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TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-000114-MR

LAWYERS MUTUAL INSURANCE
COMPANY OF KENTUCKY

APPELLANT

v. APPEAL FROM KNOX CIRCUIT COURT
HONORABLE JOHN KNOX MILLS, JUDGE
ACTION NO. 07-CI-00320

PAUL STEWART

APPELLEE

OPINION
AFFIRMING

** **

BEFORE: NICKELL AND WINE, JUDGES; HARRIS, SENIOR JUDGE.

WINE, JUDGE: Lawyers Mutual Insurance Company of Kentucky (“Lawyers Mutual”) appeals a final order of the Knox Circuit Court denying its motion for enforcement of a supersedeas bond against the surety thereon. The issue presented is whether a surety upon a supersedeas bond can escape liability thereon without further order of the court when its principal purpose has been extinguished. For

the reasons set forth herein, we find that a surety cannot be bound when a supersedeas bond fails to stay execution of a judgment.

Background

On December 23, 2003, Jeffrey Stewart obtained a loan from First National Bank & Trust of London (“First National”) in the principal amount of \$83,604.00. He executed a promissory note (the “note”) wherein he promised to repay said amount with interest by June 23, 2004. The note was secured by a real estate mortgage encumbering certain real property in Knox county (the “subject property”) owned by Jeffrey Stewart and his wife, Amy Stewart, (hereinafter “Jeffrey” and “Amy,” respectively). Although only Jeffrey signed the note, both Jeffrey and Amy executed the real estate mortgage.

Thereafter, Jeffrey failed to repay the amount due under the note, and First National commenced an action on July 5, 2007, to enforce the mortgage. Jeffrey was served on July 12, 2007 and Amy was served by warning order attorney on October 11, 2007. First National then assigned its mortgage interest to Lawyers Mutual by an assignment of mortgage dated September 28, 2007. On or about December 28, 2007, Jeffrey and Amy filed an answer, generally denying the allegations in the complaint. On January 4, 2008, Lawyers Mutual was substituted as plaintiff in the action. Also on January 4, 2008, the court entered a Default Judgment and Order of Sale against Jeffrey and Amy in the amount of \$89,486.58, plus interest and costs associated with judicial sale. Subsequently, on February 18,

2008, sale of the property was scheduled by the Knox County Master Commissioner for March 7, 2008, at 1:00 p.m.

On January 14, 2008, Jeffrey and Amy filed a timely motion pursuant to Kentucky Rule of Civil Procedure (“CR”) 59.05, and alternatively pursuant to CR 55.02 or 60.02, to set aside the Default Judgment and Order of Sale. They also moved for leave to file an answer out of time, alleging the mortgage had been paid. Neither the Stewarts nor their counsel appeared on the scheduled hearing date of February 1, 2008. As of March 3, 2008, the trial court had not ruled on the motion. As such, Jeffrey and Amy filed a “Motion to Cancel Sale” on the grounds that the pending CR 59.05 motion would operate to stay execution of the judgment. The motion came on for hearing on the morning of March 7, 2008, and was denied by the Knox Circuit Court, as was the CR 59.05 motion.

Thereafter, later in the morning on March 7, 2008, Jeffrey and Amy filed a timely notice of appeal.¹ Simultaneously therewith, they filed a supersedeas bond upon which Jeffrey’s father, Paul Stewart (“Paul”), was named as surety to prevent judicial sale of the subject property pending appeal. Copies of the notice of appeal and supersedeas bond were personally delivered to the Master Commissioner on the day of sale.

Although there was no formal order of the trial court, and although CR 62.03 states that a supersedeas bond shall be effective from the moment it is “approved by the court or clerk”, the judicial sale proceeded on March 7, 2008.

¹ This appeal was later dismissed upon the request of the appellants thereto, Jeffrey and Amy Stewart.

The notice of appeal and supersedeas bond were delivered to the Master Commissioner more than an hour-and-a-half prior to the sale. The Master Commissioner contacted the then-presiding judge (Honorable Judge Messer, now retired), who instructed the Master Commissioner to proceed with the sale and disregard the supersedeas bond.² The subject property was then sold at judicial sale and, as is often the case, failed to garner the amount due and owing under the note. Indeed, the high bid for the property was only \$1,000.00.

