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THE CONTRACT OF THE CORPORATE SURETY AND ITS DISTINCTION FROM ONE OF INSURANCE

G. M. WEICHELT¹

JUSTICE Lumpkin, in a Georgia case, referred to suretyship as "a lame excuse for a thorough knowledge of human nature."²

The law of suretyship, one of the oldest branches of our jurisprudence, shrouded in the mists of antiquity, is frequently referred to in the Old Testament, and was well recognized and in common use in Abraham's time. When Joseph, the adviser of the Pharaoh of Egypt, demanded that his brother Benjamin be brought before him before granting the requests of his other brothers, they returned for Benjamin. Israel, the father, was reluctant to allow Benjamin to go and Judah said, "I will be surety for him."³

The dangers and hazards incident to suretyship have long been recognized. Solomon warned his people of the need for extreme caution in undertaking to become surety for another when he said, "He that is surety for a stranger shall smart for it: and he that hateth suretyship is sure."⁴

¹ General Attorney, National Surety Co.

² *Jones v. Whitehead*, 4 Ga. 397.

³ XLIII Genesis 9.

⁴ XI Proverbs 15.

The Code of Hammurabi (2250 B. C.) refers to bonds and securities and in one of the translations made by Robert Francis Harper is the following quotation: "If a man have bargained for the field, garden or house of an officer, constable or tax gatherer and given sureties, the officer, constable or tax gatherer shall return his field, garden or house and he shall take himself the sureties given."

There is ample proof that suretyship was practiced by the Babylonians and Assyrians. John, in his able treatise on Babylonian and Assyrian laws, refers to surety for debts, for appearance, and for the appearance of witnesses. In the time of King Darius we find "guarantee against theft," the forerunner of the modern fidelity bond, and various other forms of suretyship frequently referred to. Among them is the case cited where "the seller warrants that if the slave prove to have certain undisclosed defects, vices or liabilities which would detract from his value to the buyer, the seller will indemnify the buyer and give surety therefor." Another case cited in the translation is one for the appearance of "L" and was known as "surety for the foot," meaning that the principal would appear and discharge the debt. Here "G" guarantees "for the foot" of "D" out of the hand of "L". If he goes away "G" will pay thirty-five Gur of dates.

The Greeks and Romans practiced suretyship extensively and here, too, we find mention made of the dangers of suretyship and that sureties frequently suffered because of their undertakings. Among the mottoes of the "Seven Wise Men of Greece," which were later inscribed on the tablet at the Delphian Temple, the fourth, attributed to Thales, a Greek sage and philosopher who lived in about the Seventh Century, B. C., is: "Suretyship is the precursor of ruin." When we realize that one of the seven mottoes given this place of honor in the Delphian Temple is devoted to the contractual relation of suretyship, we can understand that it was not only common and extensively practiced, but that its

hazardous nature was even then understood through experience. Similar examples are found in the Egyptian laws, as well as other ancient codes.

Suretyship was practiced in England as far back as we have any record. Merlin, a bard of the Sixth Century, wrote: "To this accorded, bothe the kyng and the lady and her frendes and the parents of the Duke, and maden gode suretee, bothe on that oon part and tother."

Shakespeare, in his writings, frequently refers to surety bonds. In the "Merchant of Venice" a surety bond plays a very important part and also introduces the original Portia and her famous defense for the surety.

Obligations were then strictly enforced and it was not until the Statute of William and Mary, in 1697,⁵ that sureties were discharged upon making the obligee whole. The law is now well settled that a contract of suretyship is one of indemnity only⁶ and no matter what the amount of the bond may be, the obligee can only recover the extent of the loss sustained.

However, the contract of suretyship, before companies were formed to carry on a suretyship business, was usually entered into for the benefit of the principal and the obligee as a matter of accommodation. Dealing as they do with the frailties of human nature, as well as the unforeseen contingencies which affect business and trade conditions, such contracts often work a great hardship upon the surety and not infrequently bind him far beyond the obligation anticipated when the contract was made. One may well expect his principal to fulfill the contract guaranteed, and the latter may be perfectly sincere and honest, yet something may arise over which neither has control—business depression, storm, famine, sickness and the like—which was not considered nor

⁵ 8 and 9 William & Mary, III, Sec. VIII (1697); Anno Actavo & Nono Gulielmi III, CII, Sec. II-VIII.

