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Restatement of the Law of Security (Book Review)

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BOOK REVIEWS

RESTATEMENT OF THE LAW OF SECURITY. St. Paul: American Law Institute Publishers, 1941, pp. xxiv, 596.

Mr. Hanna and his co-workers have done a good job. The *Scope Note*¹ tells the story better than any reviewer can, and for this obvious reason it is quoted here in full:

Security is an interest in chattels, in land, or in the obligation of a third party. A security interest must be the result of a transaction that gives recourse against a particular chattel or land or against a third party on an obligation. The purpose of security is generally to secure the repayment of money, but it may also secure the performance of any duty. When money is advanced a personal duty to repay will be implied even if security is given, unless the parties agree that the debtor has no personal obligation except to allow security to be used to satisfy the debt and that the creditor must rely solely upon the security in the event of default.

Security, other than the obligation of a third party, may be either possessory or non-possessory. The pledge and the common law lien as distinguished from equitable security interests and some statutory liens are forms of security dependent upon possession of a chattel or land. Non-possessory security depends upon title to or charge on a chattel or land, but not upon possession. The chattel mortgage, the conditional sale and the real estate mortgage are the principal forms of non-possessory security. The tripartite trust receipt is a form of non-possessory security having enforcement features usually associated with possessory security.

The obligation of a third party who acts as a surety is classified in this Restatement within the general category of Security. This classification is also found in the German and Austrian Codes. While not found specifically in the French Code, this classification is also often adopted by French commentators on the French Code.

This Restatement of Security is divided into two parts. Division I deals with personal property as Security; Division II with Suretyship. Division I is limited to Pledges and Possessory Liens. Statutory Liens and Equitable Security Interests are not separately treated but incidental reference to Statutory Liens is made at appropriate points and various Equitable Security Interests are considered in connection with other Topics.

Chattel Mortgages, Conditional Sales, Trust Receipts and security interests in land are not included in this Restatement.

Typically this volume of the Restatement parallels, as can be seen, the sensible treatment generally accorded materials on security in the workbooks of recent years. Since it is outstanding as the best textbook seen by your reviewer which does so, it is a shame that, being part of the Restatement, this book does not contain any of the plentiful documentation which exists to justify it, and for which we will have to await the local annotations, an unfortunate matter of no mere tomorrow in New York.

Except for suretyship, which might be called—for indeed it is—security *in personam*, only possessory security interests *in rem* are included, although in some quarters the curricular tendency has been to combine not only pledges and liens with suretyship, but the contents of courses on the law of mortgages (land mortgages, chattel mortgages, and conditional sales) in addition. It is just as

¹ RESTATEMENT, SECURITY (1941) 1.

well not to deal with them together. There is too much of what might be called "pure property" in the law of the land mortgage. The device known as the chattel mortgage and the legal advantages which protect the interests consequent upon it have, in our current economy, been pushed into a position of relative unimportance by the wider use of the conditional sale agreement. The latter is dealt with in a uniform law, and in the study of it and of the underlying decisional law, the chattel mortgage can be considered comparatively. These three types of non-possessory security *in rem* are better off in a separate course.

This volume of the Restatement constitutes one of the most remarkable pieces of work your reviewer has ever seen in the phrasing of principles so that they state the *totality* of common law, law merchant, equity and the other components of modern security law. In thus writing as though merger is complete, the reporter and his collaborators unquestionably help the fusion process toward completeness.

Yet there are some disappointments, of which the following are a few.

The so-called "*Pain v. Packard* 2 'doctrine'" receives too little attention even after allowance is made for the fact that it prevails in perhaps considerably fewer than half of the American jurisdictions. Thus, presumably, we shall never know the Institute's views about whether, being exoneration (through a compulsion of the creditor) by self-help as distinct from equity decree, it is available (where it prevails) even when the legal advantages³ are adequate, which is usual, or only when they are inadequate.⁴ Nor will we know whether it will prevail in more of our states if limited to the latter type of situations. The Institute's decision to state the majority view, both because it is the majority view and because the unlimited operation of the minority device is not in accord with principle, ought to have been accompanied at least by a *caveat* that the Institute expresses no opinion as to the availability of the *Pain v. Packard* expedient when the security party's legal advantages are inadequate. Indeed, an affirmation that under the circumstances of their inadequacy the device is available would seem to accord with general principle much more

² 13 Johns. 174, 7 Am. Dec. 369 (N. Y. 1816). The case has given its name to the "doctrine," although the latter was but a *dictum* in the former, which was a case of estoppel. But, "doctrine," or "device," or what you will, there has been a partially successful attempt to meet felt need. See Note, *The Pain v. Packard Doctrine* (1928) 7 YALE L. J. 971.

