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Suretyship: Defenses of Sureties and Guarantors under R.C.M. 1935, Sections 8188 and 8201

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an adaptation of that of California. The decisions of the California courts seem to justify such a conclusion.[2]

An interesting question which would be likely to arise only in those states where the executor has a right to the possession of the entire estate during administration, now presents itself: If the rents and profits were not needed for payment of debts, could a legatee satisfy his legacy from such rents and profits at the expense of the specific devisee where the rents and profits were not specifically charged with the payment of such legacy?

Montana has held that in marshaling assets executors may take into possession everything that belongs to an estate, and may receive the rents and profits from real estate specifically devised, for the time named in R. C. M. 1935, Section 10138; but that he receives them as security for payment of debts or expenses of administration, and if they are not needed for that purpose he may not call on such security to enhance the amount which passes to the residuary legatee at the expense of the holder of title to the land specifically devised.[3] The language of the court is broad enough there to include any legatee. This holding seems right and just if rents and profits are to be considered and treated as realty and not as personalty by the courts. An additional ground for such a holding is that it was the probable intention of the testator that the rents and profits should go with the realty to the specific devisee where he has not mentioned them otherwise in his will.

—Grover C. Schmidt, Jr.

SURETYSHIP: DEFENSES OF SURETIES AND GUARANTORS UNDER R. C. M. 1935, SECTIONS 8188 AND 8201

C was surety upon B's bond to A. A and B agreed that the interest rate thereon should be reduced. C was held to be discharged.[1]

A leased certain property to B at a rental of $28,000 per year. C guaranteed due performance by B. Subsequently A agreed to reduce the rental to $23,000 per year.

[2] See especially In re De Bernal's Estate (1913) 165 Cal. 223, 131 P. 375. And also see Estate of Woodworth (1867) 31 Cal. 595; Washington v. Black (1890) 83 Cal. 290, 23 P. 300; In re Izedorio's Estate (1929) 100 Cal. App. 469, 280 P. 171.

[3] In re Bradfield's Estate (1923) 69 Mont. 247, 221 P. 531.

[1] Board of Commissioners of Fillmore County v. Greenleaf (1900) 80 Minn. 242, 83 N. W. 157.

On the default of B in the payment of rent and suit by A against C, C was held to have been released.[2]

B contracted to purchase 16 cans of milk from A daily. C guaranteed performance by B. Later A and B agreed that B should be required to purchase only 13 cans daily. B failed to pay for the milk purchased. C was held not liable at the suit of A.[3]

In a much quoted statement of the doctrine upon which these results have been reached the United States Supreme Court said:

> ". . . the liability of a surety is not to be extended, by implication, beyond the terms of his contract. To the extent, and in the manner, and under the circumstances pointed out in his obligation, he is bound, and no further. It is not sufficient that he may sustain no injury by a change in the contract, or that it may even be for his benefit. He has a right to stand upon the very terms of his contract; and if he does not assent to any variation of it, and a variation is made, it is fatal.'"[4]

As might be expected, the principle of *strictissimi juris* as here enunciated has been widely criticized.[5] Judicial impatience with the rule has resulted in a large body of decisions seeking by various devices and distinctions—some sound, some questionable—to avoid the hardship which would result from its application.[6]

[2] Katz v. Leblang (1935) 243 App. Div. 421, 277 N. Y. S. 850.
[3] Driscoll v. Winters (1898) 122 Cal. 65, 54 P. 387.
[4] Per Justice Story in Miller v. Stewart (1824) 9 Wheat 680, 6 L. Ed. 189.
[5] Becker v. Faber (1939) 280 N. Y. 146, 19 N. E. (2d) 998; CARDOZA, NATURE OF THE JUDICIAL PROCESS (1927) pp. 152, 153; STEARNS, LAW OF SURETYSHIP (4th ed. 1934) pp. 110b, 111; LAW REVISION COMMISSION REPORT RECOMMENDATIONS AND STUDIES (New York 1937) p. 938; notes in 35 COLUM. L. REV. 620 (1935), and 25 CORNELL L. Q. 707 (1932); Durfee, *Book Review*, 17 CORNELL L. Q. 143 (1939).
[6] The courts have taken a distinction between "actual changes in the terms of the contract and acts or omissions of the plaintiff in the performance" or "departures from the terms of the contract relating to method of procedure", Roberts v. Security Trust and Savings Bank (1925) 196 Cal. 575, 238 P. 667; Martin v. Whites (1907) 128 Mo. 117, 106 S. W. 608; Smith v. Molleson (1896) 48 N. Y. 241, 42 N. E. 669; between variation of contract and mere "exemption from part performance" or "partial release from liability", Kennedy v. Mayer (1935) 5 Cal. App. (2d) 29, 42 P. (2d) 352; Duffy v. Buena Vista Ice Co. (1914) 122 Md. 642, 90 A. 55; or, as some courts have said, from a "mere remission", Becker v. Faber (1939) 280 N. Y. 146, 19 N. E. (2d) 997; ANNOTATION: 121 A. L. R. 1010; notes in 25 CORNELL L. Q. 143 (1939), and 39 COLUM. L. REV. 1254 (1939); 4 WILLISTON, CONTRACTS (Rev. ed. 1936) pp. 3554, 3555; have construed the original contract as permitting the change, United States v. McMullen (1912)

