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INDEMNIFICATION BEFORE PAYMENT — A NEW REMEDY FOR THE SURETY?

By T A. Smedley*

In order to protect himself against ultimate loss upon his suretyship obligations, the surety may call upon a varied array of legal remedies. As soon as he has paid the creditor, he may sue the principal debtor at law to enforce his direct right of reimbursement or indemnity, or he may seek repayment by the derivative route of subrogation to the rights of the creditor. Without having first paid the debt, he may bring a suit in equity for exoneration to force the principal debtor to pay the creditor; and in some jurisdictions he may, by proper formal notice and demand, require the creditor to attempt to collect from the principal debtor before enforcing the suretyship liability. Through the several centuries in which the suretyship transaction has been sanctioned by law, the scope and limits of these rights have become fairly well defined.[1]

Seeking further to minimize the risk of the undertaking, sureties have occasionally tried to add another weapon to their arsenal of remedies, in the form of a recovery of damages from the principal debtor before any payment has been made on the debt. The theory advanced is that the principal debtor is under obligation to the surety to pay the creditor at the maturity of the debt, that failure so to pay constitutes a breach of contract, and that the surety's damages from such breach are to be measured in the amount in which he remains liable to the creditor. The late Dean Arant, who for many years was recognized as the foremost authority on this branch of the law disposed of this device in short order. By contrast with the surety s equitable remedy of exoneration he asserts: "At law, however, it was well settled that no action could be maintained by the surety against the principal

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[1] For discussions of these recognized rights of sureties, see Arant, Suretyship (1931) §§ 71, 72, 73, 79; Arnold Suretyship and Guaranty (1927) c. 6, 7, 8; Simpson, Suretyship (1950) §§ 42, 46, 47, 48.

until he had paid some, though not necessarily all, of the principal's debt."[2] Professor Simpson, Arant's successor and heir in Suretyship authority appears to concur with that view in declaring that "the surety's right to repayment as a present cause of action against his principal [on the reimbursement theory] does not arise until after the surety has paid the creditor."[3] However, at another point in his text, this rule is announced: "Exoneration is purely equitable, but where the principal debtor has expressly promised the surety to pay the latter can sue at law for breach of the promise, even though the surety himself has not paid."[4] Strangely enough, the case authority cited for this proposition consists of one mortgage case[5] and three decisions establishing the surety's right of exoneration, without in any way indicating the availability of an action for recovery of damages at law.[6] Also given is a reference to Williston on Contracts, wherein it is stated that "where a principal violates a promise to a surety to pay the creditor, the surety may recover, without paying the debt, from the principal the full amount of the debt as damages."[7] Of the long list of cases cited for this proposition, only one involves a true suretyship situation;[8] the others arise from a variety of transactions out of which a quasi-suretyship relation of the parties might have

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ARANT, SURETYSHIP (1931) 319. In the footnote, following case authority sustaining the proposition stated, the qualification is added that if the principal debtor has expressly promised the surety that he will pay the creditor at the maturity of the debt, the surety may, without himself paying, recover the amount of the debt as damages for the principal's failure to pay. The validity of this qualification as declared more broadly in other sources, is the main concern of this article.

[3] SIMPSON, SURETYSHIP (1950) 224.

[4] SIMPSON, SURETYSHIP (1950) 201.

[5] Furnas v. Durgin, 119 Mass. 500, 20 Am. Rep. 341 (1876). The plaintiff, conveying his land to defendant subject to a mortgage debt which defendant assumed, may be said to have taken on the status of surety to the defendant as principal debtor. See note 38, *infra*. However, the Massachusetts court makes no mention of suretyship considerations in its opinion.

[6] Morley Construction Co. v. Maryland Casualty Co., 90 F 2d 976 (C.C.A. 8th, 1937) (The court specifically states that " As a complaint in an action at law, such a petition would be premature; the plaintiff having paid nothing, may not yet call for indemnity. " 90 F 2d 976, 977); Admiral Oriental Line v. United States, 86 F 2d 201 (C.C.A. 2d, 1936) (The court took note of the fact that the plaintiff could not sue at law, even though the creditor was suing him for the debt on which he was surety for the defendant-principal debtor.); Carpenter v. Park, 19 Cal. App. (2d) 567, 66 P 2d 224 (1939).

5 WILLISTON, CONTRACTS (Rev. ed. 1937 § 1408)

[8] Loosemore v. Radford, 9 M.&W 657, 152 Eng. Rep. 277 (1842).

been found,[9] though in few of the opinions is there any mention of that aspect of the case.[10]

Thus, it appears that, contrary to earlier general assumption and in violation of sound legal principle (or so it will be argued here), the view has somehow developed that a surety may recover from his principal debtor money in the amount of the liability of the surety to the creditor, even though no such payment has in fact been made.

