification could only benefit the surety.⁹⁸ An exception exists for compensated sureties.⁹⁹ As to noncompensated sureties (the residual category to which everyone except bonding companies belongs), the principle of *strictissimi juris* applies: any modification in the contract between the principal and creditor, apart from time extensions, will result in discharge of the surety *in toto* unless the change can only benefit the surety.

The comment to the general rule contained in section 128(a) states:

Where the nature of the alteration is such that it can only be beneficial to the surety, he is not discharged whether non-compensated or compensated. This does not mean that the creditor can hold the non-compensated surety by showing that in the particular case the change was beneficial. The

97. See *supra* note 41.

98. Section 128 states:

Where, without the surety's consent, the principal and the creditor modify their contract otherwise than by extension of time of payment

(a) the surety, other than a compensated surety, is discharged unless the modification is of a sort that can only be beneficial to the surety, and

(b) the compensated surety is

(i) discharged if the obligation materially increases his risk, and

(ii) not discharged if the risk is not materially increased, but his obligation is reduced to the extent of loss due to the modification.

RESTATEMENT OF SEC. § 128.

99. A "compensated surety" in the Restatement of Security is a special species defined as "a person who engages in the business of executing surety contracts for a compensation called a premium." *Id.* § 82 cmt. 1. In other words, compensated sureties are bonding companies or insurance companies that write bonds, and it is to these companies that subsection b of section 128 applies. Compensated sureties are, by definition, different from nonconsensual sureties; hence, subsection b plays no role in this Article.

rule does not permit a speculation as to whether the change may or may not have been to the non-compensated surety's advantage. It must be of the sort that by its very nature, in no circumstances, can increase the risk of such a surety. Some examples are the reduction of the total amount due, or the reduction of interest.¹⁰⁰

Illustration 6, which follows this comment, shows an agreement between principal and creditor for a reduction of rent for a store from \$300 per month to \$250 per month.¹⁰¹ Because this agreement could only benefit the surety, it would not be a ground for release. Conversely, any change that is not by its very nature beneficial to the surety is a ground for discharge without inquiry into whether actual harm resulted from the change. Moreover, under section 128, a creditor cannot reserve rights against a surety while agreeing with the principal obligor to a change in the underlying obligation owed by the principal.¹⁰² Section 128 thus embodies the principle of *strictissimi juris* without any escape hatch, as is available under section 122 through the reservation-of-rights doctrine. Except for compensated sureties, section 128 constitutes an iron-clad rule against principal-creditor dealings without the surety's consent.¹⁰³

3. Section 129: By an Agreement To Extend the Principal's Time for Payment, the Creditor Discharges the Surety

Under section 129 of the 1941 Restatement, a binding agreement to extend the principal's time for payment discharges any noncompensated surety, unless the creditor reserves rights or the surety makes a waiver of rights.¹⁰⁴ This rule is a harsh one

100. *Id.* § 128 cmt. e.

101. Illustration 6 states: "P leases a store from C for five years at a monthly rent of \$300. S is surety for P's performance. C contracts with P to reduce the rent to \$250 a month. S is not discharged since this change can only be beneficial." *Id.* § 128 illus. 6.

102. See *supra* note 41 (discussing the reservation-of-rights doctrine).

103. For compensated sureties, i.e., sureties who charge a premium, discharge occurs only to the extent of prejudice suffered. See RESTATEMENT OF SEC. § 128(b)(ii).

104. Section 129 states:

(1) Subject to the rule stated in Subsection (2) and to the rules in respect of negotiable instruments, where the principal and creditor, without the surety's consent, make a binding agreement to extend the time of

for a creditor who has sought to help out a principal and has neither obtained the surety's consent nor had the wit to reserve rights.¹⁰⁵ This rule is in accordance with the holding in *Union Mutual Life Insurance Co. v. Hanford*,¹⁰⁶ in which the Supreme Court sustained the sellers' discharge when the buyer assumed the mortgage debt and agreed with the creditor to a binding time extension for paying the notes assumed from the sellers. The Restatement of Security thus adopted another long-standing common-law rule.

The comment to section 129(1) sets forth the rationale for the general rule of discharge following a time extension:

A binding extension of time by the creditor to the principal is a form of modification of the principal's duty; see § 128. Its effect is stated separately because it is a form of modification under which the creditor can reserve his rights against the surety. The basic reason for the rule stated in Subsection (1) is that the surety should not be bound on a duty of the principal which he has not guaranteed. The rule can also be supported because of the possibility that the risk of the surety will be increased by the extension.¹⁰⁷

Under section 129(2), a compensated surety is discharged only *pro tanto*, i.e., to the extent of harm established as a result of the extension. For the noncompensated surety, however, *strictissimi juris* prevails for the reasons stated in the foregoing quotation. The comment to subsection (2) indicates that the rule for noncompensated sureties was somewhat divorced from economic reality.

The rule in respect of [noncompensated] sureties applies even where, in fact, it can be shown that the particular extension was beneficial to the surety. This is another instance of giving the surety other than a compensated surety the advan-

payment by the principal, the surety is discharged unless the creditor in the extension agreement reserves his rights against the surety.

Id. § 129(1). Subsection 2 merely states a special rule for compensated sureties—discharge to the extent of proved harm. *See id.* § 129(2). This special rule is not relevant to this Article.

105. *See supra* note 41 (discussing the reservation-of-rights doctrine).

106. 143 U.S. 187 (1892); *see supra* part II.A.

107. RESTATEMENT OF SEC. § 129 cmt. a.

tage of the rule of *strictissimi juris*, by which he is discharged by any variation in the performance demanded of the principal.¹⁰⁸

As an example, if the principal owes \$1000 secured by a noncompensated surety's promise and the creditor agrees to any binding time extension without the surety's consent or a reservation of rights, the surety is discharged even if the principal's fiscal situation improves during the time period of the extension, making payment by the principal more probable.

4. Summary

Sections 122, 128, and 129 are rooted more in metaphysics than in economic realities. These sections contain tersely phrased, tightly drawn rules that usually can be applied without detailed factual inquiry. The underlying philosophy of these sections is simple: the surety agreed to perform a specified obligation under defined conditions; any alteration of the agreed-upon obligation by any dealing between the principal and creditor, for better or worse, constitutes an imposition of an obligation to which the surety is a stranger. The imposition of the new obligation without the surety's consent or a reservation of rights under section 122 or section 129 is deemed a justification for an automatic and complete discharge of the surety.

Having discussed the general rules relating to discharge, this Article now investigates the impact of the Restatement of Security on cases involving sales of goods and nonconsensual sureties. The cases are few, but lawyers have sought the application of the foregoing rules, occasionally with success.

C. *The 1941 Restatement of Security and Sales of Goods*

Many reported cases involving nonconsensual suretyship in real estate sales have cited the Restatement of Security¹⁰⁹

108. *Id.* § 129 cmt. e.

109. *See, e.g.*, *Swanson v. Krenik*, 868 P.2d 297 (Ala. 1994) (entitling the vendors-subsureties to indemnity, as opposed to contribution, when they paid the outstanding debt for their vendee-surety, who had sold the encumbered land to a subvendee); *Yasuna v. Miller*, 399 A.2d 68 (D.C. 1979) (rejecting the vendor-surety's defense of an unconsented-to modification between creditor and vendee-principal because the

Even comment e to section 83, which merely explains nonconsensual suretyship, has been cited in at least six reported opinions.¹¹⁰ To date, however, there are only four reported cases in which courts have cited the Restatement of Security in conjunction with nonconsensual suretyship arising from a delegation of duties in a sale of goods.¹¹¹ An examination of the

creditor had not agreed to the vendee's assumption of vendor's obligations); *Federal Land Bank v. Butz*, 135 P.2d 883 (Kan. 1943) (entitling an intermediate vendor to an injunction preventing the creditor from executing against its property in part because of its suretyship status, which required that the property of the principal debtor (vendee) be exhausted first). *Yasuna* is questionable because notice to a creditor of the situation giving rise to involuntary suretyship (without agreement to that status) generally is sufficient to create a duty for the creditor to respect the relationship.

Along with these real estate cases, additional case law cites § 83 when nonconsensual suretyship status was invoked (wrongfully) in a stock sale in which the buyer took subject to an outstanding debt for which the stock was security. See *Bell v. Williams*, 44 Pa. D. & C. 159 (1941) (suretyship defense unsuccessful); *Bell v. Williams*, 41 Pa. D. & C. 253 (1941) (demurrer overruled). For a discussion of cases involving suretyship in sales of goods, see *infra* part III.C.1.-C.3.

110. *Oleson v. Tellson*, 98 Cal. Rptr. 668 (Ct. App. 1971); *Westinghouse Credit Corp. v. Wolfer*, 88 Cal. Rptr. 654 (Ct. App. 1970); *Yasuna v. Miller*, 399 A.2d 68; *Schmuckie v. Alvey*, 758 S.W.2d 31 (Ky. 1988); *Horman v. Gordan*, 740 P.2d 1346 (Utah Ct. App. 1987); *Fluke Capital & Management v. Richmond*, 724 P.2d 356 (Wash. 1986).

111. For examples of cases involving issues of nonconsensual suretyship in sales of goods that cite § 83, see *Western Coach Corp. v. Roscoe*, 650 P.2d 449 (Ariz. 1982); *Westinghouse Credit Corp. v. Wolfer*, 88 Cal. Rptr. 654; *Twombly v. Wulf*, 482 P.2d 166 (Or. 1971). *Twombly* and *Wolfer* arose from sales of businesses, including goods, as going concerns. Only *Roscoe* was a pure sale-of-goods case. These cases are discussed in the text.

The fourth case involving § 83 and a sale of goods is *Walin v. Young*, 180 P.2d 535 (Or. 1947). In *Walin*, sellers (Hurleys) granted a chattel mortgage in crops to their corporate creditor. *Id.* at 536. The creditor, on Hurleys' default, sought to foreclose on the mortgaged goods that were in the possession of buyers. *Id.* The buyers resisted on the grounds of suretyship, namely, that the creditor had released the buyers (sureties) by releasing to the sellers property that could have paid the outstanding debt. *Id.* at 537. Nonconsensual suretyship status was claimed on the theory that an assumption of payment obligations to the creditor was part of the purchase price for the goods. *Id.* at 539. The Supreme Court of Oregon did not decide whether the buyers really were sureties. The court deemed that decision unnecessary because, to make out the defense claimed, the buyers also would have been required to show that the creditor knew of their suretyship status, and the pleadings were insufficient on this point. *Id.* at 540-41.

Two other cases citing § 83 may have involved goods. The first is *Bell v. Williams*, 44 Pa. D. & C. 159. The opinion does not mention any sale of goods, but the headnote speaks of assuming a payment obligation upon taking an assignment of

three most prominent cases will explain the relationship between delegation in sales-of-goods contracts and nonconsensual suretyship in light of the 1941 Restatement.

1. *Oregon. Twombly v Wulf*

In 1971, the Oregon Supreme Court cited section 83 in *Twombly v. Wulf*,¹¹² a case arising from a sale of goods in connection with the sale of a business. Twombly sold a phone answering service and a taxi cab service, including three cabs, to Wulf and Fowles.¹¹³ As part of the consideration, Wulf and Fowles agreed to assume an indebtedness of approximately \$2000, the amount Twombly owed to the National Bank of Oregon (bank) on an installment sales contract for one of the cabs.¹¹⁴ The vendees (Wulf and Fowles) took possession of the cab, made two installment payments, and defaulted.¹¹⁵ The bank foreclosed and sold the cab for \$1500, leaving a deficiency¹¹⁶

The bank assigned the deficiency claim to a credit company, who sued Twombly (seller and original obligor) on the installment sales contract.¹¹⁷ Twombly settled the claim by tender of a promissory note and sued her buyers, who had assumed the

"personal property." *Id.* at 159. The doctrine of nonconsensual suretyship was no help because the person claiming its benefits was actually the person assuming the obligation—a principal obligor. *Id.* at 161. A second case that may have involved goods is *Oleson v. Tellson*, 98 Cal. Rptr. 668. The court made it clear that there was a nonconsensual suretyship because there was an assumption of a payment obligation in the sale of a business, *id.* at 669, but nothing in the opinion states that goods were part of the sale. For further discussion of *Oleson*, see *infra* note 142.

112. 482 P.2d 166 (Or. 1971). The court did not decide whether Article 2 of the UCC applied. Clearly, however, because goods were part of the transaction, there is, at minimum, a strong argument that the sale was subject to Article 2. *See, e.g., Zapatha v. Dairy Mart, Inc.*, 408 N.E.2d 1370 (Mass. 1980).

113. *Twombly*, 482 P.2d at 167-68. The court decided the case without reference to Article 2 because no Article 2 principles were needed for a resolution of the issues raised. Were it necessary to decide on the applicability of Article 2, however, the argument for Article 2 coverage is strong. Many courts apply Article 2 directly or by analogy to the sale of a business, even when goods are not the predominant factor in the sale. *See, e.g., Zapatha*, 408 N.E.2d at 1375 & n.9 (citing cases).

114. *Twombly*, 482 P.2d at 168.

115. *Id.*

116. *Id.*

117. *Id.*

debt and defaulted.¹¹⁸ The buyers defended on the theory that, because plaintiff had not yet paid in cash, she could prove no loss for which she was owed reimbursement.¹¹⁹ The trial court found the buyers liable for the deficiency owing on the installment contract plus interest, and the Supreme Court of Oregon affirmed.¹²⁰ In its discussion, the court cited section 83 of the Restatement of Security and made it clear that the seller's status as a nonconsensual surety was significant for the outcome.

The court stated:

Upon executing the contract wherein [Wulf and Fowles] agreed to assume plaintiff's indebtedness to the bank on the retail installment sales contract the parties to the contract, with respect to that covenant, created a relationship of involuntary suretyship whereby [Wulf and Fowles] became the principal obligors on the indebtedness due for the balance of the car, and the plaintiff acquired the privileges of a surety. As surety on the indebtedness, plaintiff's right of action against [Wulf and Fowles] accrued at the time she paid the indebtedness for which [Wulf and Fowles] were primarily liable.¹²¹

The court went on to consider whether the issuance of the negotiable instrument was the type of payment that triggered the right of reimbursement. Citing, *inter alia*, section 107 of the 1941 Restatement,¹²² the court held that the note was payment; thus, the decision in favor of the seller (surety) against her buyers (principals) succeeded.¹²³ Nonconsensual suretyship status undergirded the court's affirmation of the trial court's decision by supplying the justification for reimbursement upon

118. *Id.*

119. *Id.*

120. *Id.* at 168-70. The vendees were allowed a set-off of \$150 for payment of a claim that the vendor (Twombly) was supposed to have paid under the original sales agreement. *Id.* at 168.

121. *Id.* (citations omitted).

122. "Where a creditor accepts from the surety in discharge of the principal's matured duty a negotiable instrument on which the surety is liable for an amount equal to or less than the amount due from the principal, the principal is under an immediate duty to reimburse the surety to the amount of the instrument." *Id.* at 169 (quoting RESTATEMENT OF SEC. § 107 (1941)).

123. *Id.*

the surety's issuance of the promissory note. For purposes of this Article, one need only note that Twombly's delegation of her obligation to pay for a taxi cab resulted in nonconsensual suretyship, a status that sustained the court's decision.

2. *California: Westinghouse Credit Corp. v. Wolfer*

*Westinghouse Credit Corp. v. Wolfer*¹²⁴ is a 1970 case involving a sale of goods in which the court cited section 83 and other sections of the Restatement of Security. Griffin purchased restaurant equipment on credit pursuant to a written agreement.¹²⁵ The seller assigned its rights to Westinghouse Credit Corp. (Westinghouse).¹²⁶ After about six months, Griffin sold the equipment to Wolfer. As part of the consideration, Wolfer assumed Griffin's payment obligations to Westinghouse.¹²⁷ Shortly thereafter, Wolfer sold the equipment to Savoy, who agreed to assume the payments to Westinghouse as part of the consideration paid.¹²⁸ Soon after Westinghouse learned of the assumption by Savoy, the payments stopped.¹²⁹

Westinghouse sued Griffin, Wolfer, and Savoy for the balance owing.¹³⁰ Savoy settled with Westinghouse and executed a conditional stipulation of judgment in exchange for being allowed to continue in business while making smaller payments over a longer period of time.¹³¹ Wolfer refused to agree to the settlement, disclaiming any liability, and neglected to answer or appear in the court action.¹³² Savoy failed to make the reduced payments as required under the settlement agreement; therefore, Westinghouse had the stipulated judgment entered against

124. 88 Cal. Rptr. 654 (Ct. App. 1970).

125. The court also mentioned related items, but the opinion never disclosed anything of consequence besides the restaurant equipment that Wolfer and her vendee apparently were using as part of an ongoing enterprise. *Id.* at 655-56.

126. *Id.* at 655.

127. *Id.* at 655-56.

128. *Id.* at 656.

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.* Wolfer and Savoy had the same lawyer, which may have caused some of the difficulties in the case. *Id.*

Savoy and obtained a default judgment against Wolfer.¹³³ When a levy was made against her bank account and safe deposit box, Wolfer sought to have the default set aside on the basis of her status as a nonconsensual surety¹³⁴

In pursuing her motion to set aside the default judgment, Wolfer argued that, when Savoy assumed her obligation to pay for the restaurant equipment, Savoy became a principal and she a surety and that, once Westinghouse knew of this, it was bound to respect her status.¹³⁵ Having negotiated a settlement extending the time for payment without her consent, Westinghouse discharged her—or so she argued in support of the motion to set aside the default.¹³⁶ The trial court denied her motion, and the appellate court affirmed, though not without recognizing the merits of her argument.¹³⁷

In relevant part, the appellate court stated:

We believe that [Wolfer] did have a meritorious defense to Westinghouse's suit against her. A surety is, among other things, one who promises to answer for the debt of another. In a suretyship relation there are two obligors and one obligee who is entitled to but one performance. When Savoy assumed [Wolfer]'s debt to Westinghouse, [Savoy] became the principal obligor and [Wolfer] became the surety. As soon as Westinghouse learned of the assumption by Savoy of [Wolfer]'s debt to Westinghouse, Westinghouse was required to recognize the relation of suretyship between Savoy and [Wolfer] and respect it in all of its subsequent dealings with them. This it did not do. Instead, without [Wolfer]'s consent and without any reservation of its rights against [Wolfer], it extended Savoy's time for payment and thereby exonerated [Wolfer] from the debt.¹³⁸

Unfortunately, however, the meritorious defense was not enough to justify setting aside the default judgment. Wolfer was

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.* at 656-58.

