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Security Transactions

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MORTGAGES

No cases of other than general interest in the area of Mortgages were decided by the Supreme Court in the period under survey.

In a pair of cases brought to enforce chattel mortgages, the defenses went to the merits and did not substantially involve pure mortgage law. In *Tallevast v. Herzog*[1] the defense was fraud and misrepresentation by the seller in the sale of the property covered by the purchase-money mortgage in suit. A lower court direction of verdict for the plaintiff was reversed on the ground that there was sufficient evidence to go to the jury on the issues raised by the defendant. Defenses of fraud and duress were raised in *Thomas and Howard Co. v. Fowler.*[2] A demurrer to the answer was sustained, first, on the ground that the alleged promises made the foundation of the fraud related to acts to be performed in the future, and, second, that the facts set out in the answer did not constitute duress. The sustaining of the demurrer insofar as it touched on fraud was reversed, the holding being that fraud as to future performance may lie in an intention not to perform. As to duress, the facts alleged showed nothing more than a threat to resort to legal proceedings if security were not given, which the court held, as a matter of law, was not sufficient to constitute duress.

The rather common mortgage question of the absolute deed intended as a mortgage came before the Supreme Court in *Evans v. Evans,*[3] in which a wife who was suing her husband for wrongful possession of land was met with a defense that the defendant had conveyed the land to his wife as security for the repayment of amounts to be advanced by the wife for the payment of a mortgage indebtedness and the payment of existing and accruing taxes. The master's report in favor of the husband was reversed by the lower court, and the action of the lower court was affirmed on appeal. The court falls back upon the familiar propositions that while admissible the evidence to convert an absolute deed into a mortgage must be clear and convincing, and that the presumption is that the instrument (the deed) is what it purports to be, with the burden on the person seeking to disprove it.[4] In the light of these standards the

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1. 225 S.C. 563, 83 S.E. 2d 204 (1954).
2. 225 S.C. 354, 82 S.E. 2d 454 (1954).
3. 85 S.E. 2d 726 (S.C. 1955).
4. Petty v. Petty, 52 S.C. 54, 29 S.E. 406 (1897).

husband, on the basis of the testimony, failed to make out his case.

Another mortgage case,[4a] which involves the conduct of a purchaser at a foreclosure sale is, because of overriding trust features, treated in the survey of Trusts.

SURETYSHIP

The period under survey embraces a larger than average number of Suretyship cases, and some of them are of more than usual interest.

Undertaking in Attachment

In an action by a finance company to enjoin the selling under execution of an automobile on which the company had a conditional contract of sale or chattel mortgage, the issue was whether the giving of an undertaking by the automobile owner and his sureties to secure the release of the car which had been involved in an accident was a substitute for the res and discharged the lien. In *Stephenson Finance Company v. Burgess,*[5] the Supreme Court, affirming action of the lower court, held that under the statute giving a lien to a person who is injured or damaged by the negligent operation of a motor vehicle and providing for attachment, the lien is not created by the attachment, and that the function of attachment is merely to seize the property and place it in custody of the law or court. That being so, the undertaking or bond for retaking of the property is designed merely to release the offending property from custody and has no effect upon the lien which came into existence upon the occurrence of the injury.[6] The court draws the distinction between cases where the lien is an existing one created by statute and those where the attachment itself creates the lien: in the latter the redelivery bond is a substituted form of security.[7]

Construction of Bond

The question of the scope of a bond required by law, in terms of those parties for whose benefit it is intended, is presented in *Rogers v. U. S. F. & G. Co.,*[8] in which a person who had been defrauded

4a. Gardner v. Nash, 225 S.C. 303, 82 S.E. 2d 123 (1954).
5. 225 S.C. 347, 82 S.E. 2d 512 (1954).
6. The principal and sureties at the time the bond was given were solvent but apparently had become insolvent in the meantime.
The plaintiff's contention in substance was that the lien of the injured party was lost by the giving of the bond, and that the lien of its contract or mortgage, which it conceded would have been subordinate if the other lien had subsisted, was the only lien.
7. Citing Bates v. Killian, 17 S.C. 553 (1882).
8. 225 S.C. 298, 81 S.E. 2d 896 (1954).