The origin of this idea seems to lie in an accepted but unexplained irrationality in the law of indemnity contracts. Though the very word "indemnity" implies compensation for an actual loss suffered,[11] a type of indemnity contract has become recognized under which the indemnitee may have a cause of action before being damnified. If the contract is to indemnify against loss or "to save harmless" from damage, the covenantee has no right of action until he incurs a loss of the kind indemnified against, and the measure of his recovery is the amount of that loss. But if the contract is to indemnify the promisee against a liability or to discharge him from a debt, then the cause of action occurs at the time the promisor fails to satisfy the debt when it matures or otherwise fails to protect the promisee against being put under liability to pay.[12]

In the words of the Pennsylvania Supreme Court: "Any apparent want of harmony in the decisions as to the right of a party indemnified to recover without proof of loss by payment of the debt or otherwise disappears when the nature of the undertaking is considered and the distinction between an obligation to do a

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[9] For example: Alexander v. McPeck, 189 Mass. 34, 75 N.E. 88 (1905), in which plaintiff, a retiring member of a partnership, received a promise from the defendant, a new partner being added to the firm, to release and discharge plaintiff from all existing partnership debts. Banfield v. Marks, 56 Cal. 185 (1880), in which the grantee of land covenanted with his grantor to protect him against liability for the debt to a third party secured by a mortgage on the land. Port v. Jackson, 17 Johns. 239 (1819), in which a lessee assigned his interest in the leasehold, the assignee covenanting to perform all the obligations of the lease, including payment of rent to the lessor.

[10] In Wilson v. Stilwell, 9 Ohio St. 467 at 470 (1859) (partnership case) and Sparkman v. Gove, 44 N.J.L. 252 at 254 (1882) (mortgage case), the courts, while holding that the promisee could collect damages in the amount of the assumed debt without himself paying it, specifically took notice that a common surety would not have such a right.

[11] Bouvier's Law Dictionary (Baldwin, 1934) 535.

[12] 2 SEDGWICK, DAMAGES (9th ed. 1912) §§ 786, 787. 5 WILLISTON, CONTRACTS (Rev. ed. 1937) § 1409. See Steinert v. Galasso, 363 Pa. 393 69 A. 2d 841, 842 (1949).

specified thing and one of indemnity against loss resulting from nonperformance is observed. Where the indemnity is *against liability,* there is a right of recovery as soon as a liability is incurred. Where it is *against loss by reason of a liability,* there is no right of recovery until a loss occurs."[13]

This explanation leaves two problems unsolved: First, when is the agreement to be regarded as an indemnification against loss and when against liability — since the parties very often do not make their intentions clear if, indeed, they had any specific intentions in the matter; Second, if the contract is determined to be for indemnity against liability, and it is breached by the indemnitor, what damages can the indemnitee show until he has actually paid something under the liability?

The first problem would seem to call merely for an application of the normal rules of construction for determining the meaning of the terms of any ambiguous agreement. Unfortunately the decisions furnish little instruction as to how the interpretive process operates. The courts are prone to stress the importance of drawing the distinction between indemnity against loss and indemnity against liability rather than to expain the basis for their conclusions in individual cases.[14] Perhaps, where the parties have chosen to state the obligation in the simple language of indemnity the court should incline toward the interpretation that the promisee was to be protected only against actual loss, unless he can affirmatively show that the promisor s liability was intended to go further. Actually the tendency seems to run in the opposite direction, so much so in some instances that a court has declared: "When the instrument deviates the least from a simple contract to indemnify against damage, even where the indemnity is the sole object of the contract, and where, in consequence of the

[13] Faulkner v. McHenry, 235 Pa. 298, 83 Atl. 827, 828 (1912) (italics supplied). Quoted with approval in Morgan v. Loch, 95 Kan. 716, 149 Pac. 431, 432 (1915). "It is the distinction between an affirmative covenant for a specific thing, and one of indemnity against damage by reason of the non-performance of the thing specified." Gilbert v. Wiman, 1. N.Y. 550, 562, 49 Am. Dec. 359, 361 (1848).

