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Fidelity and Surety Bonds

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FIDELITY AND SURETY BONDS

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The subject mentioned is too broad for detailed discussion in all its phases. This article will not treat upon such features of surety bonds as involve their validity, assignability, and the like, but will be confined to the questions of whether or not such bonds are insurance contracts and who may enforce the obligation of the surety.

CHARACTER OF BOND.

These bonds are given as a means of security to indemnify persons against loss arising from unfaithfulness of employees, breaches of contracts, and similar contingencies. Formerly they were frequently signed by the surety through motives of friendship and solely for accommodation, and they were then construed in favor of the surety and he was not held beyond the strict terms of the undertaking. At the present time, as a general rule, these bonds are issued for compensation by corporations chartered for that purpose. By reason of the fact that the obligation is assumed by the surety company for profit, and the further fact that the contract is prepared by the company, courts have construed these instruments as contracts of insurance rather than of suretyship, and have refused to apply the rule of *strictissimi juris.* Being in the law a contract of insurance, the rules of construction peculiar to such contracts apply, and where the bond is open to two constructions, one of which will uphold and the other defeat the instrument, the courts will adopt that construction which is most favorable to the insured.[1] The overwhelming weight of authority supports the doctrine that such contracts are in effect contracts of insurance, and will be most strongly construed against the insurer.[2]

A contract to indemnify a merchant from loss arising by reason of the insolvency of customers was held to be a contract of insurance, and a corporation issuing the same in the regular

1. Amer. Surety Co. v. Pauly, 170 U. S. 133.

2. *United Amer. F. Ins. Co. v. American Bonding Co.,* 146 Wis. 573, 582; *Whinfield v. Mass. B. & I. Co.,* 162 Wis. 1; *Forest County v. United Surety Co.,* 149 Wis. 323, 327; *Milw. B. S. Co. v. Illinois S. Co.,* 163 Wis. 48, 54; 33 L. R. A. (N. S.) 513n.

course of its business was held to be an insurance corporation, and the statutes relating to such corporations were held applicable.[3]

Richards on the Law of Insurance defines a corporation engaged in the business of guaranteeing the fidelity of persons holding places of trust, and the performance of contracts or undertakings, as an insurance corporation. The Wisconsin Statutes give as one of the purposes for which an insurance corporation may be formed under Section 1897 the following: "To insure against loss from defaults of persons in positions of trust, public or private, and to guarantee the performance of contracts and obligations other than that of insurance."

Such a contract then being in the law an insurance contract, it follows that the statutes applicable to insurance contracts will be applied, so far as pertinent, to a bond of indemnity or suretyship. Section 4202m of the Wisconsin Statutes provides in substance that no oral or written statement, representation or warranty made by the insured or in his behalf in the negotiation of a *contract of insurance* shall be deemed material or avoid the policy unless such statement, representation or warranty was false and made with actual intent to deceive, or unless the matter misrepresented or made a warranty increased the risk or contributed to the loss. It was held that this provision applied to a bond issued by a surety company to indemnify an employer for loss sustained through the dishonesty of an employee, upon the ground that the bond was a contract of insurance.[4]

A provision found in practically all bonds given to secure the performance of contracts prohibits or attempts to prohibit the bringing of an action thereon after the expiration of a certain specified time, usually three or four months, from the day on which final payment under the contract is made. Similar provisions in bills of lading and on telegraph blanks have frequently been upheld. With reference to bonds or contracts of insurance, however, some states have held such a stipulation to be absolutely void as against public policy.[5] Perhaps the weight of authority is against this doctrine, and holds that contracting parties may

3. *Shakman v. U. S. Credit S. Co.*, 92 Wis. 366.

4. *Whinfield v. Mass. B. & I. Co.*, 162 Wis. 1.

5. *Miller v. State Ins. Co.*, 74 N. W. (Neb.) 416; *Omaha F. Ins. Co. v. Drennan*, 77 N. W. (Neb.) 67.

limit the time within which an action may be brought to a shorter time than that prescribed by the statute of limitations.[6] However, in jurisdictions where this rule prevails, the courts have in numberless cases avoided such a stipulation by adjudging an estoppel or waiver on the part of the insurance or bonding company.

In Wisconsin, although the validity of such a stipulation in a bond has not been determined by the court, it would doubtless be held that the matter is governed by Section 1900, Rev. Statutes, 1915. Before the adoption of this section by the Legislature of 1911, stipulations limiting the time for the commencement of actions on contracts or policies of insurance were held valid, providing the time specified was not so short as to be unreasonable, and that the insurer did nothing to induce delay.[7] Section 1900 provides that "No *contract or policy of insurance* shall be made, issued or delivered in this state containing any provision limiting the time for beginning an action on the policy or contract to a time less than that prescribed by the statute of limitations of this state." In view of the fact that other statutes relating to contracts or policies of insurance have been held to govern contracts of suretyship where entered into by a corporation for profit, it would doubtless be held by the court that Section 1900 of the Statutes applied to such contracts, and that a provision in a bond attempting to limit the time for the bringing of an action thereon would be wholly void, and that an action could be maintained on the bond at any time within six years under the provisions of Section 4222. This is emphasized by the use of the words "*contract* or policy of insurance." In keeping with other decisions of the court already referred to, the word "contract" in this section would undoubtedly be construed to include surety and fidelity bonds, although such bonds are not strictly *policies* of insurance.

