Chapter 3: Security and Mortgages

George P. Davis

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CHAPTER 3

Security and Mortgages

GEORGE P. DAVIS

§3.1. Compensated surety. In the case of a noncompensated accommodation surety where the principal and creditor without the surety's consent make a binding agreement to extend time, the surety is discharged unless the creditor in the extension agreement reserves his rights against the surety.1 A compensated surety, however, is not entitled to invoke the strict defense rules governing a voluntary surety.2

In Bayer & Mingolla Construction Co. v. Deschenes,8 the plaintiff Bayer was the general contractor on a state highway contract awarded on a unit price basis. The defendant Deschenes made a subcontract to do certain excavation in compliance with the prime contract which was incorporated by reference into the subcontract. Under the subcontract all work was to start not later than November 24, 1958. Work was in fact commenced on December 1, 1958.

The subcontract required Deschenes to furnish a bond with surety satisfactory to the prime contractor in the sum of $91,000 "conditioned that Deschenes shall faithfully perform this subcontract and satisfy all claims and demands in connection with the performance of the same." The subcontractor furnished a bond of Aetna Insurance Company.

Bayer brought an action at law against Deschenes and Aetna for breach of contract and to recover on Aetna's bond. An auditor found that Bayer was entitled to recover from Deschenes and Aetna for the work that Bayer was required to do because of the breach of the subcontract. It was also found that any extensions of the completion date of the subcontract were by mutual agreement of the prime contractor and the subcontractor, that Aetna had knowledge that the completion date had been extended, that Aetna was not in any way damaged by Bayer's performing the balance of the work required by the subcontract, that Bayer's delay in giving Aetna notice of the subcontractor's

George P. Davis is a member of the firm of Nutter, McClennen & Fish, Boston. He is author of the Massachusetts Conveyancers' Handbook (1956) and is the former chairman of the Land Use Committee of the Boston Bar Association.

default was not injurious to Aetna, and that on August 21, 1959, Aetna acknowledged Bayer's notice to it of Deschenes' default.

Aetna contended that it was discharged as surety by the extensions of time for performance given by Bayer to Deschenes despite Aetna's knowledge of these extensions and the absence of any finding of injury to Aetna caused thereby. The Court ruled that Aetna as a compensated surety was not entitled to invoke the strict defense rules governing a voluntary surety. The Court pointed out that compensated sureties stand on a very different footing from voluntary ones. They are in effect insurers and ought not to be relieved from their obligations upon merely technical grounds not affecting substantially the character of the undertaking which they assumed.4

The modern rule with respect to a compensated surety where an extension of time is given is that such a surety "is discharged only to the extent he is harmed by the extension."5 The federal courts have gone so far as to suggest that compensated sureties on performance bonds on building contracts contemplate that there will be delays in, and extension of time for, performance of the contract and thus impliedly consent to them unless they expressly provide to the contrary in the bonds which they issue.6 The Supreme Judicial Court held that Aetna was not discharged as surety since it could not show that it had been harmed by the extensions of time, or by the prime contractor's failure to notify Aetna promptly of the default.

Aetna also contended that a claim filed against the prime contractor and its surety should not have been allowed. The claim was filed more than 60 days but less than 90 days after the work in question had been done. The auditor found that the claim in question was not governed by the 60-day period for filing claims for the hire of dump trucks for common or contract carriers for use in the prosecution of the contract.7 The Court held that the claim was governed by the 90-day limitation8 for claims "for the rental or hire of vehicles" and "for labor performed." It held that Section 39A of General Laws, Chapter

