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PRINCIPAL AND SURETY - DISCHARGE OF SURETY FOR A LESSEE BY ASSIGNMENT OF THE LEASE

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PRINCIPAL AND SURETY — DISCHARGE OF SURETY FOR A LESSEE BY ASSIGNMENT OF THE LEASE — Lands set aside by statute as common property of the Chickasaw and Choctaw Indian tribes were, pursuant to an act of Congress,[1] leased to one Gunther by mining trustees of the tribes. The lease contained covenants to pay "stipulated annual advance royalties," and also provided that no assignment should be made without the consent of the trustees "subject to the approval of the Secretary of the Interior." Defendant surety company executed a bond for the faithful performance of the terms of the lease, and the same was duly approved. Then Gunther, with the consent of the trustees, but not the approval of the Secretary of the Interior or surety, assigned the lease to a mining company in which he owned 298 of the 300 shares of stock. From 1925 to 1930 the company failed to pay royalties falling due. In 1930 the surety, then notified of the assignment, entered into an agreement with the company whereby the latter should build up a fund for payment of the past due royalties. A small amount had been paid to the federal government on account when suit was instituted against Gunther and the surety for the balance. *Held*, over the defenses of assignment and alteration of the contract and estoppel, that the surety company was liable. *American Surety Co. of New York v. United States*, (C. C. A. 10th, 1940) 112 F. (2d) 903.

Due to the sovereign nature of the government of the United States, and especially where the government is acting as a guardian, it has certain privileges

[1] 37 Stat. L. 1007 (1913).

in litigation which ordinarily are denied to the private citizen. Thus the defense of estoppel entered by the defendant in the principal case was readily swept aside as hindering the government in effectuating its protective powers.[2] The court declared that the assignment was wholly void because the approval of the Secretary of the Interior had not been obtained, and thus there was no alteration. But even if the court had held the assignment to be valid, it would seem that the defense of alteration would necessarily be futile under the facts of this case. Therefore, the government did not have to rely on any "sovereign can do no wrong" theory. If the lessor in the principal case had not been allowed to deny the validity of the assignment, but had been able only to recover for the breach of the covenant not to assign without consent, and to recognize the new lessee or re-enter, it seems the surety would still be liable on its bond. The ordinary contract surety is discharged if there has been a material alteration of the contract [3] or the parties [4] without his consent. The alteration manifests itself by a subsequent agreement between the principal and creditor altering their original legal relationship existing at the inception of the suretyship. It would seem that the element of consent is the controlling element in determining whether there has been a discharge of the surety on the original obligation when such alteration occurs. The consent may be manifested expressly,[5] or may be implied from the surrounding circumstances,[6] which include the risk involved by the alteration. If the change is one which commonly occurs under a contract like the original, the surety is held to have anticipated this when he guaranteed his principal's performance and thus his consent to the alteration is implied.[7] However, the courts seem to feel that if the risk is increased, the surety is discharged if no actual consent exists, since he certainly did not contemplate additional risks when he became a surety.[8] The same rules might be applied to leases. However, the courts seem to distinguish between simple assignments and subsequent alteration of provisions of the lease. In the latter, emphasis is placed on increased risk,[9] while in the former, implicit consent depends solely on whether or not the assignment was contemplated by the surety when he guaranteed the perform-

[2] Sternfeld v. United States, (D. C. N. Y. 1929) 32 F. (2d) 789; Volker v. McDonald, 120 Neb. 508, 233 N. W. 890 (1931); Huron Portland Cement Co. v. Woodworth, (D. C. Mich. 1921) 19 F. (2d) 530; State ex rel. Stephan v. Taylor, 44 Idaho 353, 256 P. 953 (1927).

[3] United States ex rel. Townshend v. Robson, (D. C. W. Va. 1935) 9. F. Supp. 446; National Surety Co. v. New Mexico, (C. C. A. 8th, 1926) 16 F. (2d) 873; United States v. Freel, 186 U. S. 309, 22 S. Ct. 875 (1902); Cross v. Allen, 141 U. S. 528, 12 S. Ct. 67 (1891).