[14] In Faulkner v. McHenry, 235 Pa. 298, 83 Atl. 827, 828 (1912) for example, the court went to considerable lengths to explain the distinction and point out that it is the essential point on which the decision must turn. Then in two of the closing sentences of the opinion it announces suddenly that the promise in question is one of "indemnity for the protection of the [promisee]" (which is completely indecisive in itself), and that the plaintiff could not recover without proof of loss. No indication is given as to why the covenant was so interpreted.

primary liability of other persons, actual loss may be sustained, the decisions of our courts, although by no means uniform, have gradually inclined toward fixing the rule to be one of actual compensation for probable loss."[15]

However this may be, there is nearly unanimous agreement that if the contract of indemnity includes not only the usual promises to save harmless and protect from loss, but also contains an *express covenant to pay* the promisee's debt to a third party, the agreement is thereby constituted one to protect against the liability itself and not merely against the actual loss from that liability.[16] Once again, this conclusion is regularly stated without benefit of supporting logic. Indefinite references to the promisor's having made a "positive covenant,"[17] an "absolute agreement"[18] or an "unconditional contract"[19] to pay the debt appear prominently in the opinions, but it is not clear why the "positive," "absolute" or "unconditional" obligation could not be to reimburse for loss instead of to prevent the incurring of liability. The Massachusetts court viewed the direct promise to pay as amounting to "an agreement by the [promisor] that he will assume the debt as his own, and that the [promisee] shall not be called upon to pay it, or be put to any molestation or inconvenience by reason thereof."[20] The rule finds its most frequent application in cases of a promise by a grantee of land to his grantor to assume and pay the debt which is secured by a mortgage on the land,[21] and of a promise by a new or a continuing partner to a retiring partner to discharge the existing debts against the partnership.[22] It has

[15] Devol v. McIntosh, 23 Ind. 529, 530 (1864).

[16] See Steinert v. Galasso, 363 Pa. 393, 69 A. 2d 481, 482 (1949); 2 SEDGWICK, DAMAGES (9th ed. 1912) §§ 786, 789; Note (1925) 38 HARV. L. REV. 502, 504; and cases cited, notes 17-23, *infra*.

[17] Loosemore v. Radford, 9 M.&W. 657, 152 Eng. Rep. 277, 278 (1842).

[18] Helms v. Appleton, 43 Ind. App. 482, 85 N.E. 733, 735 (1908); Peterson v. Herington, 169 Minn. 65, 210 N.W. 617, 618 (1926).

[19] Fairfield v. Day, 71 N.H. 63, 51 Atl. 263 (1901).

[20] Locke v. Homer, 131 Mass. 93, 107, 41 Am. Rep. 199, 212 (1881).

[21] For example: White v. Schader, 185 Cal. 606, 198 Pac. 19 (1921); Morlan v. Loch, 95 Kan. 716, 149 Pac. 431 (1915); Nutter v. Mroczka, 303 Mass. 343, 21 N.E. 2d 979 (1939); Gustafson v. Koehler, 177 Minn. 115, 224 N.W. 699 (1929); Ruzyg v. Brown, 327 Pa. 61, 192 Atl. 876 (1937); Jefferson Cooperage Co. v. Getzendanner, 116 W. Va. 489, 182 S.E. 90 (1935). *Contra:* Thomsen v. Kopp, 204 Iowa 1176, 216 N.W. 725 (1927); John Deere Plow Co. v. Tuinstra, 47 S.D. 555, 200 N.W. 61 (1924).

[22] For example: Lathrop v. Atwood, 21 Conn. 117 (1851); Devol v. McIntosh, 23 Ind. 529 (1864); Alexander v. McPeck, 189 Mass. 34, 75 N.E. 88 (1905); Ham v. Hill, 29 Mo. 275 (1860); Fairfield v. Day, 71 N.H. 63, 51 Atl. 263 (1901).

also been invoked in a variety of other situations in which one party assumes liability for payment of the debt of another to a third party.[23]

If it be assumed that such "absolute covenants" to discharge the debts of another are contracts to indemnify against liability, the contract is breached by the failure of the promisor to pay at the date agreed, and at that time a cause of action for damages accrues to the promisee. But to recover substantial damages, the plaintiff must, as a general proposition, show that he has sustained actual loss.[24] In the usual case of the debt assumption promise, no such injury occurs to the promisee before he is required by his creditors to make payment. Though defendants persistently and logically have argued that only nominal damages can be recovered under those circumstances,[25] the courts, just as persistently and with bland unconcern for logic, have measured the damages in the amount of the liability which defendant promised to discharge.[26] It has been said, in explanation of this rule, that payment of the debt by the plaintiff was not a condition or part of the contract between the parties.[27] Of course, that fact, even if true, goes only to the issue of whether defendant has defaulted on his obligation; it does nothing to qualify the plaintiff for the special favor of receiving substantial damages for a wrong which has caused him no actual loss. Several courts, in mortgage assumption cases, have advanced the reasoning that the grantee's promise to pay the mortgage debt was a part of the consideration the grantor was to receive for the conveyance of the mortgaged

[23] For example: Assignee of lease covenants with assignor to pay rent to lessor: Beier v. Snitzer, 167 N.Y. Supp. 303 (1917). Stockholder covenants to pay debts of other stockholders incurred in borrowing money to pay corporation's debts: Helms v. Appleton, 43 Ind. App. 482, 85 N.E. 733 (1908). Direct promise to pay debts of grantee to third party in consideration for transfer of personal property: Heins v. Byers, 174 Minn. 350, 219 N.W. 287 (1928).

