SURETYSHIP

Discharge of Surety — Release of Judgment Against Principal With Reservation of Rights Against Surety

Plaintiff leased real estate for ten years to defendant, who after five years assigned the lease to G. G assumed covenants therein to pay rent and not to commit waste, but plaintiff did not release defendant from the same obligation. At the expiration of the lease plaintiff recovered against defendant and G separate judgments for $2844.75 for breaches of the covenants. Pursuant to a contract with G that on payment of $2000 plaintiff would "satisfy" his judgment against G, but "was not [thereby] to release any legal right . . . to enforce his . . . judgment" against defendant, plaintiff on such payment gave a receipt for "full satisfaction of the judgment" against G, but "not to release any legal right" to enforce the judgment against defendant. The terms of such contract were journalized in the action against G, recording the satisfaction of the judgment. Now plaintiff brings suit to collect his judgment against defendant from after-acquired property. From an affirmance in the Court of Appeals of a judgment for plaintiff based on Ohio Gen. Code, Sec. 8084, a motion to certify was allowed. *Held*, that, since after assignment of a lease the lessee becomes surety to the lessor for the obligation of the assignee assuming the covenants therein, Sections 8079-8084, precluding release of one joint debtor by settlement with another, are inapplicable; that the reservation of rights against defendant in the release is ineffective because, the judgment against G having been unqualifiedly discharged in full, the rights of the lessee-surety against the assignee-principal were not thereby reserved; and that the release of the obligation to pay the greater, liquidated amount on receipt of the lesser sum is binding because either consideration exists therefor or, if not, such transaction is executed. Judgment reversed and final judgment for appellant.

Cullen v. Schmit, 137 Ohio St. 479, 30 N.E. (2) 994 (1940); Baker v. Frazier, 137 Ohio St. 479, 30 N. E. (2d) 994 (1940); Mosey v. Hiestand, 138 Ohio St. 249, 34 N.E. (2d) 210 (1941); Schultz v. Killmer, 138 Ohio St. 249, 34 N.E. (2d) 210 (1941); *cf.* Bettman v. Northern Insurance Co., 134 Ohio St. 341, 16 N.E. (2d) 472 (1938), *overruling*, Hall v. Hall, 55 Ohio App. 67, 8 N.E. (2d) 582 (1936); The State, *Ex Rel.* Squire v. Winch, 137 Ohio St. 479, 30 N.E. (2d) 994 (1940), *overruling*, The First National Bank v. The Kittoe Boiler & Tank Co., 62 Ohio App. 411, 24 N.E. (2d) 458 (1939); Couk v. The Ocean Accident & Guarantee Corp., Ltd., 138 Ohio St. 110, 33 N.E. (2d) 9 (1941), *overruling*, Cultice v. DeMaro Realty Co., 29 Ohio L. Abs. 566 (1939); *In Re* Trusteeship of Stone, 138 Ohio St. 293, — N.E. (2d) — (1941) (reversing on merits).

Weygandt, C. J. and Zimmerman, J. dissented. *Gholson* v. *Savin*, 137 Ohio St. 551, 31 N.E. (2d) 858 (1941).

The lessee was not discharged of his obligation under the covenants of the lease, no agreement of the lessor to accept the liability of the assignee in place of that of the lessee existing.[1] But by assuming the covenants the assignee came under the same obligation as that of the lessee to the lessor, who was thereby made the beneficiary of a third party beneficiary contract,[2] if manifesting acceptance thereof.[3] Although thereby the lessee and assignee were both primarily liable to the lessor, since the whole benefit of the contract was taken by the assignee, the lessee becomes surety for him.[4]

But to affect the lessor-creditor with this change of relationship modifies his rights because to have the primary and original obligation of two *principal* debtors is very different from having the primary obligation of one as principal debtor and of another only as surety therefor. Consequently Ohio Courts have held that in the assumption-of-mortgage-by-assignee cases the liability of the first promisor-mortgagor still remains an original and principal obligation with respect to the creditor-mortgagee.[5]

But the present case is not one of non-consensual suretyship, although the surety relationship was created after the lessee was already bound

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[1] Taylor v. DeBus, 31 Ohio St. 468 (1877); Poe v. Dixon, 60 Ohio St. 124, 54 N.E. 86 (1899); *see* RESTATEMENT, CONTRACTS (1932) Secs. 427, 428 (requirements of novation) and OHIO ANNOT. (1933) Secs. 427, 428.