An examination of the cases in this field reveals three general types of factual situation: 1st, cases involving an actual physical alteration of the written contract of the principal debtor; 2nd, cases in which the written contract of the principal is intact, but one or more of its terms has been changed by a collateral agreement between the debtor and creditor; and

222 U. S. 460, 32 S. C. 128, 56 L. Ed. 269; Hohn v. Shidler (1904) 164 Ind. 632, 72 N. E. 575; Richardson v. Steuben County (1919) 226 N. Y. 13, 122 N. E. 449; Daly v. Old (1909) 35 Utah 82, 99 P. 410, 28 L. R. A. (N. S.) 463; have applied a doctrine of "implied assent" to the non-prejudicial changes, Hinton v. Stanton (1914) 112 Ark. 207, 165 S. W. 299; Fruit Growers' Supply Co. v. Goss (1935) 4 Cal. App. (2d) 651, 41 P. (2d) 356; Cooke v. White Common School District No. 7 of Barren County (1908) 33 Ky. Law Rep. 926, 111 S. W. 686; ARANT, SURETYSHIP (1931) pp. 278, 279; have held that the surety will be discharged only as to liability accruing after the variation in contract, Duffy v. Buena Vista Ice Co., *supra;* Ducker v. Rapp (1876) 67 N. Y. 464; Coe v. Cassidy (1878) 72 N. Y. 133; Magazine Digest Publishing Co. v. Shade (1938) 330 Pa. 487, 199 A. 190, 117 A. L. R. 960; Land Title Bank & Trust Co. v. Freas (1939) 334 Pa. 26, 5 A. (2d) 165; have held an alteration by a stranger to be without effect; R. C. M. 1935, §8188, provides for guarantor's release if the original obligation has been altered "by any act of the creditor"; Anderson v. Bellinger (1898) 87 Ala. 334, 6 So. 82, 4 L. R. A. 680; Bridges v. Winters (1868) 42 Miss. 135, 2 Am. Rep. 598; ARNOLD, SURETYSHIP AND GUARANTY (1927) p. 174; have held that the changes were not "material", Wilkinson v. McKimmie (1913) 299 U. S. 590, 33 S. C. 783, 57 L. Ed. 1343; Carroll v. Hanahan (1930) 221 Ala. 553, 130 So. 197; Publishers: George Knapp & Co. v. Wilks (1912) 105 Ark. 243, 151 S. W. 280; Lasky v. Bew (1913) 22 Cal. App. 393, 134 P. 358; Phil & H. Quinto, Inc. v. Stein (1936) 123 Pa. Super. 109, 186 A. 280; Stephens v. Elver (1898) 101 Wis. 392, 77 N. W. 737; have required that the variation be contractually binding, R. C. M. 1935, §8189; Dodd v. Vucovich (1909) 38 Mont. 188, 99 P. 296; Bradford v. Union Trust Co. (1932) 242 Ky. 709, 47 S. W. (2d) 536; Detroit Trust Co. et al. v. Lange (1934) 267 Mich. 69, 255 N. W. 320; Schroyer v. Thompson (1918) 262 Penn. 303, 105 A. 279, 2 A. L. R. 1567; Gillman v. Purdy (1932) 167 Wash. 659, 9 P. (2d) 1092; ANNOTATION: 121 A. L. R. 1019; have held that an alteration on the face of the instrument itself does not discharge the surety where not fraudulently made, Paulk v. Williams (1922) 28 Ga. App. 183, 110 S. E. 632; International Shoe Co. v. Mosier (1935) 173 Okla. 481, 48 P. (2d) 165; have held that modification of the contract does not release an indemnitor of a surety or guarantor in the absence of a showing of injury, Watanabe v. Ota (1926) 137 Wash. 368, 242 P. 379, 43 A. L. R. 1365; have held that a surety or guarantor "who has been indemnified by the principal, is liable to the creditor to the extent of the indemnity . . ." though the creditor may have modified the principal contract, R. C. M. 1935, §§8193, 8188; Kleinhaus v. Generous (1874) 25 Ohio St. 667; Smith v. Estate of Steele (1853) 25 Vt. 427, 60 Am. Dec. 276; have held that an alteration intended to correct a mistake and make the contract conform to the true intention of the parties does not discharge the surety, International Shoe Co. v. Mosier, *supra*; Bank of Henning v. Graves (1914) 5 Tenn. C. C. A. 262; Klunby v. Hogden (1930) 202 Wis. 438, 252 N. W. 858, 73 A. L. R. 652; have held that compensated, as distinguished from accommodation, sureties, are released only upon a showing that the variation has been prejudicial to them, and then pro tanto and not in toto, In re Taba-

