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ISSUE:

When loans, such as dealer paper, are sold to a bank pursuant to a "with recourse" assignment or endorsement, at what point should the balance of the loan be added into the assignor's total liability for purposes of the legal lending limits statute, K.S.A. 9-1104?

ANALYSIS:

Under subsection (a)(1) of K.S.A. 9-1104, so long as the obligation of a drawer, endorser or guarantor remains secondary, it is not included within the term liability for purposes of determining legal lending limits.

To determine whether an assignment "with recourse" creates primary or secondary liability it is necessary to first define "assignment". The term "assignment" is generally used to signify transfer of nonnegotiable instruments, while the term "endorsement" is used to signify transfer of negotiable instruments. 6A CJS Assignments 5a.

In an assignment, "where liability is imposed on the assignor for nonpayment or default of the debtor, the assignee usually cannot proceed against the assignor until he has exercised due diligence in an unsuccessful attempt to recover from the obligor." 6A CJS Assignments 90.

Regardless of whether an instrument is negotiable or nonnegotiable, the Kansas courts have determined that the assignor (or the endorser, in cases of negotiable instruments) does not become primarily liable until the primary debtor defaults and the assignor is given notice. Mercantile Bank v. Farmers & Merchant's State Bank, 920 F.2d 1539 (10th Cir. 1990)

In Mercantile, the 10th Circuit Court of Appeals cited Foster Frosty Foods, Inc. v. Commissioner, 32 F.2d 230, 233 (10th Cir. 1964) for the proposition that "an assignment 'with full recourse' acts as a guarantee by the assignee in case of such a breach". 920 F.2d at 1 544. The Court further held, as did the Kansas District Court, that "a 'full recourse' assignment of a nonnegotiable document, without any other explanatory language, is only a conditional guarantee." 920 F.2d at 1 544-1 545. Because it is a conditional guarantee, the creditor must first proceed against the defaulting principal obligor before attempting to collect from the guarantor. Kansas State Bank & Trust Co. v. DeLorean, 7 Kan.App.3d 246, 640 P.2d 343,350 (1982).

The Appeals Court in Mercantile expressed agreement with the District Court's reliance on both the general meaning of the word "recourse" and on an analogy to Article 3 negotiable instrument law in reaching its decision, as there was no Kansas case law on point. The District Court had noted that under Article 3 of the UCC, an endorsement without restrictive language is considered an endorsement "with full recourse". The UCC states that in this case, an endorser is only secondarily liable, because liability is conditioned on presentment, dishonor, and notice of dishonor of the negotiable instrument. Under the revised UCC statutes, the same result is still reached. See K.S.A 1 993 Supp. 84-3-41 5, 84-3-501, 84-3-502, 84-3-503, and 84-3-504.

As noted above, the "general rule" found in the UCC is that before an endorser becomes primarily liable, presentment, dishonor and notice of the dishonor must occur. However, the UCC contains a number of exceptions to this general rule which ease the requirements regarding presentment and dishonor. In fact, in a number of instances, the simple occurrence of a missed payment may trigger the recourse agreement and create a right of recourse for the assignee against the assignor/endorser.

Therefore, in the absence of language contained in the assignment or endorsement expressly establishing a trigger time for the right of recourse, a missed payment creates a strong likelihood that the endorser is primarily liable and obliged to pay the amount due on the instrument according to its terms. Consequently, it is the position of this department that the debt should be aggregated at that time with the other debts of the endorser for purposes of K.S.A. 9-1104.

CONCLUSION:

In general terms, a "with recourse" assignment, or an endorsement, without any other language, acts as a conditional guarantee. As a conditional guarantee, the assignor or endorser is only secondarily liable for the debt. According to the UCC and Kansas law, it is possible that the assignor's or endorser's liability becomes primary once the debtor misses a payment. Therefore, for the purpose of applying K.S.A. 9-1104, once the debtor misses a due payment, the department will aggregate the debt with all other assignor liability. This determination of when primary liability attaches is not a strict determination of the legal enforceability of the obligation, but is intended as a conservative determination for purposes of applying the legal lending limits statute.