⁶ Davis v. Gillett, 52 N. H. 126; Salo v. Pacific Coast Casualty Co., 95 Wash. St. 109.

thought of when the contract was made. Such facts naturally influence the court to consider sureties as favorites of the law and not to be held beyond the strict law of their contracts.⁷ Their contracts were construed *strictissimi juris* and, as announced by Swayne, J., in *Magee v. Manhattan Life Insurance Co.*,⁸ a surety is

a favored debtor. His rights are zealously guarded both at law and in equity. The slightest fraud on the part of the creditor touching the contract annuls it. Any alteration after it is made, though beneficial to the surety, has the same effect. His contract, exactly as made, is the measure of his liability and if the case against him be not clearly within it he is entitled to go acquit.

The form of the contract has changed very little since surety bonds were first written. It must be in writing,⁹ and it is usually called a surety bond. The bond given by William Shakespeare, as principal, the Diocese of Worcester, obligee, and Fulk Sandells and John Richardson, sureties, executed in 1582, is a striking example of this. The defeasance clause is as follows:

The condition of this obligation ys suche, that if hereafter there shall not appere any lawfull lett or impediment, by reason of any precontract, consanguinitie, affinitie, or by any other lawful meanes whatsoever, but that William Shagspere one thone partie, and Anne Hathwey, of Stratford in the Dioces of Worcester maiden, may lawfully solemnize matrimony together, and in the same afterwards remaine and continew like man and wiffe, according unto the lawes in that behalf provided: and moreover, if there be not at this present time any action, sute, quarrel or demaund, moved or depending before any judge, ecclesiastical or temporal, for and concerning any suche lawfull lett or impediment: and moreover, if the said William Shagspere do not proceed to solemnization of marriadg with the said Anne Hathwey without the

⁷ National Mechanics' Banking Ass'n v. Conklin et al., 90 N. Y. 116; Magee et al. v. Manhattan Life Ins. Co., 92 U. S. 93.

⁸ 92 U. S. 93.

⁹ Ingersoll et al. v. Baker, 41 Mich. 48.

consent of her frinds: and also if the said William do, upon his owne proper costs and expenses, defend and save harmles the Right Reverend Father in God, Lord John Bishop of Worcester, and his offycers, for licencing them the said William and Anne to be maried together with once asking of the bannes of matrimony betwene them, and for all other causes which may ensue by reason or occasion thereof, that then the said obligation to be voyd and of none effect, or els to stand and abide in fulle force and vertue.

The reason the wording of the undertaking is still in use is that the obligation and the relationship of the parties have not changed.

Because of the hazard assumed, usually without compensation, men were naturally reluctant to become sureties, notwithstanding that they were favorites in the law. It became difficult to secure sureties when needed. Commercial advancement and progress called the necessity for sureties into being more frequently as trade intercourse expanded. To meet this need corporations and firms were organized for the purpose of becoming sureties and guarantors on bonds. The first of these were in England, and as far back as 1720 we find record of a company organized for the purpose of executing fidelity bonds.

However, corporate suretyship in this country, where it has developed and grown to large proportions, is of comparatively recent origin. The first company, which is still in existence, was organized less than sixty years ago. With such a large industry suddenly coming into being, engaged in financial undertakings of all kinds, it is only natural that the courts should be called on to decide many questions involving these undertakings. Surety companies in many respects resemble insurance companies, especially in that they furnish indemnity for a certain fixed rate or premium, and are frequently referred to as insurance companies. They, too, because of the nature of their business, are subject to legislative control.

It has long been the established rule, in the construction of contracts of insurance, that where ambiguities exist because of the use of words of uncertain meaning, they are construed liberally and most strongly against the insurer,¹⁰ and where a doubt or ambiguity exists, it will be construed in favor of the insured and against the company, every effort being to furnish indemnity, if possible.¹¹ In this regard, insurance contracts are not *sui generis*, though often so considered.

In contracts of insurance, certain elements exist which induce a construction favorable to the one party. For instance, it is a well established rule of construction that a contract is considered most strictly against the writer, and in insurance contracts the policies usually are written by the company. Then, too, forfeiture is abhorrent to the courts, who endeavor to avoid it always. The courts consider also the relationship of the parties as such; usually on the side of the insurer there are skilled minds, technically trained and pitted against untrained minds in the particular venture.

