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GUARANTY INSURANCE.

A TREATISE

ON

GUARANTY INSURANCE;

INCLUDING THEREIN AS SUBSIDIARY BRANCHES

THE LAW OF FIDELITY, COMMERCIAL, AND JUDICIAL INSURANCES,

COVERING

ALL FORMS OF COMPENSATED SURETYSHIP, SUCH AS OFFICIAL AND PRIVATE FIDELITY BONDS, BUILDING BONDS, COURT BONDS, CREDIT AND TITLE INSURANCES.

BY

THOMAS GOLD FROST, Ph.D.,

OF THE NEW YORK BAR.

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TO THE MEMORY

OF

My Father,

THOMAS G. FROST,

Late of the Chicago Bar,

THIS TREATISE IS DEDICATED AS A TRIBUTE TO ONE WHO LIVED A LIFE TRUE TO THE BEST AND HIGHEST IDEALS OF THE PROFESSION.

RKK 9 September 53

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PREFACE.

EVERY lawyer owes a debt, be it great or small, to his profession. If he can repay that debt by contributing something to the learning of his calling, he is but satisfying a highly meritorious obligation. The life of the twentieth-century advocate is a busy one, full of ceaseless activity and arduous labor in the service of that most jealous and exacting of all professions, the law. It is difficult to snatch the necessary leisure from the demands of active practice to do the careful and laborious work required of one in the proper preparation of a text-book on any important legal subject. In the case of the author of the present work, this has been by no means easy of accomplishment. The preparation of a work upon guaranty insurance was commenced by the writer several years ago, in response to what was even then an urgent demand for a work on a subject of growing importance. One thing or another has delayed its completion until the present time. In some respects this delay has been fortunate, for it has permitted the use of a large body of exceedingly valuable case law, which has appeared during the intervening period.

No one, properly conscious of the difficulties of writing a "pioneer treatise" on any important branch of the law, can approach such a broad and comprehensive subject as that of guaranty insurance without feeling a keen sense of responsibility, as well as a disinclination to be the first "to break the soil." But the experiences of active practice, wherein for many years the writer has been associated on one side or the

other of many cases involving contracts of guaranty insurance, has afforded that necessary practical acquaintance with his "tools" which every legal writer should possess. The present work endeavors to present both the theory and practice of all the various branches of guaranty insurance law. An honest — and it is hoped successful — effort has been made to avoid being dogmatic in statement, which will serve to explain why such copious extracts from the reports have been embodied herein. On such a new and inviting field as the present there is every inducement, in the frequent absence of either well-settled principles or precedent, for an author to state dogmatically what the law should be. No one, conscious of the newness of such a subject as guaranty insurance, would care to risk his professional reputation in such a manner. The theory, if such it may be called, upon which this work is written has been that of leaving to the courts their natural and allotted task of defining the unsettled principles of guaranty insurance law by future adjudications; while to the writer of a legal treatise belongs the less pretentious task of digesting the "case law" of to-day, with a view of deducing therefrom such rules and principles as a close and intelligent reading may seem to justify.

With a consciousness that the preparation of the work here submitted to the profession has enlisted his best efforts, and in the hope that it may meet with a generous and charitable reception at their hands, the writer desires "to submit his case without further oral argument on the written brief."

THOMAS GOLD FROST.

NEW YORK CITY,
September 23, 1901.

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LAW OF GUARANTY INSURANCE.

INTRODUCTION.

ORIGIN AND HISTORY OF GUARANTY INSURANCE.

THE domain of insurance law has, by a process of gradual accession, become imperial in scope and extent. The limitations of this branch of our jurisprudence are no longer to be found in fire, marine, and life insurance contracts. To them have been added in turn other correlated subjects of insurance law. Among these may be named accident, employer's liability, plate glass, burglary, bicycle, and guaranty insurances. It is the last-named branch only, that of guaranty insurance, which will be discussed in the present work.

This branch of insurance law, though comparatively of recent origin, is already one of great and increasing importance. To the necessities of commerce and the more exacting demands of modern business methods it owes its very existence. It may not be without its practical value in the work at hand to trace briefly the historical development of that oldest form of guaranty insurance known in the business world as "fidelity insurance." The first public notice, as far as can be learned, of the proposed formation of a guaranty insurance company for the purpose of insuring the fidelity of employees appeared in 1720, in the "London Daily Post," and read as follows:

"Whereas, notwithstanding the many excellent laws now in force for punishing hired servants for robbing their masters or mistresses, yet noblemen as well as commoners are daily sufferers; and seldom a session but great numbers are convicted, to the utter ruin of many families, as also a scandal to

the Christian religion. This is to give notice that at the request of several housekeepers, books will be opened next Saturday at the Devil Tavern, Charing Cross, at ten o'clock, wherein any person may subscribe, paying 6 pence p. c. for a share called a £1000 stock; no more shares than 3000 and the call for stock not to exceed 10s. p. c. the first year by quarterly payments. This society will insure to all masters and mistresses whatever loss they shall sustain by theft from any servant that is ticketed and registered in this society."

But it was not until the appearance, in 1840, of Professor DeMorgan's article in the "Dublin Review," discussing the feasibility of fidelity insurance and its relation to the laws of general average, that the matter took definite shape. Professor DeMorgan's article was based on the crude proposition that the number of persons out of a thousand taken at hazard who cannot resist a given temptation will be found to be nearly the same as those in another thousand who cannot resist it. From this germ the present form of compensated suretyship known as fidelity insurance is a natural outgrowth. The underlying principles, nature, and theory of this important branch of guaranty insurance have not even at this day become clearly defined and crystallized. This much, however, may be said: The doctrine of general average, so universal in scope in general insurance law, has in fidelity insurance a greatly restricted application. The reason for this lies in the consideration at all times paid both to local conditions and to the personality of the "risk." Thus, for example, the effectiveness of a criminal code and of criminal procedure have a direct bearing upon the doctrine of general average in a given community. Also, by reason of heredity and family connections, the chance of loss might be greatly lessened by issuing insurance bonds only to persons whose family history was untainted by crime, and whose family ties would in themselves prove a strong barrier against the commission of crime. In short, the doctrine of general average in fidelity insurance means in these days, not an average among the community at large, but an average obtained with reference solely to those

persons possessing such necessary moral, family, and financial requisites as to entitle them to be designated as "proper risks."

To continue, now, with the history of fidelity insurance — it was not until 1840 that a company was organized for the transaction of this class of insurance business. The latter was organized in England, and was known as the "Guaranty Society of London." Mr. Francis, in his "Annals of Life Associations" (1853), says in reference thereto: "When this company was first started, in 1840, for insurance against loss by dishonesty of clerks, there was a great objection raised. It was thought to be one of those vague and speculative undertakings of which England has seen so many, and one which would necessarily fail, because the master would necessarily hesitate to take an assistant who could only give the security of a commercial company. 'The moral security is wanting,' was the exclamation of all. It was vain to answer that the objection pointed both ways, or that a relative would often give the required bond which a mercantile company would refuse. Still the parrot reply was heard, and the solemn shake of the head was followed by 'the moral security — where is the moral security?' And this was deemed sufficient to crush all argument derived from mere statistics. Time passed, and it was discovered that because the banker's clerk gave the security of a company, he did not become a rogue, but he did become independent. It was found, too, that the master would make his claim good on a company with far more promptitude than he would on a relative. It was nothing to say to a board of directors, 'I will have justice and my bond,' but it was something to say to a broken-hearted parent, 'Your son has ruined you as well as himself; discharge your obligations.' It is well known that bankers and merchants have often foregone their due, rather than thus reimburse their losses; and it has been found that, notwithstanding the fact of the moral security being wanting, the societies which guarantee the master from loss by the servant have been very successful, and are on the increase."

As early as 1842 the creation of guaranty insurance companies was recognized by successive Parliaments in England, and on June 18, 1842, were passed the Guaranty Society Acts (5 Victoria, Chapter 64). These were followed on April 19, 1859, by the European Society Acts (22 Victoria, Chapter 25), and on August 20, 1867, by the Guaranty Company Act (30 & 31 Victoria, Chapter 108); on July 25, 1872, by the European Assurance Society Arbitration Act (2 & 26 Victoria, Chapter 145), and on August 11, 1875, by the Government Officers' Security Company Act (38 & 39 Victoria, Chapter 64). At the present time there are said to be in the neighborhood of forty guaranty insurance companies organized and doing business in England and on the continent of Europe. When we turn to the United States, we find that guaranty insurance had a much later development. In the "Insurance Times," published in New York City (December Number, 1873), it was said that "guaranty insurance is unsuited to the needs and necessities of this country." However, under an act of the New York legislature passed March 31, 1880, the Knickerbocker Casualty Company was established, the name being afterwards changed to that of the Fidelity and Casualty Company of New York, and before the close of the year this latter company began to issue bonds guaranteeing the fidelity of persons holding positions of trust. It is reasonably safe to say that the principle controlling such risk assumption was the development of the marine hazard styled "barratry of the master of marines." The conducting of this class of business in the United States had been frequently suggested and recommended by insurance writers and journalists as early as the year 1877. Guaranty insurance has been in vogue in Canada since 1868. To turn now from the history to the philosophy of the subject, it has been well said that "guaranty insurance grapples with the operation of the human will, and, while admitting the temptations which constitute the necessity for protection sought, credits mankind with resisting causes which exist against wrongdoing, and so arrive at a medium capable of precise

estimate. It has not created an evil, only emphasized its existence and improved the method of dealing with it. It is exclusively a technical moral hazard; that is, a hazard whose basis is essentially the integrity of the person whose conduct forms the basis of the risk. Guaranty insurance rests upon the admitted necessity in the modern business world of greater protection to individual ownership and personal rights. It speaks for liberty, as well as for the reciprocal duties of each to all, and all to each. It tends towards equalization, with the normal differentiations of society, in so far as it equalizes loss, misfortune, and deprivation. One curious thing to be noted in this connection is that rates for guaranty insurance do not vary in the same class of employees in proportion to the separate risks involved in each individual instance. This would seem to be on its face somewhat at variance with well-recognized rules in other branches of the insurance business. But the remedy in the case of the guaranty insurance business (with reference to the prevention of the incurrence of risk, not commensurate with the premium to be paid) is found, not in an increase of premium, but in the rejection of risks."

The carrying of fidelity insurance risks has, indeed, had a most wonderful development both in this country and abroad. Within the United States there are now nearly a score of companies, with a large capitalization, engaged in the guaranty insurance business. Considered purely from a business standpoint, this growth is easily explainable. Whether looked at in the light of compensated suretyship or as a differentiated form of insurance, or both, it has its marked advantages. In its first character, as just outlined, it offers oftentimes the only method of obtaining positions of responsibility and trust. It relieves friends and relatives of the onerous and sometimes dangerous burden of becoming private sureties, and at the same time encourages good character, as that is the customary basis of guaranty insurance. To the one who receives the benefit of such insurance it offers a security certain, sure, and easily obtainable, freed from the uncertainties which

unavoidably attach to private suretyship. Again, in its two-fold character, that of a multifold restricted form of casualty insurance as well as a contract of suretyship for hire, it likewise has its merits. It takes away by one stroke the ever-present contingencies of pecuniary loss arising from causes which the utmost business foresight and caution cannot guard against. Such losses as are here referred to, coming to men of small or even moderate pecuniary means, might involve insolvency and financial ruin. But the question may be asked, "Why not make use of the old time private bonds once so generally in use?" Such bonds are objectionable, for a number of reasons. First, because the financial status of the bondsmen must be scrutinized in advance; second, because, in case of loss, recovery is not unlikely to be defeated on technical grounds not open to modern fidelity bonds, or by reason of the inability of the bondsman to meet the obligation. It was in order to meet this objection that guaranty insurance companies were formed. These met with a favorable reception at the hands of the business world, for several reasons. Among these may be mentioned the fact that in most instances the financial status of these companies needed but little investigation and admitted of no question, as their board of directors were ordinarily in themselves a guarantee of good faith. But best of all was the business necessity, felt by all insurance companies, of paying losses promptly. There appeared, too, as time wore on, other advantages than those affecting merely the convenience, comfort, and security of the assured. These insurance companies, both in England and in the United States, inspect their risks most scrutinizingly. Under the rules now in vogue no policy is issued except upon far-reaching inquiry into the character, habits, and qualifications of the person bonded. He must tell his past employment, his business history, his family associations, and his pecuniary condition. His former employer and his references are called upon for information, and where all these fail to make a satisfactory record, other inquiries are undertaken. Under this system, too, policies are frequently refused because the busi-

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ness system of the employer is defective, whether as respects methods of bookkeeping or of the collection, disbursement, and custody of moneys. Such scrutiny cannot fail to have a restraining influence upon the person bonded, and for his good.

From what has been here said, it will clearly appear that the business of guaranty insurance both here and in England can and has been made to conform to customary and time-honored insurance methods. A company doing such business must not expose itself on any risk to an unduly large hazard. It must limit the time for which its policies run; it must keep careful classification of the risks and of its losses within classifications; it must thoroughly inspect its risks in advance and at frequent intervals.

In theory, as has already been observed, it is like other branches of insurance law, — based upon the law of general average. From the nature of the risks covered it depends very largely for its financial success upon the existence of a high standard of morality in the communities where it seeks to do business. It is this element, far more than the deterrent effect of the probable punishment for crime committed, which lies at the very basis of guaranty insurance. The safety of such a business consists in inducing those who are covered by its policies to believe "that honesty is the best policy," and to act accordingly. It recognizes the market value of a good reputation, right living, creditable family connections, and a good home. It endeavors to make the securing of a bond by a private individual a mark of honor. It seeks to promote, to some degree at least, an *esprit du corps* among those who reap its unquestioned advantages.

It is probably true that it is the settled policy of the business world at the present time for men to surround themselves and their business with absolute protection, and to this end they insure their lives and property. In this last connection it is now frequently the case that losses from dishonest employees are insured against by both corporations and individuals engaged in large business enterprises.

While this is true of business men generally, it has been a custom of banks, railroad, express and telegraph companies for years to insist on the procurement of fidelity bonds by their employees. Their reasons for doing this are many. It is claimed that in this way a superior class of employees is obtained. This for the reason that "surety companies" require the best of testimonials and the strongest evidence of integrity in applicants before issuing their bonds. Investigation of the antecedents and character of the applicants is usually much more thorough than it would be possible for the employer to make himself, and the granting of bonds is not only a safeguard for the employer, but is often the best recommendation the employees can secure.

It is undoubtedly true that placing an employee under bond throws around him a wholesome restraining influence, for when thus under bond he knows that another obligation than that of faithfulness to his employer rests upon him.

Still again, looked at from the standpoint of actual business experience, it is a well-known fact that the most prudent and conservative financial institutions, exercising the strictest supervision, now generally require their employees occupying positions of trust to be bonded against any fraudulent conduct involving a loss to the institution. No supervision, however careful or thorough, ever prevents losses of this character. No system of keeping accounts or examination ever eliminates this risk. The most that can be expected is to discover the fraud before the loss becomes serious. Hence it is that only bonds for sufficient amounts to cover this character of risks are required and accepted. The amount of the bond is but a small percentage of what the employee may have access to in the usual course of his employment, but with a proper system of examination the chance of any defaults becoming serious before discovery is minimized. Experience teaches that honest men rarely become dishonest in a day. Temptation, when first encountered, is easily resisted ; with each succeeding encounter the power of resistance is weak-

ened. Defaults are small in the beginning, and gradually increase to enormous amounts, if not soon detected. Persons of experience and observation have found that those in positions of trust who speculate in stocks, grain, provisions and like commodities, invariably lured on by the hope of retrieving past losses, become defaulters to large amounts. It has been observed that persons in positions of trust who are in the habit of gaming will sooner or later become losers, and in consequence defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculation involving sums far greater than those at risk on games of hazard. Then, too, where an employee has once yielded to temptation and defaulted, he is likely to repeat the act. It is generally true that persons in positions of trust who live beyond their income are likewise greatly exposed to the temptations of small peculation, particularly if addicted to immoralities and other excesses. So, also, experience teaches that the risk is very much increased by the employee who is handling money being harassed by debt. Even a man's daily habits and associations determine very largely the likelihood as to whether he will continue in the faithful discharge of his duties. It has been found that, outside of and beyond these personal elements, the character of the supervision over the employee for the prevention of default, and the probability or improbability of an early discovery of shortage, are factors of the highest importance in determining whether or not it is likely that an employee will be guilty of his first embezzlement. The largest defalcations are usually followed by statements from the unfaithful employee's superior officer that he was a too much trusted employee, who had for years been abstracting the funds intrusted to him. Financial institutions do not procure bonds of suretyship to take the place of the duties incumbent upon the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of keeping accounts. The interests of the insured and the insurer are identical. Each is interested in and seeks to prevent a default; each desires super-

vision of such a character as to forbid opportunity for default, and to render discovery certain before such default becomes serious.

The foregoing is a brief, but perhaps not wholly useless, presentation of the genesis and philosophy of that great branch of guaranty insurance known as fidelity insurance. The two remaining branches of the subject, denominated herein as "commercial" and "judicial" insurances, are relatively less important, and are more recent developments of the business of guaranty insurance, otherwise known as compensated suretyship. These last owe their existence to the greater and more exacting demands of modern business methods, and are daily becoming of increasing importance in the commercial and judicial worlds.

PART I. — THE CONTRACT.

CHAPTER I.

GENERAL CONSIDERATION OF THE CONTRACT OF GUARANTY INSURANCE.

§ 1. **Guaranty Insurance defined.** — The term "guaranty insurance" is generic in its scope and signification, embracing within it those subsidiary species of insurance contracts known as "fidelity," "commercial," and "judicial" insurances. Not infrequently the terminology here used has been given a more restricted meaning than that stated above, but, it is believed, without proper basis for such usage.[1]

In legal acceptation, guaranty insurance is an agreement whereby one party (called the "insurer") for a valuable consideration (termed the "premium") agrees to indemnify another (called the "insured") in a stipulated amount against loss or damage arising through dishonesty, fraud, unfaithful performance of duty, or breach of contract on the part of a third person (hereinafter denominated as the "risk") sustaining a contractual relationship to the party thus indemnified. The development of the rules and principles of guaranty insurance is of such comparatively recent origin that in Eickhoff *v.* Fidelity and Casualty Company of New York[2] reference is made by the supreme court of Minnesota to the fact that in 1893 the law in regard to guaranty insurance was then unsettled.

§ 2. **Scope of Guaranty Insurance.** — For purposes of classification and treatment herein, guaranty insurance contracts

[1] See Eickhoff *v.* Fid. & Cas. Co. of N. Y., 74 Minn. 139; 76 N. W. 1030.
[2] 74 Minn. 139; 76 N. W. 1030.

may be divided into three general classes, — those of fidelity, commercial, and judicial insurances.

Of these, fidelity insurance has reference to insurance bonds or policies issued upon persons occupying fiduciary relationships with the insured, whose faithful performance of duty therein is guaranteed by such policies. The fiduciary relationships here referred to, embrace those both of a public and private nature; such, for example, as those existing between officials and the public, between corporate officers or agents and the corporation; and generally between employers and employees to whom is intrusted the disbursing of funds or the handling of property.

Commercial insurance is a popular and very elastic term, having reference to indemnity agreements issued in the form of an insurance bond or policy, whereby parties to commercial contracts are, to a designated extent, guaranteed against loss by reason of a breach of contractual obligations on the part of the other contracting party. To this class belong policies of "contract," "credit," and "title" insurances.

By judicial insurance reference is had to insurance bonds or policies issued in connection with the regular course of judicial procedure, either for the purpose of securing the faithful performance of duty on the part of court appointees, or in order to guarantee due compliance with the terms of undertakings entered into by parties litigant before the courts.

§ 3. **The Nature of Guaranty Insurance.** — Looked at from a purely legal standpoint, to what class of contracts does the instrument issued by the guaranty companies in the form of an insurance bond or policy belong? Is it in fact as well as in form a contract of insurance? Further, even assuming it to be a contract of insurance, why should it be called "guaranty insurance"? To answer the foregoing questions in any satisfactory manner requires a brief examination not only of insurance principles generally, but likewise of those governing contracts of suretyship, guaranty and indemnity. A great deal of unnecessary time and energy has been spent in attempting to distinguish along hard and fast lines the contract

of a surety from that of a guarantor. Much of the confusion, it would seem, that has arisen on the subject might be avoided by considering suretyship as a generic word, embracing all cases in which one person is primarily liable and another person is secondarily liable, and where the latter has a remedy over and against the former. It does not necessarily flow from the contract itself, but may arise from equitable principles. A guaranty, on the other hand, comes properly within the definition of suretyship just given, and is in itself a much narrower expression, being applicable solely to express or special promises to answer for the debt, default, or miscarriage of another.[1]

It has been observed not infrequently by the courts that in contracts of guaranty insurance the more natural attitude of a surety is assumed by the form thereof.[2]

But in a recent case involving the construction of a fidelity insurance bond it was said that in their very form and essence such bonds resemble insurance contracts, and differ materially from the ordinary forms coming down to us by immemorial usage.[3]

In the case just referred to, the term "common surety" was applied to the guaranty company, and in explanation of this use of the term the court observed that the latter "had voluntarily become by virtue of statute what may be called a *common surety*, not exactly in the nature of a common carrier, like railroad and telegraph companies, but still one of these common agencies to which are given unusual powers and which have assumed the most sacred responsibilities. Permitted by law to act as sureties for trustees, guardians, administrators, and other fiduciaries, they are held by the policy of the law to the full measure of the responsibility they have voluntarily assumed. They may make such reasonable regulations as are necessary for their own protection or the proper

[1] See Dwight's Notes on Contracts, Vol. I. Columbia Law Times, 133.