[24] MCCORMICK, DAMAGES (1935) § 20; 2 SEDGWICK, DAMAGES (9th ed. 1912) § 790.

[25] Lathrop v. Atwood, 21 Conn. 116, 121 (1851); Stout v. Folger, 34 Iowa 71, 75 (1871); Furnas v. Durgin, 119 Mass. 500, 504, 20 Am. Rep. 341, 344 (1876); Heins v. Byers, 174 Minn. 350, 219 N.W. 287, 288 (1928); Loosemore v. Radford, 9 M.&W. 657, 152 Eng. Rep. 277, 278 (1842).

Dye v. Mann, 10 Mich. 291 (1862), is one of the rare decisions adopting the view that though the promisee has a cause of action for breach of the debt-assumption covenant as soon as the debt matures, the damages would be only nominal until such time as the promisee actually had to make payment to the creditor.

[26] Cases cited, notes 21, 22, 23, *supra*.

[27] Morlan v. Loch, 95 Kan. 716, 149 Pac. 430 (1915).

land, and that the grantee s failure to discharge the debt deprives the grantor of that sum due him under the terms of the sale.[28] But the all too obvious answer here is that the consideration represented by the debt assumption is *not* lost until the grantor is himself required to pay the debt.[29] Following a somewhat different approach, one court asserts that plaintiff's being "kept subject to a debt from which the defendant agreed to relieve him is a continuing injury for which a sum of money which will enable him to discharge it is an appropriate remedy in damages."[30] The validity of this conclusion, however must turn entirely on the content of the word "appropriate" a recovery which conflicts "with the important and fundamental rule that actual compensation will not be given for merely probable loss"[31] is of questionable propriety.

Practical consequences, as well as legal theory demonstrate the unsatisfactory effect of the full recovery rule. As the defendant-promisors have pointed out with alarm, such a recovery puts the promisor under a real threat of double liability and leaves the promisee with a court-sanctioned opportunity to enjoy an unjust enrichment. For, once the promisee has collected his damages in the amount of his debt to the third party, there is no clear way to prevent him from squandering the money for any purpose he may desire, while the hapless promisor may at the next moment be called upon by the creditor to pay the debt to him as third-party beneficiary of the covenant.[32] The courts which take any notice of this situation are inclined to still the defendant's anguished protestations with the curt admonition that his dilemma is of his own making, since but for his default on the promise to

[28] "The majority practice but consummates the contract. By it the defendant promised plaintiff to satisfy certain of its obligations as part of the purchase price of its land. Defendant's failure to meet those obligations is a failure to complete the purchase price due the plaintiff." Jefferson Cooperage Co. v. Getzendanner, 116 W Va. 489, 491, 182 S.E. 90, 91 (1935). Also Carpenter v. Park, 19 Cal. App. 2d 567, 66 P 2d 224 (1939); Morlan v. Loch, 95 Kan. 716, 149 Pac. 431 (1915); Furnas v. Durgin, 119 Mass. 500, 20 Am. Rep. 341 (1876); Gustafson v. Koehler, 177 Minn. 115, 224 N.W 699 (1929).

[29] See Dye v. Mann, 10 Mich. 291, 295 (1862)· "The damages, it is true, in an action for not paying would be nominal; but still the action would lie."

[30] Furnas v. Durgin, 119 Mass. 500, 507, 20 Am. Rep. 341, 344 (1876).

[31] 2 SEDGWICK, DAMAGES (9th ed. 1912) § 790.

