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Brett E. Lewis

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NOTES

SECONDARY OBLIGORS AND THE RESTATEMENT THIRD OF SURETYSHIP AND GUARANTY: FOR LOVE OR MONEY

INTRODUCTION

The risky nature of the secondary obligation was well documented even in biblical times.¹ It was written that, "[c]ertain calamity comes to him who is surety for a stranger, but he who hates suretyship is secure."² The Bible warned against making a thoughtless promise to become a secondary obligor.³ Despite such caveats, people pledged first their bodies,⁴ and then their money,⁵ to answer for the obligations of others. Thousands of years after Proverbs was written, an

¹ THE NEW ENGLISH BIBLE WITH THE APOCRYPHA 675 (Samuel Sandmel, et al. eds., Oxford Univ. Press 1976). Commentary to the Book explains that Proverbs, "represents the results of a search for divinely sustained order in the lessons derived from human experience." *Id.*

² PROVERBS 11:15; *see also* WILLIAM V. HAGENDORN, THE LAW OF SURETYSHIP AND GUARANTY 1 (1938) (citing Proverbs for Israelite characterizations of the secondary obligor, which were incorporated into scripture).

³ PROVERBS 17:18 ("A man is without sense who gives a guarantee and surrenders himself to another as surety.").

⁴ HAGENDORN, *supra* note 2, at 1 ("The first surety was the hostage, who, with his body impounded, answered with his life for the observance by his family or tribe of the promises exacted by their conqueror.").

⁵ HAGENDORN, *supra* note 2, at 1 (stating that the secondary obligor's liability was first translated into money during the reign of Henry II, 1154-1189 (citing OLIVER WENDELL HOLMES, JR., THE COMMON LAW 260 (1881))).

authority on suretyship noted that, "[m]isplaced confidence has frequently pauperized the surety who unwittingly reposed his trust in a stranger he saw as his friend."⁶

The risk that the principal obligor will not perform is a risk which many uncompensated secondary obligors⁷ have been willing to take. However, there is a more pernicious risk facing those inclined to assume gratuitous secondary obligations—this being that creditors⁸ will take actions which interfere with their right to be made whole by the principal obligor or otherwise increase the cost of their performance.

There are several ways in which the creditor may increase the cost of performance to the uncompensated secondary obligor.⁹ Any modification of an underlying obligation carries the risk of worsening the principal obligor's ability to perform and, correspondingly, increasing the cost of a secondary obligor's performance.¹⁰ The possibility that the obligee could impose such costs upon the uncompensated secondary obligor has traditionally been seen as unfair.¹¹ Professor Neil B. Cohen, Reporter for The Restatement Third of the Law of Suretyship and Guaranty ("Restatement"),¹² explained that, "[b]y taking such actions, the obligee would essentially be tampering with the

⁶ HAGENDORN, *supra* note 2, at 1-2.

⁷ As used in this Note, the term "uncompensated secondary obligor" denotes secondary obligors who are not in the business of entering into secondary obligations, receive no business benefit for entering into the secondary obligation, and are not otherwise induced to enter into the secondary obligation by separate consideration that directly benefits the secondary obligor. See RESTATEMENT (THIRD) OF THE LAW OF SURETYSHIP AND GUARANTY § 49(2)(a)(i) (1995) [hereinafter RESTATEMENT OF SURETYSHIP]. Uncompensated or gratuitous secondary obligors are "consumers" who assume the secondary obligation out of motives of friendship and not for pecuniary benefit.

⁸ The term "creditor" as used in this Note is synonymous with "obligee" and "commercial lender."

⁹ Neil B. Cohen, *Striking The Balance: The Evolving Nature Of Suretyship Defenses*, 34 WM. & MARY L. REV. 1025, 1032 (1993); see *infra* Part I.B.

¹⁰ See Cohen, *supra* note 9, at 1032 (modifications include releases, extensions, impairments of collateral, and other impairments of recourse); see *infra* Part I.B.

¹¹ See Cohen, *supra* note 9, at 1033 ("The doctrines collectively known as 'suretyship defenses' have developed to prevent the obligee from unfairly imposing such costs on the secondary obligor.").

¹² RESTATEMENT OF SURETYSHIP, *supra* note 7.

delicate equilibrium of the suretyship transaction, maintaining the benefit of the secondary obligation while harming the position of the secondary obligor."¹³

The doctrines, collectively known as "suretyship defenses," were developed to prevent creditors from tampering with that equilibrium.¹⁴ The traditional model of suretyship defenses brought about an automatic, complete discharge of the secondary obligation upon any modification of the underlying obligation by the creditor without the secondary obligor's express consent.¹⁵ While protecting the secondary obligor¹⁶ from loss, this model frustrated the purpose of the secondary obligation, making it "a slim reed on which to rely."¹⁷ Creditors chose not to rely upon this "slim reed," but rather, resorted to the frequent utilization of provisions waiving suretyship defenses.¹⁸ Waiver allowed creditors to circumvent the application of suretyship defenses. Thus, while seeming to offer broad protection to uncompensated secondary obligors, the traditional model of suretyship defenses, "brought about a regime in which secondary obligors typically have no protection whatsoever,"¹⁹ as the commercial lender regularly requires the secondary obligor to waive all suretyship defenses as a condition precedent to the extension of credit to the principal obligor.²⁰

¹³ Cohen, *supra* note 9, at 1033 (stating that such actions can destroy the secondary obligor's rights to subrogation and restitution, "and the principal obligor's duties to the secondary obligor").

¹⁴ Cohen, *supra* note 9, at 1033. Courts applied the doctrine of *strictissimi juris* wherein "[a]ny alteration of the contract between the [principal obligor] and the creditor without the consent of the [secondary obligor] was sufficient to discharge him whether or not loss or prejudice to the [secondary obligor] resulted from such change." HAGENDORN, *supra* note 2, at 2; see also *infra* Part I.B.

¹⁵ See *infra* Part I.B.

¹⁶ The term "secondary obligor" as used in this Note includes "sureties" and "guarantors."

¹⁷ Cohen, *supra* note 9, at 1042.

¹⁸ Cohen, *supra* note 9, at 1042 ("[W]aivers are so heavily utilized in some commercial contexts that it is rare to see a suretyship transaction in those contexts that does not contain a waiver of suretyship defenses.").

¹⁹ Cohen, *supra* note 9, at 1043.

²⁰ Cohen, *supra* note 9, at 1043 ("[O]bligees with sufficient market power—virtually all lenders—are unlikely to extend credit unless the secondary obligor has not only entered into the secondary obligation but also waived all suretyship defenses.").

The Restatement perpetuates an imbalance between the rights of creditors and uncompensated secondary obligors. Although the Restatement adopts an equitable damages model of suretyship defenses,²¹ those defenses will rarely, if ever, provide any protection to uncompensated secondary obligors because it also sanctions the indiscriminate utilization of provisions waiving suretyship defenses.²² Thus, under the Restatement, uncompensated secondary obligors will continue to lack the protection of the law.

This Note contends that, as a matter of consumer protection, the law should extend an unwaivable protection to uncompensated secondary obligors. It also recognizes that compensated secondary obligors do not require similarly tender treatment. Part I of this Note explores how the treatment of secondary obligors in the law came to depend upon the nature of the inducement for assuming the secondary obligation, and describes the operation of the traditional model of suretyship defenses. This Part also discusses the doctrine of waiver, and the role that this doctrine had in mitigating the harshness of the traditional suretyship defenses. Part II sets forth the Restatement model of suretyship defenses, and then examines the operation of the Restatement's proposed defenses through a series of examples. This Part also explains the Restatement view on waiver of suretyship defenses. Part III criticizes the Restatement model of suretyship defenses for advocating a doctrine of permissive waiver and investigates the unconscionability of waiver as applied to the gratuitous secondary obligor's defenses. This Part also analyzes the effects of implementing non-waivable defenses for uncompensated secondary obligors, and responds to some potential critiques of a policy which would enforce such defenses.

Finally, this Note concludes that, as a matter of consumer protection, any application of the doctrine of waiver to uncompensated secondary obligations should be prohibited as against public policy. Under the law proposed by the Restatement, the rights of uncompensated secondary obligors are not adequately

²¹ See *infra* Part I.C.

²² See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 (consent may be express or implied, in terms which are general or specific, without regard to whether the secondary obligor is gratuitous or compensated).

represented. However, in this proposal, the rights of gratuitous secondary obligors are addressed, and an equilibrium between the rights of obligees and uncompensated secondary obligors is established.

I. SURETYSHIP DEFENSES

A. *Compensated and Uncompensated Secondary Obligors*

The law traditionally has been sympathetic toward secondary obligors because the uncompensated secondary obligor receives no benefit from the underlying transaction.²³ The advent of the compensated secondary obligor, however, brought about many modifications in the law of suretyship.²⁴ As courts questioned the soundness of a policy which granted absolute and complete discharge to all secondary obligors,²⁵ the extent to which suretyship defenses operated to grant discharge of the secondary obligation came to depend upon whether the secondary obligor was compensated or uncompensated.²⁶

Nearly 100 years ago, Arthur Stearns noted in his treatise on suretyship law that, "the law has long drawn distinctions between [compensated] and private [uncompensated] sureties."²⁷ An appellate court from the First District of Illinois, citing the Restatement of Security, recently noted that, "[i]t is important to distinguish between compensated and other sureties because the rules of suretyship, notably those relating to

²³ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49 cmt. b, at 213 ("The law has often articulated a special solicitude for 'uncompensated' or 'gratuitous' sureties."). See also 4 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1212A, at 3488 (Samuel Williston & George J. Thompson eds., rev. ed. 1936); HAGENDORN, *supra* note 2, at 2.