Although the statute says "No contract or policy of insurance shall be made," the insurer unquestionably would be bound by the contract. The language of the contract is of his choosing, and under familiar principles of law he would not be permitted

6. *Appel v. Cooper Ins. Co.*, 76 Oh. St. 52; 10 L. R. A. (N. S.) 674; 80 N. E. 955.

7. *Hart v. Citizens Ins. Co.*, 86 Wis. 77; *Griem v. Fidelity & Cas. Co.*, 99 Wis. 530.

to profit by his own wrong. This is particularly true in view of the provisions of Section 1966-39 of the Wisconsin Statutes for 1915 which provides in substance that any corporation which shall execute any bond, obligation or undertaking as surety shall be estopped, in any proceeding to enforce the liability which it shall have assumed to incur, to deny its power to execute the same or assume such liability. This could well be construed to mean that the corporation would be estopped from asserting not only its power to issue the bond at all, but also its want of power to execute the same in the manner and form in which it was executed.

RIGHT OF THIRD PARTY TO SUE ON BOND.

This question arises most frequently in the case of bonds given to secure the performance of building contracts. In such case if the bond apparently is for the benefit of materialmen, as well as for protection to the owner of the premises; that is, if the bond is conditioned upon the building contractor paying and discharging all indebtedness that may be incurred in carrying out his contract with the owner, or upon the contractor performing the contract on his part and satisfying all claims and demands incurred for the same, it is well settled that persons performing work or furnishing material obtain the benefit of such indemnity and may sue on the bond the same as though they had been parties thereto.[8] Third persons are permitted to sue directly on the bond under the rule allowing parties to enforce contracts made for their benefit. In the case of building contracts it is permitted also on the ground that such procedure avoids circuity of action, it being obvious that if a materialman or laborer sued the owner and recovered on his claim, the owner would thereupon become vested with a right of action against the surety to indemnify him for the loss thus sustained.

It is not necessary to enable a third person to sue on such a bond that he have knowledge at the time he furnishes material or performs labor of the promise made by the surety, but he may thereafter adopt the contract and sue thereon.[9]

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8. *Warren Webster & Co. v. Beaumont Hotel Co.*, 151 Wis. 1; *Concrete Steel Co. v. Illinois S. Co.*, 163 Wis. 41, and cases cited in the two opinions.

9. *U. S. G. Co. v. Gleason*, 135 Wis. 539, 546.

The question as to whether or not the right to a lien upon the premises determines the right of the third party to sue on the bond depends entirely upon the language of the instrument. Where the bond merely stipulates that the surety will hold the owner harmless from all mechanics' liens and claims for liens, and nothing further, it is clear that the parties to the instrument contemplated indemnity against lienable claims only, and the bond will inure solely to the benefit of persons having such claims. But where the building contract provides that the contractor shall furnish all materials, and the bond is conditioned upon the contractor faithfully performing the contract on his part and satisfying all claims and demands incurred for the same, any persons furnishing material under the building contract or performing labor pursuant to its terms is entitled to the protection of the bond, irrespective of his right to a lien.

However, where a bond was given under Section 3327a of the statutes for the erection of a state building, conditioned for the payment by the contractor of all claims for work or labor and material furnished in and about the erection of such building, it was held that the bond covered lienable claims only on the ground that the statute in question was not intended to give any more specific remedy than that furnished by the mechanics' lien law, nor to any different classes of persons.[10] In this case a railroad company sought to compel payment by the surety of its charges for freight, but it was held that freight charges are not a lien as far as a railroad is concerned, and that therefore the railroad company was not protected by the bond.[10] This case is distinguishable from cases where the bond covers *all* claims under the contract, and is distinguishable further on the ground that the railroad company having a common-law lien on the freight to the extent of its charges is amply protected, and was not intended to be benefited by the giving of the bond.

However, a bond conditioned for the payment of *all claims* is of necessity given a more liberal construction, and is much broader in its scope than a bond affording protection against claims for liens only, and such a bond gives a right of action to any one performing labor or furnishing material under the building contract, and the fact that the plaintiff has no right of lien constitutes no criterion for determining his right to maintain an

10. *Wis. Brick Co. v. National Surety Co.*, 160 N. W. (Wis.) 1044.

action on such a bond. Under such a bond the surety was held liable to a blacksmith who sharpened tools and implements used in the work of construction[11] and also to persons furnishing coal.[12] Bonds as usually executed by bonding companies are broad enough to come within the rule just stated, and afford ample protection to anyone furnishing material or performing work of any kind under the building contract.

DR. M. I. CLEAR'S COLUMN

VERNACULAR FOR USE OF THE LAWYER WHO PRACTISES IN THE DISTRICT AND MUNICIPAL COURT

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Slang we are told is "low or vulgar language or such language that is not recognized in polite or serious literature." It is said to have been originally the Gypsy term for the secret language of Gypsies, thieves and tramps, though some etymologists connect it with the verb "to sling," as being abusive language "slung" at a person.

Slang permeates all classes, and belongs to all trades and professions. Through custom and usage some slang words have become recognized as perfectly good English "as she is spoke."

Many of our ordinary every-day slang expressions are the coinage of crooks or corruptions of the criminal dialect. The writer during his several years' experience as clerk in the criminal courts of this county has compiled a criminal dictionary of the vernacular of the underworld comprising several hundred

11. *French v. Powell,* 135 Cal. 636; 68 Pac. 92.

12. *City Trust, S. D. & Surety Co. v. United States,* 77 C. C. A. 397, 147 Fed. 155.