³ The primary and remedial advantages constituting the interest known as indemnification *after* the security party has performed to and for the creditor.

⁴ As, when a sound and solvent but non-liquid security party (upon an obligation whose performance is the payment of money) is temporarily unable to meet the obligation except by selling assets at a serious loss in a temporarily depressed or inactive market. In such a case, principle justifies a decree staying the creditor, upon the posting of security to protect him against loss caused by the stay, until he has exhausted his remedies against the principal. See *King v. Baldwin*, 17 Johns. Ch. 384, 8 Am. Dec. 415 (N. Y. 1819); *Hayes v. Ward*, 4 Johns. Ch. 123, 132, 8 Am. Dec. 554, 557 (N. Y. 1819); *Remsen v. Beekman*, 25 N. Y. 552, 556 (1862); *Wright v. Austin*, 56 Barb. 13, 17 (N. Y. 1865); *Thomson v. Taylor*, 11 Hun 274, 275, *aff'd*, 72 N. Y. 32 (1877); *Newcomb v. Hale*, 90 N. Y. 326, 329, 43 Am. Rep. 173, 174 (1882).

accurately than the studied neglect inherent in the unequivocal denial implicit in Section 130 that the phenomenon exists.

To the use of the word "guarantor" as a synonym for "surety,"⁵ and then only when "employed to describe certain situations" (such as "guaranty of collection" and "continuing guaranty") "to which they are customarily applied,"⁶ upon the excuse that "there has never been general agreement as to which term is to be the broader and which the narrower,"⁷ your reviewer takes strong exception. This is in spite of his agreement that, security obligations being contractual so that the important inquiry should be directed to the undertaking, emphasis upon labels is less important.⁸

The value which inheres in having different names for different things is proved by the existence of language. Of course, generally speaking, there must be an agreement upon the meaning of a sound used as a noun or it is not the name of anything. True, there have been attacks from noteworthy sources⁹

⁵ RESTATEMENT, SECURITY (1941) § 82, *Comment g*.

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ Radin, *Guaranty and Suretyship* (1929) 17 CALIF. L. REV. 605; WILLISTON, CONTRACTS § 1211. Neither of these writers is as much concerned as he might be with the importance of adjective implications. Mr. Radin's scholarly work is deeply historical, and yet it misses the point, demonstrated by evidence he himself reports, that the persistence of the not too recent invention of the term "guaranty" shows inevitably the need for a second term. This need for a second term is to describe an undertaking of law merchant origin (*Courtis v. Dennis*, 7 Metc. 510 [Mass. 1844]) which came into modern common law through *assumpsit*. The common law term, "surety," though used by merchants, has in its connotation more of debt and covenant than of anything else that guaranty has (*Courtis v. Dennis*, *supra*). These are matters which cannot help continuing to have modern effect. Because at common law a surety was a co-debtor or co-covenantor, he could be (and where obligation was joint had to be) sued as a co-defendant with the principal debtor, and the creditor did not have to produce evidence of the principal's default in order for the surety to be held (Y. B. 40 Edw. III 5, pl. 11 [1365]); see also *Fischer v. Mahland*, 191 App. Div. 209, 181 N. Y. Supp. 179 (1920). The contrary is true in an action against a guarantor (*McShane v. Padian*, 1 Misc. 332, 336, 20 N. Y. Supp. 679, 682, *rev'd on other grounds*, 142 N. Y. 207, 36 N. E. 88 [1892]; see also 3 KENT, COMM. 121). Under modern codes, which permit two or more causes of action to be stated in one complaint, the common law still has effect, in that principal and surety may be joined in one cause of action, and performance by the principal is a matter to be taken by way of plea by the surety, the former of which was clearly intimated, the latter held, in *Fischer v. Mahland*, *supra*. Mr. Radin himself notes (in his article above mentioned at page 609, citing MALYNES, LEX MERCATORIA [1622]) that the merchants had separate names for guaranties which contained no other condition than default of the debtor ("absolute suretiships") and those which did contain others ("conditional suretiships"). Presumably this fact was dictated, if not by necessity, then by convenience learned with the wisdom of experience. If, within guaranties, various names were found advisable, how much greater must be the convenience inhering in separate names for the guaranty which is so largely of law merchant cognizance and the suretyship undertaking known to debt and covenant in the common law! True, merchants and their law called the guaranty a "suretiship," and knew not covenant or debt as such. This, however, was what made necessary a new term (guaranty) to distinguish the law merchant "suretiships," all of which seem to have been conditioned on the principal debtor's default, from

upon the use of the word "guaranty" to describe an obligation in which the principal debtor's default is made a condition of the security party's liability, while "surety" is reserved for those security obligors *in personam* whose performance is to be given irrespective of any prior or contemporaneous default of the principal. To your reviewer there would be in this exact usage a convenience great enough to justify the employment of two distinct names if the time and breath saved by them were garnered only from the implications of pleading and proof¹⁰ which inhere in the foregoing distinction.