4 Home Indemnity Co. v. F. H. Donovan Painting Co., 325 F.2d 870, 873-874 (8th Cir. 1963). See Massachusetts Bonding & Insurance Co. v. Feutz, 182 F.2d 752, 756 (8th Cir. 1950); Maryland Casualty Co. v. Dunlap, 68 F.2d 289, 291 (1st Cir. 1933); 11 Appleman, Insurance Law and Practice §6792 (1941); Restatement of Security §§82, Comment i, 129 (1941); Simpson, Suretyship 365 (1950); Stearns, Suretyship §§1.2, 6, 8 (5th ed. 1951); 4 Williston, Contracts §§1121A, 1222 (rev. ed. 1936).
7 G.L., c. 30, §39A.
8 Id., c. 149, §29.
30, and Section 29 of General Laws, Chapter 149, in respect to dump trucks seem to have, in part at least, overlapping coverage although Section 39A (unlike Section 29) extends to charges for such vehicles incurred by others than prime contractors and subcontractors. Section 39A expressly states that the security required in accordance therewith is in addition to the security required by former General Laws, Chapter 30, Section 39.9

The Court held that because Section 39A provided security in addition to that required by the former Section 39 it should be interpreted as also providing security in addition to that provided by General Laws, Chapter 149, Section 29, although, as to persons protected by both sections, it is coextensive.

The Court found no reason why a claimant who is within the scope of General Laws, Chapter 149, Section 29, and who complies with that section, should not have the benefit of the security thereby required, even if he does not comply with General Laws, Chapter 30, Section 39A. Thus, as Quinn's claim under Section 29 was seasonably filed, it was immaterial that any claim which Quinn might have had under Section 39A was not seasonably filed.

§3.2. Performance bonds. During the 1965 survey year, the Supreme Judicial Court again considered rights and obligations under performance bonds. In Town of East Longmeadow v. Maryland Casualty Co.1 the town entered into a contract dated April 28, 1959, for the revaluation of real and personal property in East Longmeadow. The defendant was surety on a performance bond posted by National Associates, Inc. National delivered to the assessors approximately 2500 to 3000 property record cards such as the contract required it to prepare. The assessors reviewed from 200 to 300 of these cards and found errors and omissions thereon. The auditor found that the assessors were unable, by the use of the cards, to assess the properties listed thereon. Before the assessors reviewed the cards for accuracy they paid National four invoices totaling $7166.00.

The lower court ruled that the contract provision for semimonthly payments "equivalent to the value of said work" placed upon the town some degree of reasonable diligence before making payment and granted the defendant's request to rule that when payment was made for each segment of the work submitted, that portion of the contract was completed and the plaintiff could thereafter neither sue National for breach of contract for that portion of the work paid for nor could it sue the surety on the bond.

The Supreme Judicial Court reversed the decision of the trial court and held that the contract was not divisible. The contract required the revaluation of the entire town by one appraising concern so that

9 Section 39 was repealed by Acts of 1957, c. 682, §2, and the provisions of Chapter 149, Section 29, were broadened by Acts of 1957, c. 682, §1, to supplant Chapter 30, Section 39, and to cover much the same ground.

the appraisal could serve as a firm basis for uniform assessments. Furthermore, the contract required National, if requested, to provide qualified persons to assist in explaining the system of revaluation to the property owners and also required that National assist in defending the values established by it in connection with applications for abatement and appeals. The town for its $21,500 was entitled to a single product, a single revaluation of all the property submitted by an appraising company who would be prepared and able to defend it. The town did not get this product.

The Court held that the issue was thus narrowed to whether the obligee-surety relationship impliedly obligated the town not to make payments without checking National's performance as asserted in the invoices. The Court in effect held that when an expert is employed the client, in making payments, is entitled to assume that the work has been accurately done and is not obligated to check the work before making payment. The requirement for payment in accordance with value was based upon the assumption that the contract would ultimately be completed so that in the case of a breach of contract and nonperformance, the obligor and surety company were not entitled to a credit for the work done.

In *Powers Regulator Co. v. Joseph Rugo, Inc.*, the petitioner, Powers, by intervention in pending proceedings brought in the Superior Court, sought and obtained an adjudication of its rights as a subcontractor to be paid from the statutory bond given by the respondent, Rugo, under General Laws, Chapter 149, Section 29. Rugo was the general contractor for the construction of a hangar at Logan Airport for the Massachusetts Port Authority. Rugo had subcontracted work to one Shaw who in turn had subcontracted work to the petitioner, Powers.