²⁴ See WILLISTON, *supra* note 23, at 3487.

²⁵ See WILLISTON, *supra* note 23, at 3487-88.

²⁶ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49 Reporter's Note, at 217 (stating that in the Restatement of Security " 'uncompensated sureties' were held to be automatically discharged by any extension or modification of the underlying obligation, while 'compensated sureties' were only discharged to the extent that the extension or modification caused a loss to the secondary obligor."); see also HAGENDORN, *supra* note 2, at 2; WILLISTON, *supra* note 23, at 3487-88.

²⁷ ARTHUR A. STEARNS, THE LAW OF SURETYSHIP 447 (1903); Cf. JAMES L. ELDER, STEARNS ON SURETYSHIP § 5.1 (6th ed. 1951) ("It is not surprising to find different judicial and legislative treatment of the corporate compensated surety, in view of the contrasting motive and method of conducting its business.").

the defenses of the surety, are not in all respects alike for the two classes."²⁸ However, the Restatement of Security defined compensated secondary obligor narrowly, as only those secondary obligors who, "engage[] in the business of executing surety contracts."²⁹ Professor Gary Monserud recently criticized this definition of compensated secondary obligors, declaring that, "the [Restatement of Security's] category of compensated sureties is too limited," for it includes only sophisticated corporate surety companies, "who require and rely upon actuarial calculations, and it excludes interested [secondary obligors] who sign as [secondary obligors] in the expectation of a monetary benefit."³⁰

In drawing a distinction between compensated and uncompensated secondary obligors, the 1995 Restatement essentially adopts Professor Monserud's definition of the term "compensated secondary obligor."³¹ This categorization makes sense.³²

²⁸ *Chandler v. Maxwell Manor Nursing Home, Inc.*, 666 N.E.2d 740, 752 (1996) (citing RESTATEMENT OF SECURITY § 82 cmt. i, 234 (1941)) (emphasis added). The Restatement of Security contained the first promulgation of the law of suretyship and guarantee by the American Law Institute.

²⁹ RESTATEMENT OF SECURITY § 82 cmt. i, 233-34 (1941).

³⁰ Gary L. Monserud, *Interested Sureties and the Restatement of Suretyship: An Argument Against Tender Treatment*, 15 HAMLINE L. REV. 247, 255 (1992) (noting that before the 1941 Restatement, "courts generally treated interested [secondary obligors] the way compensated [secondary obligors] are treated under the rules in [that] Restatement."). Thus, Professor Monserud signified that the 1941 Restatement's choice to limit the scope of compensated secondary obligors to surety companies was a decision to break with the more common interpretation—that where the inducement for assuming the secondary obligation was the prospect of receiving a benefit, the secondary obligor was considered to be compensated, and thus, subject to a more stringent, less tender set of suretyship defenses.

³¹ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49(2)(a)(i), and Reporter's Note, at 217 (adopting Professor Monserud's article as support for the, "less tender treatment of 'interested [secondary obligors].'").

³² This Note also adopts Professor Monserud's definition of "compensated secondary obligor." The Restatement defines compensated secondary obligors as those secondary obligors who are "in the business of entering into secondary obligations, received a business benefit for entering into the secondary obligation," or are otherwise "induced to enter into the secondary obligation by separate consideration that directly benefits the secondary obligor." RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49(2)(a)(i). Corporate secondary obligors, such as surety companies, are "in the business of entering into secondary obligations." RESTATEMENT OF SURETYSHIP, *supra* note 7, at 213. The commentary to the Restatement defines "business benefit" as "a benefit flowing from enhancing the credit of a customer or supplier, or of an enterprise of which the secondary obligor is an owner or officer." RESTATEMENT OF SURETYSHIP, *supra* note 7, at 214. And, "consideration that directly benefits the secondary obligor," must be "the inducement for the secondary obligor

Business persons who guarantee loans for their own companies, and individuals who are induced to assume secondary obligations by the promise of pecuniary enrichment stand to benefit from the creation of the underlying obligation. Just as the surety company is compensated for assuming the secondary obligation, so too are the business person and the private individual who are induced by the prospect of receiving a benefit.

In addition to entering into suretyship transactions for a benefit,³³ compensated secondary obligors often structure their own contracts.³⁴ Their business often demands familiarity with the law of suretyship, and they "make an elaborate investigation of . . . risk before undertaking liability."³⁵ In contrast, Stearns wrote of uncompensated secondary obligors:

The great field of special construction in favor of the surety arises from the fact that he is an accommodation party and generally takes no part in the writing of the contract . . . he gives the business no attention and relies for his protection on the rules of strict construction being applied in his favor, if any doubt arises as to the meaning of his contract.³⁶

to enter into the secondary obligation; otherwise, a sophisticated obligee would simply give the secondary obligor a nominal sum (or insist the principal obligor do so) in consideration of the secondary obligation, thereby disadvantaging a secondary obligor actually motivated by friendship or familial devotion." RESTATEMENT OF SURETYSHIP, *supra* note 7, at 214.

³³ Monserud, *supra* note 30, at 252 (defining an "interested" or "compensated" secondary obligor as "one who has a pecuniary interest in the underlying contract for which he is surety," or who has a business reason for entering into the secondary obligation). The class of secondary obligors which Professor Monserud referred to as "interested sureties" are referred to in this Note as "compensated secondary obligors." Corporate sureties unquestionably are compensated. See STEARNS, *supra* note 27, at 444 ("Corporate suretyship is a business transaction for profit."); see also WILLISTON, *supra* note 23, § 1212A, at 3488 ("[T]he corporate surety undertakes the obligation as a business and exacts therefor a profitable premium.").

³⁴ WILLISTON, *supra* note 23, at 3488. (observing that "the compensated corporate surety employs a staff of experts and attorneys who prepare carefully drawn agreements."); STEARNS, *supra* note 27, at 445 ("[T]he corporate surety . . . usually prepares its own contracts, carefully and distinctly defining its rights and liabilities . . . and also setting out in the bond itself the rights and privileges which the law affords to private sureties. . . .").

³⁵ WILLISTON, *supra* note 23, at 3488.

³⁶ STEARNS, *supra* note 27, at 450.

Thus, consumers who have assumed uncompensated secondary obligations depend upon the law to strike down unjust terms and to protect them against unfairness.³⁷

While compensated secondary obligors are motivated by the expectation of receiving a benefit,³⁸ uncompensated secondary obligors receive no benefit from assuming the secondary obligation.³⁹ Rather, they are induced by relationships⁴⁰ and motivated by bonds of family and friendship to assume secondary obligations,⁴¹ as when parents guaranty a student loan for their child. And unlike many compensated secondary obligors, they do not prepare their own contracts,⁴² they usually do not contemplate elements of risk,⁴³ and they cannot offset risk either in part or over numerous transactions.⁴⁴ Furthermore, gratuitous secondary obligors take little time to decipher the meaning of technical contractual provisions.⁴⁵ For these reasons, a distinction often has been drawn between the rules applied to compensated and uncompensated secondary obligors.⁴⁶ The courts, "have recognized that the [compen-

³⁷ See STEARNS, *supra* note 27, at 450.

³⁸ See STEARNS, *supra* note 27.

³⁹ Cohen, *supra* note 9, at 1030 ("In these cases, the secondary obligor receives no benefit from the transaction other than the satisfaction of having made possible the principal obligor's obtaining credit that otherwise would have been unavailable."); WILLISTON, *supra* note 23, § 1212A (stating that private secondary obligors generally receive no consideration).

⁴⁰ See ELDER, *supra* note 27, at 89 (stating that uncompensated secondary obligors assume legal obligations from "motives of friendliness").

⁴¹ Cohen, *supra* note 9, at 1029-30 (discussing motivation for undertaking secondary obligation and professing that "[s]ometimes the secondary obligor has familial ties to the principal obligor or is bound to the principal obligor by ties of friendship."); WILLISTON, *supra* note 23, at 3488 (stating that the uncompensated secondary obligor "usually undertakes the [secondary] obligation as a personal favor for his friend.").

⁴² ELDER, *supra* note 27, at 89 (stating that an uncompensated secondary obligor becomes "a party to a contract prepared and drawn by another.").

⁴³ See WILLISTON, *supra* note 23, at 3488 (stating that the uncompensated secondary obligor "usually undertakes the [secondary] obligation as a favor for his friend, the principal [obligor], without investigation of or particular regard for the latter's financial condition.").

⁴⁴ All compensated secondary obligors are able to offset risk to some extent, while surety companies can do so by incorporating risk into their premiums charged. See ELDER, *supra* note 27, at 89 (contrasting private uncompensated secondary obligors with corporate secondary obligors who assume classified risks in large numbers).

⁴⁵ STEARNS, *supra* note 27, at 450.

⁴⁶ See, e.g., RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49, at 217 (drawing

sated] corporate [secondary obligor] is in a better position to protect itself against improper conduct on the part of the principal and obligee," than is the uncompensated secondary obligor.⁴⁷

B. *Traditional Suretyship Defenses*

The traditional model of suretyship defenses granted the secondary obligor an automatic, complete discharge of the obligation to perform if the creditor took any action which changed the nature of the underlying obligation.⁴⁸ The traditional rule included within its ambit modifications which were beneficial to the principal obligor,⁴⁹ and thus reduced the like-

a distinction between the burden of persuasion for compensated and uncompensated secondary obligors with respect to impairment of recourse, and recognizing that "a secondary obligor who enters into the secondary obligation as its business or for separate consideration or other business benefit is likely to be in a better position to demonstrate loss than is a secondary obligor who has none of these attributes of 'professionalism.'"; RESTATEMENT OF SURETYSHIP, *supra* note 7, at 217 (stating that in the Restatement of Security, "uncompensated sureties" were held to be automatically discharged by any extension or modification of the underlying obligation, while "compensated sureties" were only discharged to the extent that the extension or modification caused a loss to the secondary obligor."); *Winston Corp. v. Continental Cas. Co.*, 508 F.2d 1298, 1302 (6th Cir. 1975) (stating that most jurisdictions differentiate between compensated and uncompensated secondary obligors for the purpose of determining contractual liability); *Barber County Sav. & Loan Ass'n v. Walker*, Civ. No. 87-2447-0, 1988 WL 139503, 2 (D. Kan. 1988) (stating that Kansas courts have been very protective of uncompensated sureties).

