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THE INDOSER AND MAKER OF A NOTE AS SURETIES

Presented for the Degree

of

Bachelor of Laws

by

James Jenkins

Cornell University

1894
The origin of the contract of suretyship is veiled in the mists of antiquity. The sanction of the contract, like that of all contracts, rested at first simply on the sacredness of the promise and found its binding force in religion. The statement that the contract of suretyship as we know it, is derived from the Civil Law is not quite accurate. Suretyship was known and recognized by the Jews before Romulus sent forth his first decree. "He that is surety for a stranger shall smart for it and he that hateth suretyship is sure". Proving that out of the social condition of the Jews the contract of suretyship must have been used to a large extent to call forth the warning and denunciation of the Solomon. Again, Frankston gives testimony to the effect that a contract of suretyship existed as part and parcel of the common law. And an examination of the law of several semi-civilized nations shows that they recognize such a contract.

Distinct and independent societies, when they reach a certain degree of civilization, originate and adopt sim-
ilar laws, and the law of suretyship is one of the laws so recognized. So we may say it has a distinct and separate origin among different peoples. The more correct statement would be that many of the principles governing the law of suretyship as recognized by the Roman law is applied to suretyship in our law. The reason for thus ingrafting the principles of the civil law of suretyship is that the civil law, in the process of evolution had reached a higher degree of perfection than that of the law of suretyship of any other people.

Judge Cooley defines a surety as follows:- "A surety is a person who being liable to pay a debt or perform an obligation, is entitled, if it be enforced against him, to be indemnified by some other person who ought himself to have made payment or performed before the surety was compelled to do so". Suretyship is distinguished from guaranty by the Supreme Court of Pennsylvania as follows: "A contract of suretyship creates a direct liability to the creditor for the act to be performed by the debtor, but a contract of guaranty creates a liability only for his ability to perform such act. A surety is an in-

(a) Smith v. Sheldon, 35 Mich. 42.
surer of the debt, while a guarantor is only an insurer of the solvency of the debtor.\(^{(b)}\)

One may become a surety by express contract, by indorsing or signing a note, by mortgage of wife's separate property to secure the debts of her husband, by agreement of partner to assume debts of the firm, by pledging property to secure the debt of another, and by entering into a joint obligation. The consideration may be some advantage to the principal or surety, or disadvantage or detriment to the creditor, usually the same consideration that supports the original contract supports the contract of suretyship. The contract is not uberrimae fidei in its inception but becomes so after it is once entered into.

It is my purpose to consider the indorser and maker of a note as a surety.

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(a) Campbell v. Sherman, 151 Pa. St. 70.
CHAPTER II.

PAROL EVIDENCE TO SHOW THAT AN APPARENT ENDORSER IS MERELY A SURETY

That a contract governed by the law of a merchant is a contract of suretyship does not usually appear upon the face of the instrument; it bears no earmarks to distinguish it from ordinary business paper. This is necessary in order that such an instrument fulfill the purpose of its creation, i.e., to answer as a circulating medium in the busy markets of trade. The business man is always justified in treating an instrument in the law of a merchant as he finds it from an inspection; he is not bound to inquire into its inception as to whether the instrument is accommodation or business paper. He is entitled to treat all parties as their names appear, thus if a man appear as a maker of an instrument in the law of a merchant the holder without notice, is entitled to treat him as such and, if the fact that he is only surety does not affect the contract and obliges the holder without notice to treat him as surety. (a)

(A) 9 S. & E. 229.
The rule being that a holder without notice is entitled to treat parties to a note or bill as they appear, the law governing accommodation paper, when in the hands of bona fide holders, the same as the law governing business paper.

A perplexed question arises in considering the right and obligations of several persons who make or endorse a note for the accommodation of a third person. A. and B. endorse a note for the accommodation of C. C. transfers the note to D. for a valuable consideration. D. recovers of B. What rights has B. against A? There appears to be three rules applied by courts of different jurisdiction. First, parol evidence cannot be admitted to vary the terms of a written contract and therefore B. may recover from A. the full amount of the note. (a) Second, that the presumption is that the parties are indorsers in the order that their names appear; but as soon as it is shown that the endorsements were made at the same time for the accommodation of the maker the parties are, in the absence of agreement, to the contrary, co-sureties. (b) 2 Camp.
Third, that the parties are to show what the contract is, and in the absence of any proof the liability is as the names appear upon the instrument. The first rule is applied very sparingly at the present time. The third rule is usually applied in this country.