[2] Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; 47 U. S. App. 91.

[3] Bank of Tarboro *v.* Fid. & Dep Co., 128 N. C. 366; 38 S. E. 908.

transaction of their business; but all such stipulations will be most strongly construed against a forfeiture of the indemnity for which alone the bond is given and in favor of a fair and equitable construction of the essential purpose of the contract."

Again, treating a guaranty as a form of suretyship, it should be noted that the words "guaranty" and "insurance" have to a great extent the same meaning and effect, and many contracts may, with equal propriety, be called contracts of insurance or contracts of guaranty. There is no hard and fast line to be drawn between contracts of insurance and contracts of guaranty. But speaking generally the former have several features in their character and in the way they are effected which distinguish them from ordinary contracts of guaranty.[1]

Next, if what are strictly indemnity contracts be contrasted with contracts of suretyship or guaranty, it will be observed that the indemnitor in such indemnity agreements undertakes to protect his indemnitee against loss or damage arising through a liability on the part of the latter to a third party, while the undertaking of a surety or guarantor as promisors, is to protect their promisee against loss or damage arising through the failure of a third person to carry out his obligations to such promisee.

This leads naturally to the remark that while all guaranty insurance bonds or policies are in one sense contracts of indemnity, yet they are such only because of their inherent nature as insurance agreements, seeking to provide indemnity to those insured. Unlike strict indemnity contracts, they are issued as matters of speculation and not from motives of friendship, and are usually accompanied by formal written applications for the same, and are themselves made subject to certain conditions and limitations unknown to the more simple indemnity contracts. Then, too, they are supported by a separate and distinct consideration running from the insured to the insurer.

If the purpose be to find points of resemblance in the

[1] See Seaton v. Heath, 1 L. R. App. Cases for 1899, p. 782.

several classes of contracts heretofore referred to, it may be noticed that in each of them the right of subrogation, whether it be in favor of the surety, guarantor, indemnitor, or insurer, is recognized and enforced.

The obligation respectively of the surety and the insurer is a primary one, so far as concerns the right to proceed against them in the first instance to enforce their liability, but collateral in the sense that such obligation is entered into with reference to the contemporaneous existence of a separate contract existing between the principal and the obligee in the one case, or the "risk" and the insured in the other.[1]

In a certain restricted sense sureties, guarantors, and indemnitors are insurers. The surety is an insurer of his principal's obligations, and liable as such in the first instance. The guarantor is an insurer of his principal's financial ability to meet certain designated pecuniary obligations. The indemnitor is an insurer that the assuming of certain obligations by the indemnitee to a third party shall not result in pecuniary loss to such indemnitee.

In view of all that has been said in this immediate connection, can it be affirmed that fidelity, commercial, and judicial bonds or policies as issued by the so-called surety companies constitute a contract of insurance, within the strict legal signification of that term? The answer to the foregoing query must be unqualifiedly in the affirmative. That such policies are essentially insurance contracts has been settled by the overwhelming authority of a large number of courts of last resort, the decisions to the contrary being few and far between.[2] Much of the early confusion that arose in respect to

[1] See U. S. Glass Co. *v.* Mathews, 89 Fed. Rep. 828; 32 C. C. A. 364.

[2] See People *ex rel.* *v.* Rose, 174 Ill. 310; 51 N. E. 246; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Trust Co., 80 Fed. 766; 26 C. C. A. 146; 47 U. S. App. 91; Am. Cr. Ind. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; Bank of Tarboro *v.* Fid. & Dep. Co., 38 S. E. 908; Jackson *v.* F. & C. Co. of New York, 75 Fed. 359; 21 C. C. A. 394; Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; Tebbetts *v.* Mercantile Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281; People *ex rel.* *v.* F. & C. Co. of N. Y., 153 Ill. 25; 38 N. E. 752; Eickoff *v.* F. & C. Co. of N. Y., 74 Minn. 139; 76 N. W. 1030; F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531; F. & C. Co. of N. Y.

classifying this class of contracts is attributable to the failure of the courts to take cognizance of the peculiar nature of the insurer's contract. With reference to the "risk" the insurer is strictly a surety, but not so as to the insured.[1] To the latter he is merely an indemnitor who undertakes to pay money contingent upon the happening of a certain event; as such he is neither a surety nor a guarantor that a third party liable for the payment of said money will be able to pay it. By the law of insurance, though the indemnitor directly promises to pay on a certain event, the contract is treated as one of indemnity.[2] The mere payment of the premium by the insured to the insurer does not create the relation of debtor and creditor between them, for the latter becomes the absolute owner of the premium paid, without any liability to return it. Neither does the existence of a contingent liability on the part of the insurer to the insured create what might be called an existing debt between these parties.[3] In its final analysis the contract of the insurer in fidelity insurance is essentially a pledge to make good, up to a certain designated amount, such pecuniary damage as may result from the misfeasance or non-feasance of the "risk" while in the employ of the insured. To the existence of a primary liability on the part of the "risk" to the insured, considered in connection with the fact that it is in effect a limited guaranty against loss, may probably be

v. Eickoff, 63 Minn. 170; 65 N. W. 351; State *v.* Hogan, 8 N. D. 301; 78 N. W. 1051; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421; Claflin *v.* U. S. Cred. Sys. Co., 165 Mass. 501; 43 N. E. 293; Hayne *v.* Met. Tr. Co., 67 Minn. 245; 69 N. W. 916; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328, 1016; Trenton Potteries Co. *v.* Title Guar. & Tr. Co., 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490; Minn. Tit. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Gauler *v.* Trust Co., 9 Pa. Co. Ct. R. 849; Wheeler *v.* Trust Co., 160 Pa. St. 408; 28 Atl. Rep. 849; Fid. & Cas. Co. of N. Y. *v.* Yoder, 64 Pac. 1027; Seaton *v.* Heath, 1 L. R. App. Cas. 1899, 782; Dane *v.* Mortg. Insur. Corp., 1 Q. B. App. Cas. 1894, p. 54; Finlay *v.* Mexican Ins. Corporation, L. R. 1 Q. B. App. Cas. 1897, p. 517.

[1] Rice *et al.* *v.* Fid. & Dep. Co. of Maryland, 103 Fed. 427; 43 C. C. A. 270; Dane *v.* Mortgage Ins. Corp., L. R. 1 Q. B. App. Cas. 1894, p. 54; Amer. Sur. Co. *v.* Thurber, 60 N. Y. Sup. 198; 43 N. Y. App. Div. 528.

[2] Dane *v.* Mort. Ins. Co., L. R. 1 Q. B. App. Cases for 1894, p. 54.

[3] People *ex rel.* National Surety Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

ascribed the use of the word "guaranty" in connection with this branch of general insurance law; for it is the existence of such primary liability which distinguishes "guaranty" so clearly from "fire," "life," "casualty," and "marine" insurances. As the purpose of all guaranty insurance contracts is indemnity only, public policy forbids the enforcement of any contract by which the insured would derive profit from the happening of the event insured against. The insured should have an interest in the preservation of the thing rather than in its destruction.[1] This leads to the conclusion that the phrase "indemnity insurance" might express more accurately the nature of the contract than the more common one of "guaranty insurance."

Attention is called at this point to the remarks of the court in Guaranty Company of North America *v.* Mechanics' Savings Bank and Trust Company,[2] to the effect that "the general purpose of the contract is full indemnity, and this should not be defeated except by clear and unambiguous limitations assented to by the parties. . . . The old-fashioned bond to secure fidelity of trust administration being a contract of suretyship strictly, and not of indemnity, in the expansion of the modern contrivance of organizing incorporated companies to furnish a guarantee of fidelity, those contracts naturally took the form of a bond, as they do, rather than that of a policy of insurance. But as to the subject-matter of indemnity, the general object is that of protection, as broad at least as that afforded by the old-fashioned bond, the form of which has been assumed, and for which the modern contrivance is intended to be a substitute. Marine, fire, or life insurance against the destructive forces of nature is not quite the same thing as an insurance against the dangers of dishonesty. The courts must interpret the contracts in view of this difference, applying the words used to the purpose of covering the peculiarities of the risk assumed on the one hand, and on the other intended to be

[1] Clark *v.* U. F. & M. Ins. Co., 7 Mass. 365.
[2] 80 Fed. 766; 26 C. C. A. 146.

discarded or shifted to others. . . . It would be contrary to public policy to inconsiderately allow the properties affected by this new insurance, the vast business interests of the country, in public administration or elsewhere, to be endangered by any lesser indemnity than that of the old form of bonds which is being so rapidly displaced, the new contracts being offered by the companies as superior to the old in safety."

§ 4. **The Principles of Guaranty Insurance contrasted with those of Private Suretyship.** — Notwithstanding the fact that the status of the "surety companies" has been judicially defined to be that of an insurer and not that of a surety,[1] in the strict legal sense of the term, nevertheless there has been in times past, and there still is, an effort being made to induce the courts to engraft upon these new forms of contract practically the entire body of suretyship law and learning. In view of this fact, the question presents itself whether these policies which are issued by the "surety companies" are subject to the same rules and governed by the same principles as those bonds furnished by private sureties, once so common, but now rapidly disappearing under the encroachment of the system of compensated suretyship already referred to. This is a most practical question, and one that must be met and answered at the very threshold of any proper treatise on guaranty insurance.[2]

It may be of interest to reproduce here the remarks on this subject made several years ago by the president of one of the leading guaranty insurance companies, as showing the practical view taken of this question from the insurer's standpoint. After calling attention to the fact that, so far as the courts were concerned, the law applicable to contracts of guaranty insurance was an unknown and untrodden field, he made these remarks, which seem now to be truly prophetic: "They" (the courts) "are going to apply the same rules to corporate suretyship that they do to other insurance companies. The

[1] See *ante*, § 3.
[2] See Bank of Tarboro *v.* F. & D. Co., 38 S. E. 908.

individual surety is always met with sympathy, but" — they will say — "we are going to be pretty strict in our interpretation of the law as against you." Returning now to the contrasting of the principles of guaranty insurance with those of private suretyship, it may be said that the law reports are full of decisions bearing upon the construction and interpretation of bonds of private suretyship, and the law on this subject is fairly well settled. For this reason it would be of great value in any discussion of the present subject to know in what respect, if at all, the principles of private suretyship are applicable to contracts of guaranty insurance. If they are fully applicable, or if in the main so but otherwise not, it is no less important that the true extent of the application of such principles to contracts of guaranty insurance should be clearly recognized. Unless this is done at the very outset, much confusion will necessarily arise, and misleading applications of legal principles are likely to ensue. Wherein then, if at all, do the rules of law governing private suretyship apply to guaranty insurance contracts? It should be observed at the outset that the law is too well settled to admit of discussion, that ordinary sureties are favorites of the law, and their obligations are in all cases to be construed in their favor under the well-known "*strictissimi juris*" rule. Therefore it may be stated as a general rule that ordinary sureties are not to be bound beyond the strictest terms of their engagements, and their liability is not to be extended beyond the clear and unequivocal terms of the obligation entered into by them.

Nowhere has the modern doctrine on this subject been better stated than by the New York court of appeals,[1] in the following language: "The liability of a surety is measured by his agreement, and is not to be extended by construction. His contract, however, is to be interpreted by the same rules which are applicable to the construction of other contracts. The extent of his obligation must be determined from the language employed, when read in the light of the circumstances sur-

[1] Ulster County Savings Inst. *v.* Young, 161 N. Y. 23; 55 N. E. 483.

rounding the transaction. Hence, where the question is as to the interpretation and meaning of the language by which a party has bound himself, there is no difference between the contract of a surety and that of a principal or other party sustaining a different relation. It is when the intention has been thus ascertained that the principle of '*strictissimi juris*' applies, and then it is that the courts guard the rights of the surety and protect him against a liability which is not strictly within the terms of his contract." The basis of the foregoing rule is not difficult to find. It finds its support in the recognition by the courts of what is common knowledge in the business world, to wit, that a contract of suretyship, as entered into by private persons, is ordinarily a gratuitous one, induced by motives of friendship or by a promise of similar accommodation at some future date. Again, it is often assumed hastily, without proper safeguards, in the form of contract stipulations, and almost always upon oral representation as to the risk and extent of the guarantee.

The obligation that is assumed is voluntary on the surety's part, entered into not only without profit, but likewise without having in view any prospect of gain. It is an act of benevolence on the part of the obligor, a convenience to the obligee, and of emphatic use to both. For these reasons the courts have said that the obligations of social duty require that the surety should be dealt with in fairness and in the utmost good faith.

The obligee and obligor are bound to know that, if they find it convenient to change or vary the terms of the original contract, they must seek the assent of the surety, because it is his contract as well as theirs, and if they will not do so, they take upon themselves the hazard and thus loose the bonds of the surety.

It is but natural that courts, so long accustomed to extending the "rule of favoritism" towards the surety in the old-time private bonds, should be slow to recognize that with the passing away of the reason for the existence of the rule by the advent of the compensated surety, the rule itself should pass away.

The contract of guaranty insurance is invariably entered into for a compensation, and usually after the fullest investigation, and frequently under stipulations largely technical in character, based upon written representations relative to the nature and extent of the risk. The policy is written by a company incorporated for the express purpose of furnishing guaranty bonds as a means of revenue to the corporation and its stockholders. So much being admitted, the question then arises as to whether there are any valid reasons why two parties sustaining a distinct legal relationship with third persons, but bound to such third persons by contracts substantially the same in purpose, should be governed by the same rules of law? In response to this important question the following may be said by way of reply along the line of judicial answer to the foregoing query. Bound by the supposed presence of a legal analogy between the two contracts, and at the same time overlooking the now well-established fact that "compensated suretyship" is a branch of insurance law, and as such controlled by the principles thereof, a respectable number of courts have been led into applying the traditional "favoritism" rule to what are in reality policies of insurance, treating them as if they were in all respects identical in nature and effect with the old-time private bonds. This is very generally the case in judicial insurance, less so in commercial insurance, and only true to a very limited extent in fidelity insurance. One finds, for example, the following expressions of judicial opinion on this subject, in each instance delivered by appellate courts when construing some form of guaranty insurance bond: "It is true," remarks the Pennsylvania supreme court, "that the liability of the surety is not to be extended by implication beyond the terms of his contract, and that any material alterations therefrom may discharge the surety."[1]

In State to the Use of County Commissioners of Howard County *v.* John H. Hill and Fidelity and Deposit Company,[2] the Maryland court cited with approval Archer *v.* The State,[3]

[1] H. S. & L. Assn. *v.* U. S. F. & G. Co., 46 Atlan. 910; 197 Pa. St. 177.
[2] 88 Md. 111; 41 Atl. 61.
[3] 74 Md. 443; 22 Atl. 8.

a private bond case, for the expressed purpose of showing with what strictness that court protected sureties against constructive liability. The Iowa supreme court has held that the compensated surety may insist on the strict construction of his contract.[1]

The Kansas court of appeals[2] said, "it is contended that the contract must be strictly construed in favor of the surety. If there was in the contract any doubt, any ambiguity, as to the obligations assumed by the surety, the rule contended for would be applied."

One of the federal courts of appeal[3] recently held that a contract of suretyship should be strictly construed, and should not be extended by implication. Another federal appellate court[4] has said that "it is a familiar rule of law that the contract of a surety must be strictly construed, and that it cannot be enlarged by construction, and that when a bond with sureties has been given to secure the performance of a contract, and the principal in the bond and the person for whose benefit it was given make a material change in the contract without the consent of the surety, the latter is thereby discharged."[5]

In March *v.* Fidelity and Deposit Company[6] the court observed that "when the statute enabled this corporation to become a surety, it described a relation perfectly well known and understood in law. Certain rights, duties, responsibilities, and functions belong to the conditions of suretyship, and they are all necessarily and conclusively implied when one lawfully becomes a surety. These incidents must attach to the suretyship in this case, unless the statute which authorized it

[1] Ind. School District *v.* Hubbard *et al.*, 81 N. W. 241; 110 Ia. 58.

[2] Am. Surety Co. *v.* Thorn-Halliwell Cement Co., 57 Pac. 237; 9 Kan. App. 8.

[3] United States to the Use of Heise, Bruns, & Co. *v.* Am. Bonding & Trust Company of Baltimore, 89 Fed. 925; 32 C. C. A. 420.

[4] United States to the Use of Anniston Pipe & Foundry Company *v.* National Surety Company, 92 Fed. 549; 34 C. C. A. 526.

[5] Same rule in House *v.* Am. Surety Co., 21 Tex. Civ. App. 590; 54 S. W. 303; Am. Surety Co. *v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[6] 79 Md. 309; 29 Atl. 521.

establishes and defines a difference between it and the contracts of ordinary suretyship."

This last remark furnishes the key-note to what is to follow. It is not to the statutes, but to the courts, that one must look to establish and define a difference, if such exists, between compensated and ordinary suretyship.[1] This the courts have, in the case of fidelity insurance, done, either by recognizing the different status occupied by the gratuitous as compared with the compensated surety, or else by arriving at the logical legal conclusion that all such contracts are governed and controlled by the law of insurance and not by that of suretyship.

It may be well at this point to call attention to the fact that up to the present time the courts have adopted a different attitude in matters of construction in the case of fidelity insurance contracts from that taken in the case of judicial insurance contracts. It should be stated that so far there has been no marked disposition evinced on the part of the courts in any jurisdiction to treat the contract of the compensated surety, as evidenced by the issuance by it of a judicial insurance bond, as materially different from that of the private surety entered into in connection with proceedings in the courts. It would appear to be the policy of the latter at the present time to allow no different construction to be placed upon judicial insurance bonds or policies from that applied in the case of private bonds of a like nature. In the case of commercial insurance, it is difficult to state just what the policy of the law has been with reference to the construction of such bonds or policies, as there has been a total absence of uniformity in the treatment of them by the courts. In the case of credit insurance policies issued by credit insurance companies, they have been construed strictly as contracts of insurance. The same is true with respect to title insurance. On the other hand, in the case of contract insurance bonds there has been a decided tendency to treat the "surety companies" issuing such policies the same as ordinary sureties, and to construe these instruments as contracts of suretyship rather than as policies

[1] See Bank of Tarboro *v.* F. & D. Co., 38 S. E. 908.

of insurance. But, as has already been observed, in the domain of fidelity insurance the trend of authority is clearly favorable to the proposition that fidelity insurance is to be treated as a contract of insurance and not as a contract of suretyship, and that the insurer who issues such policies does not occupy the same position before the courts as does the private surety who signs a fidelity bond without compensation and outside of the line of his ordinary business. In support of this last statement attention is called to Walker *v.* Holtzclaw *et al.*,[1] where a guaranty insurance policy was before the court for construction. The court there said: "Upon the hearing of the case it was argued that a surety is a favorite of the law, and it [the policy] should be strictly construed in his favor. *While this is true as a general rule, it has no application to a case like this, where the surety receives compensation and the surety is in the line of its regular business.*" Judge Lacombe, speaking for the United States circuit court of appeals for the second circuit,[2] after quoting with approval certain cases holding that all ambiguous clauses of policies of insurance are to be construed in favor of the insured, observed that "in the light of the well-settled principles of law expressed in these authorities, the contract under consideration must be construed. The cases holding that a surety is a favorite of the law, and that a claim against him is *strictissimi juris*, have no application. Corporations entering into contracts like the one at bar may call themselves 'guarantee' or 'surety' companies, but their business is in all essential particulars that of insurers, who, upon careful calculation of the risks of such business, and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure persons against loss in return for premiums sufficiently high to make such business commercially profitable. Their contracts are, in fact, policies of insurance and should be treated as such."[3] As has been well said, "the engagements

[1] 35 S. E. 754.

[2] Tebbetts *et al. v.* Mercantile Credit Guarantee Company of N. Y., 73 Fed. 95; 19 C. C. A. 281.

[3] See Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

of insurers are not founded in any philanthropic, benevolent, or charitable principle; it is purely a business adventure, in which one, for a stipulated consideration or premium per cent, engages to make up wholly or in part, or in a certain agreed amount, any specific loss which another may sustain. To grant indemnity or security against loss for a consideration is not only the design and purpose of an insurance company, but is also the dominant and characteristic feature of the contract of insurance."[1] It goes without saying that under the well-settled principles of insurance law the insurer in contracts of guaranty insurance, by reason of the similarity in many respects of his agreement with that of the surety, is not entitled to be treated as a favorite of the law. The doctrine of the United States supreme court in Pauly *v.* American Surety Company[2] contains a clear and explicit refutation of the doctrine that the so-called compensated surety is a favorite of the law, in so far as the same may relate to matters of construction. In that case Justice Harlan, speaking for the court, said: "If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond was given, must be adopted, and this for the reason that the instrument which the court is invited to interpret was drawn by the attorneys, officers and agents of the insurance company. This is the well-established rule of the law of insurance. The object of the bond in suit was to indemnify and secure the bank against loss arising through any act of fraud or dishonesty on the part of the cashier. That object should not be defeated by any narrow interpretation of its provisions, or by adopting a construction favorable to the company, if there be a construction equally admissible under the terms of the instrument executed for the protection of the bank. As was said by Lord St. Leonards,[3] 'An indemnity bond is

[1] Commonwealth *v.* Equitable Ben. Ass., 137 Pa. St. 412; 18 Atl. 1112.