⁴⁷ WILLISTON, *supra* note 23, at 3493. There is a well established line of cases, which considers to be compensated, secondary obligors who affirmatively seek a business benefit. *Monserud*, *supra* note 30, at 302 (citing *Gellis v. Gellis & Co.*, 322 A.2d 287 (Del. Ch. 1974)).

⁴⁸ Cohen, *supra* note 9, at 1037 ("Under this model, the secondary obligor is completely discharged from the secondary obligation if the obligee has impaired the secondary obligor's recourse against the principal obligor, whether or not the impairment of recourse caused (or might cause) the secondary obligor any loss." (citing *Driscoll v. Winters*, 54 P. 387, 388 (Cal. 1898) (determining that a secondary obligor for a purchaser of milk was discharged when the quantity to be purchased was decreased); and *Board of Comm'rs. v. Greenleaf*, 83 N.W. 157, 158 (Minn. 1900) (holding that a reduction of the interest rate from 3% to 2% discharged an uncompensated secondary obligor); and *Katz v. Leblang*, 277 N.Y.S. 850, 853, 243 A.D. 421 (App. Div. 1935) (holding that a reduction in lease rent discharged a secondary obligor for a tenant))). STEARNS, *supra* note 27, at 98 ("Any change in the terms of the principal contract which obliges the debtor to do something which he was not before bound to do will discharge the surety or guarantor.").

⁴⁹ The term "principal obligor" as used in this Note is synonymous with the term "debtor."

lihood that the secondary obligor would ever have to perform.⁵⁰ For example, while reducing the size of payments on a lease agreement or lowering the interest rate on a loan would benefit the secondary obligor, the creditor would bring brought about automatic unconditional discharge of the entire secondary obligation by taking such actions.⁵¹ Though clearly unfair to creditors, such results were justified on the grounds that any interference with the underlying contract was interference to which the secondary obligor did not consent.⁵²

Changes in the original contract were seen to create new risks that the subject of the guaranty would not be performed by the principal obligor.⁵³ The traditional model of suretyship defenses treated the creditor's refraining from modification of the underlying contractual obligation as a condition precedent to the duty of the secondary obligor to perform the suretyship obligation.⁵⁴ Application of the traditional suretyship defenses often would result in windfalls for the secondary obligor.⁵⁵

C. *Waiver of Suretyship Defenses*

The harsh consequences which flowed from modification of the underlying obligation led to the proliferation of waiver clauses in suretyship transactions,⁵⁶ as creditors sought to protect themselves against inequitable loss. By extending credit only where secondary obligors had waived their suretyship

⁵⁰ Cohen, *supra* note 9, at 1037.

⁵¹ Cohen, *supra* note 9, at 1037.

⁵² STEARNS, *supra* note 27, at 99. Stearns explained the traditional rationale for such a policy:

The contract as changed is not the same contract guaranteed by the promisor. The original contract has been put an end to and a new one substituted. The guarantor has never agreed to stand good for the latter, and suretyship cannot be imposed without the express consent of the promisor, and his execution of the original contract will not carry by implication any liability upon a substituted contract, although the latter is similar to the first. STEARNS, *supra* note 27, at 99.

⁵³ STEARNS, *supra* note 27, at 99 ("The addition of new burdens upon the principal may be the cause of his failure to perform any part of his contract.").

⁵⁴ Cohen, *supra* note 9, at 1047.

⁵⁵ Cohen, *supra* note 9, at 1041.

⁵⁶ Cohen, *supra* note 9, at 1042 ("The existence of a waiver doctrine, and its frequent utilization, should come as no surprise. The dire consequences that flow to the obligee . . . in the event of an impairment of recourse make a secondary obligation a slim reed on which to rely.").

defenses, creditors were able to circumvent the protections which had arisen to safeguard secondary obligors against harmful contractual modifications.⁵⁷ Although waiver protected creditors from the harsh consequences of traditional suretyship defenses, it returned uncompensated secondary obligors to a state of relative helplessness.⁵⁸ The routine utilization of waiver and consent provisions effected a virtual return in the state of the law to the time before suretyship defenses existed.⁵⁹ The rights of creditors and uncompensated secondary obligors had once again swung out of balance, this time favoring creditors.

II. THE RESTATEMENT MODEL OF SURETYSHIP DEFENSES

A. *An Overview*

The Restatement has taken quite a different approach to discharge of the secondary obligation⁶⁰ by advocating discharge only to the extent that the creditor's actions would cause loss to the secondary obligor.⁶¹ This approach is consistent with a modern damages model of suretyship defenses,⁶²

⁵⁷ See Cohen, *supra* note 9, at 1043 (explaining how traditional models of suretyship defenses, which led to the frequent utilization of the waiver doctrine "have brought about a regime in which secondary obligors typically have no protection whatsoever").

⁵⁸ Cohen, *supra* note 9, at 1043.

⁵⁹ Cohen, *supra* note 9, at 1043 ("[I]t is not much of an exaggeration to say that, at least in certain contexts, suretyship defenses essentially do not exist").

⁶⁰ See RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42 ("[I]f the secondary obligor is not discharged from its unperformed duties pursuant to the secondary obligation . . . the secondary obligor is discharged from those duties to the extent . . . that the release of a duty to pay money . . . would otherwise cause the secondary obligor a loss . . .").

⁶¹ Cohen, *supra* note 9, at 1040 (The secondary obligor always "breaks even" in the sense that remedy for releases, extensions, or impairments of collateral "puts the secondary obligor back into the same economic position it would have been in had the act never taken place").

⁶² Cohen, *supra* note 9, at 1047-1048. Professor Cohen asserted that: [M]odern doctrines . . . treat the acts of the obligee that impair the secondary obligor's recourse as breaches of the duty to refrain from upsetting the equilibrium of the secondary obligor's position. As in the case of breaches of duty in both contract and tort, the obligee is responsible for the cost of the harm caused by the bad act, but no more. Thus, if the act constituting an impairment of recourse causes the secondary obligor no harm, the secondary obligor is entitled to no relief.

and makes sense both as an evolution and innovation of suretyship law.⁶³ Creditors are free to exercise their judgment in granting releases or extensions and otherwise modifying underlying obligations; however, they are liable for any loss which is caused to a secondary obligor as a result of their acts.⁶⁴

For example, assume that a creditor granted a principal obligor an extension of time (during which performance was set to be due under the terms of the original contract), banking on the fact that an extension would improve the creditor's chances of receiving performance from the principal obligor. If the principal obligor's ability to perform subsequently deteriorated, suretyship defenses under the Restatement would place this loss upon the creditor,⁶⁵ thus allowing the secondary obligor to escape the loss caused by the creditor's modification of the underlying obligation.

Under the Restatement model, the secondary obligor remains obligated to perform to the extent that the principal obligor could not have at the time when performance became due under the terms of the original contract.⁶⁶ For example, assume that a principal obligor could have paid \$500 of a \$1000 obligation on the date set in an original contract. Following an extension of time granted by a creditor, the principal obligor's ability to perform deteriorated to the point where she could pay only \$100. The secondary obligor would be discharged to the extent of the loss caused by the extension (which is a modification of the terms of the underlying obligation). In this case, the secondary obligor would pay only the \$500 which the principal obligor could not pay on the date when the original obligation was due; the principal obligor

Id.

⁶³ See Cohen, *supra* note 9, at 1048 ("The Restatement proposes adoption of a damages model of suretyship defenses for several reasons. Generally speaking, the damages model is consistent with the remedy theory articulated in the Uniform Commercial Code that remedies should put the innocent party in as good a position (but no better) as that party would have been in had the transgressor acted consistently with its duty." (citing U.C.C. § 1-106 (1990))).

⁶⁴ RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

⁶⁵ RESTATEMENT OF SURETYSHIP, *supra* note 7, §40 cmt. d, at 178 ("The secondary obligor is discharged from its duties pursuant to the secondary obligation to the extent that it would otherwise suffer a loss because of the extension.").

⁶⁶ RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

would pay the creditor the \$100 it had left; and the creditor would suffer a \$400 loss.⁶⁷ The secondary obligor can be discharged completely only if the creditor's action completely destroys the ability of a solvent principal obligor to perform.⁶⁸ As this would be against the creditor's interest, it is unlikely that a creditor would permit a principal obligor's ability to perform so to deteriorate to the point of not being able to perform at all.⁶⁹ Under the Restatement model of suretyship defenses, the creditor is in the best position both to avoid risk and spread loss.⁷⁰ It follows that when the secondary obligor is uncompensated, the creditor should suffer such loss as the creditor induces.⁷¹ Yet, the Restatement's position on waiver of suretyship defenses is likely to ensure that creditors are almost uniformly immunized from loss.⁷²

⁶⁷ The Restatement provides other illustrations of suretyship defenses in action, such as:

D borrows \$10,000 from C, payable on July 12. S agrees with C that, if D does not repay the loan on its due date, S will repay the loan. On July 11, C grants D, who is solvent, an extension of the due date of the loan to October 31. On July 12, S seeks enforcement of D's duty to S to repay the loan. S is denied relief because of the extension. On October 31, D is insolvent and, as a result, only \$3,000 is recovered from D with respect to the loan. S is discharged to the extent of the \$7,000 loss caused by the extension.