138. *Id.* at 656-57 (citing RESTATEMENT OF SEC. §§ 82, 83(c) (1941)) (citations omitted).

also required to show that she had been denied a fair opportunity to present the defense.¹³⁹ She did not do this in her submissions because her dealings with her lawyer were not disclosed.¹⁴⁰ The court, however, explicitly recognized the importance of nonconsensual suretyship as a basis for discharge when the status arose in taking over a seller's payment obligations in the purchase of goods.¹⁴¹

If Wolfer had answered and properly pled the defense, the rule contained in section 129(1) would have exonerated her. Quite clearly, the California court did not object to blending the law of delegation and principles of discharge derived from the status of nonconsensual suretyship.¹⁴² The delegation itself created the suretyship status that gave rise to the defense.

3. *Arizona: Western Coach Corp. v. Roscoe*

The most recent case combining a sale of goods with the Restatement of Security's privileges for nonconsensual sureties is *Western Coach Corp. v. Roscoe*,¹⁴³ decided by the Supreme Court of Arizona sitting en banc in 1982. What started as a simple secured sale of a mobile home generated a complex web of relationships including claims for discharge as nonconsensual

139. *Id.* at 657.

140. *Id.* The record did not sustain her claim that she defaulted because of her lawyer's failure to represent her. *Id.* Because she failed to answer, she lost her meritorious suretyship defense. *Id.*

141. The court did not discuss the applicability of Article 2. Because equipment (goods) was part of the transaction, however, one can make an argument for Article 2's applicability. See U.C.C. § 2-102 (1994); Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370 (Mass. 1980).

142. In a second California case involving nonconsensual sureties, arising from the sale of a business, the court cited § 83 but did not allow discharge. See *Oleson v. Tellson*, 98 Cal. Rptr. 668 (Ct. App. 1971). Seller sold a business, which may have included merchandise, to the Tellsons, who signed a note as payment. *Id.* at 669. Seller assigned the note to the Olesons. *Id.* The Tellsons then sold the business to the Wikes, who assumed the note, and informed the Olesons of the sale and assumption. *Id.* The Wikes were later discharged in bankruptcy, and the Olesons (creditors) called on the Tellsons for payment. *Id.* While there is little doubt that the Tellsons rightly characterized themselves as nonconsensual sureties, there were no grounds for discharging them because their complaints, failure to accelerate and receiving only interest, were not binding extensions or other changes in the underlying agreement.

143. 650 P.2d 449 (Ariz. 1982) (en banc).

sureties.¹⁴⁴ Marvin and Carole Roscoe (Roscoe Jr.) bought a mobile home from Western Coach Corp. (Western Coach) by a retail installment contract.¹⁴⁵ J.E. and Florence Roscoe (Roscoe Sr.) guaranteed payment.¹⁴⁶ Western Coach immediately assigned its rights as seller with a right of recourse in the event that the buyers defaulted.¹⁴⁷

Through the course of intermediate assignments, Western Coach's rights were assigned to Delta Investment Co. (Delta).¹⁴⁸ Meanwhile, Roscoe Jr. sold the mobile home to Love, who assumed the payments to Delta.¹⁴⁹ Love sold to Chambers, who in turn assumed the payment obligations to Delta.¹⁵⁰ Eventually, Chambers defaulted.¹⁵¹ Western Coach paid Delta under its recourse obligation¹⁵² and repossessed the mobile home at Chambers's request.¹⁵³ The mobile home was in bad shape; therefore, in addition to the pay-out to Delta, Western Coach incurred the costs of: unpaid taxes, towing, moving, storing, and repairing and refurbishing the mobile home.¹⁵⁴ Western Coach sued both sets of Roscoes for reimbursement because Roscoe Jr. was the principal obligor and Roscoe Sr. was a surety by express agreement.¹⁵⁵

Roscoe Jr., the principal obligor before the first transfer, asserted the suretyship defense that, when Western Coach, without his consent, agreed to Love's sale to Chambers, the contract was *modified* without his consent. As a nonconsensual surety, he argued that the modification effected his discharge.¹⁵⁶ At trial,

144. *Id.* at 454-55.

145. *Id.* at 452.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. A recourse obligation is a suretyship obligation.

153. *Roscoe*, 650 P.2d at 452.

154. *Id.*

155. *Id.* at 453.

156. *Id.* at 454-55. The opinion does not specifically set out arguments made before the trial judge. The reconstruction above is based on the trial judge's decisions and the issues preserved for appeal. Curiously, in characterizing the Roscoes' argument on appeal, the appellate court took pains to state that the Roscoes were not arguing

Western Coach obtained a jury verdict against the Roscoes.¹⁵⁷ The Roscoes appealed, arguing, *inter alia*, the suretyship defense. The appellate court acknowledged that, if Roscoe Jr.'s suretyship argument were valid, it would also work for Roscoe Sr., the original consensual surety who would have been subrogated to Roscoe Jr.'s rights.¹⁵⁸ The argument was found wanting, however, because, in the sale from Love to Chambers, the record sustained the jury's implied finding that there was no modification of the obligation contained in the installment contract.¹⁵⁹ According to the court: "there was evidence which permitted the finder of fact to conclude that the Roscoes' rights against Love were unaffected by Love's sale to Chambers, with the result that the Roscoes were not released from their obligations whether they were principal debtors or sureties for Love's assumed performance."¹⁶⁰

Roscoe Jr. thus was not denied the suretyship status attained as a seller whose buyer assumed the debt. The status, however, coupled with the downstream sale from Love to Chambers with Western Coach's consent, did not constitute a reason for discharge. Everything hinged on the fact that the obligation in the principal contract was not modified. At a minimum, there was enough evidence for the jury to have found that it was not modified.¹⁶¹ The court noted that the Roscoes had not argued impairment of security,¹⁶² which might have been a successful argument if the creditor (Western Coach) had done something

discharge by the mere addition of a party, a matter on which authorities were split. *See id.* at 455 n.5. This argument actually seems very close to, or embraced within, the argument that the Roscoes made on appeal.

157. *Id.* at 453. The trial judge first granted a directed verdict for Roscoes Jr. and Sr. After further argument, however, the court granted Western Coach's motion for a new trial. Western Coach won the new trial. *Id.*

158. *Id.* at 454.

159. *Id.*

160. *Id.* at 455.

161. One should note that evidence of postdelegation conduct can effect a modification under § 128. Comment b to § 128 states: "The permitted variation of performance by the principal is in reality an alteration of the contract by substituted performance, although it frequently is evidenced by the circumstances, especially by the conduct of the parties, rather than by any specific agreement." RESTATEMENT OF SEC. § 128 cmt. b (1941).

162. *Roscoe*, 650 P.2d at 455 n.5.

negligent that led to the deterioration of the mobile home.¹⁶³ In any event, the Roscoes were liable for reimbursing Western Coach.¹⁶⁴

If the jury had found that the sale to Chambers involved a change that justified resort to section 128, then the court probably would have allowed discharge on the basis of Roscoe Jr.'s nonconsensual suretyship status coupled with a well-established rule for discharge. As in the foregoing cases, the delegation of the duty to pay for goods triggered the use of the suretyship defense. In an elaborate opinion, the court wove delegation in a sale of goods together with nonconsensual suretyship law

4. Summary

While case law blending the 1941 Restatement's principles of nonconsensual suretyship and the law of delegation in sales-of-goods contracts is sparse, the foregoing cases illustrate the several contexts in which sellers whose debt obligations were assumed by their buyers in contracts involving sales of goods have raised suretyship defenses.¹⁶⁵ Without question, suretyship law and the law of delegation intersect in sales of goods, even if case law seldom recognizes the intersection. Furthermore, the suretyship principles incorporated into the Restatement of Security obviously were extracted from older common law. Whenever applicable, these principles are a powerful weapon for the seller's lawyer if the buyer (principal obligor) and the creditor do any dealing without the seller's (surety's) consent. The application or nonapplication of suretyship principles can mean victory or defeat, as *Wolfer* demonstrated.

IV DELEGATION CASES ARISING UNDER UCC SECTION 2-210: SETTING THE STAGE FOR THE USE OF SURETYSHIP PRINCIPLES IN CASES GOVERNED BY ARTICLE 2

A. General Principles of Delegation Under Article 2

From the foregoing discussion, one can easily discern the

163. See RESTATEMENT OF SEC. § 132.

164. *Roscoe*, 650 P.2d at 455-56.

165. For Article 2's coverage, see U.C.C. §§ 2-102, -105(1) (1994); *infra* part VII.

applicability of suretyship principles when there is a sale of goods on which a debt is owed and the buyer assumes the debt as part of the purchase price. One should understand, however, that, under contracts governed by Article 2, duties can be delegated by sellers or buyers.¹⁶⁶ Section 2-210 contains selected principles of delegation that are controlling for contracts covered by Article 2.¹⁶⁷ According to section 2-210 comment 7, "[t]his section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law."¹⁶⁸ Additional principles and concepts can flow in through section 1-103.¹⁶⁹

As a fundamental matter, therefore, one must reach beyond the Code for definitions of "assignment" and "delegation," as the terms are used in section 2-210. An "assignment" is a transfer of a contract right, or the right to receive performance.¹⁷⁰ A "delegation" is the empowerment of a person (delegate) to perform a duty that the delegating party owes to another.¹⁷¹ As Professors Knapp and Crystal point out in their widely used contracts casebook, an assignment is akin to passing a football or baton; creating a new right in the assignee extinguishes the right of the assignor.¹⁷² Delegation is akin to the dissemination of a contagious disease; you can pass it on, but you do not get rid of it.¹⁷³

Of the five subsections in section 2-210, four explicitly pertain to delegation. Only subsection 2 is limited by its terms to

166. See U.C.C. § 2-210.

167. Section 2-210 probably will be revised and renumbered. See *infra* part VII.B.

168. U.C.C. § 2-210 cmt. 7.

169. See *id.* § 1-103 (concerning the applicability of supplementary principles of law).

170. FARNSWORTH, *supra* note 10, § 11.1. Professor Farnsworth states: "An obligee's transfer of a contract right is known as an *assignment* of the right. By an assignment, the obligee as *assignor* (B) transfers to an *assignee* (C) a right that the assignor has against an *obligor* (A)." *Id.*

171. *Id.* Professor Farnsworth states: "An obligor's empowering of another to perform the obligor's duty is known as a *delegation* of the performance of that duty. By a delegation, the obligor as *delegating party* (B) empowers a *delegate* (C) to perform a duty that the delegating party owes to an *obligee* (A)." *Id.*

172. CHARLES L. KNAPP & NATHAN M. CRYSTAL, PROBLEMS IN CONTRACT LAW 1233 (3d ed. 1993).

173. *Id.* at 1233-34.

rules of assignment.¹⁷⁴ In pertinent part, section 2-210 reads as follows:

(1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(3) Unless the circumstances indicate the contrary a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee. (Section 2-609).¹⁷⁵

This language is tight but easily unraveled. Delegation is generally permissible unless otherwise agreed or unless the obligee has a *substantial interest* in having the original promisor perform. Delegation, however, does not relieve the delegating party of the duty to perform.¹⁷⁶ To illustrate, a seller may delegate the duty to deliver farm machinery as promised in a contract for sale, but the seller remains liable to the buyer for failure to deliver and for any nonconforming tender. Likewise, a buyer may delegate the duty to pay (or any other duty), but, after the

174. See U.C.C. § 2-210 (1994).

175. *Id.* § 2-210(1), (3)-(5).

176. *Id.* § 2-210(1).

delegation, the buyer remains liable for failure to pay and for any other failure of performance required of the buyer under the contract. The delegating party can be released by a novation (meaning an agreed substitution of parties), but this requires the importation of non-Code principles.¹⁷⁷ Finally, section 2-210(4) aids in construction by stating that an assignment of the whole contract carries the meaning of delegation as well as assignment. Hence, "assigning a contract" transfers the burdens as well as the benefits, making the transferee a delegate as well as

177. As a leading treatise states:

A novation is generally defined as a mutual agreement among all parties concerned for the discharge of a valid existing obligation by the substitution of a new valid obligation on the part of the debtor or another, or a like agreement for the discharge of a debtor to his creditor by the substitution of a new creditor.

58 AM. JUR. 2D *Novation* § 1 (1989); see RESTATEMENT (SECOND) OF CONTRACTS § 280 (1979). The Restatement requires a substitution of parties, i.e., either the obligor or obligee must be new in a novation. See *id.* *American Jurisprudence* and the authorities it cites, however, allow for a novation between original parties. See 58 AM. JUR. 2D *Novation* § 3.

An excellent case on nonconsensual suretyship in which the court discussed novation and cited § 83 of the Restatement of Security is *Horman v. Gordon*, 740 P.2d 1346 (Utah Ct. App. 1987). In *Horman*, the purchaser of a shopping center (Kingston) assumed three promissory notes as part of the purchase price. *Id.* at 1348. The purchaser thereby became the principal obligor, and the original obligor (Gordon) attained the privileges of nonconsensual suretyship. By releasing the principal obligor for a stipulated price without a reservation of rights, the creditor unwittingly released the surety (Gordon), from whom the creditor had hoped to collect. *Id.* at 1354.

In discussing novation, the court stated:

It is undisputed that the original obligations between Horman [creditor] and Gordon were valid, and that a new, valid contract was entered into between Kingston and Gordon when Kingston assumed Gordon's obligations to Horman in connection with his purchase of the Sherwood Shopping Center. Horman, however, even though aware of Kingston's assumption of Gordon's debts, never agreed to it and never released Gordon from the obligations, but continued to look to him for payment on the notes. The authorities agree that for novation to take place, all parties must agree, at the time of substitution, that the creditor's consent constituted a discharge of the original obligor.

Because the intent of the parties to cause a novation cannot be presumed but must be clear, and because there is no evidence of such intent in the record but only evidence to the contrary, we cannot conclude that a novation occurred.

Id. at 1353 (citations omitted). Hence, novation required clear proof of intent to discharge one obligor and to accept a substitute.

an assignee.¹⁷⁸

Much important law is not stated in the text of section 2-210 or its comments, namely, the relevant rules of suretyship. Whenever a delegation is made in a contract covered by section 2-210, whether or not an assignment is made, the delegation creates a nonconsensual suretyship: the delegate becomes a principal, the delegating party becomes a surety, and the party to whom a duty is owed becomes a creditor or obligee in the tripartite suretyship relationship.

If a seller delegates a duty, the duty commonly is one to deliver goods promised under a contract for sale coupled with an assignment of the right to payment. For example, a manufacturer may delegate a duty to deliver specially fabricated goods, or a farmer may delegate a duty to deliver commodities. The delegate may or may not become an assignee of the right to payment. If a buyer delegates a duty, that duty commonly is one to pay along with an assignment of a right to take delivery of the goods. An example is a grain buyer who delegates the obligation to pay along with an assignment of the right to take delivery of the grain. Delegation and assignment commonly go together, but there can be delegation without assignment, and, of course, there are many assignments without delegation.

Section 2-210 is not a judicially overworked section; it has been cited in less than sixty reported opinions.¹⁷⁹ Moreover, section 2-210 has often been cited in opinions explaining its nonapplicability¹⁸⁰ Elsewhere, section 2-210 has been cited for its

178. See U.C.C. § 2-210(4).

179. As of February 1996, an examination of the *UCC Digest* ¶ 2210, all state annotated codes, and a Westlaw search yielded 57 opinions citing § 2-210.

180. For example, Arkansas appellate courts have cited § 2-210 three times but have never applied it. See *Wawak v. Stewart*, 449 S.W.2d 922, 932 n.1 (Ark. 1970) (Fogleman, J., dissenting in part and concurring in part) (citing § 2-210 as part of a jurisprudential argument against implying a warranty on heating and air conditioning ductwork); *Newton v. Merchants & Farmers Bank*, 668 S.W.2d 51 (Ark. Ct. App. 1984) (citing § 2-210(4) but determining that the plumbing contract in question was governed by the common law of contract rather than Article 2); *Pemberton v. Arkansas State Highway Comm'n*, 597 S.W.2d 605 (Ark. Ct. App. 1980) (determining that, while the facts showed a sale of goods (rock), there was no assignment to trigger the applicability of § 2-210). Simply, many citations to § 2-210 appear in cases that have nothing to do with delegation and, therefore, are of no value for the purpose of this Article.

embodiment of principles relating to delegation and assignment, even though Article 2 did not apply to the case *sub judice*.¹⁸¹ In a majority of the remaining cases in which section 2-210 was employed because a buyer or seller made a delegation or assignment in connection with a sale-of-goods contract, the courts cited section 2-210 only in connection with assignments.¹⁸² Approximately one-third of the reported opinions citing section 2-210 display fact patterns involving delegations. The Author's research has yielded only eight cases in which sellers made delegations incontrovertibly governed by section 2-210¹⁸³ and two more in which the facts showed some reasonable grounds for arguing that such a delegation had been made.¹⁸⁴ In other cas-

181. See, e.g., *In re F & T Contractors, Inc.*, 17 B.R. 966 (E.D. Mich. 1982); *Macke Co. v. Pízza of Gaithersburg, Inc.*, 270 A.2d 645 (Md. 1970). In *Macke*, the Court of Appeals of Maryland upheld a delegation and assignment in which the contract under scrutiny involved a license or concession for cold drink vending machines. Article 2 did not apply, but the court cited § 2-210 for its liberality in allowing delegations. *Id.* at 649. The issue in *In re F & T Contractors* was whether the FDIC had assumed liabilities (delegation) in conjunction with an assumption of rights (assignment) when it took over a bank. *In re F & T Contractors*, 17 B.R. at 968. The court cited § 2-210 to support the proposition that a delegation can be implied when an assignee gains the benefits of a contract without expressly assuming attendant obligations. *Id.* at 988.