Rugo and the two sureties omits bond appealed from the final decree on the ground that the decree did not establish the indebtedness of Shaw to his sub-subcontractor Powers so that Rugo's rights against Shaw would be determinable. Shaw was a party to the proceedings and the final decree dismissed the petition as to Shaw without prejudice. The decree ruled that the sum of $4022.40 was owing to Powers from Rugo, with interest of $392.16, ordered Rugo to pay, and, in the event of Rugo's default, that the sureties do so. The sum of $4022.40 represented the 15 per cent retainage under the subcontract between Shaw and Powers. The remainder of the contract price had already been paid to Powers by Rugo.

The Court stated that although the subcontractor Shaw was not an indispensable party, his presence in the proceedings was highly advisable. The Court found that an appropriate final decree, assuming that the indebtedness of Shaw to Powers was shown by the evidence, would have been to the effect that Shaw was indebted to Powers in

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§3.3 SECURITY AND MORTGAGES

the sum found, with interest, and that Rugo and the sureties were obligated to pay the sum if Shaw did not.4

The answers of Shaw and Rugo, however, disclosed a suit brought by Shaw against Rugo to recover for the work done by Shaw and Shaw's subcontractors, and also disclosed the claim of Shaw that all work done by Powers after a certain date was done directly for Rugo under a contract with Rugo made after Shaw had been enjoined from entering the site of the work. The answers also revealed Shaw's assertion that the decision in the other suit had credited Rugo with $22,793.60 as payments by Rugo to Powers for Shaw's account. This sum is 85 per cent of the contract price in the Shaw-Powers contract. In the circumstances of this other litigation between Rugo and Shaw, it was appropriate to adjudicate Powers' rights in the statutory security with no more concern with the Shaw-Rugo controversy than such adjudication required in the light of the facts established.

The report of material facts showed that Rugo made a plumbing and heating subcontract with Shaw and that Shaw in turn contracted with Powers for the latter to install the temperature controls for $26,816. Powers began its work, temporarily delayed performance when it learned that Shaw had been enjoined from performing its contract with Rugo, but subsequently, at the request of Rugo, completed the temperature controls in the manner agreed upon in its contract with Shaw. Powers had been paid nothing by Shaw, but had been paid the contract price by Rugo less $4022.40 which represented the 15 per cent retainage provided for in the contract. It was also found that Powers had duly filed its sworn statement of claim under General Laws, Chapter 149, Section 29, and that Rugo was indebted to Powers in the sum of $4022.40 with interest from the date of demand.

The findings and the decree do not expressly resolve the issue whether some of the $4022.40 was owed directly by Rugo. That, however, was inconsequential to Powers' right to recover from the security.5 The Court ruled that Rugo and its sureties were nevertheless entitled to a decree that would preserve any rights of Rugo against Shaw. It was also held not to be error to allow interest from the date of filing of the claim.6

The Court concluded that the final decree should provide that any accounting between Rugo and Shaw hereafter made is to reflect the fact that Rugo and its sureties have by this decree become obligated to pay Powers for performing work originally specified to be done by Powers in its contract with Shaw.

§3.3. Materialmen's liens. In N. W. Day Supply Co. v. Valenti,1

6 Ibid.

§3.3. 1 1343 F.2d 756 (1st Cir. 1965).
§3.4. Retail installment sales of motor vehicles. In Pioneer Credit Corp. v. Commissioner of Banks a bill in equity was brought for a declaratory decree to determine the rights of the plaintiff under General Laws, Chapter 255B, Section 16, relating to the payment of refunds of finance charges under motor vehicle retail installment obligations paid in full before maturity. Section 16 provides in part:

[A]ny buyer may pay in full at any time before maturity the debt of any retail installment contract, and in so paying such debt shall receive a refund credit thereon for such anticipation. The amount of such refund credit shall represent at least as great a proportion of the finance charge after deducting from such finance charge an acquisition cost of $12.50 as the sum of the periodic time balances after the day on which prepayment is made bears to the sum of all the periodic time balances under the schedule of installments in the original contract. Where the amount of the credit for anticipation of payment is less than $1.00, no refund need be made. [Emphasis supplied.]