[2] Emmitt v. Brophy, 42 Ohio St. 82 (1884).

[3] The Community Discount & Mortgage Co. v. Joseph, 117 Ohio St. 127, 157 N.E. 380 (1927); Motz v. Root, 53 Ohio App. 375, 4 N.E. (2d) 990 (1934); *cf.* Harmony Lodge v. White, 30 Ohio St. 569 (1876).

[4] Sutliff v. Atwood, 15 Ohio St. 186 (1864); McHenry v. Carson, 41 Ohio St. 212 (1884); Poe v. Dixon, 60 Ohio St. 124, 54 N.E. 86 (1899) (mortgage); The Columbus Gas & Fuel Co. v. The Knox County Oil & Gas Co., 91 Ohio St. 35, 109 N.E. 529 (1914); Walser v. Farmers Trust Co., 126 Ohio St. 367, 185 N.E. 535 (1933) (mortgage).

[5] Teeters v. Lamborn, 43 Ohio St. 144, 1 N.E. 513 (1885); Denison University v. Manning, 65 Ohio St. 138, 61 N.E. 706 (1901) (otherwise novation exists); Cone v. Rees, 11 Ohio C.C. 632 (1896) (not shown creditor knew of suretyship relation); The Northwestern Mutual Life Ins. Co. v. Menke, 45 Ohio App. 122, 186 N.E. 745 (1932); Torrey v. Stevenson, 2 Ohio N.P. (N.S.) 445 (1904); *cf.* Richards v. The Market Exchange Bank Company, 81 Ohio St. 348, 90 N.E. 1000 (1910); Washer v. Tontar, 128 Ohio St. 111, 190 N.E. 231 (1934) (same, based on N.I.L.). *But cf.* Goodman v. Goodman, 127 Ohio St. 223, 187 N.E. 777 (1933); *see* 112 A.L.R. 1324, 1331-32 (Ohio is minority rule); Note, *Suretyship Releases in The Law of Mortgages* (1937) 4 U. CHI. L. REV. 469; (1928) 12 MINN. L. REV. 668; (1928) 26 MICH. L. REV. 929; (1933) 11 N.C.L. REV. 96; (1935) 13 N.C.L. REV. 337; *cf.* (1933) 81 U. PA. L.REV. 641; (1936) 22 VA. L. REV. 964; (1937) 10 SO. CALIF. L. REV. 510; Stevens, *Extension Agreements in the "Subject-To" Mortgage Situation* (1941) 15 U. CIN. L. REV. 58; *see* Berick, *Personal Liability For Deficiency in Mortgage Foreclosures* (1934) 8 U. CIN. L. REV. 103, 131-134.

as a principal obligor to the lessor.[6] Mere knowledge of the assignment of the lease or assent thereto, manifested by treating the assignee as an obligor, accepting rent from him, while not enough to create a full novation, may be enough to make the lessee's obligation to the lessor now only that of surety, a limited novation.[7] To the extent that the lessor-creditor after the assignment must treat the lessee only as surety for the assignee, the present case reverses the prior rule in the assumption of mortgage cases, as no difference between the two—mortgage or lease—in this respect appears.

Since the relationship of principal and surety exists, at least between lessee and assignee, it seems immaterial whether Ohio Gen. Code, Sections 8079-8084, so limiting the effect of a release given to one debtor as not to discharge other "joint debtors," apply only to joint or joint and several promisors or whether these provisions apply to obligors between whom such suretyship relation exists. A release to one joint and several promisor does not discharge the several duties of the others.[8] The Court held that the statute, applying "only in cases where the codebtors are each liable in the same right for the payment of the whole obligation, and where, as a consequence, the right of contribution exists between them," is inoperative here where the assignee as "principal debtor owes the whole debt as between himself and his surety," the lessee.[9] But, even if Sections 8079-8084 were applicable, Section 8082 would result in the discharge of the lessee-surety. Section 8082 provides that "the discharge of such partner [or joint debtor by Section 8084] shall be deemed a payment to the creditor equal to the proportionate interest of the partner [debtor] discharged . . .", meaning, as applied to "other joint debtors," "equal to the proportionate" amount of such obligor's ultimate liability for the debt,[10] which liability the assignee bears.