This brings us to a discussion of the power of an indorser to show that his liability is limited by parol agreement. A case squarely in point and one often cited, is Hill v. Ely (5 S. & R. 363). In this case one Ely sold to Hill a certain quantity of coffee and took in payment certain notes drawn in favor of Hill by one Lamb, the understanding being that the notes were to be taken as absolute payment without further recourse to Hill. Hill indorsed the notes to enable Ely to collect and Ely promised not to hold Hill. At the trial this evidence was rejected as tending to vary the terms of a written contract. On appeal the court held the evidence admissible on the ground that the rule of the common law excluding parol evidence, in this case, would work a fraud and as the common law courts of Pennsylvania were constituted the evidence could be admitted the same as if the cause was in chancery.
This case, although frequently cited, has been stated by judges to apply to Pennsylvania alone owing to the peculiar constitution of her courts. (a) In Bank of the U. S. v. Dunn (6 Peters 58), where the case was relied upon to show that the contract implied by law from a blank indorsement might be thus varied by parol, the court said:— "In support of this position authorities are read from 5 S. & R. 363 and 4 Wash. C6. C. 480. In the latter case Mr. Justice Washington says,—'The reasons which forbid parol evidence to alter or explain written agreements and other instruments do not apply to those contracts implied by operation of law such as the law implies in respect to an indorser of a note of hand. The evidence of the agreement made between the plaintiff and defendants whereby the latter was to be discharged on the happenning of a particular event was therefore properly admitted. The decision in 5 S. & R. was on a question somewhat analogous to the one under consideration except in the present case there is no allegation of fraud and the decision in that case was made to turn, in part at

(a) There being no equity courts in Pennsylvania the power of the Common Law courts to apply equity doctrines is more extensive than those of any other state.
least, upon that ground. In Pennsylvania there is no court of chancery and it is known that the courts in that state admit parol proof to affect written contracts to greater extent than is sanctioned in the states where a chancery jurisdiction is exercised. "The rule has been differently settled in this court!". It was therefore held in Bank of U. S. v. Dunn that one who had indorsed a note in blank would not be permitted to show that he indorsed it upon the express condition that he was not to be held liable as an indorser in case the note was not paid by the maker. And this decision was put upon the express grounds that the liability of parties to instruments in the law merchant have been fixed by law and if parol evidence was admitted to vary the contract the value of these instruments as circulating medium would be greatly deteriorated. Other cases reaching substantially the same conclusion of Bank v. Dunn are Dale v. Gear (38 Conn. 15); Chaddock v. Vaunes (35 N. J. L. 517); Charles v. Dennis (42 Wis. 13);

The Pennsylvania courts have given the doctrine of the leading case, Hill v. Ely, a much more extensive application and have carried it to its full and logical con-
clusion. (a) I submit that it is difficult to understand how the privilege of one who indorsed a note on the express condition that he was not to be liable as indorser but the indorsement was made simply to allow the indorser to sue on the note; or that he was not an indorser of business paper for a valuable consideration but a mere surety, to show by parol in an action between the original parties, what the true contract was, affects the value of negotiable paper as a circulating medium. Of course, the defendant in the case of Hill v. Ely would not have been allowed to introduce parol evidence to show that he was an indorser without recourse if the note had been negotiated for the court said:— "If those notes had been so negotiated by Elisha Ely, William Hill's mouth would be stopped; a third person could not be affected by a latent agreement".

Again, a fraudulent use of the statutes for the prevention of fraud will not be permitted and a court of equity will interfere against a party attempting to make such a statute an instrument of fraud. (b) Now the rule

(a) Ross v. Espy, 66 Pa. St. 481.
of construction requiring that the old evidence cannot be admitted to vary a contract of the law if merchant is no stronger than the statutory requirement that certain contracts be in writing. Whenever an indorsee sues his immediate indorser on an indorsement which parties agree should be without recourse, or one of two accommodating indorsers, being compelled to pay the note upon which they were sureties, sues the other accommodating party as an indorser when they agree between themselves at the time of indorsement to become cosureties, if the parol agreement is not allowed to be shown a gross fraud will be permitted, and unless the rule excluding parol evidence to show what the contract of a man writing his name on the back of a negotiable instrument, is, of more force and stronger than the statutory rule, the evidence ought to be admitted. The court in Ross v. Epsy (supra) says:

"The better opinion on this subject would therefore seem to be that expressed by Maple, J., in Castrique v. Buttigag (10 Moore P. C. 108), where he says, 'the liability of an indorser to his immediate indorsee arises out of a contract between them and this contract in no case consists exclusively in the writing popularly called an indorsement, and which is indeed necessary to the exist-
once but that contract arises out of the written indorsement itself, the delivery of the bill to the indorsee, and by the words either spoken or written by the party, and the circumstances, (such as the usage of the place, the course of dealing between the parties and their relative situation) under which the delivery takes place. Thus a bill with an unqualified written indorsement may be delivered and received for the purpose of enabling the indorsee to receive the money for the account of the indorser, or to enable the indorsee to raise money for his own use on the credit of the signature of the indorser, or with the express stipulation that the indorsee, though for value, is to claim against the indorsee and acceptor only and not against the indorser who agrees to sell his claim against the prior party, but stipulates not to warrant their solvency. In all these cases the indorser is not liable to the indorsee and they are all in conformity with the general law of contracts, which enables parties to them to limit and modify their liability as they think fit, providing they do not infringe any prohibitory law".