by an automobile dealer in the sale of a car he had no right to sell sued the surety on a bond which the dealer was required by law to give to insure the "lawful operation" of his business.[9] A demurrer to the complaint on the ground that the bond was not intended for the benefit of third parties but was for the sole benefit of the State Highway Department was overruled. The Supreme Court reversed, holding that the statute requiring the bond, considered in conjunction with other statutes regulating the business of automobile dealers, did not indicate any legislative intent to provide security for members of the public who might be wronged by a dealer. Although many bonds required by law to be given to a public body are by their nature designed to afford individuals direct recourse against the obligors and their sureties, this bond is not one of the kind. The court uses as a comparison the similar requirement of a bond from liquor dealers conditioned upon the "lawful operation of the business," and suggests that the bond thus required is not responsive to damages caused by a tort which the dealer may commit against an individual. The case is valuable in that it disabuses the notion, easily conceived, that bonds called for by law are necessarily to be treated as contracts for the benefit of third parties.

In *U. S. v. Crosland Construction Co.*,[10] the Fourth Circuit Court of Appeals in an appeal originating in the Eastern District of South Carolina, affirmed a lower court holding[11] that a contractor's payment bond conditioned that "the principal shall promptly make payment to all persons supplying labor and material . . ." did not cover withholdings of federal income and F.I.C.A. taxes. The principal had withheld from wages but had not paid over the taxes to the Government. The basis of the decision is that when an employer withholds the taxes of the employee and pays him the balance of his wages, the wage obligation is discharged, and the liability is for taxes arising independently of the contract covered by the bond. The money which is due the United States on withholding is taxes, not wages.

The rule that the contract of suretyship is not to be construed *strictissimi juris* in favor of a compensated surety was recognized by the Supreme Court in *Greenville Airport Commission v. U. S. F. & G. Co.*,[12] but while acceding to the view that ambiguity is to be resolved against the compensated surety, the court stated that the rule ". . . does not mean that the bond of a compensated surety is to be

9. 45 STAT. 1729 (1948), incorporated in substance in §§ 46-91 *et seq.*, CODE OF LAWS OF SOUTH CAROLINA, 1952.
10. 217 Fed. 2d 275 (1954).
11. 120 Fed. Supp. 792 (1954).
12. 86 S.E. 2d 249 (S.C. 1955).

so construed as to extend liability beyond the terms of the contract, or as to nullify the plain intention of the parties."

In the present case the plaintiff was obligee under a bond furnished by a contractor who was to excavate and move a specified quantity of dirt. The bond was of the usual kind conditioned for faithful performance, for payment of claims for labor and material, and for the saving harmless of the obligee from liabilities which might be incurred in connection with the performance of the contract or ". . . other such liability resulting from negligence or otherwise . . . ." The principal contract provided that it was to be performed in accordance with the "Standard Specifications for Construction of Airports," issued by the Civil Aeronautics Administration, which contained a provision that the contractor and his surety should indemnify the obligee from liability for damages caused by the neglect of the contractor. The Airport Commission had directed the principal to move dirt along a route designated by it, and in the moving of the dirt damage had been caused to a landowner. Action was brought by the landowner against the contractor and the Commission — the action against the former being based on alleged negligence in the transportation of the dirt, which resulted in great quantities of dust settling on the premises and injuring his home; and the action against the Commission being based on the alleged unlawful taking of his property without just compensation. At the trial of the landowner's action the trial judge instructed the jury to find that if the contractor had been negligent in the transportation of the dirt, they could find a verdict against the contractor, and not against the Commission; and, on the other hand, if they found that the contractor had not been negligent they could find against the Commission for the pro tanto taking. The jury found against the Commission alone, awarding damages of $1,200. The Commission paid the judgment and this action was brought to recover from the surety the amount so paid.

The Supreme Court affirmed a lower court direction of verdict in favor of the defendant, the action below being based upon the finding of the jury absolving the contractor from negligence and upon the holding that the bond did not cover the unconstitutional taking of property, unless it resulted from the contractor's negligence. The appellant's contention in substance was that for any loss however caused to it the surety was liable.

After restating the rules of construction, the court concluded that since the liability of the surety is measured by the liability of the principal, the surety in this case was under no liability because the

principal was not liable, as the jury had found.[13] Moreover, what the contractor had done was done under the specific instructions of the commission.

