

**DEFENDING CONSUMER COSIGNERS:
An Outline of Michigan Cosigner Rights and Legal Issues
by Frederick L. Miller**

I. SOURCES OF THE LAW AND DEFINITIONS

A. Common Law

1. Surety: One who has loaned his/her credit to another, becoming collaterally liable for the debt of another. 21 Michigan Law and Practice, Suretyship, sec. 1.
 - a. Lack of receipt of any of proceeds or consideration of transaction indicates party is surety, not principal debtor. Lamberson v Love, 165 Mich 460 (1911).
 - b. Intent of parties that signer is surety may be shown by parole evidence. Lamberson v Love, *supra*.
2. Guarantor: One who becomes liable for the debt of another by independent agreement, not as a party to the principal contract. 21 MLP Suretyship, sec.1.

B. Uniform Commercial Code

1. Article 3 governs negotiable instruments. Most of the agreements our clients cosign, such as retail installment contracts and leases, are not negotiable instruments. See White and Summers, UCC, 5th Ed., sec. 14-4. Nonetheless, UCC may be cited by analogy.
2. Accommodation party: One who signs for the purpose of lending his/her name to another party to the instrument.
 - a. Indicia of accommodation party: 1) Intent that other will make all payments, MCLA 440.3419, 2) Other party receives all direct proceeds. White and Summers, UCC, 5th Ed, sec. 13-8.
3. Guarantor: "Payment Guaranteed" means the signer will pay if instrument is not paid when due. "Collection Guaranteed" means the signer will pay only if principal is uncollectable after judgment.

C. FTC Credit Practices Rule (16 CFR 444)

1. Cosigner is a person who renders himself/herself liable for obligation of another without compensation, regardless of how designated in contract or instrument.
2. Includes person whose signature is requested as condition to grant credit or to forebear on collection.

3. Does not include spouse whose signature is needed to perfect security interest.

D. Michigan Cosigner Notice Statute (MCLA 445.271)

1. Same as FTC Rule definition.

II. DEFENSES OF SURETY

A. Liability depends on terms and validity of contract

1. Surety may assert any defense available to its principal. If no action can be maintained against principal, none can be against surety. Áckron Co. v Oakland County, 108 Mich App 767 (1981), lv den 406 Mich 915.
2. Statute of limitations defense of principal can be used by surety, even though longer statute specifically applies to actions on surety bond. In Re MacDonald Estate, 341 Mich 382 (1954).
3. Suretyship agreement involving gratuitous surety should be narrowly construed to limit liability of surety. 21 MLP, Suretyship, sec. 9; 74 Am Jur 2d, Suretyship, sec.27. Agreement for indefinite, continuous liability of gratuitous surety will not be found in absence of clear language. Detroit v Blue Ribbon Association, 254 Mich 263, 266 (1931); Tolman v Clements, 98 Mich 6 (1893); Deal v Kingsbury and Sorrentino, attached.

B. Fraudulent inducement of surety is defense

1. If creditor false representation induces a surety to agree, surety is not bound. 21 MLP, Suretyship, sec. 6.
2. If creditor knows, or is on notice, that false representation by principal induced surety to agree, surety is not bound. Beath v Chapoten, 115 Mich 506 (1898).

C. Statute of Frauds

1. "A special promise to answer for the debt of another person" must be in writing and signed. MCLA 566.132.
2. If oral agreement to pay for goods or services for another is contemplated by the parties to involve principal liability, not collateral, statute of frauds does not apply. Highland Park v Grant-Mackenzie Co., 336 Mich 430 (1962).

D. Action by Creditor Against Principal

1. Creditor is not required to exhaust remedies against principal or reduce claim to judgment before suing surety. Union Bank v Rasch, 106 Mich 319 (1895).
 2. Surety has an interest in collateral held by creditor, and the creditor has a duty to preserve and enforce the security interest to protect the right of the surety. Chabut v Chabut, 66 Mich App 440 (1976). Cases do not say if that includes repossession of collateral not in the possession of creditor.
- E. Entry of default judgment against surety is inappropriate while underlying case on liability of principal is still in litigation. Ackron Co. v Oakland County, supra.

III. MODIFICATION, RELEASE OR IMPAIRMENT OF COLLATERAL

A. Modification of contract may release surety

1. Creditor who knows one party is surety is bound to take no steps to change principal's liability without surety's agreement. 21 MLP, Suretyship, sec. 43.
2. Any material change in the contract will discharge an uncompensated surety, regardless whether the change prejudiced the surety. Grinnell Realty v General Casualty, 253 Mich 16 (1931).
3. Forebearance in collection efforts will not by itself discharge a surety, but an agreement for extension of time for the principal to pay, without assent of the surety, will. Michigan State Insurance Co. v Soule, 51 Mich 312 (1883). The UCC has similar provisions, MCLA 440.3605.