See RESTATEMENT OF SURETYSHIP, *supra* note 7, §40 Ills. 3-4, at 179.

⁶⁸ See RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

⁶⁹ Cohen, *supra* note 9, at 1040-41 ("After all, an obligee is not likely to release a principal obligor who has the wherewithal to perform To the extent that a release of the principal obligor causes the secondary obligor a loss at all, such a loss will result from the obligee's failure to squeeze every last nickel from the principal obligor as consideration for the release.").

⁷⁰ See *infra* parts III.A-C.

⁷¹ See *infra* part III.

⁷² The more equitable nature of the Restatement model of suretyship defenses, alone, is unlikely to induce creditors to stop utilizing waiver provisions. Thus, what Professor Cohen said about waiver of traditional suretyship defenses will likely remain true for suretyship defenses under the Restatement; "that obligees with sufficient market power-virtually all lenders-are unlikely to extend credit unless the secondary obligor has . . . waived all suretyship defenses." Cohen, *supra* note 9, at 1043.

B. *Suretyship Defenses in Action*

An example of how the Restatement model of suretyship defenses works will help to illuminate the advantages of such a position over the traditional model of suretyship defenses. Suppose that buyer wants to purchase a car, but that dealer deems him to have insufficient credit on which to base financing. Dealer is willing to sell the car, however, if buyer's fiancée agrees to guarantee payment of buyer's obligation. Buyer's fiancée agrees to these terms, and buyer purchases the car. Buyer makes monthly payments until he decides that he would rather pursue his life-long dream of exotic bird-watching in Venezuela. But before he goes, he negotiates a release from any further obligation to make payments with dealer. In exchange for all of the cash that buyer has available at that moment, dealer releases him from any further obligation to make payments.

Under the traditional model of suretyship defenses, release of buyer would have released fiancée from her obligation to make payments. Under the Restatement view, however, fiancée's obligation would be relieved only to the extent that dealer had caused buyer to be unable to perform (i.e. pay for the car).⁷³ The effect of the Restatement model of suretyship defenses is to put the secondary obligor [fiancée] back "into the same economic position she would have been in had the act [release] never taken place."⁷⁴

Whether dealer's actions caused buyer not to perform to the fullest extent possible would require a factual determination. For example, if buyer was induced to quit his job, and/or leave the country because of the release, then a court would have to determine the extent to which the release caused him not to perform. It is this induced nonperformance which causes loss.

In a variation on this theme, if buyer did not ask for a release, but simply flew off to Venezuela to pursue his dream, fiancée would be liable to dealer for making the remaining payments on the car. What differentiates these situations is that in the first case, the creditor's actions caused the principal

⁷³ See RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

⁷⁴ Cohen, *supra* note 9, at 1040.

obligor not to perform, while in the latter, the principal obligor stopped performing of his own volition.

Similarly, assume the same set of initial facts as before, but this time buyer is fired from his job and cannot make payments. Dealer negotiates a release of buyer which leaves buyer homeless and without a nickel in his pocket. Assume further that buyer has no foreseeable prospects for employment. In this case, dealer's actions would not have harmed fiancée. There is no difference between what the principal obligor could have paid and what the creditor extracted from the principal obligor. Accordingly, the secondary obligor would be obligated to make the remaining payments on the car.

C. *Waiver of Suretyship Defenses Under the Restatement*

The Restatement takes a liberal view of the contractual doctrine of consent, or waiver,⁷⁵ in its application to suretyship transactions.⁷⁶ The creditor may utilize, without restriction, provisions waiving suretyship defenses.⁷⁷ It makes no difference, under existing law and practice as advocated by the Restatement, whether the secondary obligor whose defenses are to be waived is compensated or uncompensated.⁷⁸

Waiver can affect how much a secondary obligor has to pay,⁷⁹ when she must perform,⁸⁰ how costly her performance

⁷⁵ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. d, at 210.

⁷⁶ The Restatement provision on waiver provides that:

The secondary obligation is not discharged . . . to the extent that, in the contract creating the secondary obligation or otherwise, the secondary obligor consents to acts that would otherwise be the basis of the discharge, agrees that such discharges are unavailable to the secondary obligor, or waives such discharges. Consent may be express or implied from the circumstances. Such consent, agreement, or waiver, if express, may be effectuated by specific language or by general language indicating that the secondary obligor waives defenses based on suretyship. (emphasis added).

RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48(1), at 208.

⁷⁷ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48.

⁷⁸ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48.

⁷⁹ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. a, at 209 (consenting secondary obligor is not discharged from duty to perform where creditor grants a release, extension, or otherwise impairs the underlying obligation which results in deterioration of the principal obligor's ability to pay).

⁸⁰ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 40(a), at 176. Where a secondary obligor consents to waiver of its suretyship defenses, the time for perfor-

will be,⁸¹ and whether she has to perform at all.⁸² Waiver of suretyship defenses occurs when a secondary obligor consents to actions by a creditor which would change the terms of the underlying obligation between creditor and principal obligor.⁸³ For example, waiver can take the form of a blanket consent to release or extension of time for performance by the principal obligor, "or consent[] to acts that would otherwise be the basis of . . . discharge."⁸⁴

"[T]he secondary obligor is not discharged as a result of loss caused by actions of the obligee to which [she] consents."⁸⁵ In the following illustration, suretyship defenses operate to discharge the secondary obligor of a \$10,000 obligation:

mance of the duties of the principal obligor may be extended by the obligee. Thus, the date on which the secondary obligor has contracted to have its obligation become due is not necessarily the same as the date on which the secondary obligor will be asked to perform.

⁸¹ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 39 cmt. g, at 173 ("When the underlying obligation is performance other than the payment of money, a release of the principal obligor has an effect on the secondary obligor that is particularly difficult to quantify. First . . . the ability of a principal obligor to perform a nonmonetary obligation is typically not susceptible of reliable determination. Second . . . the cost of performance by the secondary obligor may be different than it would have been for the principal obligor. Economies of scale and accumulated expertise, for example, would make it likely that the cost of performance would be lower for the principal obligor than for the secondary obligor . . ."); see Cohen, *supra* note 9, at 1041 (a secondary obligor would be liable for any unperformed portion of the underlying obligation and might be unable to recover fully from a principal obligor, causing the secondary obligor to suffer loss).

⁸² See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 39(b), at 168 (absent consent or waiver of suretyship defenses by the secondary obligor, and absent an express "preservation of recourse" by the obligee of the rights of the secondary obligor as against the principal obligor (RESTATEMENT OF SURETYSHIP, *supra* note 7, § 38 cmt. b, at 166), the release of the principal obligor acts to release the secondary obligor from its entire obligation). If the obligee "preserves the recourse" of the secondary obligor as against the principal obligor, as provided for in § 38, "the obligee's impairment of the secondary obligor's recourse generally will discharge the secondary obligor [or secondary obligor] [only] to the extent necessary to prevent loss." *Id.* § 38 cmt. b, at 166. However, the secondary obligor who has consented, in advance, to allowing an obligee to release a principal obligor, at his or her discretion, without affecting the relationship between the secondary obligor and the obligee, will remain obligated to perform to the full extent of the underlying obligation. RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48.

⁸³ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48, at 208.

⁸⁴ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48, at 208.

⁸⁵ RESTATEMENT OF SURETYSHIP, *supra* note 7, §48 cmt. a, at 209.

To induce C to lend D \$10,000, S agrees to guarantee D's obligation to repay the loan. As part of a settlement of an unrelated dispute, C releases D, who is solvent, from liability with respect to the loan. C then seeks repayment of the loan from S. The release of D's duty to C also releases D's corresponding duty to S and, accordingly, would reduce the amount S could recover from D from \$10,000 to \$0. The difference between the cost of S's performance and the amount recoverable from D has increased from \$0 to \$10,000; therefore, S is discharged to the extent of its full \$10,000 duty.⁸⁵

However, had suretyship defenses been waived, the creditor's actions would have caused the full burden of repaying the obligation to fall upon the secondary obligor. This Note's variation on the example cited in the text and borrowed from the Restatement illustrates what is most malignant about permissive waiver—it allows creditors to frustrate the uncompensated secondary obligor's expectation that the contract will be performed in good faith, as structured, and not modified to the creditor's benefit. Moreover, it fails to differentiate between compensated and uncompensated secondary obligors. In this example, an uncompensated secondary obligor who had waived suretyship defenses would have borne the full weight of the \$10,000 loss.

Consent may be given in advance, by general language indicating that the secondary obligor waives all defenses based on suretyship,⁸⁷ or contemporaneously with the modification of the underlying obligation.⁸⁸ Secondary obligors are generally required to give up their defenses as part of the price for entering into the suretyship agreement.⁸⁹ By failing to distinguish between classes of secondary obligors, and thus, allowing indiscriminate waiver of suretyship defenses, the Restatement furthers a regime in which uncompensated secondary obligors, "typically have no protection whatsoever."⁹⁰

⁸⁵ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 39 Ills. 9, at 173.

⁸⁷ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. d, at 210 ("There is no requirement of specificity with respect to the language used to forego discharge The secondary obligor need not waive separately each ground for discharge, nor must the contract describe them.").

⁸⁸ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. a, at 209.