[2] 170 U. S. 133; 18 Supreme Ct. Rep. 552; 42 L. Ed. 977.

[3] Anderson *v.* Fitzgerald, 4 H. L. Cases, 484.

prepared by the insurance company, and if, therefore, there should be any ambiguity in it, it must be taken according to the law most strongly against the person who prepared it.'" But in the second case of the same title[1] Justice White, in his dissenting opinion therein said: "It is, of course, unquestioned that many authorities hold that where there is an ambiguity in a contract of insurance, a reasonable doubt as to its construction will be resolved in favor of the insured, because the policy is presumed to have been drawn by the officers or agents of the insurer. But granting, *arguendo*, that this rule applies to a contract of suretyship of the character of that under consideration, I know of no case which pushes the principle to the extent of holding that the express provisions of a contract must be destroyed, and thereby a liability be enforced against the insurer, not in harmony with the contract, in conflict with its spirit, in violation of the manifest intention of the parties, and productive of great injustice."

To draw just legal conclusions from the foregoing authorities as to the matter before us is by no means an easy matter. Some things, however, appear in this connection too clear to admit of argument. One of these is that the so-called surety company cannot claim at one and the same time the full benefit of both the law of insurance and that of private suretyship.[2] Such a position would be, legally speaking, impossible as well as impracticable, in view of the widely diverging character of the contract of the private surety as contrasted with that of the insurer. It would be inequitable as well as illogical to permit the "surety company" to assume at one time the attitude of a strict surety, and as such, when sought

[1] 170 U. S. 160; 42 U. S. Sup. Ct. Rep. Law. Ed. p. 987; 18 Sup. Ct. R. 563.

[2] See the following cases wherein the compensated surety is treated as an insurer: National Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; Sup. Cl C. K. of Am. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; M. K. & T. Trust Co. *et al. v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65; with reference to official bonds only, see F. & C. Co. *v.* Commonwealth, 47 S. W. 579 (Ky.); F. & C. Co. of N. Y. *v.* St. Matthews Sav. Bank, 104 Fed. 858; 44 C. C. A. 225; Rice *et al. v.* Fid. & Dep. Co. of Md., 103 Fed. 427; 43 C. C. A. 270; Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

to be held liable, to invoke to its aid every principle of law or equity applicable to that relationship; and then, at another, to assume the rôle of an insurer and call to its aid all the somewhat refined principles as well as the technicalities of insurance law. The only proper solution of this problem seems to be that adapted by so many courts of high authority; namely, to treat the compensated surety in all cases as an insurer, subject in all respects to the general principles of insurance law, modified to a limited extent by the quasi-suretyship nature of the contract arising from the dual relationship sustained by the insurer to the insured and the "risk."

Many of the rules governing contracts of suretyship or guaranty are here inapplicable. As long as the primary, if not the only, purpose of the "surety companies" in issuing their policies or bonds is to secure a pecuniary benefit for themselves, this fact alone should be sufficient in law to preclude them from asserting such rights of sureties or guarantors as are extended to the latter solely because of their position as favorites in the eye of the law.[1]

§ 5. **The Validity of Guaranty Insurance.** — The general invalidity of guaranty insurance contracts was strongly urged before the supreme court of Minnesota in the case of Fidelity and Casualty Company of New York *v.* Eickhoff.[2] The court, in passing on the question as there presented, spoke as follows: "The second point urged is that the contract guaranteeing honesty is void as being against public policy. That it is the duty of all employers dealing with the general public to employ honest agents. That the effect of such a contract as set out in the complaint is to make it a matter of indifference to the elevator company (the insured) whether it employs honest or dishonest agents to deal with the patrons of the elevator. There is nothing whatever in this objection. The same principle is involved in every bond executed by a public officer or a private agent as the security for the faithful performance of

[1] P. C. C. *v.* St. L. Ry. Co. *et al.* *v.* K. & H. Bridge Co., 107 Fed. 781-788.
[2] 63 Minn. 170; 65 N. W. 351.

his duties, and it is wholly immaterial whether the guarantor is a private person or an incorporated guaranty insurance company. The advantages of the latter mode of suretyship, if properly conducted, are very apparent."

In Samuel *v.* Fidelity and Casualty Company of New York [1] it was held that a contract for the payment of money to a "surety company" upon a guaranty insurance policy given to secure the performance of a contract with the United States government was not against public policy. The question was raised by the "surety company," and in passing thereon the court used these words: "This seems to be a remarkable proposition in view of the business which the defendant claims to be carrying on. It charges a premium for becoming a surety, and when it is sought to be charged where it has entered into such a contract of suretyship, it claims that the payment of money to it was a breach of public policy, and the party cannot recover damages by reason of the breach of its contract. The very business of the defendant itself is embraced within the proposition which it is sought to have the court pronounce to be illegal."

§ 6. **Question of the Applicability of the Statute of Frauds to Guaranty Insurance.** — In considering the question of applicability or non-applicability of the statute of frauds to guaranty insurance contracts, we are approaching a problem of more apparent than real difficulty. It is well settled that the statute of frauds has no application to contracts of fire, life, and marine insurance.

As was said by the supreme court of Maine in a leading fire insurance case,[2] "there is, indeed, nothing in the nature of a contract of fire insurance which requires it to be in writing. The issuing of a policy furnishes a convenient mode of proving the contract, but it is not essential to its validity." But when we approach the domain of guaranty insurance, an element appears which is wanting in life, fire, and marine insurance contracts, to wit, the recognition of a possible future

[1] 1 N. Y. Sup. 850; 49 Hun, 122.

[2] Walker *v.* Metropolitan Ins. Co., 56 Me. 371.

legal liability of a principal for which, under certain conditions, the guaranty company agrees to be responsible to the persons in whose favor such liability may exist.

At common law it was not necessary that the contract of a surety or guarantor should be in writing, in order to charge them. This being so, the statute,[1] commonly called the "statute of frauds," was passed. The fourth section of that statute, so far as pertinent to the subject of guaranty insurance, was as follows: "No action shall be brought whereby to charge the defendant upon any special promise to answer for the debt, default, or miscarriage of another person, unless the agreement on which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or by some person thereunto by him lawfully authorized."

To ascertain whether or not verbal contracts to furnish guaranty insurance come within the statute of frauds, it will be proper at the outset to consider in detail the phraseology of the foregoing section of the statute of frauds above cited.

The words "any special promise" have been held to confine the statute to actual promises or promises in fact made; that is, express as opposed to implied promises.

The words "debt, default, or miscarriage" include torts of the principal as well as breaches of contracts by him, and apply to every case in which one person becomes responsible for another.

Of the words "debt and default" it has been said that they refer to a liability accruing upon a contract, — the word "debt" to such as is already incurred, and the word "default" to such as may be incurred in the future.

Of the word "miscarriage" it has been said that it comprehends that species of wrongful act for the consequences of which the law will make the party civilly responsible. The words "of another," found in the statute, contemplate a present or future liability on the part of a principal.

So much, then, for the wording and meaning of the statute before us. The next inquiry is — Has the statute any practical

[1] 29 Charles II., chap. 3.

application to contracts of guaranty insurance? In answer to this question we are confronted at the outset with the proposition that the statute of frauds has no application to insurance generally. Is guaranty insurance to be the exception to the rule? A careful consideration of this question leads inevitably to a negative answer. This conclusion is based partly upon an analysis of the contract of guaranty insurance itself, and partly upon an examination of the authorities bearing upon the proposition now before us. The analysis here referred to brings before us certain salient features, all of which have a direct bearing upon the question of the applicability of the statute of frauds to guaranty insurance. These are the unquestioned intention on the part of the guarantor (the insurer) to benefit itself by securing a premium; the creation of a new contract between the guarantor and the party guaranteed; the recognition of a future rather than of a present liability, and this invariably a contingent one; the presence of a new consideration, the premium, whether running from the party guaranteed or from the principal himself; and the direct assumption of a primary liability by the guarantor contemporaneous with the creation of the contract between the principal and the party guaranteed. The rule of law which seems clearly applicable to contracts of guaranty insurance in this connection may be stated as follows: Whenever the contract of guaranty is founded upon a new and valuable consideration, with the immediate object of subserving some pecuniary or business purpose of the guarantor, then such guaranty is not within the statute of frauds, even though it has the legal effect of discharging the debt of another.

Justice Clifford, of the United States supreme court, said in this connection,[1] "Whenever the main purpose and object of the promisor is not to answer for another, but to subserve some business or pecuniary purpose of his own, involving either a benefit to himself or damage to the other contracting party, his promise is not within the statute, although it may be in form the promise to pay the debt of another, and al-

[1] Slater *v.* Emerson, 60 U. S. 224.

though the performance of it may incidentally have the effect of extinguishing that liability."

The hazy atmosphere which seems to surround this question in some quarters arises very largely by reason of the concurrent existence of a contract liability of a third party, to secure the faithful performance of which the guaranty policy of insurance is issued to the party in whose favor such liability exists. So, misled by the analogy in facts and circumstances between the situation outlined above and that existing in ordinary cases where special promises to answer for the debt, default, or miscarriage of another exist, one is apt to conclude that the statute of frauds is equally applicable in both cases. This is not true, and the misapprehension thus induced may be easily removed by bearing in mind that where the circumstances of the transaction — which include an insurance company's guaranty to the insured that the contract obligation of a third party to the latter shall be performed — are such as to raise any independent legal obligation on the part of the former to see that these contract obligations are faithfully met (such, for example, as the acceptance of the insurance premium), the fact of the existence of an exactly similar obligation on the part of such third party to the insured is immaterial as far as the statute of frauds is concerned. This for the reason that its special purpose is to afford a basis of measurement as to the amount and extent of the insurer's obligation to the insured.

But little else need be said with reference to the application of the statute of frauds to guaranty insurance. Whether the premium is paid by the insured or by the party whose faithful performance of contractual obligations is guaranteed, in neither case is the statute applicable. If paid by the latter, it still constitutes an original undertaking and one which may be enforced by the insured as the real party in interest.[1]

[1] See generally as to the applicability of the statute of frauds to guaranty insurance contracts, Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819, 32 C. C. A. 355, and F. & C. Co. of N. Y. *v.* Ballard & Ballard Co., 20 Ky. Law Rep. 1169; 48 S. W. 1074.

CHAPTER II.

PARTIES TO THE CONTRACT OF GUARANTY INSURANCE.

§ 7. **Who may be Parties.** — All parties legally capable of entering into contracts may become parties thereto. This well-settled general rule needs no citation of authorities to support it, and what exceptions or modifications thereto exist, will be adverted to later on.

In a strict legal sense, the parties to the contract of guaranty insurance are two in number, who will be referred to herein under the names so familiar in other branches of insurance law as the "insurer" and the "insured." This nomenclature, however, has not been adopted generally by the courts, which still make occasional use of the terms "obligor" and "obligee," "surety" and "employer," "guarantor" and "guarantee," "indemnitor" and "indemnitee," "common surety," etc. In the present work the words "insurer" and "insured" will be uniformly employed when referring to the parties to the contract of guaranty insurance, and the contract itself will be referred to as a "policy" or "bond." This is done for the purpose of assimilating as far as possible in the subject now before us the terminology of general insurance law. Here again there is a noticeable absence of uniformity on the part of the courts in giving a name to the instrument issued by the guaranty companies to the insured. By some it is referred to simply as a "bond," others refer to it as an "indemnity contract," while still others refer to it as an "insurance bond" or a "guaranty policy." Throughout the present work the terms "policy" and "bond" will be used interchangeably, as identical in meaning and legal effect.[1]

[1] As to terminology, see Bank of Tarboro *v.* Fid. & Dep. Co., 126 N. C. 320; 35 S. E. 588; 38 S. E. 908.

§ 8. **The Insurer defined.** — The insurer is the party — usually corporate — who to a certain limited extent undertakes, under certain conditions as designated in the contract entered into between the parties, to indemnify the insured against pecuniary loss arising through the acts of a third party sustaining a contractual relationship to the insured.

§ 9. **The Power of Guaranty Insurance Companies to issue Policies.** — It goes without saying that the right to conduct the business of guaranty insurance in the case of incorporated companies rests entirely upon the powers conveyed to the corporation by its charter. These powers must be clearly expressed in definite language, and must contain, without any forced construction, the right to transact the business of guaranty insurance. Aside from the mere question of its powers in this regard as evidenced by the charter, such corporation being engaged in the business of insurance, is governed by the laws of the several states relative to the prosecution of an insurance business by either domestic or foreign insurance companies. Then it becomes a question of special authority.[1]

In most if not all the states of the union statutes have been enacted principally for the protection of policy-holders prescribing the conditions upon which insurance companies and societies will be permitted to organize and transact business within the state, and these apply to both domestic and foreign corporations. The power of the state to enact such laws is inherent as long as corporations like natural persons are subject to the local laws which may be enacted. Sometimes this power to regulate is carried to the extent of prescribing the form and limiting the conditions of the policies issued by insurance companies.[2]

§ 10. **The Insured defined.** — The insured is the party to the

[1] See *In re* Altona & B. C. Ter. Ry. Co.'s Bond, 24 Pa. Co. Ct. 561.

[2] See on the general subject of power to transact a guaranty insurance business, People *ex rel. v.* Rose, 174 Ill. 310; 51 N. E. 246; People *ex rel. v.* F. & C. Co of N. Y., 153 Ill. 25; 38 N. E. 752; People *ex rel.* Nat. Surety Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731; U. S. Fid. & Guar. Co. *v.* Linehan, 47 Atl. 611; Bank of Tarboro *v.* Fid. & Dep. Co., 38 S. E. 908.

contract of insurance to whom the policy is issued and to whom the loss, if any, is payable. It is mainly for his benefit that perils are assumed and that indemnity against them is provided. With the possible exception of contract bonds, the real party in interest, and the one for whose benefit such bond is issued, is specifically named therein as the insured. Indeed, in most cases the recital of the name of a party in the application for the policy as the insured, would, in the absence of fraud or mistake, preclude a showing that a different party than the one named in the policy as the insured was intended as the beneficiary of such insurance; this for the reason that the contract is a personal one. But in the case of judicial and contract insurance the matter is in some jurisdictions worked out into harmony with guaranty insurance principles, on the theory that the nominal insurer in such policies is in fact a trustee for the real beneficiaries, who may or may not be determined when the policies are issued.[1]

§ 11. **Who may be insured.** — The right to apply for and receive the benefits of guaranty insurance is open to all parties possessing the necessary insurable interest hereinafter referred to. This includes private individuals, whether adults or infants, married or sole, copartnerships, societies, corporations private, public, or eleemosynary, and extends to all governmental agencies, such as municipal organizations, courts, townships, counties, states, and national governments.

Thus it has been expressly held that an infant may enter into a contract of insurance so as to make it obligatory as to the insurer, though voidable as to him.[2] So, too, it has been held that the power to take guaranty bonds or policies is inherent in every corporation, whether public or private, independent of statute.[3] This principle applies as well to religious as to private and public civil corporations. To all such corporate bodies the same equitable doctrines and rules apply.[4]

[1] See *post*, § 139.

[2] See Monaghan *v.* Agricultural Fire Insurance Co., 53 Mich. 238; 18 N. W. 797.

[3] Am. Surety Co. *v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[4] N. Ev. Luth. B. Cong. *v.* U. S. Fid. & Guar. Co., 81 Minn. 32; 83 N. W. 487.

Indeed it cannot be claimed at this late day that either public corporations or private corporations have not the power to accept policies of guaranty insurance. The defence of *ultra vires* cannot be successfully urged by the insurer as against the insured corporation under such circumstances, so long as the latter has power to make the contract to secure the faithful performance of which the policy may have been issued. Then it has the undoubted right to secure such faithful performance in any proper manner, one of which is to require parties contracting with it to provide a policy of guaranty insurance for its benefit. Such corporations not only have the powers expressly granted to them, but they have also certain implied powers necessary for the carrying out of those that are expressly granted.[1]

§ 12. **The Law of Agency as affecting the Mutual Rights and Obligations of the Parties to Contracts of Guaranty Insurance.**— It is no part of the purpose of the present work to enter into an exhaustive treatise on the law of agency in its relation to contracts of guaranty insurance. With some few exceptions, which will be carefully pointed out from time to time in their proper place, the subject of guaranty insurance is controlled by exactly the same principles in relation to the application of the law of agency as exist in other and better known branches of insurance law. To such as have occasion to investigate the subject at length reference should be had to works on agency or to works on general insurance law.

§ 13. **The "Risk."**—In the definition of guaranty insurance already given, reference is made to the existence of a personality sustaining a contractual relationship with the insured, and who is in a personal sense himself the subject-matter of the insurance contracted for. It is this personality which is referred to throughout this work as the "risk." In the case of fidelity insurance it is represented by the party whose faithful performance of duty while occupying a fiduciary relationship to the insured is guaranteed, to a limited

[1] Am. Sur. Co. *v.* Raeder, Assignee *et al.*, 15 Ohio Circuit Court, 471.

extent at least, by the furnishing of the insurance bond or policy.

Turning now to the various branches of commercial insurance, it may be said that as to contract insurance the "risk" there is represented by the party whose performance of simple contract obligations is secured by the insurance bond or policy; in credit insurance it is the debtor to whom credit has been extended by the insured who impersonates the "risk;" while in title insurance it is, in a sense at least, the grantor from whom the insured has purchased real property.

In judicial insurance the "risk" is represented either by the appointee of the court, to secure whose faithful conduct the insurance bond or policy is executed, or else by the principal, whose performance of the terms of his undertaking as given in the course of judicial or quasi-judicial proceedings is secured by the issuance of a judicial insurance bond.

Throughout this entire work care must be taken not to confuse the "risk" with the perils insured against. The "risk" in guaranty insurance has in all cases exclusive reference to a personality whose conduct, either by way of misfeasance or non-feasance, alone constitutes the perils insured against. In most forms of insurance the risk is synonymous with the perils insured against, but in guaranty insurance that is not true. Owing to the fact that in the last-named branch of insurance the perils insured against are invariably impersonated, not in the actions of the lawless and uncontrollable forces of nature, but in the action of man as a responsible human agent, the term "risk" here has reference to a human personality whose conduct along certain designated lines constitutes the perils insured against. Thus it appears that the term as herein used relates solely to a personality entering into contract obligations and possessing contractual rights which the courts will recognize and enforce.

The word, when employed in such a connection, has no reference whatever to the extent of the insurer's obligations, which, as has been pointed out, is its more common meaning. The term "risk" as herein used may, therefore, be defined to

be the person named in a contract of guaranty insurance whose faithful discharge of certain specified contractual obligations to the insured is guaranteed in the form of an indemnity obligation entered into by the insurer in favor of the insured. The "risk" must of necessity be under some contract obligations to the insured, the violation of which would cause pecuniary damage to the latter. It is in general essential, in order to render the insurer liable on the policy, that the damage so caused should be one for which the "risk" would himself be personally liable to the insured.[1]

While it has already been stated that the parties to guaranty insurance contracts are two in number, it might be argued, and with no little force, that there is yet a third party to the contract who is represented by the "risk." The latter, considered individually and apart from the perils incident to wrongful conduct on his part, in relation to the performance of certain obligations due the insured, is in reality a quasi-beneficiary of the contract of insurance. As such it then becomes a question whether his relation to, and interest in, the policy issued at his request, for the more direct benefit of the insured, gives to such "risk" the right to be deemed a party to the contract. In answer to the foregoing query it is sufficient to say that it has not so far been the policy of the law to give the "risk" any recognition whatsoever in the capacity of a party to the insurance agreement. While it is true that the "risk" not infrequently joins with the insurer in subscribing his name to the policy issued, this is not done with the purpose of making him a party to the insurance contract entered into between the insurer and the insured, but with the intent of evidencing in this formal manner his consent to its terms, and his promise to indemnify the insurer.[2]

§ 14. **Who may become a "Risk."** — Any person may become a "risk," and his proper conduct or faithful execution of trust or contract guaranteed in the form of an indemnity

[1] See § 205, *post*.

[2] Am. Bond & Tr. Co. *v.* Milwaukee Harvester Co., 91 Md. 733; 48 Atl. 72; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Trust Co., 80 Fed. 766; 26 C. C. A. 146.

insurance bond running from the insurer to the insured, provided he sustains such a contractual relationship to the latter as renders obligatory the faithful performance of the obligations concerning which the insurance is issued. Even disability to contract on the part of the "risk," by reason of infancy, insanity, guardianship, or some other cause, will not, it is believed, prevent such a one's becoming a proper "risk" in guaranty insurance to the extent of invalidating the contract entered into between the insurer and the insured.[1]

§ 15. **Reasons for the Rule requiring a Contract Relationship by the Risk with the Insured.** — As the purpose of all guaranty insurance is indemnity, it would be foreign to such professed object to admit of policies being issued upon "risks" sustaining no contractual relationship to the insured. In fact, if the rule were not as stated, the door would be thrown wide open for wagering contracts and speculation, in direct contravention of well recognized rules of public policy. On the other hand, if this distinctive contractual element were not insisted upon, the tort features, which more properly belong to accident or liability insurance, might appear. As a matter of fact and practice, insurance bonds are invariably drawn so as to make the existence of such contractual relationship a condition precedent to any recovery thereunder. It is this contractual relationship which affords the insurable interest necessary to support the contract itself.[2]

[1] See, as bearing on this question, Monaghan *v.* Agricultural Fire Insurance Co., 53 Mich. 238; 18 N. W. 797.