Thus since the "proportionate interest of the ... [debtor] discharged" is the whole of the obligation of the covenants, "the discharge of such . . . [debtor] shall be deemed a payment to the creditor equal to" the whole of the obligation and nothing will be left thereof to charge the lessee-surety. In the reverse case a release of a surety is payment of no part of

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[6] *See* Campbell, *Non-Consensual Suretyship* (1935) 45 YALE L. J. 69 (when no understanding between two obligors as to who should bear ultimate burden).

[7] *See* RESTATEMENT, SECURITY (Tent. Draft No. 4, 1940) Secs. 113, comment *a*, 115, comment *b*; *cf.* Templeton v. Shakley, 107 Pa. 370 (1884) (creditor need not know obligor is surety to give latter suretyship defenses); American Blower Company v. Lion Bonding & Surety Co. 178 Iowa 1304, 160 N.W. 939 (1917) (or even of existence of surety).

[8] *See* RESTATEMENT, CONTRACTS (1932) Sec. 123 (making resort to Secs. 8079-8084 unnecessary, "except in cases and to the extent required by the law of suretyship").

[9] *Cf.* Slatoff v. Theurich, 123 N.J. Eq. 593, 199 Atl. 49 (1938) (in equity).

[10] *Cf.* Walsh v. Miller, 51 Ohio St. 462, 38 N.E. 381 (1894).

the debt, except what is actually received in return for the release, since the surety has no ultimate "proportionate interest" in the obligation.[11]

Although the lessor-creditor cannot obtain the benefits of Sections 8079-8084 in enforcing his obligation against the lessee-surety, if release of the assignee as principal debtor on partial payment of the judgment is such a normal way of collecting the judgment from an insolvent principal debtor as to be within the contemplation of the parties when the suretyship obligation was assumed, such obligation of the lessee-surety should remain unaffected.[12] Should the lessee-surety have expected this? But release of the principal debtor before performance is due will insure that such performance will not be forthcoming. The loss is caused by the obligee's own act, the risk of which a surety does not ordinarily undertake and the latter is thereby discharged.[13] The creditor's release of real security is likewise ordinarily not within the surety's expectation of the risk assumed.[14] A surety is entitled to be subrogated to such security—the judgment of the lessor against the assignee in the present case—on payment of the obligation.[15] This right is more valuable than the direct action of indemnity or reimbursement.[16]

Although the assignee-principal debtor may have been insolvent at the time of the release, a judgment surviving against him is a basis to assert a lien on his after-acquired property, the remedy sought against the lessee in the present case. By an effective release of the judgment the lessee-surety on payment is deprived of such remedy. Releasing the judgment then might be said not to have been contemplated as part of the lessee-surety's risk. Regardless of intent of the parties, if the judgment against the principal debtor is released, the traditional rule—that the right of subrogation is impaired, if the surety can no longer enforce such judgment—discharges him to the extent of the value of such security. Here the reservation of rights against the lessee-surety was held not to

[11] *Cf.* Harris v. De Paulina, 40 Ohio App. 57, 178 N.E. 225 (1931), (1932) 10 TENN. L. REV. 140. After the discussion of the applicability of Secs. 8079-8084 the Court had no help on the other issues decided from the briefs filed.

[12] *See* ARANT, HANDBOOK OF THE LAW OF SURETYSHIP AND GUARANTY (1931) 183, 191-192; *cf.* Crawford v. Swearingen, 15 Ohio 265 (1846); Woolworth v. Brinker, 11 Ohio St. 593 (1860). *But cf.* Anthony v. Capel, 53 Miss. 350 (1876); Banana Sales Corp. v. Chuchanis, 119 Ohio St. 75, 162 N.E. 274 (1928).

[13] Compare The Trustees v. Miller, 3 Ohio 261 (1827), with Rock v. Monarch Building Company, 87 Ohio St. 244, 100 N.E. 887 (1912), The United States Fidelity & Guaranty Co. v. The Allied Products Co., 45 Ohio App. 270, 187 N.E. 83 (1933).