[32] See Glenn, *Purchasing Subject to Mortgage*, (1941) 27 VA. L. REV. 853, 867 "The only practical objection is that, on its face, the rule does not insure proper application of whatever may be collected by virtue of the judgment." Three answers are suggested, but none is entirely convincing.

discharge the debt, plaintiff would never have had an action against him.[33] In a few instances the opinions have offered some doubtful comfort to the defendant by suggesting the possibility of some sort of equitable relief which is, however, only vaguely defined.[34] In one of the early cases on the subject it was observed that the "defendant may perhaps have an equity that the money he may pay to the plaintiff shall be applied in discharge of his debt."[35] And in another: " if there are any circumstances that would make it just to do so, the court, on the trial, would, in rendering judgment, see that the defendant was made safe in paying the judgment; or it might be a ground for an injunction and relief in equity."[36] The fact remains that the law court which awards the full damages judgment is not, because of procedural limitations, in position to protect the defendant against the danger of double liability, and enforcement of the judgment is not contingent on his receiving such protection.[37]

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[33] Lathrop v. Atwood, 21 Conn. 117, 126 (1851); Stout v. Folger, 34 Iowa 71, 76 (1871); Furnas v. Durgin, 119 Mass. 500, 505, 20 Am. Rep. 341, 343 (1876); Gustafson v. Koehler, 177 Minn. 115, 224 N.W 699, 700 (1929).

This is one of the "answers" given by Glenn, *Purchasing Subject to Mortgage,* (1941) 27 VA. L. REV. 853, 867.

[34] Cooper v. Parker, 176 Ala. 122, 57 So. 472, 474 (1912), holding that a surety could, before paying the principal debt, foreclose a mortgage given to him by the principal debtor as security. "In such a case, however, it seems clear that the mortgagor-principal would have an equity to have the fund so realized applied to the principal debt, if he still remained liable thereon." Heins v. Byers, 174 Minn. 350, 219 N.W 287, 288 (1928): "It may be that the defendants could require the money paid to the plaintiff to be applied on the bank debt; or, if judgment is obtained against them, could obtain relief giving them equivalent protection; or before judgment could adopt such procedure as would prevent double payment. The danger of being subjected to double payment is not great." See SIMPSON, SURETYSHIP (1950) 201-202. But see Wilson v. Stilwell, 9 Ohio St. 467, 471 (1859), discussed in note 37, *infra.*

[35] Loosemore v. Radford, 9 M.&W 657, 152 Eng. Rep. 277, 278 (1842).

[36] Ham v. Hill, 29 Mo. 275, 281 (1860).

[37] Furnas v. Durgin, 119 Mass. 500, 508, 20 Am. Rep. 341, 345 (1876): "There is no mode, at law, by which this difficulty can be avoided, and the plaintiff enabled to receive the benefit of his contract." See Lathrop v. Atwood, 21 Conn. 117, 129 (1851. " a judgment in the present suit, and even payment to the plaintiff can have no effect upon the claims of the unpaid creditor against him [defendant], or in the least, exonerate him from his liability to them."

But see Wilson v. Stilwell, 9 Ohio St. 467, at 470, 471 (1859) which points out that the possibility of double liability, while a real threat in jurisdictions in which law and equity are separate, is not a serious consideration where the two types of remedies are available in the same court. " the court below exercising jurisdiction in equity as well as at law, and competent to administer equitable as well as legal remedies, very properly saved the rights of the obligors of the bond and defendants in the judgment, by ordering the creditors of the firm to be made parties, and permitting the obligors to pay off the creditors of the plaintiff, and to have the amount thus paid credited upon the judgment. And this, we think, ought always to be done where any party in interest, whether creditor or obligor, demands it."

Regardless of their theoretical and practical faults, the foregoing principles are so firmly entrenched that their authority is not open to successful question in indemnity contract controversies. Since they are commonly applied in mortgage, partnership, and other express debt-assumption cases wherein the assuming of liability for and promising to pay the debt of another does, for some purposes, create a quasi-suretyship relation between the promisor in the position of principal debtor and the promisee in the position of surety,[38] the contention naturally arises that these same principles should control in true suretyship cases. If this be so, the surety should be able to obtain and enforce a judgment against the principal debtor for damages in the amount of the surety's liability to the creditor, without actually having paid the debt or any of it.

Without question, the suretyship transaction includes an obligation in the principal debtor to indemnify his surety against loss by reimbursing him for any payments on the debt made by the surety to the creditor. If the obligation was not expressly assumed, the law will create it from the implications of the suretyship relation.[39] In some respects this agreement to indemnify takes on the character of an affirmative promise to pay the debt, so that indemnity against *liability* as well as against *loss* is the duty of the principal debtor to his surety. The equitable remedy of exoneration is based on this point of view — the decree may be regarded as in the nature of specific enforcement of the principal debtor's promise to the surety to pay the creditor at maturity, thus protecting the surety from the hazard of having to pay.[40] How-

[38] Carpenter v. Park, 19 Cal. App. 2d 567, 66 P. 2d 224 (1939) (new members of partnership who promise to pay firm debts regarded as principal debtors to retiring partner as surety); Cave v. Belisle, 117 Colo. 180, 184 P. 2d 869 (1947) (purchaser of land who assumes and agrees to pay mortgage debt regarded as principal debtor to owner-grantor as surety); Salmon Falls Bk. v. Leyser, 116 Mo. 51, 22 S.W 504 (1893 (purchaser of land who assumed notes which his grantor had given for purchase price of land to previous grantor regarded as principal debtor to his grantor as surety).