[2] See § 30, *post;* also Independent School District *v.* Hubbard, 110 Ia. 58; 81 N. W. 241.

CHAPTER III.

FIDELITY INSURANCE.

§ 16. **Definition and Scope of Fidelity Insurance.** — Fidelity insurance is a form of guaranty insurance whereby, for a valuable consideration, one party, termed the insurer, agrees to indemnify another, termed the insured, in a designated amount against loss arising through the fraud, dishonesty, or unfaithfulness of a third party (hereinafter designated as the "risk") sustaining a fiduciary relationship to the insured.

The term "fiduciary relationship" as used in the foregoing definition is to be given a broad and liberal interpretation, embracing positions of both private and public trust.[1] It covers cases not only of express technical trusts, but also relates to the execution of trusts springing from contract. It includes also parties holding elective or appointive official positions outside the domain of the courts. Within the broad scope thus outlined are embraced guaranty insurance bonds covering bank officials, street car conductors, railroad conductors and ticket agents, express agents, telegraph and telephone operators, insurance agents, clerks, collectors, corporate officers of all grades and character, bookkeepers and cashiers in mercantile houses, national, state, county, township, and city officials, notaries public, etc.

§ 17. **Proposals and Applications for Fidelity Insurance Bonds.** — A custom almost universal in extent has sprung up among the fidelity insurance companies, of requiring, as preliminary to the issuance of fidelity insurance bonds, the presentation to them of formal written proposals and applications therefor, signed respectively by the prospective "insured" and "risk."

[1] See Robins *v.* Hope, 57 Cal. 493; Marston *v.* Gould, 69 N. Y. 220; Smith *v.* Ogilvie, 127 N. Y. 143.

In explaining the meaning of these terms it may be said that a proposal in guaranty insurance has reference to a request made by the insured prior to the completion of the contract, looking toward the issuance to him of a policy of insurance by the insurer on some designated "risk" in manner and form as outlined in such proposal.

The application, on the other hand, is a term properly referable to the request (usually concurrent in point of time with the proposal of the insured) made by the "risk" himself, asking that an insurance policy be issued to the insured by the insurer, providing for indemnity against certain perils incident to his fiduciary relationship to the former, as therein designated.

§ 18. **Purpose of requiring Proposals and Applications.** — The underlying purpose on the part of insurance companies doing a fidelity business in requiring applications from the "risks," as well as proposals for bonds of guaranty insurance from the insured, is to ascertain the exact position of the former with reference to the perils to be assumed, and how far his circumstances as thus disclosed will expose him to temptation. Another purpose is, to see that there are sufficient checks provided for detection of fraud, dishonesty, or unfaithfulness, so that negligence on the part of the insured will not serve of itself as a temptation.

Still again, the object is to ascertain, by a knowledge of the "risk's" antecedents and business history, together with an acquaintance with his present surroundings and ties, his value as a moral hazard, and the extent or absence of opportunity for fraud or dishonesty on his part. The very fact that the contract about to be entered into is one of insurance, and as such is based on the doctrine of average, renders this entire subject of proposals and applications one of great importance in fidelity insurance. The contract implies that the risk will have the opportunity to commit fraudulent and dishonest acts, and this leaves it for the insurer to determine first, whether, on the facts as presented by the proposal and application, he cares to assume the liability at all, or if so, at what premium.

§ 19. **The Proposal.** — The proposal for a fidelity insurance policy is usually in the form of a printed letter prepared by the insurer, but addressed to it by the insured, with space therein for answers to a large number of inquiries relative to the insurance sought for, stating that the "risk" has already applied to the insurer to become his security in a designated capacity to a certain amount, and that the information is sought as a basis for the granting of the request for the policy desired. These inquiries relate first to the name and composition of the insured, and his business or occupation. This is accompanied by a statement as to whether or not the "risk" has been in previous or continuous service of the insured, and if so, in what position. Finally, there is a statement of the amount of security required, the time the same is to take effect, and the designation of the party by whom the premium is payable. In view of the importance of the inquiries inserted in this proposal, and the answers thereto, in relation to the doctrine of warranty and representation in the law of guaranty insurance, it has been deemed best to insert here a very full statement of the character and nature of the inquiries so propounded. For this reason the following specific inquiries, very generally employed by guaranty insurance companies in connection with applications for policies on "risks" in positions of private trust, are herewith presented without substantial abbreviation:

"Q. 1. If only recently employed by you, by whom was applicant introduced, or how did he become known to you?

"Q. 2. What further security, if any, will be held or required for applicant?

"Q. 3. Has the party hitherto filling this position furnished security?

"Q. 4. Has the applicant to your knowledge been refused the issue or continuance of a policy in this service by any company or association?

"Q. 5. Have you hitherto held other security from applicant? If so, of what kind, and why is it discontinued or changed to this?

"Q. 6. Is he now or has he been from any cause in arrears or indebted to the employer or any official thereof?

"Q. 7. Has the applicant to your knowledge any outstanding debts or liabilities?

"Q. 8. Are you aware of the applicant ever having been in arrears or default in any former occupation, or of anything in his past character or habits which might affect his title to confidence?

"Q. 9. Is he now or about to be engaged or interested in any other business or employment than in this service?

"Q. 10. If paid by salary, state annual amount and when payable. Will salary be subject to fine or reduction?

"Q. 11. Has there been any default by any employee holding a similar position in your service?

"Q. 12. At what date and by whom were all the funds and accounts of the applicant's office last audited?

"Q. 13. Please define nature of applicant's duties. (If there are by-laws or rules governing the office, attach copy.)

"Q. 14. Will he, at any time, hold power of attorney on behalf of the employer, and if so, for what purpose?

"Q. 15. Will he be authorized to endorse checks or drafts otherwise than for deposit to employer's credit in bank?

"Q. 16. Will he be authorized to sign negotiable paper of any kind on behalf of the employer?

"Q. 17. From what sources will he receive money or valuables?

"Q. 18. How often and to whom will he remit or pay over money received?

"Q. 19. Will he be required to make disbursements, and if so, for what purposes?

"Q. 20. How often and to whom will he report the transactions of his office?

"Q. 21. How often will the books be balanced and closed, and a statement or trial balance be rendered therefrom? By whom will these statements be examined and verified?

"Q. 22. Will the applicant be required to prepare or draw checks on the employer's bank account? Will checks be uni-

formly countersigned after signature by him, and if so, by whom?

"Q. 23. At what intervals will his books, accounts, and vouchers be personally inspected and audited, and all moneys or values reported as due on hand, or in bank, be examined and verified? By whom will this be done?

"Q. 24. Will he receive remittances from parties on current accounts?

"Q. 25. Will applicant's duties involve the handling or care of securities or treasury assets belonging to the employer?

"Q. 26. Will the applicant be charged with the custody or sale of merchandise for the employer; if so, of what kind, and what will be the maximum value at his disposition at one time?

"Q. 27. What assistants or subordinates (if any) will participate in handling the funds of the applicant's office? Are they under bonds?"

After the foregoing inquiries are answered, it is customary to add thereto the following statement over the signature of the insured:

"The foregoing answers, statements, and representations are hereby warranted to be true and correct, and it is hereby agreed on behalf of the insured, in consideration of the execution of said policy, that throughout the continuance thereof, the checks and supervisions above described shall be faithfully observed, and that the business of the insured shall continue to be managed and conducted as above set forth. The above answers, statements, and representations are to be considered warranties, and they shall form the basis of the guaranty herein applied for."

§ 20. **The Application.** — The application on the part of the "risk" to the insurer for the issuance of a guaranty insurance bond is, as a matter of practice, made almost universally upon printed forms prepared by the insurer and forwarded to the "risk," for his signature. It contains questions to be answered by the "risk," which are usually of the same gen-

eral nature and character both in this country and in England. The application in the first instances states the amount of the policy required, the name of the insured, and the general character of the liability to be insured against. In addition to these the application customarily contains inquiries with reference to the age and place of birth of the "risk," whether married or not, his business history and financial resources, including a statement of debts and liabilities of every nature and description, existence of judgments standing against him, membership in social or secret organizations, amount of life insurance carried, if any; whether or not the "risk" has been in arrears or default during any previous employment; amount of salary to be paid in the position to be thereafter assumed with the insured; the basis of the remuneration, if any other than that of salary; names of assistants, if any, who participate in the handling of funds or goods belonging to the insured; statement as to whether the latter are under bond; also statement as to whether the "risk" is to furnish additional bonds or security while in the employ of the insured, together with statement as to whether he has ever given bonds while holding previous positions of trust.

Another question is that relating to the "risk's" having theretofore applied for a policy from any other guaranty insurance company, and whether or not such application was refused or accepted. To the foregoing is customarily annexed an agreement that, in case the application is approved and a policy issued, the "risk" will reimburse the insurer for any damage that it may incur by reason of the issuance of such policy, together with a waiver of any claim for damages that may ensue by reason of the refusal of the insurance company to issue the policy applied for.

This application, in order to become legally a basis for the issuance of the guaranty policy applied for, must be and is accompanied by a statement over the signature of the insured to the effect that the replies of the "risk" in the aforesaid application are to the best of the insured's knowledge and belief correct. To this is sometimes annexed a

brief history of the "risk's" previous services, if any, with the insured, accompanied by the statement that the latter has, "to the best of the insurer's knowledge and belief, given satisfaction in his personal conduct and in the performance of duties, and kept his accounts faithfully and without default, and that when last examined or audited all of said accounts were found in every respect correct. That he has not been, nor is he at present to the insured's knowledge and belief, in arrears or in default, nor is there any unsettled balance in the service referred to or in any previous service; that the insured knows nothing about the 'risk's' habits or antecedents affecting his title to confidence, and that the insured knows of no reason why the guaranty applied for should not be granted."

§ 21. **Are Proposals and Applications Part of the Policy?** — It often becomes important in construing policies and in determining the force and effect of the statements contained in either the proposal or application, to ascertain whether the latter are parts of the policy itself. In this connection it may be safely said that a clear purpose, unequivocally expressed, manifested from either the wording of the proposal or application or from the terms of the policy itself, to make such application or proposal part thereof will have the effect in law to make them such; but where the reference to the application is expressed to be for another purpose, or where it is not clearly expressed that it is intended to make the application a part of the contract, the courts are not inclined to make it so by construction.

Sometimes, to avoid all question, it is expressly provided in the contract entered into between the parties that "this policy and the application and proposal therefor, copies of which are hereto attached, shall, taken together, constitute the contract of insurance between the insurer and the insured and shall be construed accordingly."

In general, the proposal and application jointly form the basis of the contract which is to follow, and it is in reliance upon these that the insurance policy is customarily issued. It

should, however, be carefully borne in mind that, when referred to in the policy in such a manner as to make a reference to them necessary to complete the contract of insurance, they then become part and parcel of it.[1]

§ 22. **What constitutes Acceptance of Proposals and Applications for Policies?** — Generally speaking, the delivery of the policy and its acceptance by the insured creates a valid contract of insurance binding both upon the insured and the insurer.

An application or proposal for insurance only becomes a binding contract when the insurer signifies its acceptance thereof. So there must be an acceptance of the proposal before any liability arises. In other words, there must be evidence of some act by the insurer sufficient to constitute acceptance in law, or some act must be done equivalent thereto in legal effect and from which the insurer cannot recede without liability. It may be added that it is always a question for the jury whether an application or proposal has been in fact accepted.

If an application for insurance does not set forth all the conditions which the policy is to contain, and the agent acting within the scope of his authority represents that the policy will contain certain lawful stipulations, the policy must contain them, or the insured will not be bound to accept them. So, also, where the policy issued does not conform in terms to the proposal, there is no obligation resting upon the applicant to accept it. In any event, however, it is incumbent upon the insured, in case he wishes to make good his claim that the policy issued does not conform in terms to his proposal, to immediately, upon receipt thereof, notify the insurer of his refusal to accept the same. However, the possession of the policy by the insured is only *prima facie* evidence that it was actually delivered and accepted in a legal sense.

Delivery of the policy is not, however, essential to render it effective where there is a valid contract of insurance already

[1] See, generally, Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

made. So if the contract of insurance is otherwise complete, and the parties intend that it should be effectual without the policy's being actually delivered, then actual or manual delivery is unnecessary. Again, it may be observed there is no obligation resting upon the insurer to accept the proposal or application for guaranty insurance. Therefore delay in acting thereon will not in itself warrant the presumption of acceptance. In brief, the proposal and application for insurance, whether they be oral or in writing, must be accepted before they become binding contracts. There must be an actual acceptance thereof; some act to bind the insurer, or some act must be done which is equivalent thereto and from which the insurer cannot recede without liability. If so, there has been an acceptance and the contract is complete.

In any event an acceptance of the policy by the insured will bind the insurer. The solution of questions relative to the acceptance of proposals or applications for insurance may, in very many cases, be referred to the principles of agency.

In case of absolute guaranties — to which all guaranty insurance contracts belong — no notice of acceptance is necessary. This is one of the broad distinctions that is said to exist between ordinary cases of suretyship and guaranty insurance. So, again, where provisional contracts for insurance are entered into by giving to the insured what are termed "guaranty provisional receipts," a full and complete contract of insurance continues in existence until such contract is in express terms revoked by the insurer. And any obligation or liability that may have been incurred meanwhile must be met and satisfied as in ordinary cases.[1]

§ 23. **Is the Insurer under any Obligation to accept either an Application or Proposal for a Policy?** — The question here presented is not quite as trivial as it may seem on its face to be. For in the case of the "risk" at least, the refusal to issue the policy requested may result in much hardship, or even real injury, to his character and business reputation. In a certain sense the declination by the insurer of his applica-

[1] See Hall *v.* U. S. F. & G. Company, 77 Minn. 24; 79 N. W. 590.

tion may be construed as a reflection on him, and may not improbably result in present loss of occupation, and render it well-nigh impossible for him to secure other positions of a similar nature in the future. However this may be, the case is at best but a fair example of the legal principle *damnum absque injuria.*

Even in the absence of the agreement usually contained in the application, to the effect that the guaranty company shall have the right to withdraw or cancel any surety bond previously issued, as well as the right to refuse the issuance of the policy applied for, no action for damages can be maintained, either by the prospective "risk" or the insured, on account of the refusal by the insurer to issue the policy requested.

In Hunt *v.* Simmond,[1] an action was brought for damages alleged to have been sustained through a conspiracy on the part of several insurance companies whereby the plaintiff was refused insurance on his vessels, all as alleged through malice on the part of such companies. The supreme court of Missouri, in affirming the order of the lower court sustaining a demurrer to the plaintiff's complaint, expressly recognized the right of insurance companies to refuse to issue insurance, no matter what their real motive for so doing might be.

So, also, it has been held that the proposal may be rejected even after the premium is paid.[2] But in general the contract cannot be rescinded by the insurer after the proposal is once accepted, without subjecting it to a just claim for damages for breach of contract; this on the plainest equitable principles. For inasmuch as the insured cannot, in the absence of special provisions in the contract itself, exercise the right of rescission after he has paid his premium and recover it back, it is only equitable to apply the same rule to the insurer.[3] So it has been held that where the insurer refuses

[1] 19 Mo. 583.

[2] Otterbein *v.* Iowa St. Ins. Co., 57 Iowa, 274; Weinhold *v.* Mutual Reserve F. L. Ass., 53 Fed. 208.

[3] People *ex rel.* Nat. Surety Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

to issue the insurance bond after having once accepted a proposal for the same, the party injured by such refusal may recover damages for whatever injury he may have directly suffered by reason of such refusal.[1] The measure of damages usually is the expense to which the party injured by the refusal is put in order to supply a new insurance bond.[2]

§ 24. **Legal Effect of Acceptance of Proposal and Application upon the Liability of the Insurer prior to the Issuance of the Policy.** — It is a very common practice on the part of guaranty insurance companies to issue what are known as "guaranty provisional receipts." The purpose of issuing these is to give the insured all the benefits of a valid policy without the possession of the instrument itself, while at the same time the insurer acquires thereby the same right to the premium as if the policy had in fact been issued. The reasons for the giving of such provisional receipts are varied, sometimes arising from the necessity of sending to the home office of the insurer for the formal execution of the policy, or again arising through the fact that the proposed policy is a "schedule" or "floating" policy, which is not to be formally delivered until the names of all contemplated "risks" are inserted therein. However that may be, the legal effect is the same whatever the reason for postponing the issuance of the policy. For the purpose of placing liability upon the insurer, the giving of the provisional receipts is equally as effective as if the policy itself had been at once delivered. The only possible difficulty that can arise, so far as placing this liability upon the insurer is concerned, lies in showing just what the terms and scope of the policy applied for were to be. This can usually be done in one of two ways: either by a reference to a specimen policy, if any, exhibited at the time the insurance was solicited; or in default of that, by

[1] Samuels *v.* F. & C. Co. of N. Y., 1 N. Y. Sup. 850; 49 Hun, 122; 121 N. Y. 660; see same case reported in 27 N. Y. Sup. 741; 150 N. Y. 583.

[2] Am. Bond & Tr. Co. *v.* Scott, 61 Pac. 873. See generally on this subject, McBride *v.* F. & C. Co. of N. Y., 37 S. W. 1091.

reference to the fact that nearly all policies of this nature are uniform in style, their general provisions well understood, and being printed in advance, have certain well-known names applied to them, such as "bankers'," "agents'," "grain buyers'," etc., policies.

On the other hand, the legal effect of the acceptance by the insured of this provisional receipt is not necessarily the same as if the policy itself had been received by him. Thus, for instance, to make certain clauses of the policy binding upon him which are there inserted for the purpose of making the liability of the insurer contingent upon the observing of the conditions therein contained by the insured, it would have to be shown that these clauses and conditions were either brought to his attention, or were assented to by him before the policy was delivered, in order to enable the insured to avoid liability on the ground that the insured had failed to observe the conditions therein contained.

§ 25. **Parol Testimony is inadmissible to vary the Terms of Proposals or Applications.** —As preliminary to a discussion of this subject it may be observed that the proposal or application for a policy of guaranty insurance may either of them be made in writing, or orally, as the case may be. However, it is the almost universal custom on the part of guaranty insurance companies to require that both proposal and application be made in writing.

This being true, it is of importance to know whether such proposals or applications are subject to the general rule forbidding the introduction of parol evidence to contradict, alter, or vary the terms of valid written instruments. In general it may be said that in such cases it is incumbent upon the applicant, immediately upon the receipt of the policy, to notify the company of his refusal to accept the same. In the absence of proof to the contrary, it will be presumed that the applicant knew and indorsed the contents of the application when he signed it.

Oral statements are not admissible to alter the terms of written proposals or applications, these instruments being

themselves the best evidence of their contents. Other writings may, however, become part of the proposal or application by being annexed thereto or subjoined, or by being referred to therein in plain terms as a part thereof, but the intent to incorporate other papers therein should be plainly manifest. All representations and agreements contained in applications and proposals are presumed to have been made by the parties signing the same, if no proof is given to the contrary. The signature annexed to such written applications is presumed to have been made by the party signing the same, without proof as to his handwriting or his signature.[1] So, too, all prior negotiations, proposals, and conversations are considered waived or merged in the written proposals or applications. Where the proposals and applications are made in terms part of the policy itself, it should be remembered that no rule is better settled than that parol evidence is inadmissible to vary or contradict the plain and unambiguous terms of a written contract of insurance.

§ 26. **Nature and Form of the Insurance Policy requested as determined by the Application and Proposal therefor.** — This subject is one of practical importance in the domain of guaranty insurance. It is frequently the case that the "risk" never sees the policy which he requests, and derives whatever information he may have as to the nature and provisions of the policy he seeks to secure, exclusively from the insured. This being so, the question arises at the very threshold, as to whether it is necessary, either to the validity of the policy or to the exercise of the right of indemnity by the insurer as against the "risk," that the latter should have seen the policy or have known its provisions? The inquiry here suggested may be answered, generally speaking, in the negative. As between the insured and the insurer, the knowledge or lack of knowledge as to the content of the policy on the part of the "risk" is wholly immaterial, unless by the terms of the policy itself the "risk's" consent to the giving of this identical policy by the insurer, and his execution of an agreement to

[1] N. Y. Life Ins. Co. *v.* Fletcher, 117 U. S. 519.

indemnify the insurer for any loss that the latter may sustain thereunder, is made a condition precedent to the validity of the policy. As between the insurer and the "risk," in the absence of fraud or concealment on the part of the former, it may require the "risk" to indemnify it from loss accruing under a policy given at the latter's request or by his consent, even where the "risk" has not seen the policy issued or known of the provisions it contained. The reason of this is obvious. Employment is given, as a general rule, on condition that a policy satisfactory to the employer (the insured) be furnished, and liability of the "risk" to the insurer to make indemnity follows as a matter of course, upon the insured's acceptance of the policy submitted to it by the insurer. The latter is, for that purpose at least, deemed to be the agent of the "risk." When the policy is once accepted by the insured, the "risk" is supposed in law to have read the same and to have assented to its terms. In the absence of fraud, a person who is competent to contract is conclusively presumed to have made a contract which he signs, though in fact ignorant of its contents.[1]

Turning now to the question as to the nature and form of the policy requested by the insured, it may be said that this is governed very largely by what is said in the proposal on the subject. It is rare, indeed, when a copy of the policy is annexed to such a proposal, so of necessity recourse must be had to extrinsic evidence to determine the nature and form of the policy desired. Such evidence does not conflict with the rule already given with reference to the inadmissibility of parol evidence to alter, contradict, or vary the terms of written proposals.

