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PRINCIPAL AND SURETY - EFFECT OF RELEASE OF PRINCIPAL DEBTOR WITH RESERVATION OF RIGHTS AGAINST SURETY

Raymond H. Rapaport
University of Michigan Law School

PRINCIPAL AND SURETY — EFFECT OF RELEASE OF PRINCIPAL DEBTOR WITH RESERVATION OF RIGHTS AGAINST SURETY — Plaintiff leased property to defendant, who in turn assigned his rights under the lease to one Garber, the latter assuming the covenants to pay rent and against commission of waste. Plaintiff did not release defendant from the lease. After the expiration of the lease plaintiff recovered judgment for $2,844.75 against defendant, for breaches of the covenants, and then recovered a similar judgment against Garber. Subsequently Garber paid the plaintiff $2,000, and plaintiff gave him a receipt acknowledging "full satisfaction of the judgment rendered against me in the within action. The receipt of said sum is not a release of any legal right of

the plaintiff herein to enforce his judgment against defendant in cause No. A 35993." Now plaintiff seeks to have his judgment declared a lien on property owned by the defendant. *Held*, the principal debtor by the terms of the release was fully discharged from the debt and therefore the reservation of right to enforce the claim against the surety was ineffectual. *Gholson v. Savin*, 137 Ohio St. 551, 31 N. E. (2d) 858 (1941).

Since, technically, a release extinguishes an obligation,[1] a court can logically hold, as does the court in the principal case, that the release of a principal debtor necessarily destroys the subordinate liability of his surety, and therefore any reservation of rights against the surety is without force, for the debt itself is gone.[2] No such difficulty is presented by a covenant not to sue, for here, although the creditor's remedies are held in abeyance, the obligation remains intact,[3] and consequently a reservation of rights against the surety is perfectly valid.[4] A court can thus determine whether the reservation of rights shall stand or fall by the device of construction. If the court wishes to effectuate the reservation of rights the instrument may be construed as a covenant not to sue, even though it purports to be a release; [5] if a contrary result is desired, the "rose" is labeled "release." Thus the court can decide whether the reservation of rights against the surety should prevent the surety's discharge when the principal debtor is released, without being bound by the technical doctrines of release. If the court feels that the general doctrine that the discharge of the principal also

[1] ". . . a release is a direct and immediate destruction of the claim released." 6 WILLISTON, CONTRACTS, rev. ed., 5162 (1938).

[2] This argument is made by THEOBOLD, PRACTICAL TREATISE OF THE LAW OF PRINCIPAL AND SURETY 2, 115 (1833): "The obligation of the surety being accessory to the obligation of some person who is the principal debtor, it is of its essence that there should be a valid obligation of a principal debtor. The nullity of the principal obligation necessarily induces the nullity of the accessory. . . . If the original debt be satisfied and gone, no action will lie against the surety."

[3] In early law a covenant not to sue could not be pleaded in bar to an action on a claim, the only remedy of the covenantee having been an action for breach of covenant. This clearly indicates that the covenant not to sue did not destroy the obligation, even though at present, in order to avoid circuity of action, a covenant not to sue may be pleaded in bar of the action to which it relates. See 23 R. C. L. 376 (1919).

[4] Parmalee v. Lawrence, 44 Ill. 405 (1867); Wheeler v. Werner, 140 App. Div. 695, 125 N. Y. S. 637 (1910).

[5] In Parmalee v. Lawrence, 44 Ill. 405 at 413 (1867), the court, after stating that an absolute release of one co-obligor releases the others, said: "where the release of one of several obligors shows upon its face, and in connection with the surrounding circumstances, that it was the intention of the parties not to release the co-obligors, such intention, as in the case of other written contracts, shall be carried out, and to that end the instrument shall be construed as a covenant not to sue." This case overruled an earlier case of Rice v. Webster, 18 Ill. 331 (1857), in which the court held that the law would not permit the release of one co-obligor with reservation of rights against the others. The court said that the reservation of rights was repugnant to the release and therefore void, and that even though it was the intention of the parties to release one and not the other, the law will not allow, but will defeat, such intention. In accord with the Parmalee case: Wheeler v. Werner, 140 App. Div. 695, 125 N. Y. S. 637 (1910); Duck v. Mayeu, [1892] 2 Q. B. 511.

discharges the surety is not sound,[6] then reservation of rights against the surety will afford the court an opportunity to limit this doctrine. But granting the premise that a release of the principal, without more, releases the surety,[7] is the reservation of rights by the creditor a valid basis for distinction? It has been said that when the principal debtor obtains a release from the creditor, he is defrauded if the creditor is allowed to collect from the surety, who in turn will collect from him, and that therefore the surety must be released. Conversely, if the principal debtor consents to a reservation of rights against the surety he impliedly consents to this indirect enforcement of the released obligation.[8] This argument, however, rests upon the doubtful premise that the debtor did not consent to this circuitous enforcement when he was released without reservation of rights.[9] At all events we should be more concerned with the surety, who so far as the creditor is concerned is usually a volunteer, than with the principal debtor who received the consideration. It can be said that the surety is not harmed by the release of the principal, since consent by the latter to reservation of rights against the surety implies consent to a retention of all rights against himself by the surety.[10] And, further, the creditor is under no duty to exercise diligence in pursuing the principal before he resorts to the surety.[11] But as Professor Arant pointed out, the parties contracted with reference to performance by the principal, and since this agreement between the principal and creditor makes nonperformance by the principal inevitable, such was clearly not within the contemplation of the parties, and imposes upon the surety an entirely different risk than that which he assumed.[12] Thus variation in the surety's risk, affording one basis for discharging the surety when the principal is released,[13] is equally present whether the rights against the surety are or are not reserved. An agreement between the creditor and the principal, to which the surety is not a party, should in no way be allowed to prejudice the surety's rights.

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[6] As a rule the creditor will only release the principal debtor in a fair business transaction, and hence is to be trusted to get a fair amount from him. If this is done, the surety has no cause to complain and logically should not be released.

[7] Pitts v. Congdon, 2 N. Y. 352 (1849); Potter v. Green, 88 Mass. 442 (1863); Anthony v. Capel, 53 Miss. 350 (1876); Trotter v. Strong, 63 Ill. 272 (1872); Rockville Nat. Bank v. Holt, 58 Conn. 526, 20 A. 669 (1890); Patterson v. Gibson, 81 Ga. 802, 10 S. E. 9 (1888).

[8] In re Natal Investment Co., L. R. 6 Ch. 43 (1870); Dean v. Rice, 63 Kan. 691, 66 P. 992 (1901).

[9] See 4 WILLISTON, CONTRACTS, rev. ed., § 1220 (1938).

[10] Boatmen's Savings Bank v. Johnson, 24 Mo. App. 316 (1887).

[11] ARANT, SURETYSHIP 312 (1931).

[12] Id. 185.

[13] Id. 264 ff.