3rd, cases in which there is neither a strict alteration of instrument, nor a collateral contract varying its terms, but in which the acts of the creditor, contractual or otherwise, have affected the suretyship or guaranty relationship.

Each of these situations differs in essential particulars from the other two. Many of the inequitable decisions found in this field are directly traceable to the failure of the courts to keep these distinctions carefully in mind and the resulting application of the general doctrine of "release irrespective of prejudice" in all three cases.

Where there is an actual alteration of instrument there seems no escape from the decision that a party not consenting to the alteration may not be held in a suit upon the instrument, and this though the alteration does not appear to have injured him. The contract upon which his obligation rested has been destroyed and the question of benefit or prejudice would not seem to be relevant.[7]

The doctrine generally held applicable to cases of the third type is that of "potential harm". Any act of the creditor which might by any possibility result in injury to the surety is held to discharge the surety.[8] To this rule, however, a growing body of cases have engrafted an exception—holding that a compensated surety will be discharged only if he has been actually harmed.[9]

Cases in the second class stand in an intermediate position. It is clear that they do not involve an actual alteration of instrument. The surety cannot be heard to say that the contract which he made has been destroyed. It remains whole and un-

sinsky's Estate (1940) —— Iowa ——, 293 N. W. 578; In re Lanwehr's Estate (1938) 286 Mich. 698, 282 N. W. 873; Corporation of President of Church of Jesus Christ of Latter-Day Saints v. Hartford Accident & Indemnity Co., et al. (1939) —— Utah ——, 95 P. (2d) 73; Montpelier v. National Surety Co. (1923) 97 Vt. 111, 122 A. 484; ANNOTATIONS: 12 A. L.R. 378, 382, and 94 A. L. R. 864, 876; Arnold, *The Compensated Surety*, 26 COLUM. L. REV. 174 (1926), and have exhibited a tendency to classify the various types of surety and guaranty contracts and hold the ordinary rules inapplicable to special classes, Schrieber, et al. v. Worm (1908) 164 Ind. 7, 72 N. E. 852; Borus Watson Inc. v. Henn (1932) 108 N. J. Law 514, 158 A. 484, 81 A. L. R. 1208; Yonkers Builders' Supply Co. v. Petro Luciano and Son (1935) 269 N. Y. 171, 199 N. E. 45; LAW REVISION COMMISSION REPORT RECOMMENDATIONS AND STUDIES (New York 1937) p. 918. It is significant that these examples do not approach a complete coverage, but are simply illustrative of a great body of similar cases.

[7] Coburn v. Webb (1877) 56 Ind. 96, 26 Am. Rep. 15; Fillmore Co. v. Greenleaf (1900) 80 Minn. 242, 83 N. W. 157.

[8] But a few cases have held that in this situation the surety or guarantor will not be discharged by an increase in risk not resulting in actual injury, Hohn v. Shidler (1904) 164 Ind. 242, 72 N. E. 575; Schreiber v. Worm (1904) 164 Ind. 7, 72 N. E. 852.