The evidence here referred to simply serves to explain and render certain the terms of the proposed contract embodied in the proposal, and it is admitted in all cases as a matter of course, where the terms and form of the policy requested are referred to in the proposal in general terms only.

The main consideration is, that the minds of the parties

[1] See De Jernette *v.* Fid. & Cas. Co., 17 Ky Law Rep. 1088; 33 S. W. 828.

shall have met upon all the essential terms of the proposed policy. When this state of affairs exists, there can be no valid performance on its part when the insurer furnishes a policy that differs from that outlined in the insured's proposal, for the minds of the parties do not meet in such a case.

CHAPTER IV.

THE POLICY, OR INSURANCE BOND.

§ 27. **The Policy defined.** —The policy, or insurance bond, in all forms of guaranty insurance is the printed or written form to which the contract of the parties has been reduced and which evidences it. As has already been observed,[1] it is referred to in the courts by various names, the ones which commend themselves being that of "policy" and "insurance bond."[2]

§ 28. **Requisites of a Valid Fidelity Insurance Policy.** — The formal requisites of a valid guaranty insurance policy are eight in number, and may be enumerated as follows: (1) Parties; (2) Premium; (3) Insurable interest in the insured; (4) Power, corporate and statutory, on the part of the insurer to issue the policy; (5) Statement of scope of liability growing out of acts of a designated "risk;" (6) Statement of duration of such liability; (7) Designation of the amount of liability assumed by the insurer under the policy; (8) Statement of the conditions under which the insurer will meet the liability specified in the policy. The first and fourth of the foregoing enumerated "requisites" have already been discussed at sufficient length.[3] The remaining six will be treated in subsequent parts of this work.

§ 29. **The Premium.** — A contract of fidelity insurance, to be valid and binding, must be executed upon a valid consideration running from the insured to the insurer. This consideration is familiarly known as the premium. It constitutes the compensation which induces the insurer to assume a liability

[1] *Ante*, § 7.

[2] City Trust S. D. & Sur. Co. *v.* Fid. & Cas. Co. of N. Y., 58 App. Div. 18; 68 N. Y. Sup. 601; Sloman *v.* Mer. Cr. Guar. Co., 70 N. W. 886; 112 Mich. 258.

[3] See *ante*, §§ 7-11.

which may possibly amount to many times the amount of the premium received by it for writing the policy. The premium, in the absence of special provisions in the policy authorizing it, cannot be recovered back by the insured upon offering to surrender up his policy.[1]

It is the existence of this premium as the consideration for the execution of the policy which distinguishes the contract of fidelity insurance from the obligations of private and gratuitous suretyship.

§ 30. **Insurable Interest in Fidelity Insurance.** — It being conceded that the policies issued by the "surety companies" are contracts of insurance, it would seem necessarily to follow, that, in order to sustain the validity of such agreements, the insured should in all cases possess what is termed an "insurable interest" in such policies. Insurance of this character being pre-eminently a contract of indemnity, it is entirely logical to assert that this fact alone precludes the presence in all such contracts of the elements of speculation or profit.

The underlying reasons which render it necessary that the insured shall have an insurable interest in all fidelity insurance policies where liability thereunder is sought to be enforced for his benefit are mainly three in number:

First, it is contrary to the spirit of the law, which always favors legitimate business, that it should sanction speculation on the honesty or faithfulness of one's fellow men.

Secondly, it is opposed to public policy in that it would permit a party to enter into a contract wherein it would be to his pecuniary interest to induce dishonesty or unfaithfulness on the part of the "risk," which would operate to his advantage and to another's pecuniary disadvantage. In other words, under such circumstances dishonesty and unfaithfulness would be at a premium, and honesty and faithfulness in public or private duty the last thing sought for.

Thirdly, in view of the fact that the policy is universally executed with reference to the independent contractual or official obligations of the "risk" to the insured, it is in harmony with

[1] People *ex rel.* Nat. Surety Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

the policy of the law, clearly recognized in the case of contracts identical in purpose with that entered into between the insured and the insurer in fidelity insurance, to insist that the right to enforce such contracts as between the insured and the insurer, shall not be more extensive than the right of the insured to enforce the contemporaneous contractual or official obligation of the " risk " to himself.[1]

With reference to the third of the foregoing enumerated reasons for requiring the possession of an insurable interest by the insured, the following may be said: The policy of fidelity insurance being essentially one of indemnity, to enforce a claim thereunder against the insurer for the benefit of an insured who had no concurrent existing legal claim against the " risk " therefor, would be to change the nature of the agreement from one of indemnity to that of a wagering contract. To entitle the insured to recover under a fidelity insurance policy, it is in every instance incumbent upon him to show some invasion of his legal rights on the part of the " risk," which in itself constituted, at the time such recovery is sought, a valid enforceable claim against the " risk " in favor of the insured.

In every case the relationship of the insured to the property injured by the wilful or negligent acts of the " risk " must be of such a nature as to result in pecuniary damage to the insured as a direct result of such acts. When this element exists, the necessary insurable interest is present to enable the insured to recover of the insurer under the policy.[2]

The general subject of insurable interest is discussed at length, though not under that name, in several recent cases, wherein recovery under policies of contract insurance was denied, on the ground that the claims upon which it was sought to found such liability did not constitute an enforceable lia-

[1] See Independent School District, etc. *v.* Hubbard *et al.*, 110 Ia. 58; 81 N. W. 241; Arents *v.* Commonwealth, 18 Grattan (Va.), 750.

[2] Claflin *v.* U. S. Cr. Sys. Co., 43 N. E. 293; 165 Mass. 501; Stillwell *v.* Com. Ins. Co., 2 Mo. App. 22. See also Electric Appliance Co. *v.* U. S. Fid. & Guar. Co., 110 Wis. 434; 85 N. W. 648; Am. Sur. Co. *v.* United States to the Use of Barrett, Ala. ; 28 So. 664.

bility in favor of the insured against the "risk." A careful reading of these cases seems to support the statement that the true test of the existence of an insurable interest lies in the contemporaneous existence of liability for the same claim on the part of the "risk" to the insured.[1]

In the case of the German-American Title and Trust Company *v.* Citizens' Trust and Surety Company[2] it was suggested that a true test of the existence of an insurable interest is to see whether, in the exercise of the right of subrogation by the insurer against the "risk," the former would have a valid and enforceable claim against the latter. If not, it was suggested that the insurance must be void as based upon an unenforceable contract; this on the principle that the insurance does not cover any obligation on the part of the insured, but an obligation of the "risk" only, as fixed by the latter's contract with the insured.

In another case the absence of any insurable interest in the insured named in the policy was in effect urged, though that term itself was not used, as a defence to an action brought to recover thereunder.[3] In this particular instance the insurer had contracted to indemnify the insured against any loss arising from the fraud or dishonesty of the "risk," who was a factor at a certain town, in connection with his management of the insured's funds intrusted to him with which to buy cotton. The factor was one of a firm, and the contract for buying cotton for the insured was with the firm, and not with the "risk" individually, though a member of the firm. The policy recited that Gilliam, the "risk," had been appointed to the position of cotton buyer in the service of the insured, and further recited that the insured had delivered to the insurer a statement in writing relating to the duties and responsibilities of, and checks to be used upon, the "risk" in said position. It was contended that the fact that the contract was with the

[1] Electric Appliance Co. *v.* U. S. Fid. & Guar. Co., 110 Wis. 434; 85 N. W. 648; Am. Sur. Co. *v.* United States to the Use of Barrett, Ala. ; 28 So. Rep. 664.

[2] 190 Pa. 247; 42 At. 682.

[3] Clifton Man. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790.

firm to which the " risk " belonged, and not with the " risk " individually, released the insurer from liability under its policy; this apparently on the theory that the insurable interest of the insured consisted of the obligations to it of the firm as such, rather than that of the obligations of its members as individuals. It appeared that the insurer, not only before but at the time it made the contract whereby it guaranteed the good faith of Gilliam (the " risk "), requested the insured to exhibit to it the contract had between Gilliam and it, and that the latter did exhibit the contract had between the insured and the copartnership of which the " risk " was a member. It was held that the insured could recover under the policy, though its contract with the " risk " was in the name of the firm of which he was a member.

The same doctrine is laid down by the supreme court of Louisiana in Mutual Building and Homestead Association *v.* Fidelity and Deposit Company of Maryland,[1] where it was held that a policy of commercial insurance was not affected with respect to the insurer's liability thereunder, by reason of the fact that the policy was originally issued upon two copartners as the " risk " therein named, and that after the issuance thereof one of the partners withdrew without the knowledge or consent of the insurer.

Neither of the last two cases here referred to conflict with the rule requiring the insured to have an insurable interest in the policy, for in each case there existed a concurrent joint and several liability on the part of each member of the copartnership to meet all the lawful obligations thereof to the insured. This in itself furnished the insurable interest necessary to sustain the validity of the policy.

Not only must the insurable interest exist, but such interest must be neither illegal, immoral, nor contrary to public policy. This principle is well illustrated by the case of McCanna and Fraser Company *v.* Citizens' Trust and Surety Company.[2] Here the insured, a foreign incorporation, sought to enforce a

[1] 23 So. 405; 50 La. 291.

[2] 74 Fed. 597; 76 Fed. 420; 24 C. C. A. 11.

fidelity insurance policy issued to it upon one of its agents employed by it in Pennsylvania, wherein a statute had been passed requiring the procuring of a license to do business in such a state, in order to validate its contracts made therein. The agent named as the "risk" in the policy defaulted, and suit was brought in the Pennsylvania federal courts to enforce the insurer's liability under the policy. The right to enforce such a policy was denied on, what was in effect, the ground that the insured had no valid insurable interest in the policy. In its opinion in this case on appeal, the federal court of appeals said that the policy in suit must be regarded as taken to protect the insured while engaged in prosecuting its business in violation of law, and as such was clearly unenforceable and invalid.

§ 31. **Content of Ordinary Fidelity Insurance Policies.** — The more important provisions common to policies of fidelity insurance may be enumerated as follows:

1. Name of the insured, commonly denominated as the employer.
2. Name of the "risk," commonly denominated as the employee.
3. Name of the insurer.
4. A reference to the application or proposal, or both, as the basis of the contract of insurance thereby entered into.
5. Recital of consideration.
6. Duration of time during which the liability of the insurer under the policy is to continue.
7. A provision making all declarations and statements of the insured as contained in the proposal with reference to the duties of the "risk," inspection of his accounts, etc., warranties.
8. Statement of the perils insured against.
9. Limitation as to the amount of liability under the policy.
10. Excepted perils for which the insurer assumes no liability.
11. Duty of furnishing notice of loss made imperative.
12. Duty of furnishing proof of loss made imperative.

13. Limitation of time within which notice of loss must be given in order to fasten liability, if any, upon the insurer.

14. Right to call for further proof of loss at the insurer's expense and if deemed necessary to have the same verified by oath, when demanded by the insurer.

15. Limitation of liability to losses occurring during the life of the policy.

16. Duty of the insured to notify the insurer of any circumstances tending to make the actual facts different from those represented in the proposal, or of any fact affecting the liability of the insurer at any time during the life of the policy.

17. Condition rendering the policy void if the insured shall fail to notify the insurer of the occurrence of any act of dishonesty, unfaithfulness, or negligence on the part of the "risk" which should have come to the notice or knowledge of the insured, or if the latter should continue to intrust money or valuable property to the "risk" after such discovery as has just been referred to.

18. Clause making it a condition precedent to recovery on the part of the insured to assist, at the insurer's expense, in prosecuting any "risk" either criminally or civilly on account of any claim placed with the insurer by the insured.

19. Reduction of liability *pro rata* in case the insured holds other insurance of a similar nature upon the "risk," for whose acts claim for reimbursement is made.

20. Arbitration clause, available upon the demand of either the insurer or the insured upon dispute arising with reference to the former's liability to the latter under the policy.

21. Right of cancellation reserved to the insurer on repayment of *pro rata* portion of premium.

22. Limitation of the right of suit under the policy by the insured against the insurer, to a certain designated time after the discovery of the loss.

23. Date, alteration clause, subscription, and seal if necessary. To the above may be added many others, to which brief reference will be made later on.

§ 32. **The Form of the Fidelity Insurance Policy.** — The form of the contract is a policy describing the subject-matter of the agreement, setting forth the consideration, and pledging the funds of the company to pay in case the event insured against happens, subject always, of course, to the conditions of the contract. It is in the special conditions that the policy differs from an ordinary bond of indemnity with sureties, given by a clerk, servant, or agent to secure his employers. These conditions refer, as in other kinds of insurance, to the various circumstances which attend the contract, such as the payment of the premium, the truth of the statements in the proposal or application, the limitation of the perils assumed by the insurer, the notice of loss, mode of proof, times of payment, mode of adjustment, limitation of suit, etc., according to the special views and experiences of the insurers and with such modifications as the peculiarity of the liability assumed demands. To attain the desired end the proposal contains such inquiries and answers as are calculated to enable the insurer to determine the moral value of the "risk." As in marine and fire insurance the interest of the insured in the preservation of the property is secured by limiting the indemnification to a portion of the property lost, so in guaranty insurance the interest of the insured in preventing the occurrence of the event insured against is sometimes secured by providing that in case of loss only a percentage of the loss will be paid.[1] And a not unusual provision peculiar to this form of insurance is the requirement that in case of loss the insurer shall be entitled to the services of the insured, in whatever form they may be made available, in bringing the delinquent to justice.

A policy of guaranty insurance is the contract reduced to writing. Owing to the vast diversity in occupation of the various "risks" upon whom policies are issued, there can of necessity be no "standard" policy, uniform in every state, such as is found in the case of fire insurance. It must in every instance be so framed as to meet the peculiar exigencies

[1] Solvency Mut. Guar. Co. *v.* York, 3 H. & N. 588.

of the individual case. It is, however, of course controlled by the duties which the "risk" will be called upon to perform, and the faithful performance of which is guaranteed by the insurer to the insured.

With respect to form, policies of fidelity insurance are of different kinds. They are sometimes known as "single," "schedule," and "floating" policies. A "single" policy covers acts and defaults of a single "risk," and is not open to substitution and change in the personality thereof. "Schedule" policies cover a large number of persons all occupying relatively similar positions and sustaining essentially similar contract relationships to the insured. In such cases but one policy is issued, and this covers all the "risks" enumerated upon the schedule annexed to the policy, and from which this form of policy takes its name. Substitution of one "risk" for another is not permitted in this class of policies except with the consent of the insurer. "Floating" policies are frequently issued, and differ from schedule policies only in giving to the insured the right to change the personality of the "risk" under certain limitations. This right is usually secured by inserting in the policy some such provision as the following: "That the insured shall have the right at any time during the currency of this policy to strike or deduct from said schedule the names of any of said employees or to make any changes or substitutions among them, or to add thereto the name of any new or other employee, or to increase or decrease the amount of security required, upon giving notice of such deduction, change, substitution, addition, increase, or decrease to the company or its duly authorized agent in writing and receiving acknowledgment thereof; such notice to state the name, place of employment, date of employment, capacity in which employed, and amount and security required as to each employee, and the insured shall not be liable for the acts of any employee after his name shall have been deducted from said schedule in accordance with such notice."[1]

[1] See Smith *et al.* *v.* Carmack *et al.*, 64 S. W. 372.

§ 33. **The Execution of the Policy.** — It makes no difference in what form the insurer signs the policy, if it appears that the purpose was to bind itself. Where the name of a corporate insurer in a policy appears in full in the body thereof, and its seal is impressed opposite the attestation clause between the obligatory part and the condition, and at the close of the whole instrument the names of the president and secretary are signed, this being its customary method of executing sealed instruments, it is binding.[1] After the policy has been executed and delivered by the insurer to the insured, their right to contract further in regard to the insurance sought for by the one and furnished by the other is not lost. They have the same right to abrogate or modify the agreement they have made that they originally had to make it. This includes the right to modify the first agreement by mutual consent, and to substitute new terms for the original stipulation of the contract. When this has been done, the old terms cease to have effect, and the substituted stipulations take their place.[2]

§ 34. **What constitutes Acceptance of the Insurance Policy on the Part of the Insured?** — After the insurer has accepted the proposal for an insurance bond, there still remains the necessity of an acceptance, either express or implied, on the part of the insured before the contract becomes binding.

It is eminently improper and ineffectual for the insured holding a policy subject to his approval and final acceptance if satisfactory, to accept the same after loss has actually occurred.[3] Finally, it should be observed that there can be no legal delivery to the insured so long as there are unperformed conditions. In this connection it should be noted that policies of fidelity insurance frequently contain a provision that they shall not be valid and enforceable until the premium therefor is paid.

[1] Union Guar. & Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Roberts *v.* Security Co., L. R. App. Cases (1897), 1 Q. B. 111; Fid. & Cas. Co. of N. Y. *v.* Yoder, Kan. ; 64 Pac. 1027.

[2] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

[3] Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355.

Such stipulations have repeatedly been held to be valid. This being true, the question might easily arise whether payment of an unpaid premium by the insured to the insurer might legally be insisted upon after a loss had occurred under the policy. The conclusion would seem to be that there could be no recovery under such a condition of affairs.[1]

§ 35. **Requisites of a Valid Fidelity Insurance Policy.** — A policy of guaranty insurance to be valid must not be against public policy, in violation of statute, or contrary to good morals. Fidelity insurance contracts not constituting commerce, as that word is used in the federal constitution, are subject to state control, whether the company issuing the policy be domestic or foreign.

In matters of form, statutory provisions merely directory, and not concerning either the essence of the contract, public policy, or good morals, are not prohibitive of change in the subject-matter of the contract.

In regard to fidelity insurance contracts, the enforcement of which, it is claimed, would be contrary to public policy, it should be observed that the evil effect must be such as affects the public generally, and not such as affects some particular class in the community.

So, again, where there are stipulations in the policy contrary to positive statute, it must be clearly shown that it was intended to violate the statute, and does in fact do so, to render the policy illegal.

The policy must contain the exact agreement of the parties in clear, intelligible, and unambiguous terms. If there are any statutory requisites, they should be complied with if mandatory.

The essentials of a valid contract of guaranty insurance are the same as those considered necessary in the other branches of insurance law, and are commonly stated as parties, premium (a personality called the "risk," whose faithful conduct is the subject of the insurance), insurable interest, certain designated

[1] See Bank of Asheville *v.* Fid. & Cas. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355.

perils, duration, amount of liability, and agreement to meet all specified liability within a designated time.[1]

On the general subject of validity of such contracts it may be said that, as they are proper subjects of private agreement, the parties thereto may bind themselves in any manner or to any extent not violative of public policy or positive statute.

This principle once established, it follows that whatever conditions are contained in policies coming within the foregoing rule will be upheld and enforced by the courts.[2] A contract, therefore, may be void because it violates prohibitory law, or for the same reasons the stipulations of the contract may be unenforceable. So the contract may be illegal because contrary to positive law, or an agreement may be void both on the ground of public policy and because contrary to the statute.

In considering, however, the validity or invalidity of policies of fidelity insurance, there is a difference to be observed between those cases where the invalidity of the contract rests upon some law which relates to the contract itself, and the rights and obligations to be performed thereunder, and those cases where the invalidity or illegality rests upon some law which does not define or attempt to define the rights and duties of the parties. There is also a distinction between an agreement to do a thing which cannot be performed without violating the law, and an agreement to perform in an illegal manner a contract which can be legally performed. In the latter case an intention to break the law must be shown.

There are, too, certain general principles governing these contracts of fidelity insurance and liability thereunder which should be here stated. Thus any liability may be insured against wherein the insured has an insurable interest, except such as are repugnant to public policy, positive prohibition, or are occasioned by the insurer's own fraud or misconduct, and within these limits the parties may, as a rule, make such con-

[1] See *ante*, § 28.

[2] Molson's Bank *v.* Guar. Co. of N. A., Montreal Law Reports, 4 Superior Court Reports, 376; 82 Am. Cases, 760-764.

tracts as they choose, and may qualify or limit the liability assumed with or by specification of the amount of indemnity, or by the enumeration of certain perils or by the exclusion of certain specified perils. It may be stated as a general rule that the loss must be occasioned by one of the perils specified in the policy and not excepted, to entitle the insured to recover.[1]

§ 36. **Interpretation of Policies.** — When the subject of the interpretation of fidelity insurance policies is under discussion, that term is to be understood as referring to the question of the meaning of the words therein used.

Here the general rules applicable to other contracts clearly govern ; that is to say, that words are to be taken to have their popular and natural meaning and are not to be taken in their restricted sense, unless it is clearly apparent that they were used in a technical sense by the parties.

So with reference to both interpretation and construction, fidelity insurance contracts are to be construed, as far as the capacity of the parties to make them are concerned, by the law of the place of contract.

But when a policy is executed in one state, with a view to its performance in another, the law of the latter state furnishes the rule for determining its obligation.[2]

§ 37. **Construction of Policies.** — Construction in its full legal import seeks to apply such meaning to words as is called for by the surrounding circumstances and the intent of the parties. Thus, words must be interpreted by their context, so as to produce a rational result. The general rule of construction applicable to guaranty insurance contracts is laid down by the United States supreme court as follows: [3]

"If, looking at all its provisions, the bond is fairly capable of two constructions, one favorable to the insured, the other to the insurer, the former if consistent with the objects for

[1] Industrial & Gen. Trust Co. *v.* Lawyers' Surety Co. *et al.*, 67 N. Y. S. 362. Goodman *v.* Mer. Cr. Guar. Co., 45 N. Y. Sup. 511 ; 17 N. Y. App. Div. 474.