[4] Wanamaker v. Shoemaker, 70 Pa. Super. 473 (1918); Bensinger v. Wren, 100 Pa. 500 (1882); Spokane Union Stockyards Co. v. Maryland Casualty Co., 105 Wash. 306, 178 P. 3 (1919).

[5] Powell v. Fowler, 85 Ark. 451, 108 S. W. 827 (1908); Marion Savings Bank v. Leahy, 200 Iowa 220, 204 N. W. 456 (1925).

[6] Jamieson v. Capron, 95 Pa. 15 (1880); Commonwealth v. Mendelsohn, 83 Pa. Super. 593 (1924).

[7] Id.

[8] Nichols v. Palmer, 48 Wis. 110, 4 N. W. 137 (1879); Prior v. Kiso, 81 Mo. 241 (1883).

[9] Id.

ances by the lessee.[10] Since a simple assignment of a lease leaves the assignor in privity of contract with the lessor with no change of legal obligations or duties, the risk involved has hardly been altered, thus the courts' failure to talk "risk" under such circumstances. It is generally held that an assignment without the surety's consent, which was not so contemplated, relieves him of further liability.[11] In the principal case, however, there is necessarily a contemplation of assignment since a covenant not to assign without consent assumes that there shall be assignments, but that consent is needed to prevent a breach of such covenant. Moreover, assignments in violation of such covenants are valid,[12] and thus liability of the surety should continue on the principles discussed above. If the original lessee is relieved of liability, however, it is generally held that the surety is discharged,[13] for then an alteration of parties occurs in the eyes of the law. Thus, if it could have been shown in the principal case that the assignment was really a substitution of the company as lessee for Gunther, and that the company only was liable on both privity of contract and estate, then, the court might have said that such a peculiar type of "assignment" released the surety of Gunther. If this theory had been advanced by the surety, the government would have been forced to argue, as it actually did, that the "assignment" was wholly void; and to rebut the defense of estoppel and laches the government would have had to rely on its sovereign position.[14]

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[10] Morgan v. Smith, 70 N. Y. 537 (1877); Stein v. Jones, 18 Ill. App. 543 (1886); Weinsklar Realty Co. v. Dooley, 200 Wis. 412, 228 N. W. 515 (1930).

[11] An assignment is contemplated only if the right to assign exists. See 50 C. J. 97 (1930), which says: "if the right to assign is negatived in the lease, its assignment, if accepted by the lessor will release a surety of the lessee. . . ." If assignment is contemplated, the surety is not released. See Morgan v. Smith, 70 N. Y. 537 (1877); Verschleiser v. Newman, 76 Misc. 544, 135 N. Y. S. 671 (1912).

[12] Meyer v. Alliance Investment Co., 84 N. J. L. 450, 87 A. 476 (1913), affd. 86 N. J. L. 694, 92 A. 1086 (1914).

[13] Murphy v. Ottmann, 127 App. Div. 563, 111 N. Y. S. 912 (1908). See the discussion of this case in Verschleiser v. Newman, 76 Misc. 544, 135 N. Y. S. 671 (1912); School District No. 37 in Butler City v. Aetna Accident & Liability Co., (Mo. App. 1921) 234 S. W. 1017; Brill v. Friedhoff, 102 Misc. 565, 169 N. Y. S. 193 (1918); Fayette Title & Trust Co. v. Maryland, Pennsylvania & West Virginia Tel. & Tel. Co., (C. C. Pa. 1910) 180 F. 928.

[14] On the theory presently discussed, the government could have had performance guaranteed by three parties; however, by declaring the assignment ineffective, it must rely on only two. This discussion is not an attempt to favor nor derogate the method used in the principal case; rather it is merely a discussion of alternatives.