[9] See cases cited in note 6 *supra*.

impaired. It would therefore seem that the extension of the strict legal defense of alteration of instrument to this situation is not only unnecessary but unwarranted. The surety ought properly to be discharged only where the subsequent contract between the debtor and creditor is such that it may be said that the original contract upon which the surety was liable has been rescinded, or where the change in the terms of the original contract is such that the surety is actually injured or, at the very least, potentially harmed. This approach has been succinctly stated by the Massachusetts' Court:

> "In the cases where it has been held that a material alteration of a note or other contract avoids it, there has been some change by erasure or interlineation in the paper writing constituting the evidence of the contract which the parties made. The ground of the decisions is that the identity of the contract is destroyed.
>
> "Where the act of which the surety complains is a new agreement, we think the true rule is, that, if such new agreement is or may be injurious to the surety, or if it amounts to a substitution of the new agreement for the old, so as to discharge and put an end to the latter, the surety is discharged. But if the change in the original contract from its nature is beneficial to the surety, or if it is self evident that it cannot prejudice him, the surety is not discharged."[10]

But the courts have quite generally lost sight of these basic distinctions. The physical alteration of a contract and a change in its terms by a separate agreement have been indifferently denominated and treated as "alterations" within the strict legal doctrine of alteration of instrument. As a result a surety is released by what is not in fact an alteration of instrument in situation where there is no variation of risk; i. e., no possible prejudice to the surety either "potential" or otherwise.

Fortunately the confusion of the courts may yet be clarified. Most of the cases enunciating this doctrine do so only in *dicta*. A recognition of the distinction between an alteration on the one hand and a variation by collateral agreement on the other is implicit in a growing body of decisions. Cases holding that a surety who has been indemnified is not released by a variation in his contract; that an agreement varying the terms of the principal obligation will not release the surety unless such agreement be contractually binding; that a compensated

[10]Cambridge Savings Bank v. Hyde (1881) 131 Mass. 77, 41 Am. Rep. 193.

surety will be discharged by such a variation only if he makes a showing that he suffered actual injury as a result of such variation; or that a binding contract merely "remitting" a part of the performance due the promisee from the promisor under the terms of the original obligation will not release the surety; all fall within this description.[11] For though each of these rules is applicable in a case involving a variation of contract by collateral agreement none of them would be applied in an action where there was a true alteration of instrument.[12]

The doctrinal soundness of the position that the applicable principle in a case of mere variation by collateral contract is that of release on a showing of "actual or potential harm" rather than that of "release irrespective of injury", is nicely illustrated in the recognition by the courts of an exception to the general rule that a surety will be discharged by a binding agreement extending the time within which the promisor must perform, where there is a reservation of rights against the surety.[13] Clearly the only logical grounds upon which this exception can be supported is that the possibility that the surety may be injured by his inability to pay the debt on the due date and be subrogated to the creditor's right to bring immediate action against the debtor, is lacking where the creditor has reserved his right to sue the surety and thus has put the surety in a position to claim reimbursement or exoneration from the debtor.[14] But it is equally clear that there is as much a change in the terms of the principal obligation where there has been

[11]See cases cited in note 6 *supra*.

[12]Compare, for example, Schroyer et al. v. Thompson (1918) 262 Pa. 282, 105 A. 274 with Nissen v. Ehrenpfort (1919) 42 Cal. App. 493, 183 P. 956; Keller v. Rock Island State Bank (1920) 292 Ill. 553, 127 N. E. 94; and Sloan v. Latimer (1894) 41 S. C. 217, 19 S. E. 491; and see 20 ILL. L. REV. 101 (1925). And for another interesting illustration of a situation in which the distinction between an alteration and variation is recognized examine Richards v. Market Exchange Bank (1910) 81 Ohio St. 348, 90 N. E. 1000, 26 L .R. A. (N. S.) 99; Oklahoma State Bank of Sayre v. Seaton et al. (1918) 69 Okla. 99, 170 P. 477.

[13]Dean v. Rice et al. (1901) 63 Kan. 691, 66 P. 992; 4 WILLISTON, CONTRACTS (Rev. ed. 1936) p. 3524. The same is true of a discharge of the debtor with reservation of right of recourse against guarantor, Bank of Italy v. Symmes (1931) 118 Cal. App. 716, 5 P. (2d) 956; RESTATEMENT OF CONTRACTS, §122.