182. See U.C.C. Case Dig. ¶ 2210 (1994).

183. See *May-Som Gulf, Inc. v. Chevron U.S.A., Inc.*, 869 F.2d 917, 924-25 (6th Cir. 1989) (involving delegation of a franchisor's obligations under service station franchises); *Ackley v. Gulf Oil Corp.*, 726 F Supp. 353, 361-64 (D. Conn.) (involving delegation of a franchisor's obligations under service station franchises), *aff'd*, 889 F.2d 1280 (2d Cir. 1989); *Quaker Alloy Casting Co. v. Gulfco Indus., Inc.*, 686 F Supp. 1319, 1335 (N.D. Ill. 1988) (involving delegation of an obligation for production and delivery of component parts for valves); *Tarter v. MonArk Boat Co.*, 430 F Supp. 1290 (E.D. Mo. 1977) (involving delegation of an obligation to build and deliver a houseboat), *aff'd*, 574 F.2d 984 (8th Cir. 1978); *Buckeye Ag-Center, Inc. v. Babchuck*, 533 N.E.2d 179 (Ind. Ct. App. 1989) (involving delegation of an obligation to deliver corn); *T.W. Rose v. Vulcan Materials Co.*, 194 S.E.2d 521 (N.C. 1973) (involving delegation of an obligation to deliver crushed rock); *Webber v. McCoy Lumber Co.*, 303 S.E.2d 408 (N.C. Ct. App. 1983) (involving delegation of an obligation to deliver lumber); *Shapiro Bros. Factors Corp. v. Guy Hobbs, Inc.*, 5 U.C.C. Rep. Serv. (Callaghan) 817 (Pa. Ct. Comm. Pleas 1968) (involving delegation of an obligation to deliver "merchandise" not described in the opinion).

184. *Baxter Healthcare Corp. v. O.R. Concepts, Inc.*, 869 F. Supp. 606, 610-11 (N.D. Ill. 1994) (involving an arguable delegation of an obligation to deliver health care products); *Rural Elec. Convenience Coop. Co. v. Soyland Power Coop., Inc.*, 606 N.E.2d 1269, 1275 (Ill. App. Ct. 1992) (involving delegation of an obligation to supply electric power). In *Rural Electric*, the Illinois Court of Appeals determined that

es, buyers alleged that the seller had delegated performance obligations, but the facts did not support the allegations.¹⁸⁵ The case reports contain at least nine cases citing section 2-210 in which the fact patterns demonstrate delegations by buyers.¹⁸⁶ In two other cases involving sales of goods, one of the parties urged that there had been a buyer's delegation governed by section 2-210, but the facts did not warrant its application.¹⁸⁷

the transfer of the obligation to deliver power from one utility to another fell outside of Article 2, *id.* at 1275-76, an issue on which courts disagree. In *Baxter Healthcare*, the district court assumed that § 2-210 applied. See *Baxter Healthcare*, 869 F. Supp. at 610. The "delegation," if any, however, was a result of the seller's major stockholders selling 95% of the seller's stock to a corporate competitor of the buyer. While control over the seller corporation changed, there was no transfer of the seller's obligation to a new legal entity. The court's assumption that § 2-210 controlled the delegation, therefore, is questionable.

185. See, e.g., *Associates Capital Serv. Corp. v. Fairway Private Cars, Inc.*, 590 F. Supp. 10, 16-17 (E.D.N.Y. 1982) (finding no facts to sustain the buyer's allegation that the finance company, Associates Capital Services, had assumed warranty obligations by taking an assignment of an account receivable); *Pendarvis v. General Motors Corp.*, 6 U.C.C. Rep. Serv. (Callaghan) 457 (N.Y. Sup. Ct. 1969) (holding that an assignee's acceptance of rights under a retail sale installment contract did not justify the claim that the assignee had accepted the seller's warranty obligations).

186. See *Arkla Energy Resources v. Royce Realty & Developing, Inc.*, 9 F.3d 855 (10th Cir. 1993) (involving assignment of the duty to take and pay for natural gas); *Midwest Precision Servs., Inc. v. PTM Indus. Corp.*, 887 F.2d 1128 (1st Cir. 1989) (involving delegation of the duty by lessor in finance lease whereby lessee assumed obligation to inspect, accept or reject, and allow for cure upon supplier's delivery of industrial machine); *Hefley v. Jones*, 687 F.2d 1383 (10th Cir. 1982) (involving delegation of the obligation to receive and pay for cattle); *Mitchell-Huntley Cotton Co. v. Waldrep*, 377 F. Supp. 1215 (N.D. Ala. 1974) (involving delegation of an obligation to receive and pay for cotton); *Aslakson v. Home Sav. Ass'n*, 416 N.W.2d 786 (Minn. Ct. App. 1987) (involving delegation of an obligation to pay for a mobile home following two failed attempts to delegate); *Rosenberg v. Son, Inc.*, 491 N.W.2d 71 (N.D. 1992) (involving delegation of the obligation to pay for a Dairy Queen and the goods included with the business); *C.I.T. Corp. v. Jonnet*, 3 U.C.C. Rep. Serv. (Callaghan) 321 (Pa. Ct. Comm. Pleas) (involving delegation of an obligation to pay for cocktail lounge equipment), *aff'd*, 214 A.2d 620 (Pa. 1965); *McKinzie v. Milford*, 597 S.W.2d 953 (Tex. Civ. App. 1980) (involving delegation of an obligation to make a horse available for two breedings per year); *Tennell v. Esteve Cotton Co.*, 546 S.W.2d 346, 352 (Tex. Civ. App. 1976) (involving delegation of an obligation to receive and pay for cotton). In *Jonnet*, the trial court cited § 2-210(1) for the proposition that delegation alone does not relieve the delegating party of its contractual obligations. *Jonnet*, 3 U.C.C. Rep. Serv. (Callaghan) at 322. In affirming the decision, however, the Pennsylvania Supreme Court did not cite § 2-210.

187. See *De La Rosa v. Tropical Sandwiches, Inc.*, 298 So. 2d 471 (Fla. Dist. Ct. App. 1974); *Field v. Golden Triangle Broadcasting, Inc.*, 305 A.2d 689 (Pa. 1973). In *De La Rosa*, there were a series of stock and asset sales involving delegations (as-

To date, only one court has discussed explicitly a defense based on nonconsensual suretyship when citing section 2-210.¹⁸⁸ After a discussion of this case, this Article will further explore the confluence of suretyship law and delegation under section 2-210 by examining selected delegation cases to expose the possibilities of applying suretyship law

B. Rosenberg v Son, Inc.—Sale of a Dairy Queen

In *Rosenberg v. Son, Inc.*,¹⁸⁹ the Rosenbergs agreed to sell Pratt a Dairy Queen located in Grand Forks, North Dakota. The sale included the franchise, inventory, and equipment for a price of \$62,000 to be paid over a period of fifteen years.¹⁹⁰ Pratt assigned her contract to Son, Inc. (Son), meaning that Son assumed her payment obligations as well as her rights. As part of the agreement, Son agreed to indemnify Pratt in the event of loss.¹⁹¹ Son subsequently assigned the Rosenberg contract to Merit Corp. (Merit), who thereby assumed the remaining debt obligation to the Rosenbergs. The Rosenbergs explicitly agreed to the assignment and delegation to Son, and they acquiesced in the assignment and delegation to Merit by accepting a substantial payment from Merit.¹⁹²

Merit quit paying the Rosenbergs, leaving a substantial unpaid balance. When Merit subsequently filed for bankruptcy, the

sumptions of debt). *De La Rosa*, 298 So. 2d at 472. *De La Rosa*, however, who was at the end of the chain, bought without assuming any debt. *Id.* After citing § 2-210, the court stated that "[e]ven the liberalized approach of the code, however, doesn't make one liable on an obligation where he merely purchased a chattel, or chattels as here, without assumption of the obligation." *Id.* at 473. In *Field*, the seller, Golden Triangle, argued that § 2-210 applied when the buyer of the assets of two radio stations intended to delegate his rights and obligations to a newly formed corporation. *Field*, 305 A.2d at 695. The court declined to apply Article 2, noting that only 4.6% of the purchase price was allocated to goods. *Id.* at 696 & n.9.

188. *Rosenberg*, 491 N.W.2d at 71. The case involved North Dakota's adoption of § 2-210. It was not mentioned in the UCC Reporting Service but clearly belongs with § 2-210 cases, as the court cited N.D. CENT. CODE § 41-02-17 (1983), which is North Dakota's adoption of § 2-210.

189. 491 N.W.2d 71.

190. *Id.* at 72.

191. This agreement included an obligation to indemnify Pratt if she were liable to the Rosenbergs following Son's default. *Id.* at 73 & n.3.

192. *Id.* at 73.

Rosenbergs sued Son and Pratt for the outstanding balance.¹⁹³ The trial court granted summary judgment for Pratt and Son.¹⁹⁴ While the trial court's reasoning as to Son is unclear,¹⁹⁵ the court justified summary judgment in Pratt's favor on the basis of nonconsensual suretyship. The court reasoned that Merit's conduct, acquiesced to by the Rosenbergs, had modified the principal obligation, thereby discharging Pratt, who had the status of an involuntary or nonconsensual surety.¹⁹⁶ The Supreme Court of North Dakota summarized the trial court's rationale as follows: "The trial court found that moving the business, the second assignment to Merit, and pledging business assets as collateral, all without Pratt's knowledge, constituted alterations in the underlying obligation. Therefore, because it determined that Pratt was a guarantor on the contract, she was exonerated by the trial court."¹⁹⁷

The trial court apparently blended the law of delegation with nonconsensual suretyship status to justify granting a discharge to Pratt on account of unauthorized downstream changes in the underlying obligation. The trial court's reasoning is remarkably similar to arguments raised in *Westinghouse Credit Corp. v. Wolfer*,¹⁹⁸ which involved two assignments and delegations in a sale of restaurant equipment. Pratt's summary discharge probably was consistent with section 128 of the Restatement of Security, assuming that there was sufficient proof of some action amounting to a modification by conduct.¹⁹⁹ Unfortunately for

193. *Id.*

194. *Id.* at 73-74.

195. It is difficult to understand the trial court's reasoning respecting Son. Although the Rosenbergs asserted direct claims against Son, the trial court believed that Son should be dismissed if Pratt were dismissed because Son's liability, if any, had to rest on indemnity alone. *Id.* at 74 n.6. By assuming payment obligations from Pratt, however, Son should have been directly liable to the Rosenbergs unless it had a suretyship defense or could prove a novation.

196. *Id.* at 74.

197. *Id.*

198. 88 Cal. Rptr. 654 (Ct. App. 1970); see *supra* part III.C.2.

199. For a discussion of § 128, see *supra* part III.B.2. Section 128 allows discharge because of modifications that do not by their very nature benefit a surety. Modifications can come about by conduct, i.e., variations to performance acquiesced in by the creditor without explicit agreement. See RESTATEMENT OF SEC. § 128 cmt. b (1941). Nothing in the appellate opinion, however, shows that the court or counsel consulted

Pratt, the North Dakota Supreme Court reversed.²⁰⁰ In the Author's view, the supreme court's opinion is significant and commendable for its recognition of nonconsensual suretyship in the context of a delegation governed by section 2-210, but the opinion is subject to criticism for its failure to apply sound and generally recognized suretyship principles.

The supreme court's analysis began with an acknowledgment that Pratt's delegation did not exonerate her, the delegating party. On this point, the court quoted North Dakota's adoption of section 2-210(1): "No delegation of performance relieves the party delegating of any duty to perform or any liability for breach."²⁰¹ The court next determined that the assignment and delegation from Pratt to Son had not resulted in a novation by express agreement.²⁰² While the Rosenbergs had expressly approved the transfer of rights and obligations, they had not agreed to a substitution of parties.²⁰³ The court next recognized Pratt's status as an involuntary surety: "An assignment will not extinguish the relationship and obligations between the two original contracting parties. However, an assignment does result in the assignor having a surety relationship, albeit involuntary, *with the assignee*"²⁰⁴

After this recognition of involuntary suretyship, the court's opinion took some twists and turns that make the opinion difficult to follow. The court declared that Pratt (seller) and Son (buyer) had a suretyship relationship, meaning that Pratt was a surety and Son a principal, but that Pratt was not a surety as to the Rosenbergs.²⁰⁵ While this matter was an open question at

the Restatement of Security.

200. *Rosenberg*, 491 N.W.2d at 78.

201. *Id.* at 74 (quoting N.D. CENT. CODE § 41-02-17(1) (1983)) (emphasis deleted). The court also cited 4 CORBIN, *supra* note 78, § 866, at 452. *Rosenberg*, 491 N.W.2d at 74. For a discussion of Professor Corbin's work, see *supra* notes 78-80 and accompanying text.

202. *Rosenberg*, 491 N.W.2d at 75.

203. "Thus, the express language of the agreement and intent of the parties at the time the assignment was made did not contemplate a novation by releasing Pratt and substituting Son, Inc., in her stead." *Id.* at 76.

204. *Id.* For its conclusion that Pratt was a surety, the court cited 72 C.J.S. *Principal and Surety* § 35 (1987), but made no citation to the Restatement of Security, *Rosenberg*, 491 N.W.2d at 76.

205. *Rosenberg*, 491 N.W.2d at 76.

the time of Brandt's second edition,²⁰⁶ subsequent treatises and the Restatement of Security had long ago adopted the judicially created proposition that nonconsensual suretyship confers privileges in regard to the creditor, not merely a right of reimbursement against a principal obligor.²⁰⁷ The court thus recognized nonconsensual suretyship status, but it immediately stripped the status of its significance in light of commonly accepted discharge rules.²⁰⁸

Nonetheless, in the next paragraph, the court reinjected rights akin to suretyship:

The inquiry as to Pratt's liability does not end at this juncture. Pursuant to guaranty law, the trial court released Pratt from any liability on the contract due to the changes or alterations which took place following her assignment to Son, Inc. While it is true that Pratt cannot be forced to answer on the contract irrespective of events occurring subsequent to her assignment, it is also true that she cannot be exonerated for every type of alteration or change that may develop.²⁰⁹

If Pratt was not a surety in relation to the Rosenbergs, the question remains why *any* events subsequent to her assignment would exonerate her. In this language, the court seems to have reinstated suretyship rights for Pratt in relation to the Rosenbergs while denying her the designation of involuntary surety in that relationship. The court went further, however, and required additional proof beyond merely establishing that a modification had occurred. Citing Professor Corbin, *C.J.S.*, and case law, the court determined that not every alteration would effect a discharge but that only an alteration (modification) *prejudicial* to the surety would result in discharge.²¹⁰ The law as

206. See *supra* note 68.

207. See *supra* notes 69-84 and accompanying text; *supra* part III.

208. Of course, § 83 of the Restatement of Security explicitly cross-references the discharge rules in §§ 122, 128, and 129. See *supra* part III.A.

209. *Rosenberg*, 491 N.W.2d at 76.

210. *Id.* at 76-77 (citing *Walker v. Rednalloh Co.*, 13 N.E.2d 394 (Mass. 1938)); *Jedco Dev. Co. v. Bertsch*, 441 N.W.2d 664 (N.D. 1989); 4 CORBIN, *supra* note 78, § 866, at 459; 6A C.J.S. *Assignments* § 97 (1975). While modifications that can only benefit a surety do not discharge a surety generally, see, e.g., RESTATEMENT OF SEC. § 128(a) (1941), and while discharge of compensated sureties requires proof of prejudice, see, e.g., *id.* § 128(b), the court's use of these authorities to establish a general

declared by the court thus was at variance with section 128 of the Restatement of Security, which allows discharge of an uncompensated surety, such as Pratt, for any modification that is not of the type that necessarily would benefit Pratt.²¹¹

In a final twist, the court declared that, if a *prejudicial* alteration had been made after Pratt's assignment, presumably with the Rosenbergs' acquiescence, then a novation by conduct might have resulted; hence, a novation argument might have discharged Pratt.²¹² The court stated:

If the changes in the obligation prejudicially affect the assignor, a new agreement has been formed between the assignee and the other original contracting party. More concisely, a novation has occurred and the assignor's original obligation has been discharged. This is consistent with our previous decisions and statutory authority. Although we have previously determined that the terms of the assignment agreement between Pratt and Son, Inc., did not contemplate a novation, there are additional methods of making a novation besides doing so in the express terms of an agreement.²¹³

The court went on to state that "[t]he question of whether or not there has been a novation is a question of fact."²¹⁴ The court, therefore, remanded the case for fact-finding on whether Pratt was discharged by novation.²¹⁵ After a hearing on remand in which the trial judge did not find a novation, Pratt settled with the Rosenbergs for several thousand dollars.²¹⁶

rule is questionable.

211. See *supra* part III.B.2.

212. See *Rosenberg*, 491 N.W.2d at 77.

213. *Id.* (citations omitted).

214. *Id.* at 78.