⁸⁹ See Cohen, *supra* note 9, at 1043.

⁹⁰ See Cohen, *supra* note 9, at 1043.

III. CRITICISM OF THE RESTATEMENT: WAIVER OF SURETYSHIP DEFENSES SHOULD BE PROHIBITED FOR REASONS OF PUBLIC POLICY

A. *An Argument for Extending a Special Solitude to Uncompensated Secondary Obligors*

Waiver of the suretyship defenses of uncompensated secondary obligors should be prohibited as against public policy.⁹¹ The examples from the preceding section illustrate how suretyship defenses operate under the Restatement when such defenses are not waived.⁹² Recall, however, that in practice there is "nearly uniform waiver of suretyship defenses."⁹³ When suretyship defenses are waived, they have no legal effect.⁹⁴ Thus, there is little difference between a Restatement model of suretyship defenses which allows permissive waiver of those defenses and a system in which suretyship defenses do not exist.⁹⁵

In light of the modern model of suretyship defenses which the Restatement adopts, there is no longer any need for an indiscriminate waiver doctrine. Recall that from early on, creditors utilized waiver of suretyship defenses to protect themselves from automatic and total discharge of the secondary obligation which flowed from alteration of the underlying obligation.⁹⁶ Complete discharge resulted whether the action tak-

⁹¹ Secondary obligors who are in the business of entering into secondary obligations, receive a business benefit for entering into the secondary obligation, or are otherwise induced to enter into the secondary obligation by separate consideration that directly benefits the secondary obligor, are compensated secondary obligors. That they are induced to assume the secondary obligation by receiving a benefit justifies their receiving less tender treatment from the law. See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49(2)(a)(i), and Reporter's Note.

⁹² In the above example, had suretyship defenses been waived, fiancé would have had to make the remaining car payments, even if buyer had been induced by dealer not to perform. Fiancé would not have been protected by the defenses which the Restatement advocates.

⁹³ Cohen, *supra* note 9, at 1042.

⁹⁴ Cohen, *supra* note 9, at 1042-43.

⁹⁵ See Cohen, *supra* note 9, at 1042-43 (for the proposition that there is little difference between a regime in which suretyship defenses are routinely waived and one in which there are no suretyship defenses at all).

⁹⁶ Cohen *supra* note 9, at 1042; see also, *Winston Corp. v. Continental Cas. Co.*, 508 F.2d 1298, 1302 (6th Cir. 1975) (stating that effects of traditional rule were often harsh and unjust).

en was harmful or beneficial to the secondary obligor,⁹⁷ the modification was material or collateral,⁹⁸ or the secondary obligor was compensated or uncompensated.⁹⁹ Those harsh consequences no longer endure under existing law and practice as advocated by the Restatement which relieves the secondary obligor of its obligation to perform, but only to the extent that the loss is caused by the creditor's actions,¹⁰⁰ thus, mandating that creditors bear only the loss for which they are responsible.¹⁰¹

Although such a result would be desirable,¹⁰² it is unlikely that creditors would voluntarily refrain from utilizing waiver clauses in suretyship contracts.¹⁰³ Professor Neil. B. Cohen has opined that secondary obligors would benefit from the Restatement model if, in fact, waiver became less prevalent.¹⁰⁴ Yet, the Restatement model of suretyship defenses provides no incentive for creditors to stop using these provisions¹⁰⁵ and leaves them with type of unfettered discretion that leads to continued abuse.¹⁰⁶ Indeed, there is little impetus for the creditor to use care when modifying underlying obligations.¹⁰⁷ Simply put, the Restatement model fails to eliminate the use and abuse of provisions waiving the suretyship defenses of uncompensated secondary obligors, a goal which should be realized.

⁹⁷ See Cohen *supra* note 9, at 1042.

⁹⁸ See Cohen *supra* note 9, at 1042.

⁹⁹ See Cohen *supra* note 9, at 1042. More recent models of suretyship defenses have distinguished between compensated and uncompensated secondary obligors. RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49, Reporter's Note, at 217.

¹⁰⁰ Cohen, *supra* note 9, at 1040.

¹⁰¹ RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

¹⁰² See Cohen, *supra* note 9, at 1051 (speculating that waiver might become less prevalent under the Restatement model).

¹⁰³ Cohen, *supra* note 9, at 1051 (speculating that "[a]lthough it is unrealistic to expect a widespread disappearance of waivers, such actions might become less automatic under the Restatement model").

¹⁰⁴ Cohen, *supra* note 9, at 1051.

¹⁰⁵ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48. (allowing permissive use of waiver).

¹⁰⁶ Utilization of waiver provisions renders creditors virtually loss-proof. See Cohen, *supra* note 9, at 1029.

¹⁰⁷ The creditor does not suffer the loss caused from harmful modification of the underlying obligation unless the secondary obligor is insolvent. See Cohen, *supra* note 9, at 1032.

Because of the nature of the uncompensated obligation,¹⁰⁸ where secondary obligors' actions are gratuitous, creditors should not be able to escape loss by utilizing waiver provisions. Under the Restatement paradigm, the savvy obligee will take unfair advantage of the gratuitous secondary obligation, granting releases and extensions of time and otherwise modifying the terms of the underlying obligation when the obligee stands to benefit from such action,¹⁰⁹ but placing all of the loss which its actions induce squarely upon the gratuitous secondary obligor. The Restatement allows the obligee to gamble with the gratuitous secondary obligor's money at almost no risk to itself.

The following examples help to illuminate the issue. Suppose that after the obligee extends the obligor additional time to perform on the underlying obligation, the principal obligor's ability to perform improves or remains the same. The creditor receives an equivalent or greater performance of the underlying obligation by the principal obligor plus a valuable consideration for the extension. In such a case the creditor comes out ahead, and the uncompensated secondary obligor is not harmed. However, what happens if subsequent to granting an extension the principal obligor's ability to perform deteriorates? The creditor retains the additional benefit obtained in consideration for the extension and receives full performance of the underlying obligation from the uncompensated secondary obligor.¹¹⁰ In both cases the creditor's gamble pays off equally as well, because the performance which the creditor receives is the same. However, in the latter situation, the gamble comes

¹⁰⁸ Professor Cohen points out that: "[i]n these cases, the secondary obligor receives no benefit from the transaction other than the satisfaction of having made possible the principal obligor's obtaining credit that otherwise would have been unavailable." Cohen, *supra* note 9, at 1030.

¹⁰⁹ See *infra* Part III.C.3. Creditors condition impairments of recourse upon the receipt of a monetary benefit, such as additional interest. See ELDER, *supra* note 27, at 139-41. Thus, the creditor does not grant an extension of time for performance out of a generosity of spirit, but from a desire for profit. The creditor takes advantage of the principal obligor's misfortune while insulating itself from loss—it has insisted upon waiver of the gratuitous secondary obligor's suretyship defenses. Releases, extensions, and other modifications of the underlying obligation are known as "impairments of recourse." RESTATEMENT OF SURETYSHIP, *supra* note 7, § 39 cmt. f, at 172.

¹¹⁰ Of course, this double benefit only exists where suretyship defenses have been waived.

at the expense of the gratuitous secondary obligor who is bound by waiver to compensate the creditor for the injury the creditor has inflicted upon the principal obligor. By allowing permissive waiver, the Restatement has sanctioned a view of suretyship defenses that creates an incentive for creditors to seek modifications of underlying contractual obligations in exchange for valuable consideration and with virtually no risk of loss on the underlying contractual obligation.

A further illustration demonstrates just how pernicious these results can be. Imagine a situation in which the principal obligor's ability to perform deteriorates by exactly the amount that the creditor has exacted as consideration for an extension. Having already received payment of the sum as a valuable consideration from the principal obligor, the creditor may then demand payment of the identical sum from the gratuitous secondary obligor.¹¹¹ Fundamental fairness and consumer protection dictate that where a creditor impairs the recourse of an uncompensated secondary obligor, and the ability of the principal obligor to perform subsequently deteriorates, the creditor, not the secondary obligor, should suffer the loss caused by the deterioration in the principal obligor's ability to perform.

Prohibiting waiver of suretyship defenses as applied to uncompensated secondary obligors would protect their interests while recognizing that compensated secondary obligors are not in need of similarly gentle treatment.¹¹² Stated simply, the policy supporting a special solicitude for secondary obligors is not furthered when the secondary obligor receives compensation.¹¹³

¹¹¹ The tender of a fee in consideration for an extension caused the principal obligor to default on its performance of the underlying obligation by the amount of the fee. Although the creditor caused the principal obligor's ability to perform to deteriorate, the creditor demanded full performance of the underlying obligation from the waiver-bound gratuitous secondary obligor.

¹¹² See *Generally* Monserud, *supra* note 30.

¹¹³ See ELDER, *supra* note 27, at 90 (stating that the uncompensated secondary obligor "acts without motives of pecuniary gain and hence should be protected against 'unjust' pecuniary impoverishment," and that "the contract to which he accedes is drawn by another party, or other parties."); and ELDER, *supra* note 27, at 89 (explaining that corporate secondary obligors assume "risks in large numbers, for a pecuniary profit, and on an impersonal basis, through the medium of standardized written contractual forms drawn by its own representatives with the primary aim of protecting its own interests."); other compensated secondary

A public policy proscribing such waiver would halt the unfair and unjust practice whereby the obligee causes loss to the uncompensated secondary obligor. Moreover, while enforcing the modern approach to damages,¹¹⁴ such a policy would establish an equitable balance between the rights of obligees and uncompensated secondary obligors.¹¹⁵ In this way, it is possible to articulate the law's special solicitude for uncompensated secondary obligors without bringing about harsh loss at the expense of creditors.

obligors receive a business benefit, *see* RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49 cmt. b, at 214 (defining "business benefit" as a "benefit flowing from enhancing the credit of a customer or supplier, or of an enterprise of which the secondary obligor is an owner or officer."), *or* are induced by a consideration to enter into the secondary obligation. *See* RESTATEMENT OF SURETYSHIP, *supra* note 7, § 49 cmt. b, at 214 (stating that the consideration must be the inducement for assuming the secondary obligation, *and* can be treated as having taken account of risk in setting their prices).