[14]The language of the opinion in Dean v. Rice et al. (1901) 63 Kan. 691, 66 P. 992, is typical: "When a creditor ties his own hands, and grants an indulgence which prevents a surety from obtaining that indemnity against a principal which the law gives him, the surety is necessarily prejudiced, and should be released. . . . If the surety is not deprived of the protection and indemnity which the law affords him against a principal, he is not prejudiced, and is not entitled to be released from the obligation which he had undertaken."

an extension of time with the reservation, as where there is an extension without the reservation. The conclusion seems inescapable that here, at least, the courts are holding in effect that if the surety cannot by any possibility be harmed by a variation in the contract resulting from an agreement between the debtor and creditor he will not be discharged thereby.

Yet another well established modern doctrine reveals the same implicit recognition of this position. It is said that "the doctrine supported by the cases generally is that a remission or waiver of part of the principal's obligation does not ordinarily release his surety or guarantor as to the remainder, and this . . . (though) . . . the remission or waiver is based on a binding contract with the principal. . . ".[15] Here again the rule is not applied where there is an actual alteration of instrument, and again we have a case where the only reason for the exception is that the situation which it comprehends is one in which there can be no harm, actual or potential, to the surety.

It is submitted that the authority directly supporting the rule here suggested,[16] together with the persuasive authority of

[15]121 A. L. R. 1014, 1015. Though the general statement of the annotator seems to be sound it must be noticed for the sake of accuracy that three of the eight American cases cited support the rule enunciated only in *dictum*, Ellis v. McCormick (1857) 1 Hilt. (N. Y.) 313; Revel Realty and Securities Co. v. Maxwell (1909) 65 Misc. 54, 119 N. Y. S. 257; and Becker v. Faber (1939) 280 N. Y. 146, 19 N. E. (2d) 997, 121 A. L. R. 1010; one was decided under statutory provisions which required a showing of prejudice even where an actual alteration of the principal obligation was involved, Federal Sign System v Leopold (1929) 10 La. App. 709, 120 So. 898; in two others it does not specifically appear that the variation was by binding collateral contract, Preston v. Huntingdon (1887) 67 Mich. 139, 34 N. W. 279; and Cambridge Savings Bank v. Hyde (1881) 131 Mass. 77, 41 Am. Rep. 193; and that the remaining two cases were decided upon an entirely different theory, Coe v. Cassidy (1878) 72 N. Y. 133; and Uhlman Realty Co. v. Hollander (1910) 66 Misc. 388, 123 N. Y. S. 772; the same may be said of Cambridge Savings Bank v. Hyde, *supra*.

[16]Cambridge Savings Bank v. Hyde (1881) 131 Mass. 77, 41 Am. Rep. 193 (as indicated in note 15 this case may possibly be only *dicta)*; Bearse v. Leowich et al. (1912) 212 Mass. 344, 99 N. E. 174, recognizes the distinction though for another purpose; Boston Box Co., Inc., v. Rosen (1926) 154 Mass. 331, 150 N. E. 177 (though there is some confusion in the court's language); Uhlman Realty Co. v. Hollander (1910) 66 Misc. 388, 123 N. Y. S. 772, in which a lower New York Court follows the rule of the Cambridge case without expressly making a distinction between an alteration and variation; Ganey v. Hohlman (1908) 145 Ill. App. 467, seems to be authority in point although it incidentally misuses the term "alteration". And see Smith v. United States (1865) 2 Wall. 219, 69 U. S. 788; Ziegler v. Hallahan C. C., E. D. Penn. 1904) 126 F. 788; Prescott National Bank v. Head (1907) 11 Ariz. 213, 90 P. 328. The English rule seems to be in accord, Croydon Gas Co. v. Dickinson (1876) L. R. 2 C. P. D. 46; Holme v. Brunskill (1878) 3 Q. B. D. 495.