It is submitted that this is a clear statement of
the law, and that it has been fully worked out by the Pennsylvania courts, also that the peculiar constitution of the common law courts of Pennsylvania does not give them any more, nor as much power now, as the courts of the code states to apply these rules, although equitable rather than legal.

Pennsylvania makes the intention of the parties the test of the contract and if this is expressed the general law governing contracts is applied, and if not, parol evidence is admitted to show what the agreement really is. Accordingly the following cases hold that as between an indorser and his immediate indorsee, parol evidence is always admissible to show what the contract is. Patton v. Pearson (57 Me. 448), Harrison v. McKin, (18 Iowa 485); Pike v. Street, (Moody & M. 236); Johnston v. Martinus, (4 Halst. 144);

It seems to be settled however, in many of the states, that parol evidence is not admissible to show that an indorsement in blank was agreed to be without recourse (a). However, many courts admit parol evidence to show that the contract is one of suretyship and not

(a) Charles v. Dennis, 42 Wis. 56.
an indorsement; and exclude the same kind of evidence when offered to show that the indorsement is one without recourse.(a) The grounds for the distinction are given in Esterly v. Earber, (66 I. Y. 433) as follows,—after citing the authority for the proposition that several persons who appear on a bond, jointly and severally liable as sureties, may make valid parol contracts by which one indemnifies the other, the court said:—"No reason exists why the same principle is not applicable to notes and bills of exchange. The terms of the contract contained in instruments of this character, which are within its scope to define and regulate, can not be changed by parol; but the understanding between the indorsers is a distinct and separate subject, an outside matter which may be proved independent of, and without any regard to the instrument itself."

The theory therefore, on which the Pennsylvania courts admit parol evidence to show that an apparent indorsement is a contract of suretyship is that to exclude the evidence would be fraud and the theory of the New

(a) Dale v. Gear, 38 Conn. 15.
Fassen v. Hubbard, 55 I. Y. 455.
Esterly v. Earber, (supra).
York courts is that the understanding between the several parties who appear as indorsers are sureties, is an independent and collateral matter.

The case of Fasson v. Hubbard, (55 N. Y. 455) although frequently cited to establish the doctrine that an indorser cannot introduce prool evidence to show that he indorsed without recourse does not decide that point.

Brander and Hubbard were partners, the partnership was dissolved and Hubbard was authorized to wind up the business; in pursuance of this authority he indorsed a note payable to one Martin and made by a stranger to satisfy a claim against the old firm. The indorsement was in the following words:— "Brander and Hubbard in liquidation of old firm". The defence claimed that the words "in liquidation of the old firm", showed that the note was given to liquidate the old business, whereupon the court incidentally remarked that Parsons says:— "To relieve one who indorses paper from liability, as such, he must insert in the contract itself words clearly expressing such intention. Further it was expressly shown that the words "in liquidation of old firm" were to distinguish the act from acts of a new firm that had been form-
ed by the same parties so that the question has not been
decided by the Court of Appeals in this state, whether
an indorser may show by parol that his indorsement was
understood to be without recourse.

It seems that the Pennsylvania theory, that to allow
an immediate indorsee to recover of his indorser when
it was understood that the contract was to be without re-
course, or to allow one of several who have indorsed as
cosureties to treat the writing as an indorsement would
work a fraud and therefore parol evidence is admitted to
show what the contract is, is the better rule.
CHAPTER III.

After determining the grounds upon which parol evidence is admitted to show that apparent indorsers are not what they seem but are accommodation indorsers, what is the law as to their liability if no agreement is stated? As already mentioned there are three different rules only two of which prevail to any extent. I shall briefly state the rules and the jurisdictions to which they apply. In North Carolina and those states following the case of Daniel v. McRea, accommodation indorsers on a note for the benefit of third persons, where there is no special agreement between such indorsers, and neither is benefited, are co-sureties, entitled to contribution as against each other? Though there indorsements were made at different times. (a) But the general doctrine is that in order to constitute indorsers, whether for accommodation or value, co-sureties so as to be entitled to contribution against each other, there must be a special

(a) Daniel v. McRea, 2 Hawks, 590.
agreement between them to that effect. At all events their engagements must be joint and not successive. (a) In the absence of such an agreement shown in the instrument or by parol the presumption is that the parties are to be liable as in the order that their names appear.