¹¹⁴ The Restatement model of suretyship defenses puts "the innocent party in as good a position as that party would have been in had the transgressor acted consistently with its duty." *See* Cohen, *supra* note 9, at 1047-48.

¹¹⁵ The traditional model of suretyship defenses granted the uncompensated secondary obligor an absolute discharge of its duty to perform for any actions taken to modify the underlying obligation; thus, many uncompensated secondary obligors reaped windfalls at the expense of obligees. This led to the routine use of waiver clauses to protect obligees against harsh loss. But the almost exclusive use of waiver clauses allowed obligees to take the same kinds of actions which the law had previously deemed unfair, and in response to which the law developed suretyship defenses. The Restatement model of suretyship defenses mitigates the harshness of loss by discharging secondary obligors only to the extent of the harm caused by creditors. This doctrine lacks the sting of the traditional suretyship defenses; yet, in practice, it is hardly different than a model in which suretyship defenses do not exist because the Restatement allows (imposed) waiver of those defenses. A public policy prohibiting waiver in certain contexts would allow suretyship defenses to take effect, thus, protecting the rights of uncompensated secondary obligors, while providing creditors with mechanisms for spreading loss. *See infra* Part III.C. Thus, neither party should suffer the types of burdens which they have suffered in the past.

B. *The Unconscionability of Clauses Waiving Suretyship Defenses*

1. Unconscionability Defined

Unconscionability is a term that is incapable of precise definition.¹¹⁶ A contract is unconscionable when it is, "so unfair as to 'shock the conscience of the court.'" ¹¹⁷ The comments to the Uniform Commercial Code ("U.C.C.") provide that the, "basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract." ¹¹⁸ Notions of unconscionability are often closely tied to "the unfairness of a particular clause in a form contract." ¹¹⁹

Perhaps, however, notions of unconscionability have been most closely associated with the absence of meaningful choice.¹²⁰ Professor Farnsworth defined procedural unconscionability as: "broadly conceived to encompass not only the employment of sharp practices and the use of fine print and convoluted language, but a lack of understanding and an inequality of bargaining power."¹²¹ The use of adhesion contracts and standardized agreements is not necessarily fatal where the contract term lacks the element of surprise.¹²² The doctrine of unconscionability has most often been successfully invoked by

¹¹⁶ E. ALLEN FARNSWORTH, *CONTRACTS*, § 4.28, at 327 (1990).

¹¹⁷ *Id.* at 320; see also *id.* citing U.C.C. § 2-302(1) (1984):

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

The doctrine of unconscionability has been applied to many non-sales of goods transactions, either by analogy, or as an expression of a general doctrine. FARNSWORTH, *supra* note 116, § 4.28, at 325.

¹¹⁸ FARNSWORTH, *supra* note 116, at 328 (citing U.C.C. § 2-302, cmt. 1).

¹¹⁹ FARNSWORTH, *supra* note 116, at 328 (citing *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965)).

¹²⁰ FARNSWORTH, *supra* note 116, at 332 (designating what has come to be known as procedural unconscionability).

¹²¹ FARNSWORTH, *supra* note 116, at 332-33.

¹²² FARNSWORTH, *supra* note 116, at 333-34.

consumers.¹²³

2. The Unconscionability of Waiver of the Suretyship Defenses of the Uncompensated Secondary Obligor

Commentary to the Restatement recognizes that the rules concerning unconscionability and good faith in fair dealing place limits upon the parties' freedom to contract.¹²⁴ The Restatement takes the position that waiver of discharge, based upon consent to actions that would otherwise discharge the secondary obligor, is not ordinarily unconscionable.¹²⁵ However, the Restatement commentary concludes that particular consent or waiver provisions may be unconscionable.¹²⁶ Unfair surprise and loss in contracts creating secondary obligations are most likely to be present where secondary obligors are uncompensated.

Lenders are under no duty to disclose the existence or explain the meaning of clauses waiving suretyship defenses,¹²⁷ and uncompensated secondary obligors generally do not take the time to read them or comprehend their meaning.¹²⁸ Accordingly, many uncompensated secondary obligors would be surprised to learn of the effects of waiving suretyship defenses.¹²⁹ Nevertheless, uncompensated secondary obligors who have unwittingly waived suretyship defenses will have those waivers strictly enforced against them.¹³⁰

In many cases, it would appear unconscionable to allow a

¹²³ FARNSWORTH, *supra* note 116, § 4.28, at 330.

¹²⁴ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. a, at 209.

¹²⁵ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. a, at 209.

¹²⁶ The Commentary States: "[w]hether, however, a particular consent or waiver violates those standards may depend on the content of the consent or waiver and its context." RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. a, at 209.

¹²⁷ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 cmt. d, at 210-11. Specifically, "there is no duty of disclosure or explanation as to the legal effect of foregoing grounds for discharge."

¹²⁸ STEARNS, *supra* note 27, at 450 (stating that uncompensated secondary obligors generally take no part in the writing of contracts and pay no attention to the business of suretyship).

¹²⁹ See *Agribank, FCB v. Whitlock*, 621 N.E.2d 967, 976 (Ill. Dist. Ct. App. 1993).

¹³⁰ See RESTATEMENT SECOND, CONTRACTS § 84 cmt. b, at 218. ("The common definition of waiver may lead to the incorrect inference that the promisor must know his legal rights and must intend the legal effect of the promise.") (citation omitted).

commercial lender to rely upon convoluted or vague clauses, contracts of adhesion, lack of equal bargaining power, and lack of familiarity with contract terms in order to induce waiver by an uncompensated secondary obligor.¹³¹ Charging loss incurred through the use of such contracts to the gratuitous secondary obligor violates the special solicitude that the law has, throughout history, shown to such persons.¹³²

Unless represented by legal counsel, it is unlikely that an uncompensated secondary obligor would understand (or even try to understand) provisions waiving various suretyship defenses.¹³³ Pitfalls to comprehension exist whether the drafter of a waiver clause employs specific terms or uses general language. The use of general language obscures the significance of consenting in advance to a release, extension of time, or other

¹³¹ See FARNSWORTH, *supra* note 116, § 4.26, at 311-12. The following passages from FARNSWORTH'S *Contracts* illustrate many of the dangers which are inherent in commercial transactions:

Dangers are inherent in standardization . . . for it affords a means by which one party may impose terms on another unwitting or even unwilling party. Two circumstances facilitate this imposition. First, while the party that proffers the form has the advantage of time and expert advice in preparing it, the other party is usually completely or at least relatively unfamiliar with its terms. That party may have no real opportunity to read the form, and is often not expected to do so. The opportunity to read it so may be diminished by the use of fine print and convoluted clauses . . . there may be no opportunity to bargain at all . . . [and] the standard form may be used by an enterprise with such disproportionately strong economic power that it simply dictates the terms . . . [o]r the form may be a take-it-or-leave-it proposition, often called a *contract of adhesion*, under which the only alternative to complete adherence is outright rejection.

Id. at 312. "Karl Llewellyn attacked the traditional notion of assent as applied to standard forms:"

Instead of thinking about 'assent' to boiler-plate clauses, we can recognize that so far as concerns the specific, there is no assent at all. What has in fact been assented to, specifically, are the few dickered terms, and the broad type of the transaction, and but one thing more. That one thing more is a blanket assent (not a specific assent) to any not unreasonable or indecent terms the seller may have on his form, which do not alter or eviscerate the reasonable meaning of the dickered terms.

FARNSWORTH, *supra* note 116, § 4.26, at 317 (citing KARL LLEWELLYN, *THE COMMON LAW TRADITION* 370 (1960)). For a system of contracts based upon the theory of bargain for exchange, assent to a contract of adhesion is often a hollow bargain at best.

¹³² This Note contends that charging creditor-induced loss to an uncompensated secondary obligor is substantively unfair.

¹³³ STEARNS, *supra* note 27, at 450.

contractual modification of the underlying obligation.¹³⁴ Yet, the use of specific terms may do no more to engender a sense of awareness of the nature and consequences of waiver.¹³⁵

Additionally, gratuitous secondary obligors generally take no part in the drafting of contracts.¹³⁶ Commercial lenders employ contracts of adhesion, designed by experts, to maximize the lender's benefit,¹³⁷ while uncompensated secondary obligors generally have no familiarity with the contract terms surrounding the secondary obligation.¹³⁸ An uncompensated secondary obligor who is unaware is more likely to be surprised unfairly by the effects of a waiver provision and, consequently, to suffer loss.¹³⁹

Furthermore, it is substantively unfair to deprive the uncompensated secondary obligor of suretyship defenses. Uncompensated secondary obligors traditionally have been "favorites of the law."¹⁴⁰ An authority on suretyship noted that as

¹³⁴ *But see* RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 Reporter's Note, at 212 (stating that "the requirement that the language indicate that defenses are being waived assures that a diligent indorser or accommodation party will, at the least, not be unjustly surprised when it is asserted that the terms of the instrument or agreement delete protections that would otherwise be available." (citing U.C.C., PEB Commentary No. 11, at 1199 (1994))). However, the nature of the uncompensated secondary obligation is such that uncompensated secondary obligors generally do not prepare or take part in the preparation of contracts. STEARNS, *supra* note 27, at 450-51. Thus, most uncompensated secondary obligors do not fit the definition of the "diligent accommodation party" defined by the PEB Commentary and cited by the Reporter's Note to the Restatement. Therefore, uncompensated secondary obligors are likely to be unjustly surprised when it is asserted that terms of the agreement delete suretyship defenses which would otherwise be available.