See notes in 16 HARV. L. REV. 511 (1903), and 21 HARV. L. REV.

such tacit recognitions of the rule as those set forth above, furnish a sound body of precedent upon which the Montana Supreme Court may avoid at least some measure of the hardship which would result from an uncritical application of the doctrine of *strictissimi juris.*

Further, the applicable Montana statutory provisions, properly interpreted, would seem to require our Court to take this position. The pertinent Sections of the REVISED CODE are 8188 and 8201, which are set forth in full in the margin.[11] In interpreting these statutes two distinct questions present themselves: first, as to whether the defenses which are given the surety are different from those given the guarantor; and second, as to which of these defenses are available to the surety or guarantor only if he can establish that he has been potentially harmed, or has suffered actual injury. While only the second of these two inquiries would seem to be pertinent to our discussion the language and relationship of the statutes makes separate treatment of that question impossible. Bearing both problems in mind four possible interpretations of the sections suggest themselves:

If the paragraphing of Section 8201 into three separate subsections and the setting off of these subsections by semicolons were disregarded, or if Subsection 2 and 3 were taken as controlling Subsection 1, the surety's defenses, as contrasted

63 (1907); RESTATEMENT OF CONTRACTS, MONTANA ANNOTATIONS p. 236; 4 WILLISTON, CONTRACTS (Rev. ed. 1926) p. 3555, note 16; 121 A. L. R. 1014, 1017; STEARNS, LAW OF SURETYSHIP (4th ed. 1934) p. 100b, note 27; ARNOLD, OUTLINE OF SURETYSHIP AND GUARANTY (1927) p. 176: "A variation from the terms of the original contract, by agreement between the principal and obligee, is different from an alteration. Many of the cases may be reconciled if a distinction is observed between an alteration *on* the original contract, and a separate undertaking changing its provisions. . . . An alteration of a material character releases the guarantors because the contract is destroyed. But an agreement to vary gives the surety an equitable defense. . . . To avail the surety the variation must be injurious to him."

[11] R. C. M. 1935, §8188: "A guarantor is exonerated, except so far as he may be indemnified by the principal, if by any act of the creditor, without the consent of the guarantor, the original obligation of the principal is altered in any respect, or the remedies or rights of the creditor against the principal, in respect thereto, in any wise impaired or suspended."

§8201: "A surety is exonerated:

1. In like manner with a guarantor;
2. To the extent to which he is prejudiced by any act of the creditor which would naturally prove injurious to the remedies of the surety or inconsistent with his rights, or which lessens his security; or,
3. To the extent to which he is prejudiced by an omission of the creditor to do anything, when required by the surety, which it is his duty to do."

with those of a guarantor, would be limited to situations in which the surety has been prejudiced. Such in the interpretation which seems to have been adopted in *dictum*[18] in *National Surety Company v. Lincoln County, Montana,*[19] incorrectly citing *Dodd v. Vucovich*[20] as authority in point.

If this analysis were carried still further Subdivisions 2 and 3 of Section 8201 might be given controlling effect over the whole of Section 8188. The result would be to require both sureties and guarantors to make a showing of prejudice as a condition to a discharge in any and every case.

Of these two approaches the second has at least the advantage of treating sureties and guarantors alike. That either would be adopted is rendered highly unlikely by the fact that the court would be required to take the preliminary position that these sections were intended to abrogate the ancient doctrine that an actual alteration of instrument will discharge all parties not consenting thereto irrespective of whether they be injured or benefited by the alteration. Under the first approach an actual alteration of instrument would not discharge a surety unless he had been prejudiced thereby; under the second this would be true of both sureties and guarantors.

The third and preferable[21] solution would be to interpret Section 8188 as giving the guarantor a defense where the principal contract has been altered, or where there has been a collateral contract between the creditor and debtor which impairs or suspends the rights of the creditor. On well established principles no showing of prejudice to the surety would be necessary

[18]The case involved an *act* (i. e., prepayment to the contractor) of the creditor which would "naturally prove injurious to the remedies of the surety" or "which lessens his security" and therefor fell within the terms of sub.§2 of §8201 which provides that in such case the surety is exonerated only "to the extent to which he is prejudiced".

[19](C. C. A. 9th, 1917) 238 Fed. 705.

[20](1909) 38 Mont. 188, 99 P. 296. This case holds only that the agreement varying the terms of the contract must be supported by consideration. See Building and Loan Association v. Burns, et al., at p. 418 of 90 Mont. and p. 707 of 4 P. (2d); 121 A. L. R. 1014, 1019, 1021, notes 17, 25, and 26. Relying upon the supposed authority of the Dodd case a number of authorities have classified Montana as among the few jurisdictions adopting a liberal view, STEARNS, LAW OF SURETYSHIP (4th ed. 1934) p. 110b, note 27; ARNOLD, SURETYSHIP AND GUARANTY (1927) p. 177, note 48; 4 WILLISTON, CONTRACTS (Rev. ed. 1936) p. 3555, note 15; 25 CORNELL L. Q. 143, 146, note 16 (1940); *Principal and Surety*, 50 C. J. p. 120, note 79. Though this interpretation of the Dodd case seems clearly erroneous one can scarcely help regretting its correction.