215. *Id.*

216. Shirley A. Dvorak, Pratt's attorney of record in *Rosenberg*, furnished the following summation of events:

This matter was initially commenced by Rosenberg against Pratt and a company known as Son, Inc., successor in interest to Pratt in the Dairy Queen. Pratt and Rosenberg both made cross motions for summary judgment. The initial motions were both denied, but on the second motion for summary judgment of dismissal by Pratt, the trial Court [sic] concurred and granted Mrs. Pratt's motion for summary judgment. That dismissal by summary judgment was appealed to the North Dakota Supreme Court

The court did not resort to the Restatement of Security. Obviously, the North Dakota Supreme Court is free to use or to disregard the Restatement or any of its rules. The failure to use section 128 is thus hardly a ground for criticism. Likewise, the court cannot fairly be faulted for requiring proof of a *prejudicial* change, rather than *any* change, as a grounds for discharge.²¹⁷ The opinion is subject to criticism, however, on two points. First, in rejecting the claim that Pratt was a surety in relation to the Rosenbergs, the decision undercuts the meaning of nonconsensual suretyship and runs contrary to prevailing law.²¹⁸ Second, the opinion is illogical insofar as it denied Pratt suretyship status in relation to the Rosenbergs but implied that a prejudicial postdelegation change in the contractual obligation would discharge Pratt, even if it fell short of a novation.²¹⁹ In short, the opinion seems to demonstrate fundamental confusion about the meaning and purpose of nonconsensual suretyship.

In the sole reported delegation case citing UCC section 2-210 in which nonconsensual suretyship and its possible benefits to the surety were recognized, the nonconsensual surety thus did not gain discharge on the facts.²²⁰ Moreover, the law in this area seems somewhat muddled, perhaps for lack of any cross-reference to the Restatement of Security and its systematic statement of the discharge rules. The fact pattern presented in *Rosenberg* and the twists and turns of that case's opinion call for a clarification of the intersection of suretyship law and delegation.

by Rosenberg. The Supreme Court reversed The matter was then tried to the same trial judge. In light of the Supreme Court's holdings, he felt he had no choice but to find in favor of [the] Rosenbergs, and against Pratt, in the sum of \$27,839.59 plus costs and disbursements. In September, 1993, Mrs. Pratt settled all claims with [the] Rosenbergs by mutual release for the sum of \$8,500.

Letter from Shirley A. Dvorak, Pratt's attorney of record in *Rosenberg*, to Gary L. Monserud, Professor of Law, New England School of Law (Feb. 13, 1996) (on file with Author) (quoted with Ms. Dvorak's permission).

217. This is the modern trend. See *infra* part V

218. See *supra* part II.C.

219. See *supra* text accompanying notes 212-13.

220. See *supra* notes 214-16 and accompanying text.

C. Selected Delegation Cases Arising Under Section 2-210

Given the dearth of case law and the fact that the North Dakota Supreme Court was not inclined to apply principles from the Restatement of Security,²²¹ one might conclude that, even though the law of delegation under section 2-210 and the rules of nonconsensual suretyship incorporated into the Restatement of Security have coexisted since the UCC's promulgation in the 1950s, the two are seldom, if ever, woven together. From the case reports, this is a reasonable inference about the development of the law. The lack of case law blending nonconsensual suretyship from the Restatement with section 2-210 does not, however, establish that suretyship issues are absent from commercial settings in which delegations of Article 2 obligations have been made. Quite possibly, in delegation cases, lawyers are not discerning suretyship defenses when the facts would allow them. Whether this is true is a matter of conjecture because no empirical study indicates whether practicing lawyers tend to bypass defenses involving this relatively obscure doctrine of commercial law.

On the assumption that suretyship defenses may, on occasion, be bypassed or poorly understood, this section will further expose the necessary commingling of rules of suretyship law from the 1941 Restatement with the rules of delegation under section 2-210. This effort requires two steps: first, the section will discuss three cases citing section 2-210; and second, with slight adjustments to the fact patterns, this section will apply the rules of suretyship from the Restatement, demonstrating that suretyship defenses often lie close at hand in representative fact patterns. The underlying assumption is that the delegating party under section 2-210 becomes a nonconsensual surety as a matter of law in the absence of a novation. This exercise is, therefore, an attempt to creatively weave two strands of law that are seldom woven together.

221. See *supra* part IV.B. In view of North Dakota statutory provisions, see *supra* text accompanying note 201, the North Dakota Supreme Court's decision not to apply principles from the Restatement of Security is quite understandable.

1. Tarter v MonArk Boat Co.²²²

Roy Tarter made a contract with MonArk Boat Co. (MonArk) for the construction and delivery of a custom-built houseboat in return for a promised purchase price of \$160,000.²²³ The contract contained an express six-month warranty on workmanship and materials.²²⁴ After the contract had been signed and construction commenced, MonArk *assigned the contract* to AlumaShip, Inc. (AlumaShip), who "assumed all responsibility thereunder," which meant that there was a delegation of duties as well as an assignment of rights.²²⁵ By agreement of the contracting parties, the contract was governed by Article 2 as adopted in Arkansas.²²⁶

Tarter learned of the assignment and delegation when a worker phoned and informed him of it.²²⁷ Tarter paid MonArk \$128,000 on the purchase price, and he later paid the remaining

222. 430 F Supp. 1290 (E.D. Mo. 1977), *aff'd*, 574 F.2d 984 (8th Cir. 1978).

223. *Id.* at 1291-92. The written contract included drawings, parts lists, and a detailed description of items to be included in the construction of the boat. *Id.* at 1291.

224. *Id.* The disclaimer failed to mention merchantability and was therefore ineffective under the state statute parallel to UCC § 2-316(1)(2) to disclaim that warranty. *Id.* at 1294.

225. *Id.* at 1291-92. The corporate machinations by which the assignment was completed are confusing. The court's findings of fact state:

On July 13, 1973, by a stock purchase agreement, MonArk sold to Star Enterprises, Limited the stock of MonArk Shipyards, Inc. and the name was changed to SteelShip, Inc. As part of this sale, Star Enterprises, Limited, acquired the stock of MonArk Custom Craft, Inc. which was renamed AlumaShip, Inc.

Pursuant to this sale, the contract with [Tarter] was assigned to AlumaShip.

Id. The opinion, however, never explains how MonArk Custom Craft, Inc., the assignor, acquired the contract that was made by MonArk Boat Co. Nevertheless, whether there was a prior assignment is irrelevant because AlumaShip, Inc. was an assignee who "assumed all responsibility" for building Tarter's houseboat. *Id.* at 1292.

226. *Id.* at 1293 (stating that, in the contract, the parties agreed that Arkansas law would control). The specially manufactured boat brought the case within Arkansas's state analog to UCC Article 2. *See* ARK. CODE ANN. §§ 4-2-102, -105(1) (Michie 1987). Section 4-2-105(1) states in relevant part: "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid. " *Id.* § 4-2-105(1).

227. *Tarter*, 430 F Supp. at 1292.

balance to AlumaShip.²²⁸ When Tarter took delivery and found the boat to be deficient in many respects, he notified both AlumaShip and MonArk of the deficiencies.²²⁹ Representatives of MonArk and AlumaShip met with Tarter to work out a solution, but the effort failed. As a result, Tarter sued MonArk for breach of warranty.²³⁰

MonArk offered as a defense that it had delegated its obligations by assigning its contract to AlumaShip; accordingly, it had absolved itself of any obligations to Tarter.²³¹ The court squelched the argument with a quotation from Arkansas's section 2-210(1): "No delegation of performance relieves the party delegating of any duty to perform or any liability for breach."²³² Of course, a novation could have relieved MonArk, but MonArk had the burden of proving a novation "so 'as to leave no room for doubt.'"²³³ The court found that MonArk failed to meet this burden.²³⁴ MonArk thus was liable to Tarter for direct damages in the form of repair costs and incidental damages.²³⁵

MonArk did not seek discharge on suretyship principles and, on the reported facts, had no bona fide argument for discharge when the novation argument failed.²³⁶ On the foregoing fact pattern, however, one can easily construct a suretyship defense with a slight adjustment of the facts and the use of principles borrowed from the Restatement of Security. Consider Restatement section 128, which pertains to modifications of a principal's

228. *Id.* Tarter paid AlumaShip through an escrow agent and under an indemnity agreement whereby AlumaShip's parent corporation agreed to indemnify Tarter for any claims by MonArk. *Id.*

229. *Id.* at 1293. Evidence showed that repairs would cost approximately \$37,000. *Id.* Tarter also "testified that the boat would have had a value of \$160,000 had it been as warranted" and that it had a value of only \$80,000 in its defective condition. *Id.* at 1294. The judge, however, did not find Tarter's testimony credible for calculating damages. *Id.* The judge chose to use the cost of repair, \$37,000, as the measure of damages for the defendant's breach of warranties. *Id.* at 1295.

230. *Id.* at 1292-93.

231. *Id.* at 1293.

232. *Id.* (quoting ARK. STAT. § 85-2-210(1)).

233. *Id.* (quoting *Alston v. Bitely*, 477 S.W.2d 446, 454 (Ark. 1972)); see *supra* note 10 (discussing and defining a novation).

234. *Tarter*, 430 F Supp. at 1294.

235. *Id.* at 1295.

236. See *id.* at 1291-95. The novation argument can arise in suretyship cases, but it is not itself a suretyship defense. See *supra* note 10.

duty²³⁷ Suppose that, after the worker phoned Tarter and advised him of the contractual assignment, which was both an assignment and a delegation, Tarter visited the AlumaShip yards to complain about dealing with strangers with whom he had not contracted. Suppose also that, in an effort to pacify him, AlumaShip's agent negotiated a modest design change enhancing the aesthetics of the houseboat without any change in contract price.²³⁸ Suppose further that, in accordance with the facts as reported, the boat was deficient; however, each deficiency derived from workmanship done by AlumaShip pursuant to the original plans. The enhancements involved no deficiencies.

What would have been the impact on MonArk if a design modification had been made without its consent and the 1941 Restatement were applied? The correct analysis turns on the arrangement of the parties in terms of suretyship obligations. When MonArk delegated its obligations to AlumaShip, it became a surety and AlumaShip became the principal obligor. When Tarter (obligee) was advised of the delegation, he was bound to respect MonArk's suretyship status regardless of whether he agreed to the delegation. Pursuant to section 128 of the 1941 Restatement, "the surety is discharged unless the modification is of a sort that can only be beneficial to the surety"²³⁹ The design changes that enhanced aesthetics were not *necessarily* beneficial to MonArk.²⁴⁰ As a result, under Restatement section 128, MonArk rightly could claim complete discharge due to the modification without its consent. Fair or not, this would be the correct result using suretyship principles drawn from the Restatement of Security. This result demonstrates that, while MonArk's lawyer was wrong in arguing that the delegation itself effected MonArk's discharge, a sound argument could have been constructed if the dealings between Tarter and AlumaShip re-

237. See *supra* part III.B.2.

238. Under § 2-209(1), a modification is binding even without fresh consideration. U.C.C. § 2-209(1) (1994). The hypothetical assumes the requisite writing. See *id.* § 2-209.

239. RESTATEMENT OF SEC. § 128(a) (1941).

240. What would necessarily have been beneficial to MonArk in this case is difficult to discern. Probably, a simplification of the plans eliminating a complexity of construction with no attendant price reduction would qualify.

sulted in modification. This is not to suggest that MonArk's lawyer erred; the argument is merely that a suretyship defense may lurk in the shadows when a delegation of performance is made, especially in a complex contract.

2. *Tennell v Esteve Cotton Co.*²⁴¹

H.S. Tennell, a Texas cotton farmer, agreed to sell to Gant Cooley Cotton Co. (Gant Cooley) his cotton production on a designated 120 acres, estimated to be 100 bales.²⁴² The contract price varied depending on the cotton's quality.²⁴³ Before the cotton was fully grown, Gant Cooley assigned the contract, thus delegating the obligation of payment, to Esteve Cotton Co. (Esteve).²⁴⁴ At harvest time, when the market price had risen to approximately double the contract price, Tennell delivered forty-nine bales to Esteve but refused to deliver the remaining cotton grown on the designated acreage.²⁴⁵ Esteve sued for damages, pleading alternatively for damages measured by the contract and cover or the contract and market price differential.²⁴⁶

Tennell defended on several theories, but Esteve won at trial.²⁴⁷ On appeal, Tennell contended that Esteve's failure to give timely notice of the contract's assignment was a repudiation of the contract that entitled Tennell to suspend performance.²⁴⁸ The Texas Court of Civil Appeals gave the argument short shrift, stating that, while section 2-210(5) allowed Tennell to treat the delegation as grounds for insecurity under section 2-

241. 546 S.W.2d 346 (Tex. Civ. App. 1976).

242. *Id.* at 349. At all times, Gant Cooley acted through its authorized agent, Clarence Young, a cotton buyer. *See id.*

243. *Id.* at 349-50.

244. *Id.* at 349.

245. *Id.* at 350.

246. *Id.* at 351; *see also* U.C.C. §§ 2-712, -713 (1994) (authorizing Esteve's claimed damages).

247. *Tennell*, 546 S.W.2d at 351.

248. *Id.* at 354 n.4.

609,²⁴⁹ the delegation was not an automatic repudiation.²⁵⁰ Furthermore, Esteve had no obligation to provide assurances of performance unless assurances were demanded in accordance with section 2-609.²⁵¹ As a matter of law, Tennell had no defense based on the fact of the delegation itself.²⁵² The court noted especially that Gant Cooley remained liable for payment despite the assignment and delegation.²⁵³ The trial court's judgment in favor of Esteve was sustained.²⁵⁴

Tennell raised no suretyship issues, and the reported fact pattern provided none.²⁵⁵ Suppose, however, that, at the time of delivery, the price of cotton had decreased by half rather than doubled, so that the price Esteve was obligated to pay under the assigned contract was double the market value of the cotton. In this context, Tennell would have been eager to deliver, and Esteve would have been reluctant to pay. Suppose Esteve and Tennell negotiated an extension of the payment date, so that payment for the less-valuable-than-expected cotton was extended over a year instead of being due on delivery, and that this payment schedule was made without approval of or reservation of rights against Gant Cooley. Market conditions could readily

249. The controlling law for the case technically was not the UCC; it was the version of the UCC adopted in Texas. *See* TEX. BUS. & COM. CODE ANN. §§ 2.210(e), .609 (Vernon 1968).

250. *Tennell*, 546 S.W.2d at 354 n.4.

251. *Id.*

252. *Id.*

253. *Id.* at 352 n.3. The court stated:

Tennell has not pointed to any circumstance in the transaction or to any evidence in the record to show that the assignment falls within one of the exceptions. He merely asks upon whom he would have demanded performance had the market price of cotton fallen below the contract price, and then he argues that, because he did not know about Esteve, his chance of return performance was materially impaired. The brief answer is that Tennell's chance of return performance could not be materially impaired by the mere addition of a party to whom he could look for performance, for, although by virtue of the assignment Esteve became obligated for the contractual performance of Gant Cooley, the latter was not thereby relieved of its contractual obligation if Esteve failed to perform.

Id.

254. *Id.* at 359. The court, however, made minor adjustments in the award. *Id.*

255. *Id.* at 349-51.

generate such a course of events.

On these suppositions, if Esteve defaulted, the question arises whether Gant Cooley would have remained liable to Tennell for the price of the cotton. The case must be considered in suretyship terms. Tennell was a creditor or obligee, Esteve became the principal obligor obliged to pay for the cotton under the contract, and Gant Cooley became the nonconsensual surety. Under section 129 of the Restatement of Security, if the principal and creditor make a binding agreement to extend the time for payment without a reservation of rights or the surety's consent, the surety is discharged *in toto*.²⁵⁶ By straightforward application of this rule, Tennell would have lost all rights against Gant Cooley by agreeing to the payment time extension. In the reported case, of course, the parties made no such extension agreement. The cotton market put the seller, not the buyer, in a distressful situation, and the seller breached by nondelivery.²⁵⁷ Nonetheless, suretyship issues lurk nearby whenever a buyer delegates a duty to pay and there is postdelegation stress in the relationship that leads to contractual adjustments.

3. McKinnie v Milford²⁵⁸

C.W. Milford sold a stallion to Norman Stewart, who agreed to allow Milford to use the horse for breeding purposes twice a year for as long as the stallion lived.²⁵⁹ Stewart complied initially but then reneged and sold the horse to McKinnie, who took title to the horse with knowledge of Milford's contractual right to use the horse for breeding purposes.²⁶⁰ By selling the stallion to McKinnie, Stewart delegated a duty, namely, the duty to make the stallion available for Milford's use. McKinnie refused to comply with that duty.²⁶¹ Milford sued Stewart and McKinnie for damages and recovered at trial based on a jury verdict.²⁶²

256. See RESTATEMENT OF SEC. § 129(1) (1941). Of course, the rule is different for a compensated surety. *Id.* § 129(2); see *supra* part III.B.3.

257. *Tennell*, 546 S.W.2d at 349.

258. 597 S.W.2d 953 (Tex. Civ. App. 1980).

259. *Id.* at 955.

260. *Id.*

261. *Id.*

262. *Id.* Stewart and McKinnie defended on the theory that their obligation to fur-

McKinnie argued on appeal, *inter alia*, that the judgment against him was erroneous because he owed no obligation to Milford, as he was a stranger to the original contract and there was insufficient evidence to prove an assumption of contractual obligations from Stewart.²⁶³ The court rejected this combination of arguments with a citation to section 2-210(4),²⁶⁴ which provides that, unless the language of an assignment or other circumstances indicate to the contrary, an assignment of "the contract" includes a delegation of duties.²⁶⁵ In the case *sub judice*, McKinnie's purchase gave him title to the horse with the attendant duty to make the horse available to Milford for breeding purposes.²⁶⁶ Undertaking the duty to make the horse available to Milford was akin to buying a good and assuming a debt obligation as part of the consideration paid.²⁶⁷ Because the record indicated McKinnie's assumption of this obligation, the judgment of the trial court was affirmed.²⁶⁸

McKinnie raised no suretyship issues, and none were apparent in the facts as reported. Suppose, however, that Stewart was already liable for damages at the time of the sale to McKinnie for failing to deliver the horse for breeding purposes under the original agreement. Suppose further that, as part of the purchase price, McKinnie promised to pay off any liability owing to Milford for Stewart's breach, an amount estimated at \$1000. Finally, suppose that, when Milford was informed of the terms of McKinnie's purchase, for old friendship's sake and because he believed McKinnie would honor his contractual obligations in the future, he decided to release McKinnie from any liability for Stewart's breaches for the modest sum of \$100, intending to sue Stewart for damages.