On March 8, 2008, the morning after the sale, Paul, Jeffrey and Amy filed a written “Withdrawal of Supersedeas Bond” that stated as follows:

1. The judicial sale of the property that is the subject of this action (consisting of Lot Number 62 of Unit 2 of Block A of the Stephen Trace Subdivision in Knox County, Kentucky) was scheduled at 1:00 p.m. on March 7, 2008.
2. We filed the supersedeas bond at 11:12 a.m. on the same date to prevent the judicial sale of said property.
3. Notwithstanding the timely filing of the supersedeas bond, the Court directed the master commissioner Paul Baker to disregard the bond and sell the property anyway.
4. The Court having disregarded the supersedeas bond, the purpose for filing the bond is now moot and we hereby WITHDRAW the bond and same is null and void and shall have no further effect.

² Judge Messer apparently instructed the foreclosure sale to commence despite the supersedeas bond on the grounds that the bond was ineffective to terminate the sale because a final and appealable order had not been entered at that time. However, the court had entered a default judgment and order of sale against the appellee more than two months prior, and the CR 59 motion had been denied by the court that morning. As such, we are at a loss for why the court believed there had been no final and appealable order. Moreover, if the CR 59.05 motion had not been denied—and thus was not final at the time—then it would have operated as a stay itself. Regardless, the question was not one for the trial court, as a supersedeas is binding and effective until the *appellate court* (rather than the trial court) decides whether the appeal has been properly prosecuted. *See, Daugherty v. Ringo*, 1 Ky.L.Rptr 272, 1880 WL 7377 (1880).

Also on that date, Jeffrey assigned his father Paul his statutory right of redemption. Lawyers Mutual did not object to the withdrawal of the bond at that time.³

On March 18, 2008, Lawyers Mutual filed objections/exceptions to the Commissioner's sale, citing that there was an inadequate appraisal, that the supersedeas bond should have stayed enforcement of the judgment, and that the sale brought such an inadequate price as to "shock the conscience" of the court. Thereafter, on April 3, 2008, Jeffrey filed a response to Lawyers Mutual's exceptions to the Commissioner's sale. Additionally, Paul filed a notice of his exercise of the statutory right of redemption (under KRS 426.530), tendering the amount of \$1,005.19 therewith (representing the amount of sale plus 10% interest thereon from the date of sale).

On May 8, 2008, the trial court entered an order denying Lawyers Mutual's exceptions to the sale, finding that the appraisal was not inadequate, that Lawyers Mutual inexplicably failed to have a representative present to represent its interest, that there were no other irregularities affecting the sale, and that price alone is not sufficient grounds for setting aside a judicial sale. On June 6, 2008, the trial court entered an order directing the Master Commissioner to execute a deed to Paul based upon his exercise of the statutory right of redemption.

On October 15, 2008, Lawyers Mutual filed a "Motion for Judgment Against Surety" seeking to hold Paul liable for the deficiency after the sale as surety on the supersedeas bond filed on March 7, 2008. Jeffrey filed a response

³ Jeffrey transferred his right of redemption to Paul pursuant to KRS 426.530.

noting that Paul was not, and had never been, a party to the action,⁴ that he had not been served at his proper address, and that the principal purpose of the supersedeas bond was extinguished when the sale was not stayed pursuant to CR 62.03.

Lawyers Mutual's motion was withdrawn for failure to serve Paul at his proper address. Said motion was re-filed on December 5, 2008. On January 6, 2009, the trial court (Honorable John Knox Mills now presiding) denied Lawyers Mutual's motion, stating as follows:

The Court finds and concludes that it would be unfair and inequitable, and constitute manifest injustice, to enforce the supersedeas bond against the surety, Paul Stewart, on this record.

Lawyers Mutual now appeals this order.

Analysis

The sole question presented on review is whether a surety on a supersedeas bond can voluntarily withdraw such bond without an order of the court where the principal purpose of the bond has been extinguished, or restated, whether a supersedeas bond can be enforced against the surety where the bond fails to stay execution of the judgment. Lawyers Mutual argues that Paul is bound as surety because a surety is obligated to pay under a supersedeas bond whenever the appellate court affirms the trial court or dismisses the action. For the following

⁴ However, under CR 73.07, Paul Stewart, by entering into a supersedeas bond as surety, submitted to the jurisdiction of the Knox Circuit Court and effectively agreed that his liability could be enforced by motion without the necessity of an independent action.

reasons, we must disagree with Lawyers Mutual and, therefore, affirm the trial court.

