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Julian Caplan
University of Michigan Law School

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PRINCIPAL AND SURETY — DUTY OF OBLIGEE TO DISCLOSE TO SURETY — SURETY'S RIGHT OF SUBROGATION — Surety defended an action on the bond of the town treasurer on the ground that at the time the bond was entered

into the treasurer, in violation of statute,[1] had deposited in a local bank an amount exceeding thirty per cent of the total deposits of the bank and that the town selectmen, although well aware of the situation, failed to disclose the facts to the surety. Plaintiff contended that there was no duty to disclose these facts to the surety, especially since the treasurer's annual report showed that the amount of the deposits exceeded the legal limit. As an additional defence the surety alleged that the town had impaired one surety's inchoate subrogation rights by allowing a preferential claim against the defunct bank to lapse in merely asserting the rights of a general creditor.[2] Plaintiff answered that there was no allegation that there were sufficient funds in the bank to pay off even the non-bonded part of the town's claim and hence the surety was not prejudiced. *Held*, in sustaining plaintiff's demurrer (one judge dissenting), that under the facts of the case there was no duty to disclose the excessive deposits to the surety, and that no right of subrogation was shown to be lost to the surety by any action of the town. *Town of Hamden v. American Surety Co.*, (C. C. A. 2d, 1937) 93 F. (2d) 482.

Inasmuch as the court really disposes of the question of impairment of the right of subrogation on the ground that there is no showing that there were sufficient funds in the bank to pay even the non-bonded portion of the town's claim, the discussion in the report whether the surety should be relieved of liability because of loss of subrogation is rendered largely unnecessary.[3] This note will, therefore, be confined to a discussion of the duty of disclosure. In general it may be said that the relationship between surety and creditor is a highly confidential one, although the degree of confidence is not as great as that

[1] Conn. Gen. Stat. (1930), § 512.

[2] The preferred claim would arise from the fact that the bank accepted the excessive deposits and therefore held them as a trustee ex maleficio.

[3] In general the surety's right of subrogation is subject to the important qualification that the creditor must have been paid the entire debt due him by the principal debtor before the right arises in the surety. SHELDON, SUBROGATION, 2d ed., § 127 (1893); 4 WILLISTON, CONTRACTS, rev. ed., § 1269 (1936); United States v. National Surety Co., 254 U. S. 73, 41 S. Ct. 29 (1920). The reason for this rule is that the surety impliedly contracts not to interfere in any way with the creditor in his attempts to collect from the principal debtor, and if the surety makes a claim against the principal debtor to reimburse himself, he necessarily competes with the creditor's attempt to collect the balance of his claim. 70 UNIV. PA. L. REV. 245 (1922); Grubbs v. Wysors, 32 Gratt. (73 Va.) 127 (1879) (a preliminary issue is, of course, raised as to whether "the debt" which must be paid to the creditor is the entire amount owing the creditor by the principal debtor or only the bonded part of that obligation). See Hanson, "Insolvency—the Co-Debtor as a Factor in Distribution," 35 MICH. L. REV. 1099 at 1108, note 18 (1937). In the principal case the court states that there was no showing that the town would not have allowed the surety to prosecute its preferred claim against the bank. It is clear that the receiver of the bank could not object to this procedure. Gedye v. Matson, 25 Beav. 310, 53 Eng. Rep. 655 (1858); Comins v. Culver, 35 N. J. Eq. 94 (1882); Grantham v. Nunn, 187 N. C. 394, 121 S. E. 662 (1924). However, it would be a very unusual case where the town would allow the surety to prosecute its claim, if thereby the dividend to the town would be reduced.

between insurer and insured.[4] Therefore the surety is relieved of liability if the creditor has made any misrepresentations concerning the principal debtor.[5] However, in some situations the creditor not only must not make misrepresentations to the surety but also must disclose facts which might affect the surety's willingness to assure performance by the principal debtor.[6] The circumstances in which such a duty will be imposed upon the creditor are not at all clear. In the principal case a number of factors contributed to the decision of the court that no duty existed. The creditor is ordinarily under no obligation to seek out the surety in order to make disclosures to him, and hence when, as in the principal case, the preliminary negotiations are between the surety and the debtor and not between the surety and the creditor, there is no opportunity to make known to the surety the facts known to the credior.[7] Moreover, the annual report of the treasurer was open for inspection and would have disclosed the excessive deposits in the bank.[8] And, although historically the surety is said to be a "favorite of the law"[9] the courts are reluctant to allow to compensated or "professional" sureties the indulgence which they may

[4] 4 WILLISTON, CONTRACTS, rev. ed., § 1249 (1936); 28 YALE L. J. 410 (1919); Hamilton v. Watson, 12 Cl. & F. 109 at 118, 8 Eng. Rep. 1339 (1845). Whitcomb v. Schultz, (C. C. A. 2d, 1915) 243 F. 268. However, as is pointed out in a note in 43 HARV. L. REV. 797 at 799 (1930), modern surety bonds are simply a form of fidelity insurance and there are strong logical arguments for applying the rules of insurance in these situations.

[5] ARANT, SURETYSHIP, § 28, p. 75 (1931); 4 WILLISTON, CONTRACTS, rev. ed. § 1249 (1936). Cases collected in 63 Am. St. Rep. 327 (1898).