[39] Fouts v. Maryland Casualty Co., 30 F 2d 357 (C.C.A. 4th, 1929); Springfield National Bk. v. American Surety Co., 7 F 2d 44 (C.C.A. 6th, 1925); Vermeule v. York Cliffs Imp. Co., 105 Me. 350, 74 Atl. 800 (1909); ARNOLD, SURETYSHIP AND GUARANTY (1927) 240, 241, STEARNS, SURETYSHIP (1934) § 279.

Since the implied promise to pay is said to grow out of the surety's having incurred liability at the principal debtor's behest, an exception is often made when the surety has undertaken his obligation without the request, consent or acquiescence of the debtor — the "non-consensual surety" See SIMPSON, SURETYSHIP (1950) 226.

[40] See Roberts v. Keene, 74 Misc. 238, 240, 133 N.Y. Supp. 1091, 1093 (1911).

ever the promise to pay is implied in law in every case of "consensual suretyship," and the right of exoneration is not dependent on the existence of an express agreement.

In true suretyship cases, the prohibition against the surety's recovering damages from the principal debtor without first paying at least some of the debt has been so often and so positively asserted and invoked that there can be no doubt of its force.[41] The principal debtor cannot "be made liable at law for subjecting his surety to the peril of paying his debt . . ."[42] for "suit by the surety must be based upon money paid by him for the principal . . ., and his right of action dates from the time of his payment."[43] Since it is commonly said that no cause of action exists until the surety has paid something in the principal debtor's behalf, the indemnity obligation incident to the normal suretyship transaction is apparently of the type which protects against actual loss, and not against the incurring of liability. In view of the theory of the exoneration remedy, however, the position might logically be taken that upon the failure of the debtor to pay the principal debt at maturity he has breached his contract to the surety to pay the debt and that a cause of action arises at that point; but only

[41] Howard Johnson, Inc. v. Tucker, 157 F. 2d 959 (C.C.A. 5th, 1946); United States Fidelity Co. v. State ex. rel. Finley, 69 Ind. App. 638, 122 N.E. 598, 599 (1919) ("It is the rule that a surety may not originate affirmative action until he has paid the debt for which he is bound."); Vermeule v. York Cliffs Imp. Co., 105 Me. 350, 74 Atl. 800, 801 (1909) ("It is well settled in this state that in an action by a surety against his principal it is necessary for the plaintiff to prove that he has paid the debt, or discharged the principal for the amount which he seeks to recover. . . ."); McCormick v. Obanion, 169 Mo. App. 606, 153 S.W. 267, 271 (1913) ("It goes without saying that the surety cannot recover of the principal until he first pays the surety debt."); Hellams v. Abercrombie, 15 S.C. 110, 116, 40 Am. Rep. 684, 688 (1880) ("No action can be had until a cause of action has accrued, and the only cause that can ordinarily exist between a principal and his surety . . . is payment of the debt by the surety."); Henegar v. Brannon, 24 Tenn. App. 1, 137 S.W. 2d 889, 892 (1939) ("To entitle him to such a decree or judgment [for reimbursement] he must allege and prove the amount he paid."); Meier v. Service Corp., 129 S.W. 2d 690, 692 (Tex. Civ. App. 1939) (". . . no cause of action in favor of plaintiff [surety] . . . would arise, unless and until plaintiff was compelled to pay the debts thus assumed."); Newell v. Morrow, 9 Wyo. 1, 59 Pac. 429, 431 (1899) ("A surety has no right of action against his principal, in respect to the debt for which he is surety, until he has paid such debt for his principal.") See Bennett v. Bennett, 230 Minn. 415, 42 N.W. 2d 39, 44 (1950).

[42] McConnell v. Scott, 15 Ohio 401, 402, 45 Am. Dec. 583 (1846).

[43] Farmers & Mechanics Sav. Bk. v. Jennings, 138 S.W. 2d 703, 705 (Mo. App. 1940) ("It is no longer open to question but that the surety cannot collect any more than the amount actually paid by him with interest, and until the surety pays the debt for which he is security, his demand has no existence.") 138 S.W. 2d 703, 704.

nominal damages would be recoverable, because the surety has not sustained substantial damages until he pays the creditor.