¹³⁵ RESTATEMENT OF SURETYSHIP, *supra* note 7, § 48 Reporter's Note, at 212 (stating that "[b]y allowing the use of general language, the rule recognizes that the use of lengthy provisions containing detailed waivers or even separate identification of each ground for discharge does not necessarily promote greater understanding of an instrument's terms." (citing U.C.C., PEB Commentary No. 11, at 1199 (1994))).

¹³⁶ ELDER, *supra* note 27, at 89.

¹³⁷ *See* ELDER, *supra* note 27, at 89.

¹³⁸ STEARNS, *supra* note 27, at 450.

¹³⁹ *See Agribank*, 621 N.E.2d at 976 ("While many accommodation parties may be surprised to learn the consent provisions in the instrument or accompanying documents essentially preclude them from asserting suretyship defenses and render little difference between their liability and the liability of the accommodated party, such consent provisions . . . are routinely utilized by lenders.").

¹⁴⁰ *See, e.g., Winston Corp. v. Continental Cas. Co.*, 508 F.2d 1298, 1302 (6th Cir.), (stating that most jurisdictions differentiate between compensated and uncompensated secondary obligors for the purpose of determining contractual liability).

courts were, "[s]ympathetically inclined toward the surety who customarily received no benefit from the transaction, the courts have been loath to apply the 'smarting.'"¹⁴¹ Professor Elder described the rationale underlying the special status given to uncompensated secondary obligors: "the early suretyship cases treated the contract as one of great burden to the surety, because of the fact that it was usually made for accommodation only, and without any participation in the benefits of the principal contract."¹⁴² Accordingly, the law developed doctrines to protect the uncompensated secondary obligor against unjust advantage taking.¹⁴³ Creditors should not be able to circumvent these historic doctrines of consumer protection and enrich themselves in exactly the manner that the law has otherwise proscribed.

Prohibiting waiver of the uncompensated secondary obligor's suretyship defenses would greatly reduce unfair surprise and enhance the uncompensated secondary obligor's understanding of her legal rights and obligations. Moreover, the prohibition of waiver would prevent loss which is substantively unfair from falling upon gratuitous secondary obligors.

ty); *Barber County Sav. & Loan Ass'n v. Walker*, No. Civ. A. 87-2447-0, 1988 WL 139503, at *2 (D. Kan. Dec. 9, 1988) (stating that Kansas courts have been very protective of uncompensated sureties); *In re Farmers' Co-op of Ark. and Okla., Inc.*, 43 B.R. 619, 623 (W.D. Ark. 1984) (reciting familiar proposition that uncompensated secondary obligors are favorites of the law); *Chandler v. Maxwell Manor Nursing Home, Inc.*, 666 N.E.2d 740 (Ill. App. Ct. 1st Dist. 5th Div. 1996). See also ELDER, *supra* note 27, at 11 ("the [uncompensated] surety is a favorite of the law . . .").

¹⁴¹ HAGENDORN, *supra* note 2, at 2. The concept was much misunderstood because the policy which created the special status for uncompensated secondary obligors did not support the extension of a special status to compensated secondary obligors. To say that *all* secondary obligors are favorites of the law, would be to ignore the distinction between compensated and uncompensated secondary obligors. The rationale behind creating a special status for certain secondary obligors only applies to uncompensated individuals.

¹⁴² ELDER, *supra* note 27, at 11-12. The favored status of uncompensated secondary obligors arose from the fact that they charge no premiums. Stearns, *supra* note 27, at 450; RESTATEMENT OF SECURITY, *supra* note 29, at 234.

¹⁴³ The law also enforced provisions waiving suretyship defenses. However, at that time, the remedy for modification of the underlying obligation was absolute discharge of the secondary obligor's duty to perform. The remedy for modification of the underlying obligation is no longer automatic, complete discharge, but discharge to the extent of the harm caused. As a matter of consumer protection, and in light of the new model of suretyship defenses, the law should mandate that the protections offered to uncompensated secondary obligors cannot be waived.

That waiver clauses within such a context are susceptible to unconscionability lends additional support to a public policy argument for prohibiting waiver of a gratuitous secondary obligor's suretyship defenses.

C. Side Effects of a Policy Enforcing Suretyship Defenses

A policy precluding the waiver of suretyship defenses in transactions with uncompensated secondary obligors would alter the way suretyship transactions are carried out. By prohibiting waiver, every action taken by a creditor which caused loss would result in a corresponding loss to that creditor. Creditors might respond by charging initiation fees or higher interest rates to offset this loss. They could also pursue the alternative route of taking no action to encourage payment of debts by principal obligors, waiting instead until loans became due, and then demanding payment in full from secondary obligors. It might be argued that banks would have little incentive to grant releases or extensions because such actions might ultimately cause them loss, while the benefit of any actions that improved the principal obligor's ability to perform would be reaped by secondary obligors. Finally, this proposal would restrict the ability of autonomous actors to decide for themselves whether to waive suretyship defenses.

1. Incentive to Enter into Contracts With Uncompensated Secondary Obligors Where Suretyship Defenses are Enforced

It might be argued that in a jurisdiction prohibiting waiver of an uncompensated secondary obligor's suretyship defenses, creditors would lack the incentive to enter into contracts creating this class of secondary obligations. The risk of suffering loss would discourage creditors from entering into such contracts. Some principal obligors would then suffer because creditors would not make loans to them, while creditors would lose income which they currently collect on loans to riskier principal obligors. Uncompensated secondary obligors would suffer to the extent that they derive utility from assuming the secondary obligation.

Contrary to these contentions, in a jurisdiction prohibiting

such waiver, the lender would retain significant incentives to enter into suretyship relationships. The lender still would have two parties from whom to collect, and if the lender did nothing to impair the recourse of the gratuitous secondary obligor, it could collect in full from either obligor. This situation would change only if the lender induced loss; yet, even if the lender brought about loss, the uncompensated secondary obligor would remain obligated to perform to the extent not discharged.¹⁴⁴ Recall that it is only where the lender's actions have impacted adversely upon the principal obligor's ability to perform that the secondary obligor will be relieved to any extent of its obligations.¹⁴⁵

More importantly, the creditor could offset loss by charging somewhat higher interest rates and fees. Accordingly, the creditor's incentive to enter into such transactions without waiver of suretyship defenses would remain roughly equivalent to the incentive to enter into them with waiver because loss could be spread across the entire class of uncompensated secondary obligors, while the guarantee of performance would remain available. Finally, where applicable, the creditor could choose not to cause loss by choosing not to take the risk of worsening the principal obligor's ability to perform when that risk was too great.

2. Compensating for Loss By Charging Higher Fees

An arguable side effect of a policy prohibiting waiver is the possibility that interest rates on suretyship transactions would rise.¹⁴⁶ This would occur as banks incurred losses from the operation of heretofore dormant suretyship defenses. This loss would be charged to principal and secondary obligors in the form of fees and higher interest rates. For example, assume that a bank granted an extension for payment expecting that

¹⁴⁴ See RESTATEMENT OF SURETYSHIP, *supra* note 7, § 37, at 163-64. As long as the creditor preserves the recourse of the secondary obligor as against the principal obligor, the secondary obligor will only be discharged from its obligation to the extent of the harm caused by the creditor to the principal obligor's ability to perform.

¹⁴⁵ See generally RESTATEMENT OF SURETYSHIP, *supra* note 7, §§ 39-42.

¹⁴⁶ Note that higher interest rates and fees should accrue only where creditors have continued to risk causing loss.

the principal obligor would get a great job in six month's time upon earning a law degree. Unfortunately, the principal obligor fails the bar.¹⁴⁷ The bank guessed wrong. In that time, the principal obligor's ability to perform deteriorates by \$5000, and suretyship defenses operate to place this loss upon the bank. The bank will pass the loss off to principal and secondary obligors in the form of higher interest rates and fees. For every dollar lost, the bank will seek to gain at least an equivalent amount.

Some secondary obligors may not like having to compensate for this loss in the form of higher fees, and a policy prohibiting consumers from waiving their suretyship defenses is a limitation on the freedom of those individuals to contract—individuals who might prefer to take the risk of suffering a large loss rather than pay modest fees. Nonetheless, the freedom of uncompensated secondary obligors to contract should be limited as a matter of consumer protection.¹⁴⁸

Limiting the ability of consumers to waive suretyship defenses protects the uninformed consumer from waiving valuable protections while encouraging creditors to spread loss. This prevents heavy burdens from falling on such individuals. A policy decision in favor of loss spreading (and prohibiting

¹⁴⁷ Example verbally transmitted by Professor Neil B. Cohen.