Subrogation

The extensiveness of the right of subrogation is pointed up in *St. Paul-Mercury Indemnity Co. v. Donaldson*,[14] in which the priority and privilege of a State for unpaid taxes, protected by a bond, passed by subrogation to the surety which had discharged the obligation. The principal while doing business in California had furnished a bond to that State, written by the plaintiff in this action, conditioned for the payment of sales and use taxes. The principal agreed to indemnify the surety. The principal failed to pay sales and use taxes, and the surety paid the amount of the bond. The principal removed to South Carolina and the present action was brought against him to recover the amount paid by the surety on his account, together with expenses incurred by the surety and for attorney's fees. The defense was that the defendant had filed a voluntary petition in bankruptcy and had received his discharge; that through oversight the surety's claim had not been listed, but that the surety knew of the bankruptcy and was on that account barred. The lower court, on the pleadings, held the surety subrogated to the right of the taxing authority, which was not affected by the bankruptcy, and gave judgment for the amount of the bond plus interest from the date of its payment by the surety, for reimbursement of expenses incurred plus interest from the time they were made, and for attorney's fees.

On appeal the chief contention revolved about subrogation and its

13. The court notes the exception to the rule of measuring the surety's liability by that of the principal in pointing to cases where the original contract is unenforceable because of infancy or other disability, citing Smyley v. Head, 2 Richardson Law 590 (S.C. 1846). The cases generally draw a distinction between "vices inherent in the contract" and personal defenses of the principal — such as bankruptcy, infancy, coverture (at common law), the statute of limitations. Where the principal has a defense of the former kind, the defense is open to surety as well. Thus the surety may avail himself of these defects or defenses arising out of the principal obligation: want or failure of consideration — Savings Bank v. Strother, 28 S.C. 504, 6 S.E. 313 (1887), cited by the court; fraud or duress practiced on the principal — Evans v. Huey, 1 Bay 313 (S.C. 1793); illegality — W. T. Rawleigh Co. v. Johnson, 139 S.C. 318, 137 S.E. 820 (1927); excusable impossibility — Ordinary v. Corbett, 1 Bay 328 (S.C. 1793). Similarly, where as here the defense is that there has been no failure to perform — that there has been no breach — a finding to that effect in favor of the principal results as well in favor of the surety. Martin v. Hodge, 87 S.C. 214, 69 S.E. 225 (1910); Nelson v. Parson, 187 S.C. 478, 198 S.E. 401 (1938); Scott v. Wells, 214 S.C. 511, 53 S.E. 2d 400 (1949).

14. 225 S.C. 476, 83 S.E. 2d 159 (1954).

consequences. The fundamental argument that the agreement for indemnity negatived the right of subrogation was dismissed, the court pointing out that subrogation does not depend on contract.[15] Having determined that the right of subrogation existed, the court logically concluded that the nondischargeable quality of the obligee's claim under the Bankruptcy Act[16] remained and was available to the subrogee.[17] In so holding the court treated the tax liability as creating a personal obligation the right to enforce which passed to the surety.

Although on the main aspects of the case the court thus held in favor of the surety, affirming the lower court in this respect, there was reversal with regard to the allowability of expenses, interest and attorney's fees. Although apparently conceding that expenses and fees were proper items chargeable against the principal, the court held that they were not rights available to the taxing authority and hence did not pass by way of subrogation. These claims being contractual in their nature would be barred if the surety, having knowledge of the bankruptcy, had failed to avail itself of the Bankruptcy Act. As to interest the court held that with respect to the claim based on the paid taxes and expenses, interest would be allowed only to the date of the filing of the petition in bankruptcy.

15. Citing Powers v. Calvert Fire Ins. Co., 216 S.C. 309, 57 S.E. 2d 642, 16 A.L.R. 2d 1261 (1950). To which may be added as probably the best case describing subrogation as the creature of equity Gadsden v. Brown, Speers Equity 37 (S.C. 1843). The other South Carolina cases making the same point are legion.

16. 11 U.S.C.A. § 35 — to the effect that a discharge in bankruptcy shall not release a bankrupt from liability for taxes levied by the United States or any State, county, district or municipality.

17. The succession by the subrogee to the privileged position of the State or other governmental unit has been sanctioned in American Surety Co. v. Hamrick, 191 S.C. 362, 4 S.E. 2d 308, 124 A.L.R. 1147 (1939), making available to the subrogee a longer statute of limitations on a tax claim in favor of the State. An early case denied subrogation on a claim by a surety against his co-surety for contribution on a United States customs house bond. Bank v. Adger, 2 Hill Equity 262 (S.C. 1835).