If the suretyship transaction itself creates only an obligation to indemnify against loss, the question remains as to whether any greater liability rests on the principal debtor who, in the course of dealing with his surety, makes an express promise that he will pay the principal debt to the creditor. Certainly such an expression of liability is not necessary to create the obligations of reimbursement and exoneration.[44] If the surety gives any specific thought to the reason for exacting an express promise from the principal debtor, it seems likely that his desire is merely to make the nature of the transaction completely clear, and to establish irrevocably in the mind of the debtor that he has the ultimate responsibility for making payment. However, since the express promise is not necessary to create that responsibility, it may well be argued that the surety's purpose was to secure an additional remedy for use in the event of a default on the principal obligation — perhaps an action for damages for the failure to pay the creditor at maturity.

Apparently sureties seldom secure from their principal debtors express promises to pay the debts, or, at least, if such promises are obtained, not much significance is attached to them, for very few true suretyship cases have been found in which the decision turns on that factor. A common practice has been established in modern times, especially among the commercial surety companies, of requiring the principal debtor to execute a formal covenant to indemnify the surety against any loss which might arise from the suretyship undertaking. Such contracts have been held to be "legal and enforceable,"[45] and by specifically providing for such items as counsel fees and other reasonable expenses incurred in resisting the creditor's claim or in otherwise serving the debtor's interests, a surety may be able to increase the extent of reimburse-

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[44] See note 39, *supra*.

[45] United States Fidelity & Guaranty Co. v. Centropolis Bk., 17 F 2d 913, 915 (C.C.A. 8th, 1927). Also Tennant v. United States Fidelity & Guaranty Co., 17 F 2d 38 (C.C.A. 3d, 1927). National Surety Corp. v. Buckles, 219 S.W 2d 207 (Tenn. App. 1949) held that the indemnity agreement, contained in the application for the surety bond which the principal debtor filled out and signed; was enforceable even though he had failed to read the application and did not realize that it included an indemnity provision. This agreement authorized the surety to settle claims against the principal debtor unless the surety was specifically notified not to do so.

ment he may recover after payment to the creditor. But the express provision for indemnification is not regarded as affording the surety any new type of remedy not available under the implied contract of indemnity which is inherent in the suretyship relation.[46]

Occasionally, a court, in stating the general limitation against recovery before payment, will qualify the absoluteness of the rule. Thus, it is said that "A surety or guarantor can not recover indemnity from the principal until he has paid the debt; unless there is a clause in the contract of indemnity which varies this general rule."[47] And in a few opinions it is positively stated, though mostly by way of dictum, that if a surety takes an express covenant to pav the debt from his principal debtor, he has a right to recover damages for the failure to pay as soon as the maturity date has passed.[48]

More than a century ago, an English court, in a decision often cited but rarely followed on its facts, allowed one who was suretv on a promissory note to recover from his primicpal debtor the amount of the note, even though the surety had made no payment on the note. It was concluded, without citation of any authority, that since the principal debtor had made an "absolute and positive covenant" to pay the debt, the covenantee-surety "is entitled to be placed in the same situation under this agreement, as if he had paid the money to the payees of the bill."[49] Early in the present century, the Alabama Supreme Court upheld the right of a surety, who had not paid the principal debt, to enforce a mortgage given to him by the principal debtor as security. The rule was asserted that "It is competent for the parties to so frame their contract, either by the terms of the principal contract, or by a separate independent contract, as to authorize the surety to proceed against his principal, or against the independent security given by the principal to the surety, at any stated time, independently of the

[46] Fouts v. Maryland Casualty Co., 30 F 2d 357 (C.C.A. 4th, 1929); United States Fidelity & Guaranty Co. v. Centropolis Bk., 17 F 2d 913 (C.C.A. 8th, 1927); Springfield National Bk. v. American Surety Co., 7 F 2d 44 (C.C.A. 6th, 1925). See Glen Falls Indemnity Co. v. American Awning & Tent Co., 55 R.I. 284, 180 Atl. 367, 375 (1935).

[47] Cooper v. Parker, 176 Ala. 122, 57 So. 472, 473 (1912), quoting Lane v. Westmoreland, 79 Ala. 374 (1885).

[48] Tennant v. United States Fidelity & Guaranty Co., 17 F 2d 38 (C.C.A. 3d, 1927); Locke v. Homer, 131 Mass. 93, 95, 41 Am. Rep. 199, 201 (1881); Hellams v. Abercrombie, 15 S.C. 110, 116, 40 Am. Rep. 684, 689 (1880).