In your reviewer's opinion, the work would be more useful if the topics on fraud contained differentiations between the legal consequence of fraud in the inducement and duress amounting to mere undue influence on the one hand, and, on the other, fraud in the *factum* and duress effecting a total absence of assent. Because the position is taken in Section 118(1) that, though there be no exercise of the power of avoidance by the principal for fraud or duress upon him which merely influenced or induced him, the security party is free from liability nevertheless (to the contrary of an important minority view¹¹), the

the common law suretyship obligation (*Courtis v. Dennis, supra*).

Mr. Williston's observations are not particularly helpful, both because, as stated above, he, like Mr. Radin, was not adequately considering implications within the adjective law, and also because his view depends on the meaning of "surety" as one which focuses "attention on the one vital point that the debt as between principal and surety is the debt of the principal" more efficiently than does the word "guarantor." A reference to any dictionary will show that the contrary is the case. Indeed, if the dictionary chosen is WEBSTER'S NEW INTERNATIONAL, SECOND EDITION, UNABRIDGED (1938), the greater efficiency of the word "guaranty" for the purpose will become manifest and, interestingly enough, the case of *Courtis v. Dennis, supra*, will be found cited and quoted there, within the definition of "guarantor." That Mr. Radin calls insubstantial the points of differentiation noticed in *Courtis v. Dennis* does not seem to be justified in the light of all the foregoing implications of those points.

The Restatement might well have taken the lead in this terminological matter, in the interests of a more precise legal language, in the same courageous way in which it engaged in the phrasing of principles as though the fusion or merger of law merchant, common law and equity were already complete. The furtherance which the latter step may be expected to accomplish might thus have had an equivalent in the direction of terminological improvement. As it is, this reviewer fears that the Institute has joined with Messrs. Radin and Williston in what will prove to be the sort of oversimplification which leads to more trouble than that to correct which the simplification was designed.

On the other hand, while it seems impossible to believe that research at the Institute did not go deep enough to take account of the evidence on which this reviewer's conclusions are based, there is at least ground for suspicion that for some reason our modern composite legal Homer nodded in the following sentence which opens *Comment c* to Subsection 1 of Section 118: "*The essential feature of suretyship is that the surety's obligation is conditioned upon the non-performance of a principal.*" (Italics reviewer's.) Not only is this the "definition" of guaranty, but also it excludes suretyships from the law of suretyship!

¹⁰ Note 9, *supra*.

¹¹ ARANT, SURETYSHIP (1931) 164-168. The large commercial states of New York and Massachusetts will be seen in the minority list. In it they will remain while their notion continues that the majority view potentially permits the security party to bar a large claim against the creditor by cancelling a small one against himself (*Ettlinger v. National Surety Co.*, 221 N. Y. 467, 117 N. E.

Institute undoubtedly felt that there was no need for discussing differences between the legal consequences of inducing misbehavior and the jural results of conduct inequitably accomplishing the appearance of assent while preventing any assent from being given. Yet it is precisely because the minority is important that the need exists for fuller treatment or for an emphatic *caveat* to the dissenting jurisdictions.

This reviewer regrets, too, that full consideration was not given to the legal advantages of the creditor's assignee in the many security cases in which, partly by reason of special facts and partly by reason of the influence of the law merchant, the assignee's position is better than his assignor's was. This would include cases of a guaranty made to induce one to take an assignment from the creditor, cases of a guaranty made to induce one to take an assignment from an assignee of the creditor, and cases of a guaranty made under circumstances justifying the inference that security was being furnished by the guarantor against eventualities not generally held to be within the operation of the security of guaranties.¹²

Last and, of course, least, your reviewer dislikes the usage which permits the description of the obligation of a security party as "secondary,"¹³ whether it describes the "order of" obligation or liability, which really means the fact that the security party is entitled to be indemnified by the principal debtor,¹⁴ or is used as synonymous with "conditional."¹⁵ In the first place, this very ambiguity is enough reason for the dislike. In the next, because in a better usage "secondary" means "remedial,"¹⁶ the use of "secondary" in connection with the guarantor's "liability" (meaning obligation)¹⁷ misleads students into thinking that a guarantor undertakes to pay damages if the principal does not

495, 3 A. L. R. 865 [1917]), in spite of the reassurance contained in RESTATEMENT, SECURITY, § 118, *Comment c*. Nor need New York withdraw while its CIVIL PRACTICE ACT § 193(2) remains as an instrument by which the security party may compel the exercise of the power in one way or another by the principal.