Would Milford still have had a claim against Stewart for any

nish the stud was suspended because Milford owed Stewart money for veterinary services and board. The jury found that Milford did not owe Stewart money and thereby laid this defense to rest. *Id.*

263. *Id.* at 956. Stewart did not appeal. *Id.* at 955.

264. *Id.* at 957 (citing TEX. BUS. & COM. CODE ANN. § 2.210(d) (Vernon 1968)).

265. TEX. BUS. & COM. CODE ANN. § 2.210(d) (Vernon 1968).

266. *McKinnie*, 597 S.W.2d at 956.

267. *Id.* at 958.

268. *Id.*

of the damages incurred due to Stewart's breach before the sale? On these assumed facts, the 1941 Restatement is not helpful to Milford. Under the hypothetical, in suretyship terms, Stewart became a surety and McKinnie became the principal obligor as to liability for Stewart's breach. The obligee or creditor to whom the obligation was owed was Milford. When Milford struck the deal with McKinnie for the \$100 cash payment, thereby releasing McKinnie from his assumed obligation, under the rule contained in section 122 of the Restatement of Security, Stewart also was released because Milford neither reserved rights nor procured Stewart's consent to the release. The privileges of nonconsensual suretyship would, therefore, drive a court toward exonerating Stewart because of Milford's miscalculated, though good faith, release of McKinnie.

D. Summary

While it seems as if principles of nonconsensual suretyship and the rules of delegation under section 2-210 of the UCC have been combined in only one reported case,²⁶⁹ in which, it should be noted, the court did not use the Restatement of Security, the practical importance of discerning the intersection of delegation and nonconsensual suretyship is readily apparent. As previously illustrated through use of adjusted fact patterns from the reported delegation cases, release of the delegate, an extension of time for payment, or any other alteration of the delegate's duties can lead to immediate discharge of the delegating party, who occupies the position of nonconsensual surety. To be sure, the frequency of postdelegation dealings between the delegate and the obligee (creditor) remains a matter of speculation in the absence of field studies.²⁷⁰ Nonetheless, given the hundreds of billions of dollars involved in exchanges of goods in any given year, the absence of postdelegation marketplace conduct sufficient to trigger suretyship defenses seems very unlikely

269. *Rosenberg v. Son, Inc.*, 491 N.W.2d 71 (N.D. 1992).

270. Undertaking a study on a scale sufficient to generate reliable data might be impractical or even impossible.

V CHANGES IN SURETYSHIP LAW UNDER THE RESTATEMENT OF SURETYSHIP

Thus far, this Article has discussed delegation cases, which are reported under UCC section 2-210, and has borrowed suretyship principles from the Restatement of Security to demonstrate how suretyship law and ordinary delegations can intersect. In this section, the Article will examine the changes made in suretyship law in the new Restatement of Suretyship approved by the American Law Institute in 1995.²⁷¹

Generally, nonconsensual sureties are less privileged under the Restatement of Suretyship than under the Restatement of Security. This result is not because nonconsensual sureties are singled out for bad treatment. It is simply a consequence of changes made in the rules for discharge that apply to all sureties, nonconsensual sureties included. This part of the Article will first discuss the recognition of nonconsensual suretyship in the new Restatement. This discussion will be followed by an overview of suretyship defenses. This Article will next discuss three new discharge rules: those dealing with release of a principal, those dealing with time extensions, and those dealing with modifications other than time extensions. Hence, this discussion parallels the discussion of discharge rules under the 1941 Restatement of Security contained in Part III of this Article.

In discussing the Restatement of Suretyship, this Article will use a slight shift in terminology from that used in the Restatement of Security. The Restatement of Suretyship avoids using the term "surety" and generally substitutes the term "secondary obligor."²⁷² Accordingly, the term "secondary obligor" will be used instead of "surety," and the term "creditor" will be replaced by "obligee," in an effort to make the discussion consistent with the language of the new Restatement.²⁷³

271. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. (1995).

272. *Id.* § 1 cmt. d.

273. *Id.*

A. Recognition of Nonconsensual Suretyship Under the Restatement (Third) of Suretyship

What this Article has called nonconsensual suretyship is recognized in section 2, paragraph e, of the new Restatement, which provides that suretyship status is attained "by contract between an obligor and another person pursuant to which, without a novation, the other person assumes a duty of the obligor to the obligee, with the result that the other person becomes the principal obligor and the original obligor becomes the secondary obligor."²⁷⁴

Clearly, paragraph e of section 2, quoted above, recognizes the status of nonconsensual suretyship. The reporter's note following section 2 cites section 83 of the Restatement of Security as its source.²⁷⁵ The comment to paragraph e confirms an interpretation that recognizes nonconsensual suretyship as a special type of relationship covered by the Restatement.²⁷⁶

Illustration 3 following the comment sets forth the traditional scenario:

S owns Blackacre, an item of real estate worth approximately \$500,000, subject to a mortgage debt of \$300,000. S transfers Blackacre to P in exchange for \$200,000 and P's assumption of the mortgage debt. By the assumption of the mortgage debt, P is the principal obligor and S is the secondary obligor.²⁷⁷

This illustration is in perfect harmony with *Union Mutual Life Insurance Co. v. Hanford*.²⁷⁸ Moreover, the reporter's note,

274. *Id.* § 2(e).

275. *Id.* § 2 reporter's note.

276. The comment states:

When another person assumes a contractual duty of an obligor, both that person and the original obligor are liable to the obligee. As between the person that assumed the obligation and the original obligor, the person that assumed the obligation has a duty to perform. Therefore, as a result of the assumption contract, the third person becomes a principal obligor and the original obligor becomes a secondary obligor with suretyship status.

Id. § 2 cmt. e.

277. *Id.* § 2 illus. 3.

278. 143 U.S. 187 (1892); see *supra* part II.A (discussing *Hanford*).

in its sources for the comment to paragraph e, cites, inter alia, *Twombly v. Wulf*.²⁷⁹ *Twombly* arose from the sale of a business in which a taxi cab was sold subject to a security interest.²⁸⁰ By implication, therefore, section 2(e) recognizes that nonconsensual suretyship can arise in sales of goods, as well as in sales of real estate.²⁸¹ This recognition of the status of nonconsensual suretyship in sales of both goods and real estate must now be matched with the substantive rules in sections 39, 40, and 41 and the procedural rules of section 49 to ascertain the legal impact of nonconsensual suretyship under the new Restatement. First, however, an examination of the jurisprudential viewpoint underlying the discharge rules is warranted.

B. An Introduction to Suretyship Defenses Under the New Restatement

1. A Change in the Underlying Jurisprudential Viewpoint

As discussed in Parts II and III, under the common law and the Restatement of Security, the doctrine of *strictissimi juris* played a major role in protecting uncompensated secondary obligors against dealings between the principal obligors and obligees to which secondary obligors did not consent. The new Restatement contains a fundamental shift in jurisprudential viewpoint in the section entitled "Suretyship Defenses."²⁸² Although the secondary obligor is furnished with an impressive defensive arsenal, *strictissimi juris* no longer provides the iron-clad defenses afforded at common law or in the old Restatement.

The introductory note preceding section 37 explains the reasons for the changes in suretyship defenses wrought by the new Restatement.²⁸³ The changes are based upon the fact that a

279. 482 P.2d 166 (Or. 1971); see *supra* part III.C.1 (discussing *Twombly*).

280. *Twombly*, 482 P.2d at 167.

281. This fact can also reasonably be inferred from illustration 2, which states: "S Corporation sells all of its assets to P, who pays \$1,000,000 and agrees to assume all of S Corporation's liabilities. With respect to each liability of S Corporation, P is the principal obligor and S Corporation is the secondary obligor." RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 2 illus. 2. Of course, the assets sold by S to P could be goods, real estate, intangibles, or any combination thereof.

282. See *id.* §§ 37-49.

283. *Id.* tit. B, introductory note.

secondary obligor undertakes two distinct economic risks: (1) the risk that the principal obligor will not perform and (2) the risk that the secondary obligor will be unable to pass its cost of performance to the principal obligor.²⁸⁴ These risks can be increased by acts of the obligee. The Restatement therefore adopts the general principle that, in the absence of the secondary obligor's agreement to the contrary, Title B, which includes the suretyship defenses, "discharges a secondary obligor to the extent that such [obligee's] acts would otherwise cause the secondary obligor to suffer a loss."²⁸⁵ The words "to the extent" are key. The rules for discharge generally allow discharge *pro tanto*, meaning to the extent that an obligee's act actually causes economic detriment to a secondary obligor. Nonetheless, some obligee acts can so fundamentally alter the secondary obligor's risks that total discharge is justified.

The Restatement explains the different grounds for complete discharge.²⁸⁶ Specifically, section 37(2) sets forth two grounds for complete discharge:

(2) If the obligee fundamentally alters the risks imposed on the secondary obligor by:

(a) releasing the principal obligor from a duty other than the payment of money (§ 39(c)(iii)); or

(b) agreeing to a modification of the duties of the principal obligor that either amounts to a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed on the secondary obligor prior to modification (§ 41(b)(i));

the secondary obligor is discharged from any unperformed portion of the secondary obligation as more fully set forth in those sections.²⁸⁷

In plain language, the new Restatement thus isolates two situations for special treatment. In the first situation, an obligee in the underlying contract is entitled to a performance other

284. *Id.*

285. *Id.*

286. *Id.* § 37(2)-(3).

287. *Id.* § 37(2)(a)-(b).

than the payment of money.²⁸⁸ For example, an obligee (buyer) may have contracted to purchase commodities, and the secondary obligor may have undertaken the risk that the principal obligor (seller) would not deliver. In this case, the obligee's release of the seller would foist upon the secondary obligor the duty to perform a nonmonetary obligation, which would be difficult to quantify, at least in advance of the release.²⁸⁹ Moreover, the obligee's release of the principal obligor in this situation is not a risk for which a secondary obligor normally bargains.²⁹⁰ As a result, there is complete discharge.

The second situation, considered in section 37(2)(b), is similar. When an obligee and principal obligor fundamentally change the nature of the underlying contract or substitute a new contract, the secondary obligor is discharged.²⁹¹ For example, if the underlying contract provided that the principal obligor should deliver wheat and, by modification, the principal obligor's duty was changed to require the delivery of soybeans, the risk of nonperformance of the substituted obligation clearly was not a risk for which the secondary obligor bargained. Complete discharge therefore follows.

Section 37(3)(a)-(c) sets forth three grounds for *pro tanto* discharge:

(3) If the obligee impairs the secondary obligor's recourse against the principal obligor by

(a) releasing the principal obligor from a duty to pay money (§ 39(c)(ii));

(b) granting the principal obligor an extension of time for performance of its duties pursuant to the underlying obligation (§ 40(b)); [or]

(c) agreeing to a modification of the duties of the principal obligor, other than a release or an extension of time, that does not amount to a substituted contract or impose risks on the secondary obligor fundamentally different from those imposed on the secondary obligor prior to modification (§ 41(b)(ii))

288. *Id.* § 37(2)(a).

289. *See id.* § 39 cmt. g.

290. *See id.* § 37 cmt. a.

291. *Id.* § 37(2)(b).

the secondary obligor is discharged from its duties pursuant to the secondary obligation *to the extent set forth in these sections*²⁹²

According to this language, a release from an obligation to pay money, an extension of time in which to perform any obligation, or a less-than-fundamental modification of the underlying obligation leads to discharge by degrees. The Restatement thus takes a bifurcated approach:²⁹³ major modifications substantially changing a secondary obligor's risks result in complete discharge, but lesser modifications are treated simply as a breach of the obligee's duty toward the secondary obligor, resulting in discharge to the extent of the harm, if any, caused by the obligee's act.²⁹⁴ Sections 39 through 49 fine tune the application of these principles.²⁹⁵

The results in situations in which an obligee acts to the detriment of a secondary obligor turn on the nature of the obligee's

292. *Id.* § 37(3)(a)-(c). The remainder of § 37(3) covers other reasons for which discharge might occur, *see id.* § 37(3)(d)-(f), all of which are beyond the scope of this Article.

293. As the comments to § 37 state:

This Restatement adopts a bifurcated approach to impairments of the secondary obligor's suretyship status. When the impairment fundamentally alters the risks imposed on the secondary obligor, the resulting situation is no longer that for which the secondary obligor bargained. Accordingly, the secondary obligor is discharged from its obligation. When the consequences of the impairment are only a potential increase in cost of performance not capable of being shifted to the principal obligor, though, the obligee's act is treated as a breach of a duty not to impair that recourse, and this Restatement adopts the view espoused in U.C.C. § 1-106 that an aggrieved party's remedy should put that party in as good a position, but not a better one, as would have been the case if the other party had not impaired the aggrieved party's rights.

Id. § 37 cmt. a.

294. *Id.*

295. *See id.* §§ 39-49. The comments to § 37 further state:

Accordingly, in those cases, this section and §§ 39-44 provide rules discharging the secondary obligor from liability on the secondary obligation to the extent that the impairment of recourse would otherwise prejudice the secondary obligor, and providing for recovery from the obligee if the loss has already occurred because the secondary obligation has been performed.

Id. § 37 cmt. a.

act²⁹⁶ rather than on the classification of the secondary obligor as compensated or uncompensated, which was the case under the Restatement of Security.²⁹⁷ The allocation of the burden of persuasion when suretyship defenses are raised turns, however, upon the purpose for which the secondary obligor became obligated, which is discussed in section 49.²⁹⁸ Moreover, the secondary obligor may waive its suretyship defenses,²⁹⁹ and, under certain circumstances, an obligee may effect a preservation of the secondary obligor's recourse against the principal obligor, thereby preventing or diminishing by degrees the extent of the secondary obligor's discharge.³⁰⁰

In sum, the jurisprudential viewpoint espoused in section 37 and its comments is a viewpoint rooted in a hard, practical analysis of risks assumed by secondary obligors. It is a viewpoint that tries to pull the law into harmony with realistic economic expectations in concrete situations. The distinctions made in the sections stating the defenses are based upon assessments of the extent to which an obligee's act increases a secondary obligor's risk of loss. An obligee's acts that generally lead to substantial loss have harsh consequences; obligees' acts giving rise to slightly increased risks or lesser losses have lesser consequences. The rules are designed to avoid granting secondary obligors windfalls resulting from minor alterations in the underlying contract, which was often the case under the rule of *strictissimi juris*, in which the relief given to the secondary obligors "often exceeded any harm caused by the obligee's acts."³⁰¹

296. See *id.* § 37 cmt. a.

297. See *id.*

298. See *infra* part V.B.3.

299. As the introductory note to Title B states:

Generally speaking, in the absence of the secondary obligor's agreement to the contrary, this Title discharges a secondary obligor to the extent that such acts would otherwise cause the secondary obligor to suffer a loss. It should be noted however, that agreement to the contrary, especially in form of consent to such an act or waiver of discharge resulting from such act, is common in many contexts.

RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. tit. B, introductory note.

300. See *id.* § 38; *infra* part V.B.2.

301. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 37 cmt. a. The comment states in full:

As time passed, courts became unsatisfied with a rigid application of this

2. *Preservation of the Secondary Obligor's Recourse*

The new Restatement discards the traditional reservation-of-rights doctrine.³⁰² A leaner and more modern approach has taken its place, stating:

(1) When an obligee releases the principal from, or agrees to extend the time for performance of, a duty to pay money pursuant to the underlying obligation, the release or extension effects a "preservation of the secondary obligor's recourse" with respect to that duty if the express terms of the release or extension provide that:

(a) the obligee retains the right to seek performance of the secondary obligation by the secondary obligor; and

(b) the rights of the secondary obligor to recourse against the principal obligor (§§ 21-31) continue as though the release or extension had not been granted.

(2) When the obligee effects a preservation of the secondary obligor's recourse in conjunction with a release or extension, the principal obligor's duties of performance and reimbursement and the secondary obligor's rights of restitution and subrogation continue as though the release or extension did not occur.³⁰³

Notably, this preservation-of-recourse doctrine does not pertain to modifications other than time extensions; moreover, it pertains *only* to releases and time extensions when the principal obligor's promise is to pay money. This section forces upon the obligee an obligation to be forthright because the extension or

doctrine, often referred to as *strictissimi juris*. The problem was that rigid application of the doctrine resulted in secondary obligors being discharged from substantial secondary obligations because of minor, immaterial changes in the relationship between the principal obligor and the obligee. Consequently, application of the doctrine often resulted in windfalls for these secondary obligors in that the relief provided by the doctrine often exceeded any harm caused by the obligee's acts.

Id.

302. See *id.* § 38 cmt. a (stating that "this Restatement adopts the modern view that the traditional reservation of rights doctrine has outlived whatever usefulness it may have had. Therefore, the rules in this Restatement do not allow the obligee to prevent the discharge of the secondary obligor merely by reserving rights against the secondary obligor.").