B. Release of the principal debtor without consent of the surety releases the surety. Greenlee v Loring, 35 Mich 63 (1876).

C. An impairment of collateral will release the guarantor or surety to the extent security is damaged. National Discount v Harper, 262 Mich 490 (1933). See also MCLA 440.3605. Impairment under the UCC includes any failure to obtain and maintain perfection of security interest..

IV. COSIGNER'S RIGHTS AGAINST PRINCIPAL

A. Surety has a right of reimbursement or indemnification of any loss against principal if part of all of debt is paid by surety. Ellis v Phillips, 363 Mich 587 (1961)

B. Subrogation

1. A surety, upon payment of the principal's full debt, is subrogated to all rights, remedies and securities which were available to the creditor. 21 MLP, Subrogation, sec. 3; In Re Pangori & Sons, 53 BR 711 (Bank ED MI 1985); MCL 440.3419.

2. The surety who has paid the principal's debt can enforce by replevin the creditor's rights in collateral securing the debt. Myers v Yapple, 65 Mich 403 (1887).

V. COSIGNER'S RIGHTS UNDER UCC ARTICLE 9

- A. Cosigner is an "obligor" under Article 9, MCLA 440.9105(1)(d), and therefore:
 1. Cosigner is entitled to proper notice before sale of collateral under MCLA 440.9611, and after the sale under MCL 440.9616. In Re Bluestone Estate, 121 Mich App 659 (1982).
 2. Cosigner can assert requirement that disposition must be commercially reasonable in all respects.
 3. Cosigner can sue for UCC statutory damages under MCLA 440.9625 for breach of any rights in the disposition of collateral.
- B. UCC prohibits waiver of rights regarding disposition of collateral, MCLA 440.9602.

VI. COSIGNER NOTICE UNDER FTC CREDIT PRACTICES RULE

- A. Applies to extensions of credit to consumers involving goods, services or money (not real property).
- B. Notice, on separate document, must be given prior to signing contract, with specific language of FTC rule. 16 CFR 444.3.
- C. There is no private right of action. Argue that failure to provide the notice violates the Michigan Consumer Protection Act, MCLA 445.903, by:
 1. "Causing a probability of confusion or of misunderstanding as to the terms or conditions of credit" under MCLA 445.903(1)(o);
 2. "Causing a probability of confusion or of misunderstanding as to the legal rights, obligations or remedies of a party" under MCLA 445.903(1)(n).
- D. Argue remedy for violation should be discharge of cosigner, or full amount of liability as actual damages.
 1. Can analogize cases under ECOA. See NCLC, Credit Discrimination, sec. 11-5-2.
 2. Fed Reserve Staff Guidelines on Credit Practices Rule (attached) state that it would be a violation of the Rule for a bank to try to collect from a cosigner who not been given the notice. See Q14(a)-2.

VII. RIGHTS OF COSIGNER UNDER MICHIGAN NOTICE STATUTE

- A. Under MCLA 445.271, et. seq., notice must be sent to a cosigner before any of the following are done:
 - 1. Any adverse information about a cosigner is sent to a credit reporting agency;
 - 2. The cosigner's obligation is sent to a collection agency;
 - 3. Any collection action on the obligation is taken against the cosigner.
- B. The notice informs the cosigner of the default and gives the cosigner 30 days to pay the debt or make acceptable payment arrangements. If payment or payment arrangements are made, there can be no adverse credit report.
- C. Suit authorized for actuals or \$250, plus attorneys fees. 30-day notice of intention to sue is required.

VIII. RIGHTS OF COSIGNER UNDER TILA

- A. TILA disclosures need not be given to a cosigner, as long as they are given to a consumer who is primarily liable, unless the cosigner has a right to rescind.
- B. Cosigner can raise TILA violations in disclosure in defending against liability, since remedy section refers broadly to "any person" and supports application of common law rule. 15 USC 1640(a).

IX. RIGHTS OF COSIGNER UNDER EQUAL CREDIT OPPORTUNITY ACT

- A. Act generally prohibits discrimination based on race, sex, age, marital status, etc. 15 USC 1691, et. seq. Cosigner cannot be required on prohibited basis.
- B. Regulation B under Act prohibits requiring cosigner when individual account is requested, no joint property is involved and the applicant meets the creditor's minimum standards for creditworthiness. Spouse mentioned specifically, but rule is not limited. 12 CFR 202.7(d).
- C. Some courts have voided liability based on violation. Liability may otherwise constitute actual damages from violation. See NCLC, Credit Discrimination, sec. 11.5.2.