[2] Am. Cr. In. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111 ; 36 C. C. A. 671 ;

[3] American Surety Company *v.* Pauly, 170 U. S. 133.

which the bond was given must be adopted, and this for the reason that the instrument which the court is invited to interpret was drawn by the attorneys, officers and agents of the insurer. This is a well-established rule in the law of insurance. As said by Lord St. Leonards in Anderson *v.* Fitzgerald,[1] it is of course prepared by the company, and if, therefore, there should be any ambiguity in it, it must be taken according to law most strongly against the person who prepared it."

So, again, the United States circuit court of appeals (sixth circuit), in the case of Guaranty Company of North America *v.* Mechanics' Savings Bank and Trust Company,[2] in reference to this same subject spoke as follows:

"Nothing is to be implied not necessarily indicated by words used, as might be in other examples of insurance where the relation of the parties and the character of the risk are different, and where these relations properly breed implications that would import a meaning not admissible when the thing guaranteed is so far disassociated from any duty owing by the assured to the insurer as we find in the subject-matter of insurance here.

"Where two provisions of a policy are susceptible of a construction which will give a fair and reasonable effect to both, this construction should be adopted. Such provisions ought to be so construed as not to make the one destroy the other, nor so as to give a significance to the contract never intended by the parties, and thereby to overthrow the elementary rule governing all judicial proceedings, that is, that upon the one who makes a claim there rests the burden of establishing it."[3]

In Supreme Council Catholic Knights of America *v.* Fidelity and Casualty Company[4] it was said that, "with reference to bonds of this kind executed upon a consideration by a corporation organized to make such bonds for profit, the rule of con-

[1] 4 H. L. Cas. 484-507.

[2] 80 Fed. Rep. 766; 26 C. C. A. 146.

[3] See dissenting opinion of Justice White, Am. Sur. Co. *v.* Pauly, 170 U. S. 180.

[4] 63 Fed. 48; 11 C. C. A. 96.

struction applied to ordinary sureties is not applicable. The bond is in the terms prescribed by the surety, and any doubtful language should be construed most strongly against the surety and in favor of the indemnity which the assured had reasonable grounds to expect. The rule applicable to fire and life insurance is the rule by analogy most applicable to a contract like that in this case." Again, in Lombard Investment Company *v.* American Surety Company,[1] it was held that, "if the whole policy be susceptible of two constructions, one fixing the liability of the insurer, and the other exempting him from liability, that construction is to be preferred which fixes the liability on the underwriters. But while this is correct, other well-recognized rules are to be applied to the interpretation of such instrument as to other contracts. Among these recognized canons of construction are that ordinary words and terms shall be given their ordinary accepted meaning, and that the real intent and meaning of the parties to the contract is to be sought out through the instrument as a whole, so that due effect and operation shall be given to all its parts and provisions, so as, if possible, to make them all harmonious and consistent."

The rule just given is undoubtedly sound and salutary in its effect. It may be stated that most of the rules applicable to the construction of ordinary insurance policies are equally applicable to contracts of fidelity insurance.[2]

In this connection it may serve some useful purpose to reproduce here certain of the more important rules of construction applicable to fidelity insurance policies.[3]

First. "As between the insurer and the insured, if the words of the policy are of doubtful import, that construction shall be placed upon them which is most favorable to the holder," with a due regard to the design and object of the policy as a contract of indemnity.[4]

[1] 65 Fed. 476.

[2] Mechanics' Savings Bank *v.* Guar. Co., 68 Fed. 459; Supreme Council Catholic Knights of America *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; Cotten *v.* F. & C. Co. of N. Y., 41 Fed. 506.

[3] Union Sewer Pipe Co. *v.* Olson *et al.*, 84 N. W. 756.

[4] Field *v.* Cit. Ins. Co., 11 Mo. 51.

The doctrine of the law is that a party who makes an instrument, being charged with the duty of making all conditions certain and clear, should take care to so express himself as to the extent of his liability that he may not be held further than it was his intention to be; and that the party who receives the instrument should always have a construction put upon it in his favor, because the words of the instrument are not his, but those of the other party.[1]

Second. Where the language defining the scope of the insurer's liability is unambiguous and clear, the words thus used should be given their ordinary and natural meaning, so as not to extend such liability by process of construction.[2]

Third. In matters of construction, the whole contract should be considered, in order to determine its legal effect. This is peculiarly applicable to cases where the attempt is made to restrain the conditions of the policy by the recitals therein contained.

Fourth. In ascertaining the intention of the parties, reference should always be had to the perils against which the policy was issued as well as to the situation of the parties.[3]

Fifth. All defeasance clauses must be strictly construed against the insurer.[4]

Sixth. All parts of the contract should be effected rather than defeated, if this can be done without defeating the plain intention and purpose of the parties.[5]

Seventh. Where the policy refers to other instruments for the purpose of reference or in order to incorporate the provisions of the same therein, all must be read, construed, and enforced together; for in such case the real contract of the parties consists of all the stipulations and provisions contained not only in the policy itself, but of those in said instruments as well.[6]

[1] Jaeckel *v.* Am. Cr. Ins. Co. of N. Y., 54 N. Y. Sup. 505.

[2] People *v.* Mer. Cr. Co., 55 App. Div. N. Y. 594; 67 N. Y. Sup. 447.

[3] Field *v.* Cit. Ins. Co., 11 Mo. 51.

[4] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[5] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 459; 4 N. Y. Sup. 191.

[6] Rice *v.* Fid. & Dep. Co., 103 Fed. 427.

Eighth. A construction, in case of doubt, must, as a last resort, be adopted which is sanctioned by the general principles and nature of insurance law.[1]

Ninth. Where one provision of a policy is in harmony with a statute under which it is given, and the other not, force and effect should be given to the first provision.[2]

Tenth. The general purpose of all forms of guaranty insurance is indemnity pure and simple, and the contract, if such purpose is to be effected, must at all times be so construed as to advance this principle.[3]

Eleventh. If an instrument is susceptible of two constructions, one legal and the other illegal, the presumption is always in favor of the legality of the instrument.[4]

Twelfth. If a policy is so drawn as to leave room for two constructions of its provisions, either of which, it may be conceded, is reasonable, one favorable to the insurer and the other favorable to the insured, and most likely to subserve the purposes for which the policy was written, then it is to be construed most strongly against the insurer, as the party who prepared the policy and delivered it to the one for whose protection it was executed.[5]

[1] Talcott *v.* Nat. Cr. Ins. Co., 51 N. Y. Sup. 84.

[2] Walker *v.* Holtzclaw, 35 S. E. 754 (S. Car.).

[3] Clark *v.* U. F. & M. Ins. Co., 7 Mass. 365.

[4] Glover *v.* Amer. Cas. Ins. & Security Co., 130 Mo. 173; 32 S. W. 302.

[5] Am. Sur. Co. *v.* Pauly, 170 U. S. 160. See generally on the question of construction of guaranty insurance contracts, Penn. Mut. Life Ins. Co. *v.* Mech. Bank & Tr. Co., 72 Fed. 413; Am. Cr. Ind. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671.

PART II.—ATTACHMENT, DURATION, AND SCOPE OF LIABILITY.

CHAPTER V.

ATTACHMENT AND DURATION OF LIABILITY.

§ 38. **Attachment of Liability under Policies covering Persons holding Positions of Private Trust.** — Perils of a kind calculated to give rise to a legal liability on the part of the "risk" to make good to his employer (the insured) all damage arising through wrongful acts on his part are of the essence of fidelity insurance, and form the principal foundation of the contract. When the agreement between the parties is consummated, the insurer takes upon itself responsibility for the perils which the property or interests of the insured are liable to encounter. By necessary implication the contract involves the presumption that such property or interests of the insured will be exposed to perils of some sort. The important question then arises, At what time does the liability of the insurer under such a contract arise, and for how long a period does it continue? Inasmuch as the foundation of guaranty insurance rests upon the principle of non-liability for any loss not occurring within the life of the policy, it would seem to necessarily follow that liability should not attach until the time named in the policy for such attachment arrives. Thus it may be said that any provision in the policy with reference to the period for which it is to run is conclusive upon the parties therein named. The contract of insurance is deemed to be operative only during the period prescribed in the policy itself, and is deemed to take effect at

the time mentioned thereon, if delivered to the insured. The policy, however, is not invalid because it has no written date.

In one case where the policy given for the fidelity of an employee recited that it was for a term of one year, from July 1, 1891, to July 1, 1892, and there was indorsed on the back of the policy words to the same effect, but the policy was dated July 10, it was held that it was properly construed as taking effect from July 1, 1891, without regard to the evidence as to when it was accepted.[1]

Again, in Ætna Insurance Company *v.* American Surety Company,[2] a policy issued upon the agent of an insurance company bore date June 15, 1884, and it was not delivered nor accepted by the insured until July 29, and the certificate as to the character of the agent, which had previously been submitted to the insured, contained a blank to be filled in by him, stating when the bond was to be dated, and in this blank had been written "June 15 or June 16, 1884," the policy itself declaring that it was made June 15, 1884, and that it was in consideration of the premium for a term of twelve months ending June 15, 1885. The court held that the liability of the insurer under the policy accrued by relation as of the time of its date. A most instructive case with respect to the question of attachment of liability is that of Hall *v.* United States Fidelity and Guaranty Company.[3] The facts therein were as follows: The United States Fidelity and Guaranty Company was an insurance company engaged in guaranteeing the fidelity and honesty of persons in the employ of others. On March 9, 1898, one Newton, a stranger to Hall, the insured, applied to him for employment as his agent for the purchase of potatoes on commission, at River Falls, Wisconsin. The guaranty company had been in the habit of insuring the fidelity of the insured's employees, and sent its agent with Newton to Hall's office in Minneapolis to procure employment for him. The agent of the guaranty company then made a written application for insurance, and

[1] Supreme Council *v.* Fid. & Cas. Co., 63 Fed. 48; 11 C. C. A. 96.

[2] 34 Fed. 291.

[3] 79 N. W. 590; 77 Minn. 24.

informed the company that Newton was an entire stranger to him and to Hall, and that the insurance was wanted without delay. The next day the insurance company executed to Hall the following contract: "In consideration of the sum of $5.00 the United States Fidelity and Guaranty Company hereby guarantees the fidelity of A. Tracey Newton in the sum of $500.00 in favor of C. H. Hall & Co. from the ninth day of March, 1898, to the ninth day of March, 1899, subject to all the covenants and conditions set forth and expressed in the bond of this company to be issued of even date herewith and forwarded from the home office within fifteen days from the date of issue. All liability of the company on this instrument shall cease and determine on the issuance by the company of a duly executed bond, or, if the bond is not issued on the fifteenth day, from the countersigning of the said instrument by the general agent." Across the face of this instrument was written in ink, "Subject to the result of investigation." Upon receipt of this contract the insured employed Newton and advanced him money to purchase potatoes for it at River Falls, Wisconsin. Later, upon default of the "risk," the insured brought an action on the contract upon the claim that the "risk" had embezzled $211.53 of his money within the fifteen days mentioned in the contract. On the trial, the insured had a verdict for that amount, and the guaranty company appealed. The supreme court of Minnesota, in its opinion in this case, observed that "appellants' contention that the words, 'subject to result of investigation,' written across the face of the contract, converted what otherwise would have been a contract into a mere proposal for one, to become binding on defendant only in the case that the investigation proved satisfactory, was untenable. . . . This construction," the court said, "would render the temporary contract wholly meaningless and nugatory. The insured had already made application for insurance, and there was no occasion for a counter proposal. The contract states in plain and decided terms that the insurer hereby guarantees the fidelity of Newton, and that all liability on the instrument shall cease on the issuance of the regular

bond, or in fifteen days, if no such bond is issued. Why should such language be used, if it was not intended to mean anything? If a mere proposal was intended, why not rest upon the insured's written application and wait for the bond? In our opinion, the words "subject to the result of investigation" should be so construed as to merely give to defendant a right of cancelling the contract on further investigation, and thereby exempt itself from any loss resulting from continuing Newton in the employ of the insured after notice of the cancellation. This construction will give effect to all parts of the contract, and it seems to us in accord with the intention of the parties."[1]

§ 39. **Attachment of Liability under Fidelity Insurance Policies covering Persons holding Positions of Public Trust.** — Not infrequently in the case of insurance policies issued upon parties holding positions of public trust attempts are made to avoid liability by claiming that the same has not attached under the policy, through lack of consideration or by showing that the officer was never in fact appointed or elected to the position wherein the policy was required by law to be given. On this subject the Alabama supreme court in Fidelity and Deposit Company *v.* Mobile County[2] observed that "little is necessary to be said in disposition of the alleged want of consideration for the execution of the bond by Lott [the 'risk'] and the defendant [the insurer]. The recitals of the instrument itself cut off the defendant from showing that it is lacking in consideration. The bond was given by Lott in compliance with the requirement of the judge of probate professing to be predicated on an address of the grand jury of the county under the code. The instrument in substance recites that it was executed on the address of the grand jury for the execution of an additional bond by Lott as tax collector. The record address of the grand jury required an additional bond, and that the bond was given upon that requirement,

[1] As to what time the liability attaches, see Shakman *v.* U. S. Credit System Co., 92 Wis. 366; 66 N. W. 528.

[2] 27 Sou. 386.

and under it Lott continued in the office of tax collector, as without it he would have been immediately ousted. On this state of the case the defendant is estopped to say that the address of the grand jury had spent itself and become ineffective before the requisition was made; that, therefore, the requisition was of no efficacy, there being no grand jury address to support it; that there was no legal occasion for the execution of the additional bond, and in consequence the bond which was given was without a consideration and void. From all this," the court said, "the insurer has precluded itself by the recitals of the instrument it executed."

The principle to be deduced from the foregoing is that the insurer may estop itself by means of apt recitals in its policy from contending that liability thereunder had not attached.[1]

In order that the policy should relate back, the language of the policy must be retrospective and employ terms that relate to the past rather than to the future.[2]

§ 40. **Duration of Liability under Fidelity Insurance Policies covering "Risks" holding Positions of Private Trust.** — In the days of private suretyship the question of the time during which the liability of the bondsmen continued to exist was an important, as well as at times a most difficult, one to determine. With the advent of guaranty insurance companies most of the difficulties that once surrounded this subject have disappeared. The policies issued by these companies generally prescribe in definite terms the period for which they are to run. If not, the extent of liability in point of time is so clearly suggested as to render the matter ordinarily one of little difficulty. Under the old surety bonds procured for private individuals and public officials a great many questions arose with reference to the period of time covered by the bond procured, in connection with the performance of public or private duty by such persons. These questions, as has already been suggested, are now very largely things of the past. In private suretyship, where no definite period of liability was named in such bonds,

[1] See Walker County v. Fid. & Dep. Co., 107 Fed. 851.

[2] City of Grand Haven v. U. S. Fid. & Cas. Co., 87 N. W. 101.

the sureties thereon were usually held to be liable only for one year, because such is presumed to have been the intention of the parties. But there is nothing to prevent such sureties from becoming bound for a longer time, and if an intention to that effect clearly appears, they will be so held.[1]

§ 41. **Duration of Liability under Fidelity Insurance Policies covering "Risks" holding Positions of Public Trust.** — With respect to the duration of liability under policies of fidelity insurance, the rules of law governing the same are not materially different whether the "risk" named in such policies occupies a position of public or private trust.

Where definite and ambiguous language is employed in the policy with reference to the period of liability thereunder, the rule undoubtedly is that such period is not to be extended by implication or forced judicial construction beyond that named in the contract.[2]

But where the words defining the period of liability are ambiguous or uncertain, then in such case the courts would undoubtedly adopt a construction most favorable to the insured.[3] This on the principle that as the insurer is charged with the duty of preparing the contract, and this necessarily embraces the correlative duty of using certain and clear language, it would be unjust and inequitable to permit such insurer to receive the most favorable construction of blind and obscure phraseology of its own choosing.[4]

With respect to duration of liability in case of policies covering officials, the only questions of any difficulty likely to arise are those relative to the question of when such period of liability terminates. Such policies are customarily issued pursuant to some statutory provision regulating the duties of the office, and for this reason there has been evinced a tendency on the part of certain courts to establish (in the case of bonds

[1] See F. & C. Co. of N. Y. *v.* Lawler *et al.*, 64 Minn. 144; 66 N. W. 143.

[2] See Walker *v.* Holtzclaw *et al.*, S. C. ; 35 S. E. 754; Dorsey *v.* F. & C. Co. of N. Y., 98 Ga. 456; 25 S. E. 521.

[3] American Surety Co. *v.* Pauly, 170 U. S. 133.

[4] See Jaeckel *v.* Am. Cr. Ins. Co. of N. Y., 54 N. Y. Sup. 505; Indemnity Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

furnished by private parties) a legal presumption that bonds issued pursuant to such statutes are to continue in full force and effect during the entire period contemplated by the statute as the term of such office.

There, however, is no such presumption in the case of policies of fidelity insurance where the rule undoubtedly is that the intention of the parties must govern, and if such intention is evidenced by language prescribing a period of liability less than that of the term of office of the "risk" named in the policy, effect must be given to the intention so expressed.[1]

However, in the absence of specific limitations in the policy as to the period of liability, the rule would seem to obtain that inasmuch as the policy was issued for the purpose of securing the faithful performance of official duties, it must be construed as to time with reference to the term for which the "risk" therein named was elected or appointed. In such a case, in the absence of provisions in the policy evidencing a different intention, all statutes relating to the commencement, duration, or termination of the term of office of such "risk" are to be treated as part and parcel of the policy itself. The insurer under such circumstances is presumed to know the extent of the term of office of the "risk," and to have intended to bind itself to the extent and for and during the same period that the "risk" was bound to the public for the faithful performance of the duties of his office.

Under this principle, if there is a statute providing that a certain public officer covered by a policy of the character outlined above shall continue to hold his office until his successor is appointed or elected and qualified, then the insurer is liable on the policy of a "risk" holding such office until his successor is so appointed or elected and qualified.[2]

However, it would be unreasonable to extend this prin-

[1] See Walker *v.* Holtzclaw *et al.*, S. C. ; 35 S. E. 754; State to the Use of, etc. *v.* John E. Hill *et al.*, 88 Md. 111; 41 Atl. 61.

[2] City of Grand Haven *v.* U. S. Fid. & Guar. Co., 87 N. W. 104.

ciple to unconscionable periods of time not within the fair contemplation of the parties at the time the policy was issued.

Under Michigan statutes, providing that the city treasurer shall hold office for one year from the second Monday in April of the year when elected, and until his successor has qualified, the time between the election of a successor and the time he actually qualifies is a part of the preceding term, though the party elected is his own successor. Where the bond of a city treasurer elected to succeed himself is conditioned "that if he shall perform the duties of his office for and during the time for which he was elected, and shall account for and pay over all sums of money that shall come into his hands as such treasurer," etc., the insurer issuing such insurance bond will not be liable for any defalcation occurring prior to the time of the acceptance and approval of the bond by the common council, though it is of a prior date, since the term for which the bond is given does not commence until such bond is accepted and approved.[1]

Mr. Pingrey in his late work on Suretyship and Guaranty (p. 70) fairly states the rule as to the duration of liability under the old-time private bonds covering public officials, as follows: "The general rule as touching the extent of the obligation of the surety on official bonds is, that the obligation by intendment will be confined to the official term about to commence, or current at the time such bond comes into existence; and when the office is annual, the parties to the bond are presumed by law to bind themselves accordingly, if there are no words in the bond clearly extending to a future term. But when the bond provides that the officer is to be chosen annually, and holds his office until another is chosen and qualified in his stead, the sureties are bound only for the year for which he was chosen, and for such further time as is reasonably sufficient for the election and qualification of his successor, but no longer. When a bond is conditioned for the faithful per-

[1] City of Grand Haven *v.* U. S. F. & G. Co., 87 N. W. 104.

formance of the principal's duties during his continuance in office, without specifying the length of time, the surety is liable for one year only, the term of the principal being limited to that time."[1]

§ 42. **Effect of Renewal Provision in Policies as to Duration of Liability.** — A renewal of a policy of insurance is in a legal sense a new contract.[2] The provisions of policies containing stipulations for renewal of liability are valid, and the courts will effectuate them in every possible way. In the case of The Official Managers Mutual Guarantee Company *v.* Froane,[3] the plaintiff guaranteed the gross annual returns from defendant's business against loss for a term of two years as against the purchasers becoming bankrupt. The policy contained the following provision: "Every guarantee shall be for a specified term, but all guarantees upon gross annual returns, etc., whatever may be the original term, shall, from the expiration of such original term, be treated as a renewed contract of like nature and condition, unless either party gives notice of the intention not to renew." It was held, "that in the event of no notice being given the guarantee became a renewed contract for only one period of two years from the expiration of the original term, and not from time to time renewable."

In Guarantee Company of North America *v.* Mechanics' Savings Bank and Trust Company[4] the court held that where the policy contained a provision for renewal, that as respects time a new contract is made, but it contained only the terms of the old contract. It is generally held to be a new contract upon the terms and conditions stated in the policy expired; the old application, in the absence of evidence to the contrary, serving as the basis of the new contract, as if made at the time of the renewal. In all such cases where necessary, the courts will apply the equitable principle of considering that done which ought to be done, and to that end enforce all

[1] See generally on the subject of duration of liability under policies governing official "risks," Murfree on Official Bonds, §§ 265–330.