[49] Loosemore v. Radford, 9 M. & W 657, 152 Eng. Rep. 277, 278 (1842).

surety's prior payment of the principal debt."[50] Aside from a few such isolated decisions, there seems to be no direct primary authority to sustain a right in the true surety to collect substantial damages from his principal debtor before payment, in spite of the wide acceptance of the same principle in the mortgage and partnership indemnity contract and similar cases.

Arguing against its incorporation into suretyship law are the same considerations which have already been discussed in regard to the indemnity contract situation. Recovery of the amount of the principal debt is inconsistent with basic damages law because the surety has not yet sustained loss by paying the creditor, leaves the principal debtor under imminent threat of double liability by having to pay the creditor also, and puts the surety in position to gain an undeserved advantage from his suretyship undertaking.

Furthermore, at least two distinguishing factors appear which justify a variance between the rules governing the two transactions. In the debt assumption cases, the original debtor, who moves into the status of a quasi-surety by having liability for his debt assumed by another party, gives a direct consideration in some form or other to induce the promisor to undertake that obligation. The most familiar example is the landowner who conveys property subject to a mortgage lien, the grantee assuming and agreeing to pay the debt. Obviously the grantor sells his land for a lower price in consideration of the grantee's assumption of the debt. While this does not, as previously indicated, make the grantor's damages amount to the sum of the debt automatically upon the grantee's failure to pay, yet it does give basis for the feeling as expressed by the late Professor Glenn that it seems "more fair to the mortgagor . . . to adopt the rule that an indemnity contract is broken at and with the maturity of the debt which it secures; the measure of damages being the face amount of such debt, with interest."[51] By contrast, the true surety has, of course, not given the principal debtor any monetary remuneration for his promise to pay the principal debt, inasmuch as that obligation was the

[50] Cooper v. Parker, 176 Ala. 122, 57 So. 472, 473 (1912). Also allowing the surety to enforce collateral security given by the principal debtor, though no payment has been made on the debt: Easton v. Boston Investment Co., 51 Cal. App. 246, 196 Pac. 796 (1921); Hellams v. Abercrombie, 15 S.C. 110, 40 Am. Rep. 684 (1880).

[51] Glenn, *Purchasing Subject To Mortgage* (1941) 27 VA. L. REV. 853, 867.

primary liability to which the suretyship contract appends.[52] The chances of injury to the surety from the principal debtor s failure to pay lie only in the possibility that the creditor may in the future call on him to pay The mortgagor-grantor, however, is not only under the same peril of prospective loss but has also sacrificed a gain in favor of the grantee in the past transaction.[53]

Perhaps an even more persuasive argument for refusing the surety the substantial damages remedy accorded to the indemnitee rests on the availability to the former of another more effective remedy for coercing the ultimate obligor to satisfy the debt. A suit for exoneration brought in equity by the surety against the principal debtor with the creditor joined as an interested party,[54] will presumably force the debtor to pay his obligation directly to the creditor thus protecting the surety against the danger of being called upon to pay With this type of relief at hand, the surety has no need for a damages recovery before payment of the debt. Ordinarily there would seem to be no basis in the debt assumption cases for equity to take jurisdiction and give specific enforcement relief, inasmuch as the contract in question merely calls for the payment of money

Because there is no apparent need for the damages-before-payment remedy for the surety and because such a recovery could easily result in the misapplication of the money, with consequent hardship on both principal debtors and creditors, and because the general damages rule limiting recovery to the amount of actual loss is a sound principle, the right to recover the damages in the amount of the principal debt before its payment should not be accorded to a surety The existence of an express promise from the principal debtor to the surety to pay the debt does not diminish the force of any of those considerations and so should not give rise to greater rights than inhere in the suretyship status generally As has been noted already, the courts have shown little

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[52] Morlan v. Loch, 95 Kan. 716, 149 Pac. 431 (1915)· "In the ordinary case of principal and surety, the surety parts with nothing until he pays the debt for which he bound himself. Here the plaintiff parted with the land which the defendant received."

[53] See Note (1925) 38 HARV. L. REV. 502, 504.

[54] Alabama Bank & Trust Co. v. Garner, 225 Ala. 269, 142 So. 568, 570 (1932) "While the creditor may not be a necessary party to the suit, he is at least a proper party that may be on hand to receive the money " See ARANT, SURETYSHIP (1931) 320.

inclination so to favor sureties. It is to be hoped that the somewhat overreaching assertions of some highly respected textwriters, in this one instance not well supported by their cited authority, will not divert the law into wayward paths.

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