303. *Id.* § 38.

release must explicitly state two things: (1) that the obligee is retaining rights against the secondary obligor and (2) that the secondary obligor's rights against the principal obligor will continue as if the release or extension had not been granted. The unsophisticated principal obligor thus will not be surprised after a release or extension by a claim for reimbursement from the secondary obligor.³⁰⁴

Illustration 1 following section 38 shows the operation of this section in the case of a release.³⁰⁵ According to the illustration, the principal obligor owes \$1000 to the obligee. The obligee finds that the principal obligor is facing bankruptcy and therefore collects \$100 in return for a release of the principal obligor. This release is made with an express preservation of rights in accord with section 38. Consequently, the obligee can pursue the secondary obligor for \$900.³⁰⁶ The preservation-of-rights mechanism has allowed release of the principal obligor without release of the secondary obligor. The secondary obligor has suffered "no loss flowing from unavailability of claims against [the principal obligor] because those claims continue as though the release had not been granted."³⁰⁷ Notice to the secondary obligor is not required.³⁰⁸

Section 38, however, must be blended with section 37(3), which provides for *pro tanto* discharge caused by an obligee's acts. Even with a preservation of the secondary obligor's rights against the principal obligor, the principal obligor's release quite possibly will induce conduct detrimental to the secondary obligor. Release of a debt might induce a principal obligor to work less, earn less, or otherwise dispose of assets. Such a result would prejudice the secondary obligor to the extent that the likelihood of reimbursement was reduced. Notice to the secondary obligor therefore is the recommended practice when a release or time extension is granted because the secondary obligor

304. See *id.* § 38 cmt. a ("Thus, the preservation of recourse prevents loss to the secondary obligor that would otherwise result from obviation of the principal obligor's duty to the secondary obligor without causing the principal obligor unfair surprise.").

305. *Id.* § 38 illus. 1.

306. *Id.*

307. *Id.*

308. *Id.* § 38 cmt. b.

will then have the knowledge and incentive to insist upon responsible behavior by the principal obligor.³⁰⁹ Notice is important because, while preservation of rights under section 38 operates to prevent discharge of both an obligee's claim against a secondary obligor and the secondary obligor's claim against the principal obligor solely on account of a release or extension, the secondary obligor may nonetheless raise as a defense the extension or discharge *to the extent it has caused actual loss*.³¹⁰ Notice from the obligee to the secondary obligor of an extension or release and an accompanying preservation of rights may extinguish or diminish any causal connection between a secondary obligor's loss and obligee's act.

Nothing in section 38 or its comments states explicitly that the preservation-of-rights doctrine pertains to situations involving nonconsensual suretyship. Logically, however, because the nonconsensual surety is a special kind of secondary obligor who gains important privileges by operation of law, a nonconsensual surety should be subject to the normal limitations on its privileges. The text provides no good reason nor is there any policy reason to cast away the reservation-of-rights doctrine in connection with nonconsensual suretyship. Because nonconsensual suretyship is not often recognized when delegations are made under Article 2 contracts, however, frequent use of this mechanism in these situations is very unlikely

3. Burden of Persuasion with Respect to Impairment of Recourse

Clearly, many cases are won or lost depending upon the allocation of burdens that litigants must carry at trial. Section 49

309. The comments to § 38 state:

If the secondary obligor first learns of an extension or release (and the accompanying preservation of recourse) a significant time later, the passage of time may rob the secondary obligor's recourse of any practical value if the principal obligor's ability to perform has degenerated during that time. If, on the other hand, the obligee informs the secondary obligor promptly of the extension or release and the preservation of recourse, the obligee can prevent this type of loss.

Id.

310. *See id.* § 38 illus. 2.

sets forth rules that allocate the burden of persuasion and discusses the attendant risk of nonpersuasion with respect to defenses arising from an obligee's impairment, or alleged impairment, of a secondary obligor's rights of recourse.³¹¹ The section provides a discrete rule with respect to the burden of persuading a fact finder that the act causing impairment occurred³¹² and a discrete set of rules about the burden of proving the amount of loss flowing from the impairment.³¹³

First, under section 49(1), the secondary obligor has "the burden of persuasion with respect to occurrence of the act constituting the impairment."³¹⁴ The secondary obligor must persuade the fact finder that the obligee performed the act causing impairment, which is always the rule no matter which type of impairment is alleged.³¹⁵ Second, the allocation of the burden of persuasion as to the extent of the harm caused by the obligee's act is dependent upon two factors: (1) the nature of the secondary obligor and (2) the nature of the act causing impairment.³¹⁶

The rules for allocating the burden of persuasion on the issue of loss or prejudice are contained in section 49(2):

(2) Except as provided in subsection (3), the burden of persuasion with respect to loss or prejudice caused by an obligee's act impairing the secondary obligor's recourse against the principal obligor is allocated as follows:

(a) the burden of persuasion is on the secondary obligor if:

(i) the secondary obligor is in the business of entering into secondary obligations, received a business benefit for entering into the secondary obligation, or otherwise was induced to enter into the secondary obligation by separate consideration that directly benefits the secondary obligor; or

(ii) the act impairing recourse is a modification of the

311. *Id.* § 49.

312. *Id.* § 49(1).

313. *Id.* § 49(2)-(3).

314. *Id.* § 49(1).

315. *Id.* § 49 cmt. a ("The burden of persuasion as to the occurrence of the act impairing suretyship status is always on the secondary obligor.").

316. *Id.* ("If the act is an impairment of the secondary obligor's recourse, allocation of the burden of persuasion as to the harm resulting from that act depends on the nature of the secondary obligor and of the act.").

underlying obligation, unless the secondary obligor establishes that the modification is material³¹⁷

One must inquire as to where a nonconsensual surety fits into this scheme for allocating burdens. Neither the comments nor the illustrations specifically address the link between section 49(2) and nonconsensual sureties. A nonconsensual surety who attains that status through a delegation of duties under an Article 2 contract, however, will nearly always have received a business benefit in connection with the delegation. A buyer delegating the obligation to pay for goods often will receive a benefit from the delegate, namely, a commission for arranging the sale.

Another example is a franchisee who delegates a duty to take and pay for goods in connection with the sale of a franchise. The franchisee will receive consideration for the sale of rights under the franchise, usually coupled with the sale of other assets. A reading of cases reported under UCC section 2-210 does not disclose delegations that occur other than from apparent business benefits, although the benefit sometimes is merely shedding an obligation no longer wanted in a particular business context.³¹⁸ Nonconsensual sureties who attain that status under section 2-210 thus logically should generally bear the burden of persuasion pursuant to section 49(2)(a)(i).³¹⁹ Of course, under section 49(2)(a)(ii), all secondary obligors bear the burden of persuasion as to loss due to a minor, less-than-material modification unlikely to cause any loss in the normal course, an allocation which seems eminently fair.³²⁰

317. *Id.* § 49(2)(a).

318. For a discussion of the delegation cases, see *supra* part IV

319. This assertion does not imply that any other interpretation is illogical. Because nonconsensual sureties are not specifically covered in § 49, a court might find applicable rules elsewhere in the law or fashion rules pertaining particularly to nonconsensual sureties.

320. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 49(2)(a)(ii).

When the discharging event is a modification of the underlying obligation that is not material, and, therefore, quite unlikely to cause loss, it would be unfair to put the obligee in the position of proving a negative—i.e., the lack of loss. Accordingly, in all cases, the burden of persuasion as to loss caused by a modification to the secondary obligation that is not material is on the secondary obligor.

Id. § 49 cmt. c.

Finally, section 49(3) contains what can be justly described as an equitable rule designed for cases that are too complex to be determined under the rules contained in subsection 2.³²¹ Suppose a secondary obligor persuades the fact finder that the obligee committed an act causing impairment of the right of recourse and further proves monetary loss flowing from the obligee's act but, due to inherent complexities of the case, cannot quantify any loss. Lest the harm attributable to the obligee's act go unremedied because of proof problems, subsection 3 creates a presumption that the impairment is equal to the secondary obligor's liability and shifts the burden of persuasion as to any lesser amount to the obligee.³²² Subsection 3 thus allows judicial discretion in determining whether "the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable."³²³ A nonconsensual surety should have the benefit of this subsection, as would any other secondary obligor in appropriately ambiguous fact situations.

C. Nonconsensual Suretyship and the Restatement (Third) of Suretyship's Rules for Discharge of the Secondary Obligor

1. Section 39: Release

Section 39 of the Restatement (Third) of Suretyship has replaced section 122 of the 1941 Restatement of Security.³²⁴ Section 39 is more complex than was section 122 of the old Restatement. For the purposes of this Article, it is sufficient to extract

321. The rule states:

(3) Notwithstanding subsection (2)(a), if:

(a) the secondary obligor demonstrates prejudice caused by the impairment of recourse and

(b) the circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable,

it is presumed that the act impairing recourse caused a loss or impairment equal to the secondary obligor's liability pursuant to the secondary obligation, and the burden of persuasion as to any lesser amount of such loss is on the obligee.

Id. § 49(3).

322. *See id.* § 49 cmt. d.

323. *Id.* § 49(3)(b).

324. *See id.* § 39 reporter's note.

two main principles from paragraphs b and c of section 39, which state:

To the extent that the obligee releases the principal obligor from its duties pursuant to the underlying obligation:

(b) the secondary obligor is discharged from any unperformed duties pursuant to the secondary obligation unless:

(i) the terms of the release effect a preservation of the secondary obligor's recourse (§ 38); or

(ii) the language or circumstances of the release otherwise show the obligee's intent to retain its claim against the secondary obligor;

(c) if the secondary obligor is not discharged from its unperformed duties pursuant to the secondary obligation by operation of paragraph (b), the secondary obligor is discharged from those duties to the extent:

(i) of the value of the consideration for the release;

(ii) that the release of a duty to pay money pursuant to the underlying obligation would otherwise cause the secondary obligor a loss; and

(iii) that the release discharges a duty of the principal obligor other than the payment of money ³²⁵

An important principle to grasp from paragraph b is that a secondary obligor is not discharged automatically by a creditor's release of a principal obligor, even in the absence of an express preservation of rights, if the *language or circumstances* of the release show the obligee's intent to retain a claim against the secondary obligor.³²⁶ An obligee, therefore, quite possibly may release a principal obligor and yet retain a claim or part of a claim against a secondary obligor without an explicit preservation of rights.³²⁷ A second fundamental principle underlies subsection c of section 39, namely, that a secondary obligor against whom an obligee retains rights while releasing a principal may nonetheless have a claim for *partial discharge* measured according to the standards established in subsections (c)(i) through

325. *Id.* § 39.

326. *See id.*

327. "Preservation of rights" has been substituted for the term "reservation of rights." *See id.* § 38.

(c)(iii). A third principle, embedded in subsection (c)(iii), discharges a secondary obligor to the extent that an obligee discharges the principal obligor from any obligation other than payment of money

Illustrations 5 and 6 following section 39 are helpful in explaining paragraphs b and c. Illustration 5 states:

D buys a computer system from C on credit for \$10,000. G guarantees D's obligation to pay the remainder of the purchase price. Later, when the unpaid balance is \$7,000, D stops paying, claiming that the system is not merchantable as warranted. C denies D's allegation. After negotiation, C and D agree that D will pay \$5,000 of the unpaid balance of \$7,000 and that C and D will release each other from further liability with respect to the transaction. The release of D discharges G from its duties pursuant to the guaranty³²⁸

Manifest in this illustration is a compromise when the rights of the parties were unclear. Under UCC Article 2, D would have an array of remedial rights if C breached a warranty³²⁹ In contrast, if C could prove that D was wrong and that no warranty had been breached, C would have a claim for the full price of the accepted goods.³³⁰ The negotiated \$5000 settlement on C's \$7000 claim has the appearance of an accord and satisfaction; hence, leaving a claim over against G would run contrary to common sense. C's release of D releases G because neither the language of the release nor the circumstances indicate otherwise, nor was there an express preservation of rights.

By a slight spin of the facts, illustration 6 makes a good residual claim against G:

D buys a computer system from C on credit for \$10,000. G guarantees D's obligation to pay the remainder of the purchase price. Later, when the unpaid balance is \$7,000, D, who is insolvent, stops paying. Investigation reveals that D's only asset is \$5,000 in cash that D had realized by selling the computer system. Realizing that any judgment against D

328. *Id.* § 39 illus. 5.

329. For the catalog of a buyer's remedies, see U.C.C. § 2-711 (1994). For the buyer's right of set-off in the event of breach, see *id.* § 2-717.

330. See *id.* § 2-709.

would be difficult to collect, C agrees to release D from the obligation to pay the remainder of the purchase price in exchange for the \$5,000. The circumstances indicate that C intended to retain its claim against G. G is not discharged pursuant to paragraph (b), but is discharged to the extent provided in paragraph (c).³³¹

The fact that *D* stopped payment because of insolvency rather than due to any complaint about the computer system is important. As a matter of business judgment, therefore, *C* took \$5000 and released *D* from any further obligation. This situation does not have the appearance of an accord and satisfaction. From the "situation sense,"³³² we know that *C* did not intend to discharge *G* by the compromise with *D*, especially because a fundamental purpose of having a guarantor is to guard against the principal's insolvency. Nevertheless, the payment of \$5000 should *diminish* *G*'s obligation, lest *C* be overcompensated. Accordingly, under paragraph (c)(i), *G*'s obligation is reduced: "the secondary obligor is discharged to the extent: (i) of the value of the consideration for the release."³³³ *G* is consequently discharged to the extent of \$5000 and is liable only for the deficiency. If the consideration for the release had been \$1000, *G* would have been discharged to that extent and would have remained

331. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 39 illus. 6.

332. "Situation sense" refers to Karl Llewellyn's jurisprudential realism. See KARL N. LLEWELLYN, *THE COMMON LAW TRADITION* 59-61, 121-57, 206-08 (1960). Llewellyn best indicated the meaning of the term when he stated:

Situation-Sense will serve well enough to indicate the type-facts in their context and at the same time in their pressure for a satisfying working result, coupled with whatever the judge or court brings and adds to the evidence, in the way of knowledge and experience and values to see with, and to judge with.

Id. at 60.

Thus, for Llewellyn, "situation sense" was a judicial virtue combining an ability (1) to see that the facts of a case belong to a type and (2) to discern the practical result toward which the fact-type tends to push. For example, in the illustration quoted in the text, the fact-type is that of an insolvent principal from whom the creditor needs to extract whatever settlement he can manage. This fact-type should push the discerning judge to recognize that complete release is inappropriate because it would undercut the creditor's legitimate expectation of satisfaction from the guarantor. See also WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* 216-27 (1973) (discussing at length the term "situation sense" as used by Llewellyn).

333. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 39(c)(i).

liable for the \$6000 deficiency³³⁴

If, however, *C* agreed to release a solvent *D* from any further obligation to pay the \$7000 in order to settle an unrelated dispute, this release would have discharged *G* totally³³⁵ This result makes perfect sense; there is no reason why a claim against a secondary obligor should survive when a solvent principal obligor cuts a deal on an unrelated matter and gains a release. Section 39 of the Restatement of Suretyship thus contains vestiges of *strictissimi juris*,³³⁶ but this old doctrine, so antagonistic to obligees, has been tamed; *G*'s release and the extent thereof are governed more by the parties' reasonable expectations surrounding the institution of suretyship than by an unyielding formalism under which any release resulted in total discharge of a secondary obligor in the absence of consent or a reservation of rights. In a sense, section 39³³⁷ strikes a hard blow against dichotomous reasoning: instead of asking simply whether a secondary obligor is liable, a court often must determine the secondary obligor's liability on a spectrum between zero and one hundred percent.³³⁸ The answer will require fact-finding, with particular attention to the burden of persuasion as allocated in section 49.³³⁹

For example, harking back to the case of *McKinnie v. Milford*³⁴⁰ and its spin-off, discussed in Part IV, recall that the obligee (Milford) released the buyer-principal obligor (McKinnie) from liability for an assumed monetary obligation arising from his seller's breach of contract. Under section 122 of the Restatement of Security, the obligee thereby unwittingly released the

334. This result assumes that *G* would not have been able to recover anything more than the settlement amount under its right of recourse. *See id.* § 39 illus. 7. For the burden of proof on the amount of the loss, *see id.* § 39 cmt. f; *see also id.* § 49 (discussing the burden of persuasion).

335. *Id.* § 39 illus. 9.

336. *See supra* notes 39-41 and accompanying text (discussing *strictissimi juris*).

337. The discussion of § 39 includes the sections that follow it.

338. *See* Curtis Nyquist, *A Spectrum Theory of Negotiability*, 78 MARQ. L. REV. 897, 903-09 (1995). As Professor Nyquist has demonstrated, transferees inside and outside of the Code take rights by degrees; similarly, under the Restatement of Suretyship, delegators can be exculpated gradually based on postdelegation conduct.

339. *See, e.g., id.* at 907 (detailing how to allocate and determine the burden of persuasion using a spectrum theory of negotiation). In addition, *see supra* part V.B.3.

340. 597 S.W.2d 953 (Tex. Civ. App. 1980).

seller-secondary obligor (Stewart). If section 39 of the Restatement of Suretyship applied instead, the release *probably* would be considered partial because the circumstances tend to show Milford's *intent* to keep his claim against the original obligor. Under section 39(c)(i), however, Stewart, as secondary obligor, could claim a partial discharge to the extent of the consideration McKinnie paid for his release. Stewart would remain liable beyond that sum unless he could prove a loss as a result of the release, as allowed by section 39(c)(ii).³⁴¹ It should be noted that, if Milford released McKinnie from an obligation other than the payment of money, Stewart, as a secondary obligor, would be completely released as to that obligation under section 39(c)(iii).