¹² These, of course, include possible cases of inducing duress and fraud upon the principal debtor in which the security party is held liable, even though the principal has exercised his power of avoidance, for the reason that special circumstances exist to put security for the particular person who is plaintiff within the intendment of the security obligation. *E.g.*, *A*, being about to take by assignment from *B* a contract between *B* and *C* into which *B* has induced *C* to enter by fraud, insists upon a guaranty by *D* of *A*'s performance before he (*A*) will pay the consideration for the assignment, and *D* executes and delivers such a guaranty. Subsequently *C* avoids. Will *A* not recover from *D*?

¹³ *E.g.*, RESTATEMENT, SECURITY (1941) § 82, *Comments f* and *h*.

¹⁴ *Ibid.*

¹⁵ This is a common classroom use. See ARANT, SURETYSHIP (1931) 4, 5. However, in this respect the Restatement does not offend. See Section 82, *Comment f*. But a condition exists of which the Restatement's use of the word "secondary" does not take adequate regard, unless the use of an ambiguous term with a definition is a wholly efficient educational safeguard in spite of the fact that the other usage is as well established in legal speech as is the first.

¹⁶ Corbin, *Legal Analysis and Terminology* (1919) 29 YALE L. J. 163.

¹⁷ See RESTATEMENT, SECURITY (1942) § 82, *Comments f* and *h*; § 137, *Comment a*.

perform,¹⁸ when, in fact, he undertakes to *perform* if the principal does not; and when the student is permitted to think of a surety's obligation as ever being a secondary liability,¹⁹ more than misleading is involved.²⁰

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FEDERAL TAX HANDBOOK 1940-1941. By Robert H. Montgomery. Vol. 1, pp. i to xii, 1 to 1178; Vol. 2, pp. i to iv, 1179 to 2331. \$17.50.

FEDERAL TAX HANDBOOK SUPPLEMENT 1941-1942. By Robert H. Montgomery. Pp. iv, 498. \$3.00.

FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS. By Robert H. Montgomery. Pp. vi, 761. \$7.50.

EXCESS PROFITS AND OTHER TAXES ON CORPORATION. By Robert H. Montgomery. Pp. x, 710. \$7.50.

AUDITING. By Robert H. Montgomery. Pp. 692. \$6.00.
New York: Ronald Press.

An avalanche of books has come from the pen of Robert H. Montgomery during the past year. Five of the books are in the field of federal income, estate and gift taxation and one is in the field of auditing, theory and practice. Following the enactment of the Revenue Acts of 1940 which, among other things, launched the new excess profits tax on corporations, the author was obliged to bring up to date his now familiar Handbooks on federal taxes,¹ which have been appearing regularly for over twenty years. Normally the author would not have considered a revision of this material for several years in order to give the courts an opportunity to confirm or revise his opinions on mooted points. However, close upon the heels of the 1940 Revenue Act, Con-

¹⁸ This is true no matter how many times one explains to them the contents of *Comment e* and the rest of the contents of *Comment f*, so that once again we are faced with need to ask if a choice of an ambiguous term with a warning definition is educationally safe.

¹⁹ Cf. RESTATEMENT, SECURITY (1941) § 82, *Comments f* and *h*; § 137, *Comment a*; § 146, *Comments a* and *b*.

²⁰ Your reviewer would recommend that the word "secondary" be wholly dropped; that the only use made of "primary" be in the Hohfeldian sense; that in the Hohfeldian sense use be made of "remedial" instead of "secondary"; that adjectives describing a supposed "order of" obligation or liability be not used at all, but instead that we refer to the "principal debtor" and the "security party," calling the latter "surety" or "guarantor," as the case may be, when the generic phrase will not do. If adjectives ever do prove necessary, we can invent new ones. Until better ones are given to hand, "principal" and "accessorial" will serve. It is submitted that "conditional" should be used instead of "secondary" in the last of the senses of that word.

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¹ FEDERAL TAX HANDBOOK 1940-1941, Vol. 1; FEDERAL TAX HANDBOOK 1940-1941, Vol. 2.