[21]It is interesting to note that our CODE sections have been cited as offering a model for those states which desire to abrogate the common-law rule by legislative action, 39 COLUM. L. REV. 1254, 1256, note 13 (1939).

in either case. In the first the contract for whose performance the guarantor became bound has been destroyed, in the second the doctrine of potential harm is applicable. This analysis would simply exclude from the defenses of the guarantor any variation of contract by collateral agreement where that variation does not at least potentially harm the guarantor.

Subsection 1 of Section 8201 would make these same defenses (and with the same limitation) available to the surety. Subsections 2 and 3 would add to these by giving a defense where an act of the creditor (such as overpayment to a contractor in violation of the terms of a construction contract), or omission of the creditor (such as failure to record a mortgage given by the principal debtor as security), actually resulted in injury to the surety. Section 8188 would be interpreted as simply failing to be as exhaustive as 8201 and these last two defenses would be applied by analogy to the case of a guarantor.

The crucial points in this analysis—those at which the danger of a misinterpretation is the greatest—may best be considered by stating a fourth and final possible approach to these statutes. Section 8201 may be read as giving a surety (in Subsection 1) all the defenses that a guarantor would have *and in addition* those enumerated in Subsections 2 and 3. This analysis would be the one adopted if stress were laid upon the paragraphing and punctuation of Section 8201. The obvious objection to such an interpretation is that it gives to a surety defenses which are not available to a guarantor when on principle there seems to be no reason for such a discrimination. In truth, logic would furnish greater justification for according the more extensive defenses to a guarantor. The surety's promise is absolute in form; the guarantor's promise is only to answer in the event that the principal defaults in the performance of his obligation.

The second and more serious possibility of error is that the first clause of Section 8188 giving the guarantor and surety an absolute defense where there has been an alteration of the principal contract, may be interpreted as covering mere variations of contract by collateral agreement. As we have seen, such a mistake would not be surprising. Even the highest court of our land has spoken of "alteration of contract" when the instrument with which it was concerned was untouched.[25] In *United States Building and Loan Association v. Burns, et al.*[26]

[25]See; *e. g.* Wilkinson v. McKimmie (1912) 229 U. S. 590, 57 L. Ed. 1342, 33 S. C. 879.
[26](1931) 90 Mont. 402, 4 P. (2d) 703.

the Montana Court succeeded, in part, in avoiding this pitfall. Section 8188 was carefully and properly analyzed:

> "Section 8188, relating to the exoneration of a guarantor, for convenience we divide into divisions (a) and (b), is as follows: '(a) A guarantor is exonerated, except so far as he may be indemnified by the principal, if by any act of the creditor, without the consent of the guarantor, the original obligation of the principal is altered in any respect, (b) or the remedies or rights of the creditor against the principal, in respect thereto, in any wise impaired or suspended.
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> ". . . That part of Section 8188, which we have designated (a), deals with a legal defense as distinct from one that is equitable in its origin. For example, if a creditor changes the date on a note the surety has a defense, whether he will be prejudiced or not; his defense is that the changed note is not his contract. That part which is designated (b) has to do with cases where, strictly speaking, there may not be an alteration of the instrument itself.
>
> "Section 8188 deals with alterations of contract, and collateral contracts which cripple the rights of subrogation.'"[34]

After this commendable beginning the Court forgot its analysis and spoke of a collateral contract by which the creditor has suspended or impaired his rights against the debtor as an "alteration" of contract. The error seems especially unjustifiable in that the particular variation of contract involved was one of those specifically enumerated in the second clause of Section 8188.

In spite of this unfortunate language the *Burns* case seems to furnish, in its analysis of Section 8188, a sound foundation for the adoption of the more liberal position suggested in the third interpretation set forth above. The decision in the *Burns* case would probably[35] have been the same if the Court had main-

[34] At p. 417 of 90 Mont., p. 706 of 4 P. (2d).