2. Section 40: Time Extensions

As with section 39 of the Restatement of Suretyship, there are many complexities in section 40 that are beyond the scope of this Article. The main points are found in paragraphs a and b, which, in combination with the introductory language, read as follows:

If the obligee grants the principal obligor an extension of the time for performance of its duties pursuant to the underlying obligation:

(a) the extension also extends the time for performance of any corresponding duties of performance and reimbursement owed by the principal obligor to the secondary obligor, unless the extension effects a preservation of the secondary obligor's recourse (§ 38);

(b) to the extent that the secondary obligor has not performed its duties pursuant to the secondary obligation, it is discharged from those duties to the extent that the extension would otherwise cause the secondary obligor a loss ³⁴²

341. Assigning the burden of persuasion to Stewart (secondary obligor) under Restatement of Suretyship § 49(2)(a)(i) assumes that a nonconsensual surety can be considered a "professional" who has attained the status of secondary obligor in a business transaction. Section 49, however, probably was not written specifically with nonconsensual sureties in mind. A court might, therefore, place the burden of persuasion on the obligee, who would be required to prove loss less than the amount of the total obligation to negate discharge. *See supra* part V.B.3.

342. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 40(a)-(b) (1995).

As under section 39, *partial discharge* plays a major role in the correct application of section 40 to suretyship problems. Illustrations 5 and 6 are helpful. Illustration 5 states:

D borrows \$10,000 from C, payable on July 12. S agrees with C that, if D does not repay the loan on its due date, S will repay the loan. On July 11, C grants D, who is solvent, an extension of the due date of the loan to October 31. On July 12, S, who is unaware of the extension, repays the loan and seeks reimbursement from D. Because the extension also extends the corresponding time for D's duties of performance and reimbursement, however, S is unable to proceed against D until October 31, at which time D is insolvent. As a result, only \$3,000 is recovered from D. S would have been discharged to the extent of the \$7,000 loss. Because S repaid the loan without knowledge of the extension, S has a claim against C for the amount of that loss.³⁴³

The justification for the secondary obligor's claim against the obligee is that the unconsented-to delay hurt the secondary obligor by diminishing his reimbursement from the principal obligor from \$10,000 to \$3000. If the value of recourse had been diminished to zero, S's just claim would have been for \$10,000 because the extension harmed him to that extent. Likewise, if S had delayed payment knowing of C's extension to D, and D had become insolvent during the delay so that S's right of recourse had no value, S would have been discharged *in toto*.³⁴⁴ It follows that, if the right of recourse yielded \$5000 after a six-month extension and would have been worth the full \$10,000 before the extension, the discharge would be in the amount of \$5000. The extent of discharge due to an unconsented-to extension of time equals the economic harm to the surety resulting from the time extension.³⁴⁵

The reporter's note to section 40 states that this section fol-

343. *Id.* § 40 illus. 5 (citing § 37(4)).

344. *Id.* § 40 illus. 6.

345. The comments to § 40 state: "If the extension granted to the principal obligor would cause a secondary obligor that performed the secondary obligation a loss with respect to its ability to obtain recovery through reimbursement, restitution, or subrogation, the secondary obligor is discharged to the extent of that loss." *Id.* § 40 cmt. f.

lows UCC section 3-605(c) and replaces Restatement of Security section 129. One should note, however, that the language of section 40, paragraph a, pertains to extensions of time for the performance of *any obligation* secured by a secondary obligor, while section 129 and UCC section 3-605(c) by their terms pertain only to time extensions of monetary payment schedules.³⁴⁶ Moreover, pursuant to section 49 of the Restatement of Suretyship, unless the surety becomes such for a business purpose or for consideration or is in the business of entering into secondary obligations, a presumption arises that his loss or impairment equals his liability and the burden of negating the loss or proving its lesser amount will be on the obligee.³⁴⁷

Consider again *Tennell v. Esteve*³⁴⁸ and its spin-off, discussed in Part IV. While the time extension for payment, without the consent of the surety or a reservation of rights by the creditor, discharged Gant Cooley as secondary obligor (delegating party) under section 129 of the old Restatement of Security, under section 40 of the Restatement of Suretyship, any discharge of the secondary obligor would have to correspond to his economic loss. If the burden of persuasion were allocated to Gant Cooley (secondary obligor) because he had attained his suretyship status in a business transaction pursuant to section 49(2)(a)(i), he would need to prove that the loss incurred due to the time extension. If the burden of persuasion were allocated to the obligee under section 49(2)(b), a presumption of a loss equal to the secondary obligor's remaining debt burden would arise. In that case, to rebut the presumption, Tennell (obligee) would be required to show the nonexistence or lesser amount of harm caused by the extension. Either way, there would be fact-finding rather than automatic discharge following proof of the time extension.³⁴⁹

346. Compare *id.* § 40(a) (applying equally to any secured obligation) with RESTATEMENT OF SEC. § 129 (1941) (applying only to extensions of time for payment) and U.C.C. § 3-605(c) (1994) (same).

347. See RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 49(2)(b).

348. 546 S.W.2d 346 (Tex. Civ. App. 1976).

349. In the Author's view, Gant Cooley, as secondary obligor, should have the burden of persuasion because he gained the privileges of suretyship in a business transaction.

3. Section 41. Modifications (*Apart from Time Extensions*)

The reporter's note indicates that section 41 is based on UCC section 3-605(d) and is intended to replace section 128 of the Restatement of Security³⁵⁰ Generally, partial discharge equal to the prejudice suffered underlies section 41. For purposes of this Article, the main points are in paragraphs a and b, which, in combination with the introductory language, state:

If the principal obligor and the obligee agree to a modification, other than an extension of time or a complete or partial release, of the principal obligor's duties pursuant to the underlying obligation:

(a) any duty of the principal obligor to the secondary obligor of performance or reimbursement is correspondingly modified;

(b) the secondary obligor is discharged from any unperformed duties pursuant to the secondary obligation:

(i) if the modification creates a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed pursuant to the transaction prior to modification;

(ii) in other cases, to the extent that the modification would otherwise cause the secondary obligor a loss³⁵¹

Illustration 2 following section 41 demonstrates how partial discharge can occur:

B agrees to construct a building for O in accordance with specifications contained in the contract. S issues a performance bond to O with respect to this contract. Later, O and B agree to a modification of the contract pursuant to which a different, more complicated climate control system is to be installed in the building without additional compensation to B. Later, B, who is insolvent, defaults on the contract, and S is called upon to complete construction. S is discharged to the extent that the modified climate control system adds to the costs of S not recoverable from B by S.³⁵²

350. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 41 reporter's note.

351. *Id.* § 41(a)-(b).

352. *Id.* § 41 illus. 2.

According to illustration 2, the extra cost, to the extent not recoverable under the surety's right of recourse, is the measure of the discharge. The surety otherwise remains liable to the owner (obligee). The possibility of complete discharge is displayed in illustration 4: if *B* and *O* changed the contract from construction of an office building for \$1.5 million to a factory for \$2 million, the change would be "so fundamental as to amount to a substituted contract."³⁵³ The secondary obligor therefore would be discharged completely. Anything short of a *fundamental change*, however, yields only a discharge *pro tanto*. Questions about the burden of persuasion arising under section 49, discussed previously with respect to section 40, can arise here also.³⁵⁴ Of course, there can be no preservation of rights under section 41.³⁵⁵

Most important, for the purpose of this Article, is the sweeping change from *strictissimi juris* as it was incorporated into section 128 of the 1941 Restatement.³⁵⁶ Under the old regime, except for compensated sureties,³⁵⁷ any unconsented-to change other than a time extension for payment resulted in complete discharge of the uncompensated surety. The reservation-of-rights device did not apply to modifications other than time extensions. Under section 41 of the Restatement of Suretyship, anything short of a substituted contract or its functional equivalent yields only discharge proportionate to the harm caused by the change.³⁵⁸ Economic estimates of actual harm thus replace the rigid rules of the 1941 Restatement.

Revisiting *Tarter v. MonArk Boat Co.*,³⁵⁹ discussed with its spin-off in Part IV to illustrate principles of suretyship, the design change, which did not necessarily benefit the surety, result-

353. *Id.* § 41 illus. 4.

354. *See id.* § 49(2)(a)-(b) cmts. b-c. Whether a nonconsensual surety can be classified as a "professional" under § 49(2)(a)(i) is questionable, but the Author believes that, in most fact situations, the answer will be affirmative.

355. *Id.* § 41 cmt. c.

356. *See* RESTATEMENT OF SEC. § 128 (1941).

357. The compensation a surety charges for executing surety contracts is called the "premium." *See supra* note 99.

358. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 41.

359. 430 F Supp. 1290 (E.D. Mo. 1977), *aff'd*, 574 F.2d 984 (8th Cir. 1978).

ed in a complete discharge under section 128 of the Restatement of Security. If section 41 applied, it is difficult to discern how any loss could be claimed on account of the change in design. The design change was not so fundamental as to create a substituted contract. The change also did not cause a loss cognizable under section 41(b)(ii) because the change did not generate any discernible increase in the difference between the cost to perform the secondary obligation and the amount recoverable by the secondary obligor (MonArk) under its recourse rights. Therefore, the change wrought by the Restatement in section 41 would, on these facts, be radical—a change from total discharge to no discharge in the case of a minimal design change not agreed to by the secondary obligor.³⁶⁰

D. Summary

With respect to three special suretyship defenses, namely, (1) release of a principal obligor, (2) time extensions, and (3) other modifications, this Article has reviewed the changes in the law from the 1941 Restatement of Security to the Restatement of Suretyship. The focal point of the inquiry has been the way in which these defenses can be used by nonconsensual sureties in sales-of-goods cases. By considering typical commercial situations, the Article has demonstrated that the Restatement of Suretyship has changed the law significantly. The law has changed from the days of *strictissimi juris*, in which a surety was discharged automatically and completely by the creditor's release of the principal or by a time extension not agreed upon by the surety (assuming no reservation of rights) or by any other modification of a sort that would not necessarily benefit the surety. The new Restatement allows far less frequent and often only partial discharge. Additionally, its rules are more in accordance with the reasonable expectations of the parties. The em-

360. Some of the old decisions implementing the rules contained in § 128, or its common-law antecedents, seemed mindless. Professor Cohen noted this when he stated, in the reporter's note following § 41: "The traditional rule was often applied in a mechanical, almost mindless way, often resulting in discharge of the secondary obligor even when the modification could only result in a benefit to the secondary obligor." RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 41 reporter's note.

phasis has shifted from rigid rules to the economic realities of concrete situations. A surety under the new regime is treated less tenderly than he would have been under the old regime. Further, the less tender treatment pertains to nonconsensual sureties as well as sureties who intentionally assume the burdens and benefits of suretyship status. In jurisprudential jargon, the new Restatement may be regarded as a delayed victory of realism over formalism in American legal thinking.

VI. THREE HYPOTHETICALS: COMPARING RESULTS UNDER THE RESTATEMENT OF SECURITY AND THE RESTATEMENT OF SURETYSHIP

Having investigated some basic changes the new Restatement of Suretyship³⁶¹ has made in suretyship law, this Article will now examine how these new standards require a different style of lawyering and judicial decisionmaking than was required under the Restatement of Security. Often, the two different regimes reach opposite results. Even when the results are the same, however, the pathway to the results is different. In seeking to demonstrate the truth of these claims, this Article will use three hypothetical situations, each of which could arise easily under a delegation governed by section 2-210 of the UCC.

A. *Situation 1. The Carnival Ride*

Assume that manufacturer A made a contract to construct and deliver to its customer, Fun City, within one year of the contract date, an exotic carnival ride for an agreed price of \$1 million, to be paid in installments before the delivery date.³⁶² The proposed ride, designed by Fun City, was an imaginary rocket launch. Before fabrication commenced, manufacturer A's officers, for business reasons, decided to assign the Fun City contract, including all benefits and burdens, to manufacturer B.³⁶³ Manufacturer B agreed to perform the obligations under the contract

361. The Author wants to emphasize that §§ 37-49 are enriched with notes, comments, and illustrations that contain many nuances not covered in this Article.

362. This situation would be covered by Article 2, even though the goods are specially manufactured. See U.C.C. §§ 2-102, -105(1) (1994).

363. The "assignment" therefore included a delegation of duties. *Id.* § 2-210(4).

in return for direct payment by Fun City of the stipulated price of \$1 million—delivery and payment to proceed according to the original contract schedule. A notified Fun City of its agreement with *B*. Fun City neither protested nor agreed to release *A*, hence, there was no novation.

Soon after *B* had started construction, Fun City's agents proposed a design change: a modification to enhance the thrill by increasing the speed preceding the launch. As a trade-off, the rider capacity was to be reduced slightly. *B*'s engineers discerned neither technical problems nor greater expense, therefore, the modification was agreed to without extra charge.³⁶⁴ Work proceeded as planned, and nobody mentioned the design change to *A*. Fun City sent periodic payments to *B*. As the work neared fifty percent completion, *B* suffered unexpected financial problems, became insolvent, and ceased production. As a result of these setbacks, *B* failed to deliver. Because the failure to deliver coincided with the commencement of Fun City's main carnival season, it lost substantial revenues until it effectively covered with a substitute purchase from manufacturer *C* for \$1.5 million. Although notified of the default, *A* had made no efforts to cure it. Regrettably, by the time the cover was made in perfect good faith, the main season was over.

Fun City sued *A* and *B* for direct, incidental, and consequential damages amounting to \$2 million. *Quaere*: (1) Is *A* liable for *B*'s default?; (2) If the design change is discovered, does *A* have a solid defense on the facts presented? Consider these questions in light of suretyship principles.³⁶⁵ Under section 128 of the Restatement of Security, the answer is predictable and reasonably certain. Any modification agreed to by the principal and the creditor (obligee) without the surety's consent means the surety (other than a compensated surety) "is discharged unless the modification is of a sort that can only be beneficial to the surety."³⁶⁶ Nothing in a design change by its nature makes the change beneficial to the surety. Under section 128, therefore,

364. This situation is allowed under *id.* § 2-209(1).

365. The proper designation of the parties in suretyship terms is simple. *B* was the principal obligor, *A*, by its delegation, became a surety or secondary obligor, and Fun City was the creditor or obligee.

366. RESTATEMENT OF SEC. § 128(a) (1941).

discharge should follow proof of the modification without further fact-finding as to its economic impact. Section 128 easily could lead to disposition by summary judgment.

Under section 41 of the Restatement of Suretyship, however, furnishing a legal opinion about A's liability or making a decision on the question becomes a more complex endeavor. Under section 41(b)(i), the secondary obligor (surety) is discharged *in toto* "if the modification creates a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed pursuant to the transaction prior to modification."³⁶⁷ On the stated facts, was the modification such as to create a substituted contract? Did the change impose on the secondary obligor (surety) a fundamentally different risk? The answer to both questions is "no." Nevertheless, because the design change was more than aesthetic, a judge *might* discern a factual issue respecting the impact of the change on production scheduling and costs, as these factors would be relevant to whether the change brought about a fundamentally different risk. Under section 41, summary judgment for a surety thus is less likely than under section 128, except in cases of the most minimal changes.

If there were no discharge under section 41(b)(i), subsection (b)(ii) allows discharge "to the extent that the modification would otherwise cause the secondary obligor a loss."³⁶⁸ If proof of increased engineering difficulty and increased costs to the principal manufacturer (B) attributable to the modification could be mustered, it could tend to show a reduction in B's assets available for reimbursement to A. As a result, A would have an argument for *partial* discharge.³⁶⁹ Moreover, in this situation, the burden of persuasion depends on whether the modification is material.³⁷⁰ The *burden of persuasion* as to amount of loss is on

367. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 41(b)(i) (1995).

368. *Id.* § 41(b)(ii).

369. The reporter's note following § 41 is illuminating: "This Restatement applies the same rule to all secondary obligors, whether compensated or not, adopting the more modern policy generally followed by the Uniform Commercial Code of discharging the secondary obligor only to the extent it would otherwise suffer loss as a result of the modification." *Id.* § 41 reporter's note.

370. *See id.* § 49(2)(a)(ii).

the secondary obligor unless it proves that the modification was material.³⁷¹ Therefore, there might be a factual issue to be decided in order to allocate the burden of proof properly. Section 41 can be expected, therefore, to drive parties toward compromise and settlement.

B. Situation 2: Two Farmers

Suppose farmer Olson owned 320 acres of land upon which he intended to plant corn. In preparation for the season, he ordered fertilizer to be applied at the time of planting and again during the growing season. The seller agreed to sell Olson the fertilizer on credit. The total debt of \$32,000 was to be paid by year's end, which was about two months after harvest time. Before planting, Olson suffered a mild heart attack; therefore, he leased the 320 acres to farmer Flannery, who paid a fair consideration, including an assumption of the fertilizer order and the obligation to pay for it. Olson notified the fertilizer supplier that Flannery had taken over the farming operation as well as the fertilizer debt. The supplier took note but neither agreed to release Olson nor complained about Flannery assuming the obligation.

That year, a severe drought lowered the corn yield. Flannery requested a time extension for payment on the fertilizer debt. Without Olson's knowledge or consent, the supplier agreed to a year's extension at prevailing interest rates without an express reservation of rights. Subsequently, due to falling corn prices and excessive debt, Flannery was unable to repay the \$32,000 debt for fertilizer. *Quaere*: (1) Is Olson liable?; (2) If Olson uncovers the terms of the time extension, is this a solid defense?³⁷² Under section 129(1) of the Restatement of Security,³⁷³ the binding agreement to extend the principal obligor's time for payment constitutes grounds for *complete discharge* of Olson in his capacity as nonconsensual surety. Establishing the

371. *Id.*

372. In suretyship terms, Flannery became a principal obligor, Olson became a surety or secondary obligor, and the fertilizer supplier became a creditor or obligee.