The rule of construction of insurance contracts would be the same in any other contract where the same elements are present. They are, to a large degree, present in the contracts of compensated or corporate sureties, and the same rule of construction has been applied to their contracts.¹² It has been held that compensated or corporate sureties cannot invoke the rule of *strictissimi juris* allowed to personal or gratuitous sureties,¹³ and as to their contracts or undertakings, if there is room for construction, the rules applicable to gratuitous sureties are reversed.¹⁴

In reaching this conclusion, however, the courts have frequently referred to the undertaking of a corporate surety as a contract of insurance.¹⁵ In the case of *Guar-*

¹⁰ *Liverpool & London & Globe Ins. Co. v. Kearney*, 180 U. S. 132.

¹¹ *Palatine Ins. Co. v. Ewing et al.*, 92 Fed. 111.

¹² *American Surety Co. v. Pauly*, 170 U. S. 133.

¹³ *Cowles v. United States Fidelity & Guaranty Co.*, 32 Wash. 120.

¹⁴ *Philadelphia v. Fidelity Deposit Co. of Maryland*, 231 Pa. St. 208.

¹⁵ *United States Fidelity & Guaranty Co. v. First Nat'l Bank of Dundee*, 233 Ill. 475.

anty Company v. Bank,¹⁶ the court said, "The bond in question must, we think, be regarded as an insurance contract." Such expressions have led to endless confusion. While surety companies may enter into contracts whereby they virtually become insurers, there is a wide difference between an ordinary contract of suretyship and one of insurance. Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event; whereas a contract of suretyship is one to answer for the debt, default, or miscarriage of another. Obviously, the contract of suretyship is not altered because made by a corporation for compensation.

The rules of construction applicable to insurance contracts are applied to contracts made by corporate sureties, but once the contract has been construed, the law applicable to all contracts of suretyship applies. For example, where a bond provides for certain antecedent conditions to be performed by the obligee, the surety's liability does not become fixed until compliance, notwithstanding the surety was corporate and compensated,¹⁷ and no amount of construction in favor of the obligee will change this situation. Judge Wells M. Cook states the rule to be,

If the accommodation and compensated surety make exactly the same kind of contract, no court has yet gone so far as to construe the contracts differently, merely because one was corporate and compensated. Surety companies have been classified with insurance companies for purposes of legislative control, because of the similarity of their business methods, but these statutes merely regulate the conduct of the business and do not relate to the suretyship question involved.¹⁸

It was never the intent of legislatures to change the contract of a surety company from one of suretyship

¹⁶ 233 Ill. 475.

¹⁷ *Union Central Life Ins. Co. v. United States Fidelity & Guaranty Co.*, 99 Md. 423.

¹⁸ *Stearns'*, *The Law of Suretyship*, (Wells M. Cook, 3d ed.) p. 402.

to one of insurance, nor was such the intent of the courts. Reference to insurance contracts was made only for the purpose of construction, and this rule of construction "cannot be availed of to refine away the terms of the contract expressed with sufficient clearness to convey the plain meaning of the parties and embodying requirements, compliance with which is made the condition of liability."¹⁹

Like insurance contracts, corporate surety contracts may be considered as aleatory, though not gambling contracts, and the courts have given similar protection to surety companies against bad faith. For example, insurance contracts are considered *uberrima fides* and are so construed.²⁰ For the same reasons corporate surety companies may insist that their contracts be free from concealment and fraud,²¹ and the rule of strict construction in favor of the obligee is applied in like manner, as it is in favor of the insured in an insurance contract.²² Yet the courts will not go beyond the terms of the contract, and where no ambiguity exists and the language is plain and definite, contracts of a corporate surety will be administered the same as any other written contract, the rule of construction not being allowed to refine away the true meaning and intent of the parties.²³

¹⁹ Guarantee Co. of N. A. v. Mechanics' Savings Bank & Trust Co., 183 U. S. 402. See also United States Fidelity & Guaranty Co. v. Overstreet, 27 Ky. 248.

²⁰ McDonald v. Black's Administrator, 20 Ohio 185.

²¹ Copper Process Co. v. Chicago Bonding & Ins. Co., 262 Fed. 66.

²² Terwilliger v. Masonic Accident Ass'n, 197 Ill. 9.

²³ Leshner v. United States Fidelity & Guaranty Co., 239 Ill. 502.