Anomalous Indorser.— It now remains to consider the anomalous indorsement, that is an indorsement by a stranger before the indorsement of the payee. "Now this act though often spoken of as a kind of indorsement or an anomalous indorsement, is not properly speaking an indorsement; while the papers in the hands of the payee it cannot be indorsed by another, according to the meaning of the indorsement in the law of merchant; the payee of paper, payable to order must be the first indorser." (b) However, some courts treat the party as an indorser as far as they can; such courts refuse to say that he can be treated as the maker but treat him as an indorser sub modo. Thus in the case of Colter v. Richards (59 N. Y. 478) the doctrine before laid down was re-stated, that te

(a) MacDonnel v. Magruder, 3 Peters 470;
McCarty v. Roots, 21 How. (U. S.) 452;
Clapp v. Rich, 13 Gray 403;
Core v. Wilson, 40 Ind. 204;
Easterly v. Barber, 66 N. Y. 452;
Gibbons v. Merchants, etc Bank, 85 Ill. 443.
(b) Eigelow on Bills and Notes, p. 33.
presumption that one who indorsed a promissory note in blank, before delivery to the payee, was that he intended to become liable simply as separate indorser but that this presumption may be rebutted by parol.

The Vermont courts treat the contract as imperfectly expressed and receive parol evidence to show what the real contract is. (a) The general rule is to treat the party as being in the situation of the maker of the note. (b) If he signed the paper when executed he is co-maker and joint-maker with the real maker; if he signed at some later time he is still maker though not a joint maker, or maker by way of guarantor or surety. (c)

(a) Sylvester v. Downer, 20 Vt. 355.
(b) Union Bank v. Willet, 8 Metcalf, 504;
(c) Seymour v. Mickey 15 O. St. 15.
CHAPTER IV.

RIGHTS OF A SURETY

As has been said, the contract of suretyship after its inception is *uberrima fidei* and in general any modification of the original contract without the consent of the surety will work his discharge. A surety is entitled to share the benefits of any security which his co-surety has taken from his principal for his own indemnity against loss before being indemnified (a). If a surety signs a note payable to A., who declines to receive it, and it is then negotiated to E. such change in the payee if made without the knowledge and consent of the surety, releases him from liability (b). A surety has a right to stand upon the strict terms of his obligation (c).

In... A surety will be discharged if creditor by a binding agreement gives fuller time for the payment of debt.

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(a) Hoover v. Nowros, 34 Iowa, 43; Brown v. Wray, 18 N. H. 102; 2 Randall 514.
(b) Jones v. Bemson,
(c) 150 Ill. 536.
principal debtor. (a) Any variation of the contract between the principal debtor and the assured will discharge surety whether the surety is in fact injured or not. (b) But mere indulgence by an obligee to the principal debtor will not discharge. (c)

Sureties on a note who have been induced to believe for five years that the note has been paid will be discharged. (d)

When of two debtors one is surety for the other and the common creditor has taken security from the principal debtor he must give the surety the benefit of the security either by payment or by subrogation, and creditor, by surrendering security without consent of the surety discharges surety pro tanto. (e)

Liability of surety can not be extended by implication because they have a right to stand upon the exact letter of their contract. (f)

(b) 36 Minn. 39; Place v. McIlvaine, 38 N. Y. 96.
(c) Powers v. Silberstein, 108 N. Y. 169;
(d) 83 Kentucky 431.
(f) 39 Kansas 381.
A note given and accepted in place of a former note operates to extinguish it together with all rights of action thereon, and therefore surety on former note is discharged. (a)

Unless there is an agreement binding on the creditor the surety is not released by forbearance. (b) The general rule underlying the cases is said to be, a creditor does not lose his right to hold the surety by inaction of passiveness, except in cases in which the surety has taken such steps as compel the creditor to proceed or lose his claim. Thus the mere omission by the holder of a note to present it to the assignee for the benefit of creditors will not discharge the surety. (c) Neither is a surety discharged by the creditor's failure to present the claim to an administrator of effects of the principal debtor. (d).

In Scott v. Fisher, 120 N. C. 311) the facts were as follows:—J. S. Fisher was the maker of a promissory note payable one day after date to one A. C. Scott, with

(a) 51 Pa. St. 190.
(b) 3 J. J. Marsh. 525.
(c) Barnes v. Howre, 129 Ind. 568; 21 0. St. 26.
(d) 4 Smeads & N. 465.
with interest at eight per cent. The defence relied upon by the surety was that the payee, without his consent, had entered into a valid agreement with the maker to forbear and extend the collection of the note. It appeared that some time after the execution of the note, the maker met the payee and offered to pay the note when the payee remarked that he did not need the money, and that if the maker would pay him the interest semi-annually, he might keep the note, to which the latter replied, "all right" and kept the money; and that this agreement was entered into by the maker and payee of the note without the knowledge or consent of the surety thereon. The court below instructed the jury that such an agreement was not such a contract to forbear to collect the note as would discharge the surety. Held on appeal, error, and that there was a binding agreement extending the time of payment and therefore the surety was discharged.