¹⁴⁸ "Beginning in the 1970s, a flurry of legislation at the state and federal levels was enacted to protect the consumer . . . it is clear that nowadays the law perceives the equality gap between the provider of goods, money or credit on one hand, and the acquirer of these amenities on the other hand, and tries to step in to fill that gap." TANG THANH TRAI LE, PROTECTING CONSUMER RIGHTS § 102, at 3 (1987) (emphasis added). Most states have enacted usury laws proscribing the imposition of interest above a predetermined limit. *Id.* at 142. At least 45 states have enacted statutes limiting or precluding the use of "waiver-of-defense" clauses in consumer transactions. These clauses generally provide that "defenses available against the seller cannot be used against the seller's assignee, the finance company." HOWARD J. ALPERIN & ROLAND F. CHASE, CONSUMER LAW: SALES PRACTICES AND CREDIT REGULATION § 596, at 316 (1986); see also Edward J. Murphy, *Another "Assault Upon the Citadel": Limiting the Use of Negotiable Notes and Waiver-of-Defense Clauses in Consumer Sales*, 29 OHIO ST. L.J. 667 (1968), reprinted in CONSUMER PROTECTION: A SYMPOSIUM (Leonard W. Levy ed., 1972). Finally, the 1974 version of the Uniform Commercial Credit Code "flatly prohibits agreements to limit or waive the claims or defenses of a consumer." ALPERIN & CHASE, § 596, at 324-25. The preceding examples only are intended to be illustrative of the types of areas in which state and federal governments have enacted statutes limiting the freedom of parties to contract away consumer protections, and not as an exhaustive list.

waiver) postulates that the autonomy of a small minority of consumers must be subjugated in order to protect the autonomy of consumers in general.

3. Incentives to Collect From Principal Obligors

It may be argued that under a policy prohibiting waiver of the suretyship defenses of gratuitous secondary obligors, creditors will have no incentive to collect from principal obligors. Instead, they will wait until due dates arrive and demand full performance from secondary obligors.¹⁴⁹ The likelihood that secondary obligors will be asked to perform will increase dramatically. The extent of such performance will also increase, as creditors will make no efforts to extract performance from principal obligors. Secondary obligors will be burdened with the job of collecting from principal obligors in subrogation to the rights of creditors. Simply put, implementation of such a policy would make it more likely that uncompensated secondary obligors would be asked to perform and then be forced to collect from principal obligors. For example, on the date that the loan for the same law student (as discussed above) becomes due, the creditor will not grant an extension of time to that student because the risk of the student not passing the bar is too great to justify the extension. Instead, the creditor will go straight to the secondary obligor for full performance.

This line of argumentation fails to appreciate that there remains a strong incentive for creditors to continue to grant releases and extensions of the time for performance. Creditors who grant extensions of time or alter the terms of a contract are not driven by compassion but by profit. A creditor who opts to grant a six month extension can collect six month's worth of additional interest.¹⁵⁰ Such a creditor might condition the ex-

¹⁴⁹ Note that if creditors opted to collect directly from secondary obligors without first pursuing principal obligors for payment (including granting extensions and releases), there would be no need to charge higher interest rates and fees, because creditors would not suffer any loss.

¹⁵⁰ See ELDER, *supra* note 27, at 140-41 (discussing the conditioning of an extension in the time for performance by principal obligor upon the payment of interest).

tension of time on the payment of a consideration—payment of advance interest, a higher interest rate,¹⁵¹ or other fee.¹⁵² Thus, considerable incentives remain for creditors to grant extensions.

It may be asked if these incentives would be weighty enough to overcome the danger of suffering loss caused by discharge of secondary obligations. A creditor could spread potential losses across the entire pool of obligors, minimizing the risk of loss to itself, by charging additional fees and interest dollars to offset individual losses. Such a creditor would have the same motivation, in the form of consideration, to grant releases and extensions as a creditor functioning under the Restatement model, and accordingly, would be no more likely to call for performance by a secondary obligor on a due date than would a Restatement model creditor. Thus, it is unlikely that a creditor would choose to forego the possibility of earning additional income where suretyship defenses are in effect any more than a creditor would choose to do so where those defenses have been waived.

4. The Well Informed Uncompensated Secondary Obligor

This proposal would bar informed uncompensated secondary obligors from waiving their suretyship defenses (in interference with the freedom of contract).¹⁵³ An informed uncompensated secondary obligor might prefer to gamble away suretyship defenses in exchange for better contract terms, such as a lower interest rate. For example, Acme Bank, a creditor,

¹⁵¹ See ELDER, *supra* note 27, at 140-41 (discussing higher rate of interest in terms of consideration for modification of underlying obligation).

¹⁵² See ELDER, *supra* note 27, at 139 (stating that payment of interest may be made in advance of due date). It is conceivable that creditors might also condition extensions upon other consideration.

¹⁵³ See Hamish Stewart, *Where is the Freedom in Freedom of Contract? A Comment on Trebilcock's The Limits of Freedom of Contract*, 33 OSGOODE HALL L.J. 259, 260-61 (1995). Hamish Stewart defines the freedom of contract as "both allowing individuals to make their own decisions about what agreements to enter into and enforcing strictly those agreements-in private ordering." *Id.* at 260 (concluding that freedom of choice is presupposed by doctrines of contract law in that "those doctrines treat the contracting parties as autonomous agents who are free and equal in the sense that they have an abstract capacity to enter into contracts.").

rate of 8.5% if Jane agrees to guarantee the loan. However, if Acme gives Jane a choice between guaranteeing the loan at 8.5% interest and keeping her suretyship defenses, or waiving her suretyship defenses in exchange for a lower interest rate of 7%, should Jane, who is a gratuitous secondary obligor, be permitted to waive her suretyship defenses?

There are several reasons why Jane should not be permitted to waive her defenses.¹⁵⁴ In the first place, it is unlikely that a creditor would offer her such a choice. The creditor does not need to bargain for waiver of suretyship defenses which are routinely waived in suretyship contracts.¹⁵⁵ It is no secret that informed uncompensated secondary obligors are uncommon; put simply, there is only a slim possibility that an informed secondary obligor would be offered a contractual choice. For most consumers, placing a prohibition on the freedom to waive suretyship defenses would not restrict any freedom of which the consumer was ever aware or would ever have had an opportunity to exercise. Assuming, however, that an uncompensated secondary obligor was offered a choice, and assuming that he or she was informed about suretyship defenses, the uncompensated secondary obligor should not be permitted to waive its suretyship defenses.¹⁵⁶

This policy protects the great majority of gratuitous secondary obligors who assume secondary obligations out of friendship¹⁵⁷ and who are not informed about suretyship defenses.¹⁵⁸ It also prevents creditors from taking advantage of

¹⁵⁴ See Eric A. Posner, *Contract Law In The Welfare State: A Defense Of The Unconscionability Doctrine, Usury Laws, And Related Limitations On The Freedom To Contract*, 24 J. LEGAL STUD. 283, 283 (1995). "Conventional theories of contract law" which emphasize freedom to contract "do not satisfactorily account for laws that restrict contractual freedom, such as usury laws, the unconscionability and related doctrines, and certain bankruptcy laws." *Id.* Such laws, and many others already in place, limit an actor's freedom to contract.

¹⁵⁵ Cohen, *supra* note 9, at 1042.

¹⁵⁶ The gratuitous actor who would choose to waive his or her defenses should be precluded from doing so. Cf. Posner, *supra* note 155, at 285, 307 (stating that, "The nonwaivable right to discharge in bankruptcy prevents debtors from pledging future assets as collateral . . . [Although] [t]he debtor might be willing to waive in advance his [or her] right to discharge in bankruptcy in order to obtain a lower interest rate . . . the law prohibits such a waiver.").

¹⁵⁷ Cohen, *supra* note 9, at 1042; WILLISTON, *supra* note 23, at 3488.

¹⁵⁸ Uninformed uncompensated secondary obligors should not be held legally liable for waiving suretyship defenses. See Bailey H. Kuklin, *The Asymmetrical Conditions of Legal Responsibility In The Marketplace*, 44 U. MIAMI L. REV. 893

unwitting secondary obligors, and it precludes from arising the situation where an uncompensated secondary obligor is forced to choose between waiving its suretyship defenses and guarantying a loan with an exorbitant interest rate. Like other laws which have been enacted to protect consumers, this policy restricts the autonomy of individuals for the benefit of the group.¹⁵⁹

CONCLUSION

Unlike the traditional approach to suretyship defenses, the Restatement model protects creditors against harsh, automatic, complete discharge of the secondary obligation. The Restatement adopts a modern damages model of suretyship defenses, discharging secondary obligors only to the extent of the harm caused, but allows permissive waiver of those defenses. Although the Restatement fails to protect them from creditor-generated loss, uncompensated secondary obligors should be protected. The uncompensated secondary obligation is a gratuitous obligation, and the uncompensated secondary obligor generally takes no part in drawing up the contract and does not investigate the risk that the principal obligor will not perform. Moreover, the enforcement of suretyship defenses would not be an obstacle to the creation of secondary obligations because creditors have ample incentives to continue entering into such agreements and have the ability to offset risk and spread loss. This proposal establishes a close balance between

(1990). For the uninformed, "[l]egal liability is limited . . . because they are not in a posture to obtain or process [information]." *Id.* at 938.

¹⁵⁹ See Joseph R. Grodin, *Contract, Tort, And Individual Responsibility: An Analytic Framework*, 77 CORNELL L. REV. 1040, 1041 (1992). Professor Grodin enumerated a number of common limitations on the freedom to contract in daily consumer life:

We cannot contract to sell ourselves into slavery Legislatively imposed wage and hour laws exist. We also have worker's compensation, which overrides the terms of any contrary agreement Title VII, with its limitations upon contract, promotes nondiscrimination principles. The Occupational Safety and Health Act tells us that, as a matter of public policy, questions of safety will not be left entirely to the marketplace . . . [and] a contract cannot determine when an employer may insist upon giving employees a polygraph test or when that employer may rely upon such tests as a basis for dismissal.

Id. (footnotes omitted).

the rights of obligees and uncompensated secondary obligors, while eliminating unfair loss and surprise.

Brett E. Lewis