Lawyers Mutual argues that the supersedeas bond does not actually state the purported purpose Paul, Jeffrey and Amy recited in the Withdrawal of Supersedeas Bond, namely: “to prevent the judicial sale of [the subject] property.” However, the purpose of *any* supersedeas bond is *always* to stay execution of a judgment pending appeal. CR 62.03, CR 73.04. Indeed, that is its basic function. *Id.* See also, 30 AM.JUR.2D *Executions and Enforcement of Judgments* §36 (2005). (The sole purpose of a supersedeas bond “is to preserve the status quo pending appeal so that the appellant may reap the benefit of a potentially meritorious appeal.”).

Here, the supersedeas bond did not stay execution of the judgment and the subject property was sold at Commissioner’s sale. As the supersedeas bond failed to stay execution of the judgment, the surety was deprived of the benefit of his bargain. See, e.g., *Thompson v. Henson*, 307 Ky. 61, 209 S.W.2d 849 (1948) (“*Quid pro quo*” is the veritable mainspring of legal contract). Moreover, it is a long-standing principle under the law of suretyship that “any change whatever in the contract for the performance of which the guarantor is liable . . . discharges the guarantor from liability.” *United States Fidelity & Guaranty Co. v. United States*, 191 U.S. 416, 423, 24 S.Ct. 142, 48 L.Ed. 242 (1903).

It is irrelevant for the purpose of our decision today that Lawyers Mutual did not receive an amount sufficient at foreclosure sale to satisfy the note.

The purpose of real estate mortgages is to allow lenders the option of foreclosure to satisfy indebtedness on promissory notes in the event of default. However, the courts can be no guarantor to the holders of mortgages or other security interests that they will be able to recoup the amount of indebtedness therefrom. We note that Lawyers Mutual still holds a *judgment* against Jeffrey. In situations where a lender is left with an unsecured debt, a lender may resort to such other methods as prescribed by law for the enforcement of judgments (including garnishment). *See, e.g.* KRS 425.501, *et. seq.* and KRS 427.005 *et. seq.* Although the money raised at judicial sale was insufficient to satisfy the amount due and owing under the note, Lawyers Mutual is left only with the methods *the law will allow* to collect its now unsecured debt.

A surety cannot be bound by a supersedeas bond where its principal purpose—to stay execution of the judgment—is thwarted. Surely, when this occurs, the bond is unenforceable. *See, e.g.,* 72 C.J.S. Principal and Surety §120(b) (“A surety on a forthcoming bond is released if the creditor seizes and sells the property for which the bond was given.”). While the surety to a supersedeas bond agrees to pay the judgment amount in the event the appeal is unsuccessful or is dismissed by the appellate court, a surety *cannot* be bound where there is a complete lack of performance of the underlying contract (*i.e.* forbearance of execution pending appeal). Indeed, it appears that an underlying condition to any supersedeas bond is that the judgment be stayed pending appeal. *See, e.g., Horn v. Ranier*, 560 S.W.2d 233, 235 (Ky.App. 1977) (If it is apparent

“from the nature of the contract and the surrounding circumstances [that] the parties from the beginning must have known that it could not be fulfilled unless . . . some particular thing or condition of things exist[ed] . . . and such ... existence as the foundation of what was to be done . . . the contract is to be construed as subject to an implied condition.”). Accordingly, we hold that when there has been an execution of judgment in disregard of a supersedeas bond, it would be unconscionable, indeed unjust and inequitable, to enforce it as against the surety.⁵

Thus, we affirm the order of the Knox Circuit Court.

ALL CONCUR.

BRIEFS AND ORAL ARGUMENT
FOR APPELLANT:

Darrell L. Saunders
Corbin, Kentucky

BRIEF AND ORAL ARGUMENT
FOR APPELLEE:

Ralph W. Hoskins
Corbin, Kentucky

⁵ We note that had Lawyers Mutual appealed the validity of the sale based upon the fact that the trial court did not have discretion to disregard the supersedeas bond, the result may have been different. However, Lawyers Mutual did not appeal the trial court’s denial of its motion to set aside the sale, but instead appealed the trial court’s denial of their motion for judgment against the surety.