[35] As noticed above, notes 6 and 9 *supra*, the well nigh universal modern rule is that the doctrine of *strictissimi juris* is inapplicable to the contracts of compensated sureties and guarantors; and, correlatively, that a variation of contract will discharge such a surety only if it operates to his prejudice. This rule is applied where, as in the Burns case, the surety defends on the ground that the creditor has bound himself to an extension of time, In re Tabinsky's Estate (1940) —— Iowa ——, 293 N. W. 578. It would seem that the surety in the Burns case (a mortgagor who had conveyed the mortgaged premises to one who assumed payment of the mortgage debt) ought properly to be treated as being in the compensated class within this rule. But

tained this position through the whole of its opinion, for the collateral contract involved had, as indicated, suspended the rights of the creditor and thus potentially harmed the surety.

It is to be hoped that when the Montana Court is called upon to decide a case in which a collateral agreement between debtor and creditor changes the terms of the principal contract without either recinding that contract or potentially harming the surety or guarantor, it will reaffirm the statutory interpretation adopted in the *Burns* case and hold that the surety or guarantor remains bound.[36]

—James R. Browning.

it has been suggested that the absolute form of the Montana statutes stating the causes for which a surety or guarantor will be released precludes the recognition of any distinction between compensated and gratuitous sureties in our state. The decisions in states having the same CODE sections indicate that fortunately such a result is unnecessary. It is true that in early cases the California Court seems to have held that compensated and accomodation sureties must be treated in the same manner, First Congregational Church of Christ in Cornona v. Lowrey (1917) 175 Cal. 124, 165 P. 440, adversely commented upon in 6 CALIF. L. REV. 80 (1917), wherein an interesting if rather startling doctrine of Code construction is suggested to overcome the difficulty; 25 CAL. JUR. 1088-9. A change in the Court's attitude is evident in the later cases of Turner v. Fidelity & Deposit Co. of Maryland (1921) 187 Cal. 76, 200 P. 959; and Roberts v. Security Trust and Savings Bank (1925) 196 Cal. 575, 238 P. 677, commented upon in 14 CALIF. L. REV. 395 (1926). And in 1932 a lower California Appellate court adopted the general rule unqualifiedly, Hansen v. Covell (Cal. App.) 14 P. (2d) 889. Both North and South Dakota have likewise applied the general doctrine that the converse of the rule of *strictissimi juris* is to be applied to the engagements of compensated sureties and guarantors, Long v. American Surety Co. (1912) 23 N. D. 492, 137 N. W. 41; Onida Independent School District No. 1 v. Groth (1928) 53 S. D. 458, 221 N. W. 49; though no case involving a non-prejudicial change in contract seem to have arisen. The Montana Court has also so held, State v. American Surety Co. of New York (1927) 78 Mont. 504, 255 P. 1063; Montana Auto Finance Corp. v. Federal Surety Co. (1929) 85 Mont. 149, 278 P. 116. And see State of Montana v. Fidelity & Deposit Co. (1936) 16 F. Supp. 489. It is significant that in so holding the Montana Court was confronted with a statute, absolute in form, which apparently required a different result; *viz.*, R. C. M. 1935, §8148: "In interpreting the terms of a contract of suretyship the same rules are to be observed as in the case of other contracts." Texas seems to be the only state which today applies the same rule to compensated and accomodation sureties and guarantors, Lonergan v. San Antonio Loan & Trust Co. (1927) 101 Tex. 63, 104 S. W. 1061, 22 L. R. A. (N. S.) 364, 130 Am. St. Rep. 803, being the leading case in that state. But see Aetna Casualty & Surety Co. v. Hawn Lumber Co. (Tex. Civ. App. 1933) 62 S. W. (2d) 329, wherein an inferior Texas Appellate court adopts the general rule.

[36]Even as to actual alterations of instrument the Court could avoid an inequitable result in many cases by an application of the rule that such an alteration will operate as a discharge only if fraudulently made, Paulk v. Williams (1922) 28 Ga. App. 183, 110 S. E. 632; International Shoe Co. v. Mosier (1935) 173 Okla. 481, 48 P. (2d) 165. But

see RESTATEMENT OF CONTRACTS, MONTANA ANNOTATIONS, §434: "The code section (R. C. M. 1935, §7071) and decided cases do not in their language require that the intent be fraudulent." If the Montana Court can be induced to adopt the rule of the Paulk and Mosier cases discharge of a surety by a beneficial alteration will be highly unlikely, RESTATEMENT OF CONTRACTS, §§434, 435 comment *c*.