373. "[W]here the principal and creditor, without the surety's consent, make a binding agreement to extend the time of payment by the principal, the surety is discharged unless the creditor in the extension agreement reserves his rights against the surety." RESTATEMENT OF SEC. § 129(1) (1941).

fact of the binding extension agreement is sufficient for discharge without inquiry into whether harm was caused by the extension.³⁷⁴

Under section 40(b) of the Restatement of Suretyship, any discharge on account of the time extension would only be "to the extent that the extension would otherwise cause the secondary obligor a loss."³⁷⁵ Proving loss could be very difficult for the secondary obligor, Olson. In light of this difficulty, the burden of persuasion could be shifted under section 49(3). If the facts showed that farmer Flannery's financial situation was as bad at the time of the original due date as it proved to be later, then the supplier-obligee would have negated any claim of loss resulting from the extension. The obligee, however, might fall short of proving an equally bad financial situation on both due dates; rather, the evidence might show a steady deterioration of Flannery's financial situation, as suggested in the hypothetical. Unless the facts are clear, a triable issue will arise, precluding summary judgment. In the foregoing situation, complete discharge will be much less likely than if the 1941 Restatement were used as a source of authority. It was Olson, however, who ordered the fertilizer from which he derived a benefit in the form of rental payments either in crops or cash. Section 40 seems fair.

C. Situation 3: Two Fishermen

Suppose Fran, a commercial fisherman, entered into a contract by the terms of which she agreed to sell her catfish catch to a restaurant for one season. Fran usually sold approximately one hundred pounds of catfish per day, and the restaurant sold about that much during good times. The supply contract proved mutually beneficial and was continued year to year. One year, in mid-season, Fran's old friend, Anna, arrived unexpectedly and asked her to go sailing. She promptly agreed, assigning her contract for supplying catfish to Sammy, who thereby assumed the obligation to supply his daily catfish catch to the

374. Olson would not be a compensated surety under the Restatement of Security. See *id.* § 129(2).

375. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 40(b).

restaurant in return for payment of the price at which Fran had been compensated.³⁷⁶

Sammy was inexperienced, had poor equipment, and had even poorer judgment. Consequently, his catch was smaller than Fran's had been and his income less. After thirty days, Sammy became discouraged and quit fishing, leaving the restaurant without a steady catfish supply. The impact on the restaurant was devastating. Catfish from other suppliers cost double the price the restaurant had been paying Fran and Sammy, and it could not acquire enough to meet demand. The restaurant's reputation suffered, customers drifted off, and, consequently, income diminished significantly—all for want of its culinary mainstay, fried catfish.

Upon Fran's return, the restaurant's owner sought a settlement with Fran. Fran, however, refused to bargain because she felt no obligation in relation to Sammy's poor performance. The restaurant owner, therefore, sued both Fran and Sammy, seeking to recoup losses estimated at \$25,000. Being a man of very modest means and little experience in business matters, Sammy was frightened by the suit and offered \$1000 for an immediate release. Realizing that Sammy had few resources and no roots in the community, plaintiff took the \$1000 and gave Sammy a complete written release, intending to continue the litigation against Fran, who was in better financial condition and apparently more attached to the community. On learning of the release, Fran filed a motion to dismiss. *Quaere*: (1) Is Fran liable for Sammy's failure to supply the catfish?; (2) Does Fran have a good defense on account of Sammy's release?³⁷⁷

If section 122 of the Restatement of Security applied, Fran would be discharged because she neither agreed to remain liable nor did the creditor reserve rights against her.³⁷⁸ Under section

376. See *supra* part IV (discussing delegation as part of an assignment of a contract); see also U.C.C. § 2-210(4) (1994) (stating that assignment of the "contract" includes both an assignment of rights and a delegation of duties).

377. In suretyship terms, Sammy became the principal obligor, Fran became a nonconsensual surety or secondary obligor, and the restaurant owner became a creditor or obligee.

378. Section 122 states: "Where the creditor releases a principal, the surety is discharged, unless (a) the surety consents to remain liable notwithstanding the release,

39 of the Restatement of Suretyship, Fran's release is also likely, but the correct analysis involves some subtleties. First, under section 39(b)(ii), the "circumstances of the release show the obligee's intent to retain its claim against the secondary obligor."³⁷⁹ Hence, pursuant to section 39(b), release *in toto* should not occur. Second, under section 39(c)(i), Fran would be released to the extent of \$1000, i.e., "the value of the consideration for the release."³⁸⁰ Whether Fran would be released to a greater extent under section 39(c)(ii) is questionable.³⁸¹ Under section 39(c)(iii), however, Fran's case for complete discharge is very strong. This is true because Fran's release of Sammy will most likely be deemed a release that discharges a duty of the principal obligor (Sammy) other than the payment of money, namely, the obligation to supply fish. The results *could* be affected by the allocation of the burden of persuasion under section 49(2) and (3), but Fran's discharge is likely if her attorney carefully unravels section 39 and uses it in her favor.

D. Summary

The foregoing hypotheticals illustrate the significance of the new Restatement of Suretyship in situations involving contract modification, time extension for payment, and release. Under the Restatement of Security, the principle of *strictissimi juris* usually resulted in discharge of the nonconsensual surety (secondary obligor) without any proof of harm.³⁸² *Strictissimi juris*

or (b) the creditor in the release reserves his rights against the surety." RESTATEMENT OF SEC. § 122.

379. RESTATEMENT (THIRD) OF SURETYSHIP & GUAR. § 39(b)(ii).

380. *Id.* § 39(c)(i).

381. Subsection 39(c) states:

[I]f the secondary obligor is not discharged from its unperformed duties pursuant to the secondary obligation by operation of paragraph (b), the secondary obligor is discharged from those duties to the extent:

(ii) that the release of a duty to pay money pursuant to the underlying obligation would otherwise cause the secondary obligor a loss; and

(iii) that the release discharges a duty of the principal obligor other than the payment of money;

Id. § 39(c)(ii)-(iii).

382. Obviously, there would be discharge for a voluntary surety under the same sections, with exceptions for compensated sureties. *See, e.g.*, RESTATEMENT OF SEC.

was applied with a total indifference to the economic realities involved. Under the Restatement of Suretyship, the existence or absence of economic harm is critical. *Strictissimi juris* has lost its power. In this Author's view, sections 37 through 49 of the Restatement of Suretyship drive toward results that better agree with the reasonable expectations of persons engaged in commerce than did the Restatement of Security.

This new doctrinal system *might* be slightly more complex to administer. The more sophisticated approach of the Restatement of Suretyship sometimes will require more factual inquiry than did its predecessor, making cases more difficult to dispose of by pre-trial motions. This *could* increase litigation and its attendant costs. If, however, the commercial players act rationally, the balance of risks and obligations built into the new Restatement should be a factor that induces reasonable settlements. If settlements cannot be effected, the results of litigation also should be reflective of this balance, which is built into the new Restatement. The new Restatement should be welcomed, not resisted, though it may be challenging to use at first, as is the case with the operation of any complex and innovative machinery.

VII. THE INCREASING IMPORTANCE OF BLENDING ARTICLE 2 DELEGATIONS AND PRIVILEGES OF NONCONSENSUAL SURETYSHIP LAW

A. *The Imperialistic Tendency of Article 2*

In millions of common Article 2 transactions, neither delegation nor nonconsensual suretyship will play any role. In consumer purchases, making a sale subject to a buyer's assumption of a seller's outstanding liabilities to an upstream seller is virtually unheard of. Common experience suggests that few commercial buyers will buy goods assuming their sellers' payment obligations to upstream sellers.³⁸³ Moreover, delegations of obligations necessarily occur when obligations are executory, and there

§ 129(2).

383. The Author knows of no empirical study respecting incidents of debt assumptions in Article 2 transactions.

are no executory obligations³⁸⁴ in simple exchanges of title to goods for a price.³⁸⁵

Article 2 has an imperialistic tendency, however, as it tends to conquer areas not recognized as being within its realm when the Code was promulgated in the 1950s. Distribution agreements, which, by their inherent nature, are relational rather than transactional contracts, are one such area being subjected to the Code's dominion.³⁸⁶ On occasion, distribution contracts are assigned and the duties thereunder are delegated, triggering the application of section 2-210. A textbook example is *Sally Beauty Co. v. Nexxus Products Co.*,³⁸⁷ in which the majority of the Seventh Circuit held that the delegation of duties in a hair care products distribution contract was unlawful under section 2-210. Suretyship principles were not imported, but the case illustrates an expansive trend of Article 2 jurisprudence that will lead toward greater applicability of suretyship law.

Best Barber & Beauty Supply Co. (Best) was engaged in the business of distributing hair care products to barber shops, beauty salons, and retail stores in Texas.³⁸⁸ Nexxus Products Co. (Nexxus), a supplier of hair care products, negotiated an agreement whereby Best became Nexxus's exclusive distributor

384. The one possible exception may be seller's warranties under U.C.C. §§ 2-312 to -315 (1994).

385. See *id.* § 2-106(1) (defining "sale" as "the passing of title from the seller to the buyer for a price").

386. For examples of recent cases in which courts have either applied Article 2 to adjudicate rights in distribution contracts or have found, by application of Article 2, that there was no enforceable distribution contract, see *Ralph's Distrib. Co. v. AMF, Inc.*, 667 F.2d 670 (8th Cir. 1981) (applying the UCC to a snowmobile distributorship); *Spiering v. Fairmont Foods Co.*, 424 F.2d 337 (7th Cir. 1970) (holding a milk distribution contract unenforceable under § 2-201); *Pharo Distrib. Co. v. Stahl*, 782 S.W.2d 635 (Ky. Ct. App. 1989) (applying the UCC to a beer distribution contract); *Leibel v. Raynor Mfg. Co.*, 571 S.W.2d 640 (Ky. Ct. App. 1978) (applying the UCC to a garage door distribution contract); *United Beer Distrib. Co. v. Hiram Walker*, 557 N.Y.S.2d 336 (App. Div. 1990) (holding a beer distribution agreement unenforceable under § 2-201); *Computer Strategies, Inc. v. Commodore Business Machs., Inc.*, 483 N.Y.S.2d 716 (App. Div. 1984) (applying the UCC to a microcomputer distributorship); *Quality Performance Lines v. Yoho Automotive, Inc.*, 609 P.2d 1340 (Utah 1980) (applying the UCC to a brake shoe distribution agreement).

387. 801 F.2d 1001, 1005-06 (7th Cir. 1986) (citing many recent distribution cases in which the courts found Article 2 applicable).

388. *Id.* at 1002.

in most of Texas.³⁸⁹ Sally Beauty Co. (Sally Beauty) purchased Best,³⁹⁰ making Sally Beauty a distributor for Nexxus. Sally Beauty assumed Best's obligations under its distribution agreement with Nexxus.³⁹¹ Differently stated, Best delegated its obligations under the distribution agreement to Sally Beauty. After finding out about the delegation, Nexxus terminated the distributorship because Sally Beauty was a corporation wholly owned by Alberto-Culver Co., a major Nexxus competitor.³⁹²

Sally Beauty sued, claiming breach by wrongful termination.³⁹³ Using the test from UCC section 2-210(1), that "[a] party may perform his duty through a delegate unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract,"³⁹⁴ the court upheld a summary judgment for Nexxus, who had terminated the contract.³⁹⁵ The majority concluded that Nexxus had "a substantial interest in not seeing this contract performed by Sally Beauty."³⁹⁶ The dissent from Judge Posner was stinging.³⁹⁷ Without going further into the merits, it is sufficient to note that none of the judges doubted the applicability of Article 2. Moreover, had the delegation been allowed, Best (assuming its corporate continuity) would have been a nonconsensual surety for Sally Beauty's performance in the absence of a novation.

Sally Beauty Co. illustrates the modern context in which section 2-210 likely will be invoked, namely, in the transfer of obligations under a distribution contract. In this context, issues of nonconsensual suretyship usually are latent. With ever-increas-

389. *Id.* at 1002-03.

390. *Id.* at 1001. The opinion does not state explicitly whether Best was acquired through a stock purchase or a purchase of assets. *Id.*

391. *Id.* at 1003.

392. *Id.*

393. *Id.*

394. *Id.* at 1006 (quoting TEX. BUS. & COM. CODE ANN. § 2-210(a) (Vernon 1968)).

395. *Id.* at 1008.

396. *Id.*

397. "My brethren have decided, with no better foundation than judicial intuition about what businessmen consider reasonable, that the Uniform Commercial Code gives a supplier an absolute right to cancel an exclusive-dealing contract if the dealer is acquired, directly or indirectly, by a competitor of the supplier." *Id.* (Posner, J., dissenting).

ing trade freedom, no reason remains for believing that distribution contracts and assignments with attendant delegations will diminish in frequency or economic importance. Consequently, the knitting together of the law of delegation under section 2-210 and principles of nonconsensual suretyship from the new Restatement of Suretyship will be more important than ever before, as businesses reshuffle, taking on or shedding distribution contracts.³⁹⁸ Furthermore, the tendency of recent drafts under discussion for the revision of Article 2 has been toward expanded coverage rather than toward any constriction of scope.³⁹⁹

B. Delegations Under Article 2: A Case for Inclusion of Suretyship Principles

According to comment 1 to section 2-210: "Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods."⁴⁰⁰ In the recent drafts of the proposals for a revised Article 2, delegation remains a normal and permissible incident of a contract, although rules on delegation may be

398. Naturally, selling assets to a buyer who assumes seller's liabilities as part of the price triggers suretyship principles, regardless of whether a distribution contract is involved.

399. The March 1, 1996 draft states in relevant part:

(a) Unless the context otherwise requires, this [Article] applies to any:

(1) transaction, regardless of form, that creates a contract for the sale of goods, including a contract in which a sale of goods predominates;

(2) claim that goods supplied under a contract in which the sale of goods does not predominate fail to conform to the terms of the contract; and

(3) term in a contract for sale or a collateral contract obligating the seller to install, customize, service, repair, or replace the goods sold at or after the time of delivery.

(b) If a transaction involves information and goods that are not copies of the information or documentation pertaining to the information this [Article] applies to the aspects of the transaction that involve the goods and their performance and rights in the goods, but [Article] 2B applies to the aspects of the transaction involving the information and copies or documentation of the information.

U.C.C. § 2-103(a)-(b) (Tentative Draft Mar. 1, 1996).

400. U.C.C. § 2-210 cmt. 1 (1994).

moved into a new section 2-211 and assignment may be moved elsewhere.⁴⁰¹

According to the proposed section 2-211.

A party may delegate to another its performance under a contract for sale unless the other party to the contract has a substantial interest in having the original promisor perform or directly control the performance required by the contract or the contract prohibits delegation. A delegation of performance does not relieve the delegating party of any duty to perform or liability for breach.⁴⁰²

While giving delegation its own section in revised Article 2 does not necessarily signal an elevation in importance, it is clear that a liberal policy toward delegation will continue as the Code is revised. Assuming an increasing frequency of delegations in complex Article 2 transactions, the absence of any Code reference to the privileges of nonconsensual suretyship attained by the delegating party is unfortunate. Whether it is the seller or the buyer who delegates, the imposition of the privileges of suretyship can be very important, as the foregoing pages have sought to demonstrate. The privileges of nonconsensual suretyship can be decisive in litigation, and they can therefore have substantial economic consequences for the creditors (original nondelegating party), the sureties (delegating parties), and the principal obligors (delegates).

In some ways, the Restatement of Suretyship represents a significant reduction of the privileges of nonconsensual sureties.⁴⁰³ This development makes sense for policy reasons. Substantively, the new Restatement melds well with Article 2. Discharge by surprise is less likely to occur than under the 1941 Restatement. Moreover, the technical quality of the new Restatement of Suretyship is very high.⁴⁰⁴ It should be cited more frequently than was its predecessor. Lawyers should be aware not

401. Under the March 1, 1996, draft, assignment will be treated in a new § 2-403. U.C.C. § 2-403 (Tentative Draft Mar. 1, 1996).

402. *Id.* § 2-211.

403. The Restatement of Suretyship affects other noncompensated sureties as well.

404. The bench and bar undoubtedly owe a debt to the Reporter, Professor Neil Cohen, for the speed with which the Restatement was prepared and for the quality of the completed text.

only of the intersection of delegation and suretyship law but also of the changes wrought by the new Restatement. There seems to be no justification for hiding the Restatement from lawyers working with Article 2.

Consequently, at minimum, a cross-reference to suretyship principles in the comments to a new section 2-211 would be most helpful. Such a reference would not unduly pollute the Code. Counsel would be alerted to the potential blending of section 2-210 and suretyship principles on account of nonconsensual suretyship status. Even more helpful would be a slight statutory alteration at the end of the new section 2-211. Where the proposed statute states that a delegation of performance "does not relieve the delegating party of any duty to perform or liability for breach,"⁴⁰⁵ it could go on to state: "but the delegating party may have the privileges of nonconsensual suretyship." The comments could then make appropriate references to section (2)(e) of the Restatement of Suretyship and the related standards for discharge. This change would go far to blend the law of suretyship and delegation.

VIII. CONCLUSION

Professor D. Benjamin Beard stated with respect to sureties created by operation of law:

[A]lthough the obligee obtains additional security for the performance of the principal obligation, its rights in dealing with the principal obligor may be circumscribed in order for it to retain its full rights against the secondary obligor. Because failure to recognize those transactions that implicate suretyship principles may result in an obligee's losing the security for the principal obligation represented by a secondary obligor, it is critical for an obligee and its counsel to be able to recognize such transactions.⁴⁰⁶

This Article is largely an elaboration of Professor Beard's insights. It has gone somewhat farther into delegation cases under Article 2 than did Professor Beard's article, in an attempt

405. *Id.*

406. Beard, *supra* note 43, at 1158-59.

to give special attention to the application of suretyship principles to delegations under section 2-210 of the Code. Additionally, it has contained an emphasis on history to demonstrate the significance of the transition from the 1941 Restatement of Security to the new Restatement of Suretyship. With the promulgation and adoption of the new Restatement and the imminent revision of Article 2, the blending of delegation under Article 2 with the law of nonconsensual suretyship merits greater recognition. Either the text of the revised Article 2 or its comments should recognize explicitly the privileges of nonconsensual suretyship.