[6] See note in 43 HARV. L. REV. 797 (1930). Cases where a duty is imposed are collected in 8 A. L. R. 1485 (1920). Cases where a duty was not imposed collected in 8 A. L. R. 1485 at 1490 (1920). Lee v. Jones, 17 C. B. (N. S.) 482, 144 Eng. Rep. 194 (1864); Sherman v. Harbin, 125 Iowa 174 at 183, 100 N. W. 629 (1904); Wright v. German Brewing Co., 103 Md. 377, 63 A. 807 (1906); United States Fidelity & Guar. Co. v. Means & Fulton Iron Works, 63 Tex. Civ. App. 56, 132 S. W. 536 (1910). Some courts impose a corresponding duty on the surety to inquire of the creditor as to the facts. Magee v. Manhattan Life Ins. Co., 92 U. S. 93, 23 L. Ed. 699 (1876); Western New York Life Ins. Co., v. Clinton, 66 N. Y. 326 at 331 (1876); 8 A. L. R. 1485 at 1495 (1920).

[7] There is no need for the creditor to seek the surety out. ARNOLD, SURETYSHIP AND GUARANTY, § 34, p. 56 (1927); 8 A. L. R. 1485 at 1494 (1920); Ham v. Greve, 34 Ind. 18 at 22 (1870).

Emphasizing the fact that surety and creditor are not dealing face to face: Magee v. Manhattan Life Ins. Co., 92 U. S. 93, 23 L. Ed. 699 (1875); Watertown Sav. Bank v. Mattoon, 78 Conn. 388 at 393, 62 A. 622 (1905); Cawley v. People, 95 Ill. 249 (1880); Julius Winter & Co. v. Forrest, 145 Ky. 581, 140 S. W. 1005 (1911); Lake v. Thomas, 84 Md. 608, 36 A. 437 (1897).

[8] Mentioning this factor are State v. Dunn, 11 La. Ann. 549 (1856), and City v. Long, 11 Tex. Civ. App. 180, 32 S. W. 567 (1895).

[9] This principal is fundamental to the law of suretyship and accounts for the fact that so many defenses are allowed sureties which are denied ordinary obligors.

allow uncompensated sureties.[10] Finally, the plaintiff in this case was a governmental agency, and the courts often allow recovery by these creditors where recovery would be denied private parties.[11] The dissenting judge placed much emphasis on the fact that a majority of the board of selectmen were also officers and directors of the bank in which the town's funds were deposited, and that, although examination of the treasurer's report would have disclosed excessive deposits by the town, the surety could not have discovered except through the selectmen that withdrawal of the excess deposits would have left the bank insolvent. This view ignores the premise on which many of the cases involving bonds securing public funds rest, namely that the funds belong to the people and hence, if one governmental agent defaults, his surety should not be relieved of liability merely because another agency, such as the board of selectmen in this case, is also derelict in its duty.[12]

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It arises from the fact that most sureties formerly acted gratuitously. Cases applying the rule are numerous. See Miller v. Stewart, 9 Wheat. 680, 6 L. Ed. 189 (1824); Smith v. United States, 2 Wall. (69 U. S.) 219 at 235, 17 L. Ed. 788 (1864); Ulster County Savings Institution v. Young, 161 N. Y. 23, 55 N. E. 483 (1899).

[10] The courts are more strict as to professional or compensated sureties because it seems inequitable for the surety to keep the premium paid it when it assumed the obligation and still evade payment on a technicality. American Surety Co. v. Pauly, 170 U. S. 133, 18 S. Ct. 552 (1898); Illinois Surety Co. v. John Davis Co., 244 U. S. 376, 37 S. Ct. 614 (1916); People v. Rosewarne, 247 Mich. 22, 225 N. W. 590 (1929); Columbia Bank v. U. S. Fidelity & Guar. Co., 33 Okla. 535, 126 P. 556 (1912). But see Barnes v. Century Savings Bank, 149 Iowa 367, 128 N. W. 541 (1910).

[11] ARANT, SURETYSHIP, § 28, p. 79 (1931); STEARNS, LAW OF SURETYSHIP, 4th ed., § 155 (1934); Cawley v. People, 95 Ill. 249 at 255 (1880); Independent School District v. Hubbard, 110 Iowa 58, 81 N. W. 241 (1899); Fidelity & Deposit Co. v. Commonwealth, 104 Ky. 579, 47 S. W. 579, 49 S. W. 467 (1898); State v. Dunn, 11 La. Ann. 549 (1856); City v. Webber, 26 Mich. 284 (1873); Pine County v. Willard, 39 Minn. 125, 39 N. W. 71 (1888); Commonwealth v. Ramsey, 314 Pa. 508, 171 A. 575 (1934); City v. Long, 11 Tex. Civ. App. 180, 32 S. W. 567 (1895).

Contra: Sooy v. State, 39 N. J. L. 135 (1877), affirmed 41 N. J. L. 394 (1879).

[12] This contention is brought out in the majority opinion in City of Detroit v. Weber, 26 Mich. 284 (1873). But see the dissenting opinion of Cooley, J., in that case.