The Court first considered computation of the refund credit for fractional portions of a month. The bank commissioner had ruled that the words "after the day" as used in Section 16 mean that only full months can be charged against the buyer. The effect of this ruling was to give full credit for any partial month to the buyer. The plaintiff finance company argued that the credit should be prorated to cover the expired portion of the month. After studying the statutory history of Section 16, the Court upheld the position of the commissioner, stating that the $12.50 acquisition charge would compensate for any loss involved in not prorating monthly interest charges.

The plaintiff also contended that the regulation, fees and examina-

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2 G.L., c. 254, §31.
4 Commercial Credit Co., Inc. v. Davidson, 112 F.2d 54, 56 (5th Cir. 1940).

tions provided by General Laws, Chapter 255B, are unconstitutionally discriminatory since banks compete with automobile finance companies but are exempt from the operation of the statute. The Court found no unconstitutional discrimination since banks are extensively regulated under other statutes. On the basis of this fact the legislature had a rational basis for distinguishing between banks and small loan licensees as to their presumptive fitness to operate in the motor vehicle financing business and could determine that banks need not be licensed under General Laws, Chapter 255B, Section 2.\(^2\) The Court held that the licensing requirements of General Laws, Chapter 255B, Section 2, as applied to the plaintiff, do not constitute "invidious discrimination," and are not "essentially arbitrary."\(^3\) The statutory distinction between banks and others is based on differences that are reasonably related to the purposes of the act in which it is found.\(^4\)

\section{Mortgage bond indenture.} In \textit{University Club v. National Shawmut Bank of Boston},\(^1\) an incorporated club issued bonds secured by a second mortgage indenture with the defendant bank as trustee. The bonds matured on January 1, 1956, and were in default until August 3, 1962, when the club deposited with the trustee certain of the bonds and sufficient cash to pay all the outstanding indebtedness. At the time of this case, the trustee held approximately $35,000, which had not been claimed by bondholders.

The trust indenture provided:

... any moneys so deposited with the Trustee, and any moneys... held by the Trustee as the redemption price of Bonds called for redemption under section 2 of Article 9 hereof, remaining unclaimed by Bondholders for eight (8) years after said date on which the principal shall have become payable shall be repaid by and Trustee to the Club, and thereafter Bondholders shall be entitled to look only to the Club for the payment of their Bonds

\(^1\) Rockland Atlas National Bank v. Murphy, 329 Mass. 755, 757, 110 N.E.2d 688, 640 (1953); see Mutual Loan Co. v. Martell, 200 Mass. 482, 486-487, 86 N.E. 916, 918 (1911), aff'd, 222 U.S. 225, 32 Sup. Ct. 74, 56 L. Ed. 175 (1911); Dewey v. Richardson, 206 Mass. 430, 433, 92 N.E. 708, 709 (1910). The Court pointed out that the Pioneer Credit Corp. case is therefore unlike Hall-Omar Baking Co. v. Commissioner of Labor and Industries, 344 Mass. 695, 184 N.E.2d 344 (1962), noted in 1962 Ann. Surv. Mass. Law §§10.5, 14.8, 18.56; 1963 Ann. Surv. Mass. Law §10.4 n.9, where it was held that there was nothing in the nature of the itinerant sale of baking goods to support the statutory requirement of a license to do business while at the same time the statute exempted similar businesses in dairy production from all such license requirements.


\section{1964 Mass. Adv. Sh. 1307, 202 N.E.2d 801.}
and then only to the extent of the amount so repaid, and the Club
shall not be liable for any interest on such amount and shall not
be regarded as a trustee of such money. [Emphasis supplied.]