[2] De Jernette *v.* Fid. & Cas. Co., 17 Ky. Law Rep. 1088; 33 S. W. 828.

[3] 7 H. & N. 5.

[4] 80 Fed. 766; 26 C. C. A 146.

agreements made by the insurer with the insured looking towards a renewal of an expired policy.[1]

A most instructive case on the general subject of "renewal provisions" is De Jernette *v.* Fidelity and Casualty Company of New York.[2] The policy under consideration in that case contained a provision to the effect that "the contract under bond No. —— is hereby renewed in accordance with the terms of the bond, the guaranty to cover the period above named only." The Kentucky court of appeals, referring to this provision, said that "a renewal of the bond constituted a separate and distinct contract for the period of time covered by such renewal. It is, however, a contract with the same terms and conditions as is evidenced by the bond which is renewed, because the renewal recites that it is renewed in accordance with the terms of the bond. Such contracts standing as separate and distinct contracts, the rights of the parties must be determined under them as such. A renewal of the bond did not alter, change, limit, or increase the rights of the parties under the bond; nor did such renewal increase or limit the time for the performance of any act which is required to be done by the parties to ascertain their rights under the bond. When the bond speaks of acts 'committed during the continuance of said renewal thereof,' it has reference to the bond as one contract, and the renewal thereof as other and distinct contracts. For the fraud and dishonesty of the employed during the time covered by the bond no recovery could be had under the renewed contract, nor will the contract, if renewed, enable the assured to maintain an action on the bond which had been barred by the lapse of time."[3]

[1] Lauer *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. 53.

[2] 33 S. W. 828; 17 Ky. Law Rep. 1088.

[3] See also Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Solvency Mutual Guarantee Company *v.* Freeman *et al.*, 7 H. & N. 5, 17; 3 H. & N. 588; American Credit Indemnity Co. *v.* Champion Coated Paper Co., 103 Fed. 609; Indemnity Co. *v.* Wood, 19 C. C. A. 264; 73 Fed. 81; Am. Cr. Indemnity Co. *v.* Athens Woolen Mills, 34 C. C. A. 161; 92 Fed. 581; Fid. & Cas. Co. of N. Y. *v.* Lawler *et al.*, 64 Minn. 144; 66 N. W. 143.

CHAPTER VI.

SCOPE OF LIABILITY.

§ 43. **General Remarks on the Scope of the Insurer's Liability under Policies of Fidelity Insurance.** — The phrase "scope of liability" when employed in fidelity insurance has reference to those perils against which the insurer agrees to indemnify the insured in case they occur and operate to the pecuniary injury of such insured. The general subject of the insurer's liability is itself limited by many and diverse elements, chief among which may be mentioned time, place, and cause.

For the purpose of logical treatment herein the general subject of scope of liability should be discussed both from the standpoint of private and public trusts. Taking up, then, first the scope of liability in the case of policies covering persons occupying positions of private trust, the subject may be divided with sole reference to the character of the perils insured against as follows: (A) Perils arising through acts of actual fraud or dishonesty on the part of the "risk" while in the employ of the insured. (B) Perils arising through acts of constructive fraud or dishonesty on the part of the "risk" while in the employ of the insured. (C) Perils arising through negligence on the part of the "risk" while in the employ of the insured.

§ 44. (A) **Perils arising through Acts of Actual Fraud or Dishonesty on the Part of the "Risk" while in the Employ of the Insured.** — In defining the scope of liability with reference to acts of criminality on the part of the "risk," policies make use of a variety of terms, all having substantially the same general meaning. By way of example there is here presented a clause of a policy which defines the scope of the insurer's liability, reading as follows: "It is hereby covenanted and agreed that the insurer shall at the expira-

tion of one year make good and reimburse to the insured all and any pecuniary loss sustained by the insured of moneys, securities, or other personal property belonging to the employer in the possession of the risk, or for the possession of which he is responsible, directly occasioned by 'fraud,' 'larceny,' or 'embezzlement' on the part of the 'risk' in connection with the duties of the office or position in the service of the insured, as set forth in the proposal for this policy heretofore made by the insured." Or, again, we find the liability simply limited to any "fraudulent" or "dishonest" acts of the "risk" in connection with the duties of his position. Sometimes the liability is limited to "fraudulent acts" alone, or to "dishonesty" alone, or both combined. Still other policies name specifically "misapplication," "misappropriation," "embezzlement," "larceny," and "theft," as within the scope of liability. To determine definitely and satisfactorily just what the scope of liability is in any particular case, it is eminently essential that each of these words should have a well-defined legal meaning. In other words, recourse must be had to the interpretation given them by the courts. This will now be done at length, for the subject is one of great practical importance

Fraud has been defined by the courts in general terms as any "artifice whereby another is deceived to his disadvantage." Actual fraud is such fraud as is premeditated, and implies deceit, artifice, trick, designing, in short, some direct operation of the human mind.[1] The general subject of what constitutes fraudulent acts within the meaning of a fidelity insurance bond was considered by the supreme court of Pennsylvania in a recent case.[2] Here a tailoring firm employed an agent to solicit orders. It was agreed that he should return the clothes not accepted by the persons ordering them within thirty days after they were sent to him, and if they were accepted he was to collect the money and remit. Clothes were shipped to the agent on his order,

[1] People *v.* Kelly, 35 Barb. 444.
[2] Reed *et al.* *v.* Fid. & Cas. Co. of N. Y., 42 Atl. Rep. 294; 189 Pa. 596.

and he never accounted for them. It was not shown that he ever actually received any of the clothes, that he had not delivered them to the customers on credit, nor that he received any of the price. The court in its opinion spoke as follows:

"The fraudulent and dishonest acts insured against in the contract before us may be classified in two categories, namely: fraudulent and dishonest acts in violation of equity, good conscience, and the civil law, and fraudulent and dishonest acts which go beyond that line, and subject the perpetrator of them to the penalty of the criminal law. By the express terms of this bond the defendants insured against fraudulent and dishonest acts upon the second category only, to wit (as expressed in the bond), those amounting to embezzlement or larceny. Embezzlement and larceny are both terms of the criminal law, and in no respect are they terms of contract law. Therefore unless criminal offences be proven against the risk, the bond does not insure against his acts. Now, what criminal offence has been proved against the risk by the evidence? To test his criminality a simple defence may be resorted to. If he should come into the court here, being on trial for embezzlement or larceny, and hear all the evidence that has been submitted, and then say, 'I acknowledge that every word that has been said is true,' notwithstanding that acknowledgment, it would be entirely consistent with his having committed at most a civil offence, and I do not think a conviction could be sustained. Every one of the delinquencies charged to the risk may be due to causes beyond his control, and if due to causes under his control they are entirely compatible with non-criminality. Not one of these goods may, for all we know, ever get to the 'risk's' hands. It is admitted that a large portion of them went to other hands, and the plaintiff himself shipped goods contemporaneously to two places distant from each other, where the 'risk' could not have been physically to take them both at the same instant of time. Wherever the evidence of his receiving them simply shows a constructive receipt of the goods, that is not sufficient

to hold a man guilty of a criminal offence. He may have been guilty of a wrong, that is, instead of sending the goods to the customers C. O. D., as he was required to do by his contract, he may have violated this in the belief that he was benefiting his master, and concluded that he would send out the goods on credit, relying upon the responsibility of his parties to return the goods that were delivered. This is a wrongful act in view of the contract law. It is a violation of duty; but it is not a criminal offence, if he had no intent to steal or appropriate anything. If he never got the proceeds, and, therefore, could not have appropriated them, then he never did appropriate them. I shall have to enter a nonsuit in this case."[1]

Attention is called in this connection to the opinion of the United States supreme court in American Surety Company *v.* Pauly.[2] One of the questions before the court in that case was as to what constituted fraud or dishonesty. The supreme court therein approved of the instructions given by the lower court to the jury covering this point. These instructions are in themselves so instructive in this immediate connection that they are given here in full:

"I am not going to call attention to that evidence in detail. Suffice it to say that it tends to prove that on or about the 13th of October the president of the bank procured a discount of certain notes of the bank with the customers' notes belonging to the bank as collateral, to the amount altogether of about $45,000; that about that time he sent telegrams in cipher to the cashier of the bank at San Diego; that about that time the cashier caused a credit to be given in the president's personal account for items amounting to about $45,000; that when the bank failed the apparent balance to the credit of the president in his private account was about $11,000, showing that he had drawn out about $34,000

[1] See in general as to the meaning of the words "criminal fraud," the following cases: Fid. & Cas. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; Railroad Company *v.* Gow, 59 Ga. 685; Bostwick *v.* Van Vorhees, 91 N. Y. 353; Tapley *v.* Martin, 116 Mass. 275.

[2] 170 U. S. 133, 160.

of the $45,000 which had been placed to his credit on the 13th or 14th of October. It is insisted that this evidence authorizes and requires you to find that the president obtained an improper credit, and by means thereof appropriated more than $25,000 of the funds of the bank.

"I shall not allude to the evidence which has been given as to the president in his personal account with the bank. This is only important as tending to characterize the nature of the transactions of October 13 and 14, and as tending to show the total loss sustained by the bank through its president. But the question for you to determine is, whether by reason of these improper credits of the 13th and 14th of October the defendant became liable for a loss within the meaning of the terms of the policy. Was that a fraudulent or dishonest transaction on the part of the president? If it was not, the plaintiff is not entitled to recover. If it was a mere irregularity, or if he was not aware of the fact that these credit items were passed to his account, the plaintiff is not entitled to recover. You must find that when he drew this money out he knew, or had reason to believe, that these items had been credited to his account; and you must find that in drawing out the money on those credits he was actuated by a fraudulent or dishonest mind. If, upon the evidence in this case, you can come to the conclusion that he believed that if the directors of the bank had known of these transactions they would have acquiesced and regarded them as entirely satisfactory, why, then it is your duty to find that he was not actuated by a dishonest motive, and therefore his acts in appropriating this money were not fraudulent and dishonest. The burden is upon the plaintiff to satisfy you by a fair preponderance of evidence of the truth of this issue. Fraud is not to be legally presumed, and the law presumes that every man acts honestly until the contrary is shown. On the other hand, fraud or dishonesty is a condition of the mind. It is incapable of direct evidence. It must always be found from circumstances. There is no way in which the plaintiff could

show in what state of mind Mr. Collins was while these transactions were taking place unless he could produce him as a witness on the stand and elicit the truth. Well, as I have said before, the plaintiff has made a *prima facie* case upon this issue, because he has complied with that condition of the policy which prescribes that the written statement of claim shall be *prima facie* evidence of a loss within the terms of the policy. Now it is for you to say, upon the other evidence in the case, which has been decided principally upon the cross-examination of the plaintiff's witnesses whether the defendant has overcome that case. If you conclude that the defendant has overcome that presumption, and upon all the evidence before you, that the transactions in controversy are as consistent with the theory of honesty on the part of the president, as of his dishonesty or fraud, then the defendant will be entitled to your verdict."[1]

"Misapplication" and "misappropriation" are words having a meaning somewhat analogous to that of "embezzlement," but differ from it somewhat in legal effect. In this connection attention is called to the case of Guaranty Company of North America *v.* Mechanics' Savings Bank and Trust Company.[2] Here a cashier's guaranty policy stipulated that the "surety company" should make good those losses of the bank (the insured) which might result from such fraudulent acts of Scardt (the "risk") as were equivalent to embezzlement or larceny. The obligation of the "surety company" by its express terms was limited to that character of wrongdoing upon Scardt's part. The evidence in the case is very explicit that the defalcations of Scardt during the period when his policy was in force, namely, from Jan. 1, 1893, to April 17, 1893, was $22,964, of which the sum of $5,992 was on account of over-drafts paid by him but not authorized by the bank. "This defalcation," said the court, "even if it had been in some respects fraudulent, must necessarily have been on account of moneys paid out on the checks of customers who

[1] See also Am. Sur. Co. *v.* Haynes, 91 Fed. 90.

[2] 100 Fed. 559; 40 C. C. A. 442.

had no funds to their credit to meet them ; but it is not shown that Scardt embezzled or appropriated any part of the proceeds of these over-drafts or received any benefit therefrom. If this is true, it is manifest that while Scardt was individually responsible for it to the bank as his principal, no act was done by him which was either embezzlement or larceny, and consequently that the loss was not one which by any fair interpretation would bring it within the obligation of the surety on the bond of Scardt."

The term "dishonesty" employed in many of these bonds implies, of course, the reverse of honesty. It signifies lack of probity or integrity on the part of the "risk." It has a broad meaning, including within its scope acts of thievishness, abuse of confidence, intentional fraud, and any intentional deviation from the path of legal rectitude which borders on or is in fact criminal in its nature. In Toronto Bank *v.* European Insurance Company,[1] a policy was issued against losses through the want of integrity, honesty, or fidelity, or by the negligence, defaults, or irregularities of the "risk," and it was held that where the "risk" allowed certain customers of the insured bank to overdraw their accounts while he knew they were not able to pay the amount of the over-draft, the insurer was liable, particularly on the ground that the "risk" had concealed the existence of these over-drafts from the insured by fictitious returns and in collusion with the parties who were allowed to overdraw.[2]

It has been held in a federal court that in order to give the insured the right to recover under a policy providing for indemnity against loss by reason of fraud, dishonesty, misappropriation, or misapplication on the part of the "risk," it is not necessary that such fraud, dishonesty, misappropriation, or misapplication amount to a crime.[3] However, a different view of this question was taken by the supreme court of

[1] 14 L. Can. Jurist, 186; 7 Rev. Leg. 57.

[2] See also Am. Sur. Co. *v.* Haynes, 91 Fed. 90; Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 72 Fed. 481; 18 C. C. A. 644.

[3] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 18 C. C. A. 644.

South Carolina in the case of Clifton Manufacturing Company *v.* United States Fidelity and Guaranty Company.[1] "It is evident," remarked that court, "that the intention of the 'risk' in his acts respecting this money must have been established before it could be said that he was guilty of fraud or dishonesty as to said funds. A man cannot be found guilty of fraud or dishonesty in the absence of a criminal intent."

As to the meaning of the word "embezzlement," as found in so many fidelity insurance policies, the case of the Milwaukee Theatre Company *v.* Fidelity and Casualty Company[2] is directly in point. In this case the insurer executed a bond of indemnity to the insured, agreeing to make good and reimburse to the latter to the extent of $6,000 such pecuniary loss, if any, as may be sustained by the insured by reason of the fraud or dishonesty of the employed in connection with the duties referred to, amounting to embezzlement or larceny. The Wisconsin supreme court, in its opinion in this case, spoke as follows: "So far as necessary to define embezzlement for the purposes of this case, it may be defined as the fraudulent conversion of the money or personal property of another, which is in the possession of a trustee, servant, agent, or bailee in a trust capacity. There can be no embezzlement unless the property charged to have been embezzled was, at the time of the conversion, held in trust. A mere debtor does not embezzle the money of his creditor by failing to pay the debt when due. Did Obermann hold the money in question in a trust capacity, or was he simply the debtor of the plaintiff to that amount? The trial court evidently thought that he had become a mere debtor, and with that conclusion we agree. Interest is compensation for the use of money. When the theatre company resolved that Obermann should pay them interest on moneys in his hands, and charged him with such interest, and Obermann assented, the necessary implication resulting from the arrangement was that he was to have the use of the money. He was to pay for the use of it. Why should he not have what he paid for? We could not sustain a conviction on

[1] S. C. ; 38 S. E. 790. [2] 92 Wis. 412; 66 Northwestern, 360.

these facts, nor have we been referred to any case where such a conviction on similar facts has been sustained."

The general subject of what acts are sufficient to constitute embezzlement or larceny was considered at length by the supreme court of Maryland in American Bonding and Trust Company *v.* Milwaukee Harvester Company.[1]

Here a fidelity bond had been issued by a guaranty insurance company to the Milwaukee Harvester Company, guaranteeing the latter against fraudulent or dishonest acts of one Brumbaugh in connection with his duties as general agent for the insured, amounting to embezzlement or larceny. In its opinion in the case, the court had occasion to review the action of the trial court in overruling the demurrer to the insured's replication to the insurer's third plea, which alleged that all the moneys collected by Brumbaugh during the term of the bond and the renewal thereof were paid over to the insured, and hence that there was no pecuniary loss sustained by it during the term of the bond sued upon. The plea set out a list of accounts collected by the "risk," and alleged that each and all of them were paid over to the insured. The latter denied that the sums of money included in the aggregate of these accounts so collected were paid over to it for and on account of the parties from whom they had in fact been collected. This for the reason that the insured had been damnified to the full amount of the accounts so collected, amounting to the sum of $2,814.85, which constituted an actual deficit in the "risk's" accounts, for which the insurer was liable under the terms of the bond. On this point the court spoke as follows: "The defendant asked the court to instruct the jury that if they believed that the agent Brumbaugh paid to the plaintiff all the money he collected, including the sum sued for, during the term of the bond and the renewal thereof, then they must find for the defendant, even though they further believe that he directed the company to apply his said payments to accounts other than those from which they were actually collected. The theory of the appellant is, that if all the money was paid,

[1] 91 Md. 733; 48 Atl. Rep. 72.

then, first, the plaintiff sustained no loss as contemplated by the bond, and, second, that Brumbaugh's acts did not constitute the crime of embezzlement. This plea did not allege in terms that the acts of Brumbaugh did not amount to embezzlement, but that defence was made by another plea, on which issue was joined. The declaration, however, does specifically charge that Brumbaugh did fraudulently and dishonestly appropriate the sum of $2,841.85 of the money of the plaintiff in such a way as to amount to that crime, and this plea undertook to meet the allegations in the narr. by simply alleging that all the money collected during the term of the bond had been paid over, which was replied to by the plaintiff by the allegations that they were not paid on account of the items set out in the plea. The discussion of the point must, therefore, be narrowed to the inquiry whether the fact that the money collected by the agent was paid to the plaintiff, although on accounts other than those so collected relieved the agent of embezzlement and the defendant of liability; and giving the plea the greatest possible latitude, we are not called upon to discuss the many technical defences that may be interposed on the charge of embezzlement. It is a statutory crime, and we have a number of provisions in our Code in reference to it. The necessary elements to bring Brumbaugh's acts within the statute are: first, agency; second, receipt of money for, in the name of, or on account of his principal as such agent; and, third, a fraudulent conversion thereof. The agency and receipt of the money are conceded, and it is contended that the third element is lacking; but the evidence produced at the trial not being before us, we have nothing to do with the legal sufficiency to sustain the charge, but can only determine whether the payment as above stated is an answer to it, and relieve the defendant. Independent of authority, we cannot understand how the position of the appellant can be successfully maintained. If Brumbaugh had fraudulently appropriated this money to his own use by paying it to some creditor other than the plaintiff, there could be no question as to the responsibility of the bonding company;

and upon what principle can it be relieved merely because he so used it in payment of other debts he owed the plaintiff? If the bonding company had given the appellee one bond to be in effect Dec. 1, 1895, to Dec. 1, 1896, and another from the latter date to Dec. 1, 1897, and Brumbaugh had collected from A. and B. $1,000 during the first year, which he appropriated to his own use, and during the second year collected from C. and D. $1,000, which he paid to the harvester company to be credited on the accounts of the first year, and that company did so credit A. and B. without any knowledge that the sums were collected from C. and D., and there was still a deficit of $1,000 at the end of the second year, a suit on the first bond would have been met by the defence that Brumbaugh's obligations were cancelled by the payment so made, and the books of the appellee would have tended to sustain that defence. Then, if suit was brought on the second bond, according to appellant's theory it could defeat that action because the money received by the agent during that year had in fact been paid over to the plaintiff. Bonds of this character would be worse than useless if such results could follow, as the party undertaking to be indemnified by them might be misled, and subject to loss, by relying on what he believed to be a security, but which would prove to be a snare and delusion. Or take another instance: Suppose the agent collected $100 from each of four parties, and paid to his principal $200 to be credited on the accounts of A. and B., but kept the balance, and the bonding company was sued for the amounts he received from C. and D., could it be possible that it would be a defence to say that the money paid on account of A. and B. was actually received from C. and D., and that having been paid to the principal he could not recover? Or, if the agent was indicted for embezzlement of the money received from C. and D., would it avail him to prove that that particular money was paid over to the principal, although it was paid on account of what the agent had received from A. and B.? If that be true, then if a bank officer appropriates $100 to himself one week, and replaces that with another $100, so appropri-

ated, the next week, and continues that operation from time to time until he finally owes the last $100, which he does not pay, he could not be convicted of embezzlement, or a bonding company could not be held liable on a bond of this character for the last $100, because the agent had paid that money over to his principal, although he had appropriated the last sum to pay what he previously owed. If Brumbaugh had been the agent of the harvester company for Maryland and Virginia, and the appellant had been his surety for collections in Maryland alone, and another company for those in Virginia, and he had collected $2,800 in Maryland, which he appropriated to his own use, and afterwards collected $2,800 in Virginia, which he paid to his principal to be credited on account of the Maryland collections, would the appellant admit that he was still liable because the money paid was in reality collected from the Virginia debtors? Or would the other company be excused because that money (even if he paid the identical notes received by him) was actually received by the principal, although without knowledge of the source it came from, and was credited by the direction of the agent to the Maryland claims? Other illustrations might be given to show not only how useless securities of this character would be, but the results that might follow if such a doctrine as is contended for be adopted. It might be well said that if A. owes B. $5, and he surreptitiously takes that amount out of the safe of B. and then pays B. the debt with it, that it would not be larceny; for he could with equal propriety say that he had not appropriated it to his own use, but had taken it simply to pay B., although he was thereby cancelling a debt he owed him. As the point is now presented to us, the agent used his principal's money received during the term and under the conditions of the bond, and applied it to his own use — that is, to the payment of debts he owed the principal on account of collections previously made by him for which he was liable; and it was therefore as much a conversion of the principal's money as if he had paid it to some other party. He could not successfully defend himself from the charge of embezzlement by reason

of such payment, nor can his security do so under the terms of the bond. There is no allegation that the harvester company was in any way responsible for, or knew of the use of, the money which the appellant was liable for under the bond by Brumbaugh to pay other debts he owed it. If it had been accepted with such knowledge, another question would have arisen.