[14] Arant, *Why Release of Security Discharges a Surety* (1930) 14 MINN. L. REV. 725; ARANT, *op. cit. supra* note 12, at 219-238; *Cf.* Hochevar v. Maryland Casualty Co., 114 F. (2d) 948 (C.C.A. 6th, 1940).

[15] Hill v. King, 48 Ohio St. 75, 26 N.E. 988 (1891); *cf.* Neal v. Nash, 23 Ohio St. 483 (1872); Zuellig v. Hemerlie, 60 Ohio St. 27, 53 N.E. 447 (1899); City of Toledo v. Fidelity & Deposit Co., 46 Ohio App. 97, 187 N.E. 790 (1933).

[16] *Cf.* Nelson v. Webster, 72 Neb. 332, 100 N.W. 411 (1904).

have prevented complete discharge and satisfaction of such judgment. Hence the release impaired the right of subrogation. Although heretofore harmonizing the conflicting intents expressed in a release of the principal debtor with a reservation of rights against the surety has resulted in a covenant not to sue, which, not preventing suit in the creditor's name, does not impair the right of subrogation,[17] yet in the principal case the intent was considered clear to give a complete discharge of the judgment against the assignee-principal obligor. Preserving to the surety only the direct right of reimbursement would not seem to be enough when, as here, the right of subrogation is better. Conversely, had no judgment existed, a release merely of the obligation of the assignee-principal with the same reservation might not have discharged the lessee-surety. Although equity could revive the creditor's judgment against the principal for the benefit of the surety on payment, such action would nullify the express release given the assignee-principal debtor.[18] But a careful lawyer can still draw a release with reservation of rights that will be effective against a surety in Ohio.[19]

Finally, since the right of subrogation is not impaired if the release is not so binding that the creditor, and hence the surety when subrogated, is prevented from enforcing his judgment against the principal debtor, the Court was required to find some consideration for the release of the larger, liquidated amount—$2844.75—upon payment of the smaller—$2000.[20] But this rule of the sufficiency of consideration has been modified.[21] Thus consideration was found in an application of a bird-in-the-hand-is-worth-two-in-the-bush policy. Furthermore, performance and execution of a transaction here will not be undone. The fact that the contract of release was carried into the journal entry, satisfying the judgment against the assignee, and thereby made part of the court record gave the transaction such an air of solemnity that the policy underlying the doctrine of consideration was satisfied. C. B. B., JR.

[17] *See* 4 WILLISTON, THE LAW OF CONTRACTS (rev. ed. 1936) Sec. 1230.

[18] *See* CAMPBELL, *Protection Against Indirect Attack* in HARVARD LEGAL ESSAYS (1934) 3-4.

[19] *See* Gholson v. Savin, *supra* at pp. 560-1; *cf.* The Adams Express Co. v. Beckwith, 100 Ohio St. 348, 126 N.E. 300 (1919), *overruling*, Ellis v. Bitzer, 2 Ohio 89 (1825). Compare Losito v. Kruse, Jr. 136 Ohio St. 183, 24 N.E. (2d) 705 (1940), with Herron v. City of Youngstown, 136 Ohio St. 190, 24 N.E. (2d) 708 (1940).

[20] *See* RESTATEMENT, CONTRACTS (1932) Sec. 76 (c); *cf.* Turnbull v. Brock, 31 Ohio St. 649 (1877).

[21] *Cf.* Harper v. Graham, 20 Ohio 106 (1851); Adams Recreation Palace, Inc. v. Griffith, 58 Ohio App. 216, 16 N.E. (2d) 489 (1937), (1938) 5 O.S.L.J. 115, (1939) 13 U. CIN. L. REV. 496; *see* WRIGHT, *Ought the Doctrine of Consideration to be Abolished from the Common Law?* (1936) 49 HARV. L. REV. 1225; Ohio Gen. Code, Secs. 8079-8084 and RESTATEMENT, CONTRACTS, OHIO ANNOT. (1933) Sec. 121; 119 A.L.R. 112. *But cf.* Schaefer v. The First National Bank, 134 Ohio St. 511, 18 N.E. (2d) 263 (1938), (1939) 52 HARV. L. REV. 687.