On April 29, 1963, the club requested the bank to deliver to it all
unclaimed funds. On January 1, 1964, the bank advised the club that
it would not do so until August 3, 1970. The club contended that
under the bond indenture the eight-year period commenced to run on
January 1, 1956, and that payment of the unclaimed funds should be
made to the club on January 1, 1964; but the trustee took the posi­
tion that the eight-year period commenced running only when funds
became available to pay the bonds, and that, accordingly, it should not
be required to pay the unclaimed money to the club until August 3,
1970.

The Court held that the eight-year period provided for in the bond
indenture did not commence to run until funds were available to pay
the bonds so that the trustee was not required to return unclaimed
moneys to the club until August 3, 1970.

§3.6. Statutory bonds. In construing bonds given pursuant to a
statute, controlling weight is given to the language of the statute and
to the intention and purpose of the statute rather than to the language
actually used in the bond. In Sands, Taylor & Wood Co. v. The Ameri­
can Co.,¹ a judgment by default was secured against Bowman and
Bowman's Bakery, Inc. Bowman filed a petition to vacate the judg­
ment as to him individually, and, in connection therewith, filed a
surety bond² requiring that Bowman “shall within thirty (30) days
after final judgment in aforesaid action pay ... [the plaintiffs] ... the
amount, if any, which they shall recover.” No petition was filed to
vacate the judgment as to the corporate defendant, and the default
judgment was allowed to stand as to the corporate defendant. At the
trial on the merits, Bowman prevailed and no judgment was entered
against Bowman individually.

The plaintiff in this action contended that Bowman and his surety
were liable on the bond because of the original default judgment
against the corporate defendant. The plaintiff contended that the
words of the bond requiring payment of “the amount, if any, which
they shall recover” included the amount of a judgment recovered
against any codefendant in the same action.

The Court rejected this argument holding that statutory bonds
should be construed to carry out statutory purposes.³ The words of
the bond requiring payment of “the amount, if any, which they shall
recover” did not refer to the default judgment already recovered

101, 102 (1963); Walsh Holyoke Steam Boiler Works, Inc. v. McCue, 289 Mass. 291,
against the corporate codefendant who was a stranger to the proceedings to vacate the judgment.

§3.7. Statutes. The 1965 legislature has passed a variety of acts relative to security and mortgages.

Chapter 265 of the Acts of 1965 makes it clear that the statutory limit of the liabilities of one person, partnership, association, trust, or corporation to a savings bank also applied to separate legal entities which are controlled by one such person, partnership, association, trust, or corporation. The statute somewhat liberalizes the method of computing maximum liability for purposes of the statute.

Chapter 266 of the Acts of 1965 liberalizes the method of computing the maximum permissible liability on co-operative bank real estate mortgages.

Chapter 356 of the Acts of 1965 provides that no person shall send out of the Commonwealth, or institute in a court of another state, any action upon a claim against a resident debtor of this Commonwealth with the intent of depriving such resident debtor of the benefit of the exemptions and protection accorded in Massachusetts to wage earners whose wages are in the hands of their employers, so long as such resident debtor and the employer holding such wages intended to be reached by such proceedings are within the jurisdiction of the Massachusetts courts. Any person violating this section is made liable in contract to the person from whom such claim was collected for the full amount of such claim, interest, and costs.

Chapter 306 of the Acts of 1965 authorizes co-operative banks to grant 90 per cent mortgages on two-family dwellings. The statute previously permitted such loans only on one-family dwellings.

Chapter 307 of the Acts of 1965 provides that co-operative bank mortgage loans may be made in excess of $30,000 subject to the 20 per cent limitation, provided that the amount of any such loan does not exceed 70 per cent of the value of the mortgaged property and provided further that no loan of this class shall be made or acquired in a sum in excess of 5 per cent of the aggregate amount of the guarantee fund, bad debt reserves, and surplus or of $30,000, whichever is greater.

Chapter 308 of the Acts of 1965 provides that at least two members of the security committee of a co-operative bank must approve real estate offered as security for loans, but if the real estate is examined by one or more appraisers, it is no longer required by statute that at least one member of the security committee examine the real estate.