"If, then, we were without authorities on the subject, we would have no difficulty in reaching the conclusion that the defence intended to be relied on under this plea is not well taken, but those reflecting on the question are not wanting. . . . These cases in no way conflict with the general principles applicable to sureties, — such as they are only liable for defaults, etc., during the time the bonds are in force, — but they hold that default is made by the application of money collected under the terms of the bond to the payments of other debts, even if such debts are due the obligee of the bond, provided, of course, he is not a party to its misappropriation, and has no knowledge of it." [1]

Larceny is the wrongful taking and carrying away by any person of the mere personal goods of another from any place, with the felonious intent to convert them to his own use, and to make them his property without the consent of the owner.[2] Theft, on the other hand, is really a popular term for larceny.[3] It may be defined as a fraudulent taking of property with intent to deprive the owner of the value of the same and to appropriate it to the use of the person taking. The taking must be a fraud upon the rights of another, and there must be an actual and intended fraud, and not a constructive or legal one. The crime of theft is not constituted merely by the taking nor the fraudulent taking, but it must also include the purpose and intent to defraud. There must be an intentional taking without the consent of the owner, an intentional fraud and an intentional appropriation, or the crime of theft is incomplete.[4]

[1] See also London Guar. & Acc. Co. *v.* Geddes, 22 Fed. 639.

[2] Ransom *v.* State, 22 Conn. 153.

[3] People *ex rel.* *v.* Donohue, 84 N. Y. 438.

[4] Mullins *v.* State, 37 Tex. 337.

Embezzlement is a species of larceny, and the term is applicable to cases of furtive and fraudulent appropriation by clerks, servants or carriers, of property coming into their possession by virtue of their employment. It is distinguished from larceny, as being committed in respect of property which is not at the time in the actual possession of the owner.[1]

The question as to what constitutes larceny and embezzlement was gone into quite fully in Monongahela Coal Company *v.* The Fidelity and Deposit Company of Maryland, decided by the United States circuit court of appeals for the fifth circuit.[2] In this case an insurance bond had been issued providing for indemnity against loss sustained by the insured of moneys, securities, or other personal property belonging to the insured in the possession or custody of the " risk," directly occasioned by larceny or embezzlement on the latter's part. In construing this policy with reference to the scope of liability therein provided for, the court of appeals spoke as follows :

" The bond sued on is one of indemnity, but it is a contract imposing different obligations on the several makers. The plaintiff in error is called in the bond the 'employer,' the defendant in error the 'company,' and the J. B. Donnelly Company, Limited, the 'employee.' These terms will be used for brevity. The contract first recites that the employee 'has been required to furnish a bond for his honesty in the performance of his duties in a said position' [meaning as agent for the employer]. After reciting the consideration and making the other recitals not material here, the agreement is that 'the company shall make good and reimburse to the employer to the extent of ten thousand dollars, . . . all and any pecuniary loss sustained by the employer, of moneys, securities, or other personal property belonging to the employer in the possession or custody of the employee, or for the possession of which he is responsible, directly occasioned by larceny or embezzlement on the part of the employee in connection with the duties of the office or position. . . .' The employer, if required by the company, is to give aid and information 'for

[1] People *v.* Burr, 41 How. Pr. 293. [2] 94 Fed. 732 ; 36 C. C. A. 444.

the purpose of prosecuting and bringing the said employee to justice.' It is declared by its terms 'that the true intent and meaning' of the bond are, 'that the company shall be responsible . . . for moneys, securities, or property diverted from the employer through fraud or dishonesty on the part of the employee. . . .' These provisions all relate to the obligations of the company. From these it appears that the liability of the company is restricted to claims based upon the larceny, embezzlement, or, at least, the dishonesty, of the employee. The obligation of the company does not cover every liability or claim which might accrue in favor of the employer and against the employee. A loss by carelessness or inattention to business might be the foundation of a just claim against the employee by the employer, which would impose no liability on the company by the terms of its obligations in the bond. If with the consent of the employer, expressed or implied from the course of dealings between it and the employee, the latter used or retained moneys, charging itself with them, it would be no obligation covered by the insurance or indemnity of the company. It follows, therefore, that the fact that the account between the employer and the employee shows an indebtedness from the latter to the former is not sufficient of itself to support a claim on the bond against the company. To recover in an action on a bond, defence being made, there must be an allegation of a breach of it, sustained by evidence. There is neither allegation nor proof that the employee has, through fraud or dishonesty, diverted from the employer moneys, securities, or other property, nor that it has committed larceny or embezzlement of such property. O'Neill and Theis, the only witnesses, testify that the course of business between the employer and the employee was for the latter to transmit the notes of the purchasers for coal sold on credit, and subsequently out of cash sales to retain commissions on account of the sales for which the notes were given. Such dealings made it necessary to keep accounts of debit and credit. Fraud and dishonesty are not to be presumed. The law presumes that every man acts honestly till the contrary is shown. No

fact is shown tending to prove that the debt originated in the fraud or dishonesty of the employee. As late as the 20th of April, 1897, O'Neill, the president of the employer company, furnished a certificate that the employee had performed its duties in an acceptable manner, 'and that we know of no reason why the guaranty should not be continued.' The amount of the debt of the employee to the employer is $6,634.15. Part of this sum ($1,088.64) was collected in 1896. The remainder was collected in April and June, 1897. J. B. Donnelly, Sen., the president of the employee company, died Aug. 29, 1897. The fact that on settlement the employee owed the employer was discovered Nov. 24, 1897, nearly three months after Donnelly's death. Under the circumstances, the fact that the employee, on settlement, is found to owe the employer is not sufficient to show that the debt originated in fraud or dishonesty, in embezzlement or larceny. It is alleged in the petition that the company 'did bind and obligate itself unto your petitioner, in the sum of ten thousand dollars, that it would save, defend, and keep harmless your petitioner from and against all loss and damage whatsoever, of any nature or kind, and from all other legal costs and expenses, direct or indirect, incidental thereto which petitioner shall or may at any time sustain.' The bond sued on does not contain this or any similar obligation on the part of the company to the employer. Such language, in substance, is in the latter part thereof, but it is the obligation of the employed [the J. B. Donnelly Company, Limited] to the company [the Fidelity and Deposit Company of Maryland]. That part of the bond is as follows: 'and the said employee doth hereby . . . agree that he will save, defend, and keep harmless the said company from and against all loss and damage of whatever nature and kind, and from all legal and other costs and expenses, direct or incidental. . . .'

"This part of the bond is the agreement of the employee to reimburse the company, if it has to pay anything to the employer by reason of the contract. It contains no such obligation of the company to the employer. There was no evidence,

in our opinion, before the jury to sustain the allegations of the petition, or to justify a recovery of the case. It was proper to direct a verdict for the Fidelity and Deposit Company of Maryland. The judgment of the circuit court is affirmed."

The question as to what constitutes fraud or dishonesty amounting to embezzlement was considered in London Guaranty and Accident Company *v.* Hochelaga Bank.[1] It appeared in evidence in that case that the "risk," who was cashier of the insured bank, had removed bundles of notes from the bank to his residence for the purpose of signing them; they were all returned, but subsequently, in his office in the bank, he put a number of five-dollar notes in the bundles instead of ten-dollar notes. It was held that the loss was covered by the policy. The same "risk," just prior to absconding, caused his own checks to a large amount to be certified by the ledger keeper of the bank, although he had no funds there to his credit at the time. This act, the court said, while not embezzlement in the technical sense, was fraud and dishonesty amounting to embezzlement, and came within the language of the policy which was to be taken in its ordinary sense.

§ 45. (B) **Perils arising through Constructive Fraud or Dishonesty on the Part of the "Risk."** — Constructive fraud or dishonesty is indirect, and if it exists at all, is to be implied from other acts or omissions to act which may be, in moral contemplation as well as in fact, untainted with intentional fraud or dishonesty, and yet, without the ability or inclination on the part of the party implicated to give or offer proof of his innocence, is legally held to constitute constructive fraud or dishonesty.[2] The circumstances in such a case raise the legal presumption of the existence of fraud or dishonesty, and because it is only presumptive and circumstantial, the courts term it constructive fraud or dishonesty.[3]

Constructive fraud or dishonesty occupies an intermediate position between cases where bonds cover acts of intentional

[1] Quebec L. R. 3 Q. B. 25.

[2] People *v.* Kelly, 35 Barb. 444.

[3] See City Trust S. D. & Sur. Co. *v.* Fid. & Cas. Co., 58 App. Div. 18; 68 N. Y. Sup. 601; Fairfax *v.* R. R., 67 N. Y. 11.

criminality and those relating simply to negligence, carelessness, etc., on the part of the "risk." A bond exemplifying an agreement to indemnify against acts which may be considered as constructively fraudulent or dishonest was construed and set forth in the case of Fidelity and Casualty Company of New York *v.* Eickoff.[1] The scope of the policy therein construed by the Minnesota supreme court is set forth in the following provisions, to wit, "The company [the insurer] shall, subject to the conditions and provisions herein contained, make good and reimburse to the said employer [the insured] such pecuniary loss as may be sustained by the employer by reason of the fraud or dishonesty of any or either of the employees named upon the said schedule, or added thereto as hereinafter provided, in connection with his duty as receiving agent or buyer [in buying wheat for the employer at a country elevator], provided that the company shall be liable only for the acts of fraud or dishonesty on the part of the persons mentioned in the schedule hereto attached as receiving agents for shortages in their grain account, as follows, to wit:

"There shall be deducted from the total amount of grain and dockage received by the receiving agent at said elevator or elevators screenings and dirt from such grain as has been cleaned at said elevator or elevators, together with the amount of shipments based upon the weights of grain and dockage at terminals; . . . and if the result shows a deficit, and the shortage is not caused by the various exceptions agreed to, this proof of loss will be accepted as binding on the part of the company. In cases where screenings and dirt are burned at the elevator, they shall be weighed before being burned and the weight reported daily to the employer, provided that the company shall not be liable for the grading of grain lost by heating, drying, or leakage of cars, or other damage, etc. And it is further agreed that the company shall not be liable for errors or carelessness in the weighing of grain, nor for thefts of grain by persons other than those covered by this bond, nor for robbery or theft of money from the person

[1] 63 Minn. 170; 65 N. W. 351.

so covered, where proof of such error, carelessness, thefts, or robbery are conclusive, as negligence is not covered by this bond."

It appeared that the acts on the part of the " risk," which gave rise to the claim for indemnity placed by the insured (the " risk's " employer) with the insurer, arose from the fact that said " risk " during the period of his employment had received nearly one thousand more bushels of wheat than he subsequently delivered to his employer. There was no evidence, other than the existence of the shortage of one thousand bushels of wheat, which tended to establish actual fraud or dishonesty on the part of the " risk." The claim was made by the attorneys for the " risk " in a suit brought against the latter by the insurer for reimbursement for moneys paid on his account to the insured under the policy, that the latter only covered acts of specific fraud and dishonesty, and that there being no allegation in the complaint that the shortage was caused by the fraud or dishonesty of the " risk," that therefore the insurer was under no liability to pay a claim thereunder. This contention was denied by the court in the following language: " Our construction is that the plaintiff [the insurer] was only bound to make good and reimburse the elevator company for loss sustained by reason of the shortage of grain caused by the actual fraud or dishonesty of the defendant [the 'risk']; but the bond also provides how the existence and amount of the shortage shall be ascertained, and that when thus ascertained, it shall be accepted as evidence that it was caused by the fraud or dishonesty of the defendant ['risk'], and not by any of the various other causes enumerated in the exceptions for which the plaintiff [insurer] was not to be liable. In other words, that the shortage ascertained in the manner prescribed should be *prima facie* evidence of its existence, and that it was caused by the defendant's fraud and dishonesty, thus casting the burden upon the defendant to rebut this *prima facie* case by proof." [1]

Another case in point is that of the School Commissioners

[1] See also F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531.

v. Guaranty Company.[1] In this case the guaranty company had issued a guaranty bond on Evans, as accountant and treasurer for the school commissioners, against acts of fraud and dishonesty on the part of said Evans. The latter was arrested for larceny of moneys from the school commissioners, was tried, and acquitted. Thereafter the school commissioners sued the guaranty company on the theory that inability on the part of Evans or the guaranty company to explain the former's shortage, created a case of constructive fraud or dishonesty on Evans' part, and that the policy issued on Evans covered the same. The court, in its opinion, said: "It appears that it is established in evidence that between the 15th and 26th of September, 1884, Evans received in his capacity as accountant and treasurer for the school commissioners, $2,025, and that he had received prior to that time, but since his arrest, another sum of $60; in all, $2,085. That he has not rendered account of these sums to the insured, but has simply pretended that said sum was stolen from the safe put at his disposition for the purposes of his employment, which must have been opened by some unknown person or left open through forgetfulness. It appears that Evans, in the due course of his employment, was required to turn over to the insured all sums received by him for their account, and that his refusal to comply with this duty, without justification on his part, of a fortuitous cause, or by an event of exterior force putting an end to his responsibility, constituted an act of fraud and dishonesty which it was the express purpose of the guaranty bond of defendant company to cover." It was held that the explanation given of the matter by Evans and by the insurer was completely insufficient. That the facts proved did not demonstrate in any manner that a robbery had been committed to the detriment of said Evans and without his participation, and that therefore the insurer was liable.

It has been said in this connection that "where one person alone is charged with the duty in his employment of receiv-

[1] 31 Lower Canada Jurist, 254.

ing and disbursing funds and of keeping the books of account, and the books of the insured show the receipts of funds of which there is no account of disbursements, the legal presumption is that the person whose duty it was to receive the funds did, in fact, receive them, and no explanation being made, that he has dishonestly appropriated them to his own use." Such a presumption is of course rebuttable.[1] On the other hand, the supreme court of Missouri has definitely asserted the principle, "that if a party's conduct is equally consistent with innocence or guilt, the presumption is always in favor of innocence. If an act is as consistent with an honest as a dishonest purpose, the finding must be in favor of the honesty of the transaction.[2] And in Louisville Trust Company *v.* Columbia Finance and Trust Company[3] it is affirmed that wherever a duty rests upon an individual, in the absence of all evidence to the contrary, it will be presumed that a person intended to do right rather than to do wrong; to act conscientiously rather than with bad faith; to perform his duty rather than violate it."

In any event, it may be said that the courts are extremely loath to construe acts of the "risk" as dishonest or fraudulent, even when declared by the policy to be constructively so, provided they are also consonant with honesty and fairness.[4] Indeed, it has been asserted that, in order that a "risk" should be guilty of fraud or dishonesty within the meaning of those terms as used in a fidelity insurance policy, a criminal intent on his part must be shown to exist.[5]

§ 46. (C) **Perils arising through Acts of Negligence on the Part of the "Risk."** — Negligence in the law of fidelity insurance is a relative term, and the amount of care necessary to be shown in order to disprove the allegation of such negligence depends upon the peculiar circumstances of each individual

1 Guar. Co. of N. A. *v.* Mut. Bldg. & Loan Ass., 57 Ill. App. 254.

2 Glover *v.* Am. Cas. Ins. & Security Co., 32 S. W. 302; 130 Mo. 173.

3 Ky. ; 60 S. W. 1.

4 Fid. & Cas. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531.

5 Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 60 S. C. 128; 38 S. E. 790.

case. Thus the fact that the "risk" named in a fidelity insurance bond, conditioned upon his diligently and faithfully discharging his duty to the insured, left a large sum of money in open bags while he went to lunch, instead of availing himself of the means of safekeeping provided for him by the insured, constitutes negligence on the part of the "risk" for which the insurer is liable under the insurance bond.[1] A most instructive case in this connection is that of the City Trust, Safe Deposit, and Surety Company *v.* Fidelity and Casualty Company of New York,[2] where the court had occasion to construe an insurance bond guaranteeing and indemnifying against loss by reason of the personal dishonesty or *culpable negligence* of one Wickham, as collector general for the Metropolitan Street Railway. The bond specifically provided that the insurer should not be liable for any act or thing left undone by Wickham in obedience to or in pursuance of any instructions or authorization received by him from the insured, nor for any error of judgment, nor for any injudiciary exercise of discretion, nor for any loss by robbery, unless the same should be occasioned by or with the connivance or culpable negligence of said Wickham. The facts in the case were as follows: While Wickham was in the discharge of his duties, conveying money of the insured in canvas bags by wagon in New York City, he had occasion to stop at the Pacific Bank for the purpose of depositing said money there. The driver drew up to the curb, being driven by one Battey, a fellow-employee, who alighted and brought out a small truck from the bank. The street was full of people at the time. Wickham then unlocked the closed wagon, opened the money-box therein, and threw the bags near to the front of the wagon down by the dashboard. He then locked the money-box and placed the canvas bags behind him on the lid of the money-box, and handed out to Battey two bags of coin. Battey

[1] *In re* Citizens' Insurance Co. *v.* Grand Trunk Ry. Co., 16 Law Jour. Q. B. 334 (Quebec).

[2] 58 App. Div. 18; 68 N. Y. Sup. 601.

carried the bags up the stairs to the truck and came back for two more. They were given him; Wickham having meanwhile seen that the canvas bill-bag was safe. After Battey had gone with the second set of bags, a man approached the wagon and said something to Wickham that he could not understand. Wickham at this time looked back again for the bag and it was there, and he handed Battey, who had returned, the two remaining bags of coin, who then took these into the bank. Turning then again to get the bag of bills, Wickham found that it had disappeared. Wickham thereupon promptly reported the loss. On this state of facts the trial court submitted to the jury the question whether the money was lost through the culpable negligence of Wickham, and in its charge said that if he performed his duty in the premises "imprudently with a lack of watchfulness which he should have exercised, and permitted his attention to be diverted for one instant, upon any pretext, he was guilty of negligence." The court also charged that, in order to hold the insurer liable, the jury must find that the loss of the money in question was by or through the culpable negligence of Wickham, defining the term "culpable negligence" as an extensive degree of negligence stronger and greater than is meant by the ordinary term "negligent." The court further instructed the jury that if they found that Wickham performed his duties with which he was charged at the time when the loss occurred in pursuance of his judgment, and that such loss occurred solely by reason of the judicious exercise of discretion on his part wherein he was allotted with discretion, either by instruction or by rules and requirements of the insured, then the verdict must be for the insurer. On appeal the court spoke as follows: "The charge of the court, that if Wickham permitted his attention to be diverted for one instant upon any pretext, he was guilty of negligence, was erroneous. An examination of the whole charge, however, shows that the court connected these words with what preceded, 'with a lack of watchfulness which he should have exercised;' and im-

mediately after that the court stated that only for culpable negligence on his part could there be a recovery, defining correctly the term 'culpable negligence.' Any wrong impression was therefore removed. The real question was, therefore, whether it appeared that Wickham was guilty of culpable negligence which necessitated the loss of the money. It is argued that there is no specific evidence of such negligence, or any negligence; that, taking his story as true, there was nothing shown that he did or left undone, which was an act of negligence, and, moreover, that the testimony proved that everything that he did was in accordance with the custom and rules of the insured as to such work. It is not claimed that there was any defect in the manner in which the work was done, so far as the method of doing it is concerned, and the case must turn, therefore, on whether, from the version given, the inference could be drawn that Wickham was guilty of culpable negligence. It was necessary to prove that Wickham deliberately left the wagon or was directly implicated in the theft. All that the insured was required to prove was that he was culpably negligent. Culpable negligence, however, may be inferred from the circumstances under which, according to Wickham's version and the undisputed facts, the loss occurred. He says he had the canvas bag behind him, and that he occupied the seat, and that from there handed out the coin bags to Battey. At such time he says the money was taken. As the wagon bed was above the front wheels and there was no step, and the seat was but three feet and four inches, and it was eighteen inches wide and had a hinged back behind on which the bag was resting, it will be seen that any one to have taken it must have climbed upon the wheel and into the wagon which rested on the springs and reached by Wickham through the narrow space he did not occupy, over the seat and back to where the large and heavy bag had been placed. All this the thief must have done and escaped with the bag without attracting Wickham's attention, for he says he never knew of the loss until the last minute, though he saw the bag but a short inter-

val before. It is inconceivable that the bag could have been taken without the culpable negligence or dishonesty of Wickham. No direct charge is made that he was dishonest, but the only fair and reasonable inference is that he was culpably negligent. The fact of the disappearance of the bag under circumstances described raises a presumption of culpable negligence. The probability of a deliberate plan being conceived by dishonest persons to obtain large sums of money, should they be able at any time to outwit those charged with making deposits at the bank, imposed upon the employer of the insured the duty and necessity of exercising active vigilance and care. The mere recital of how that duty was performed on the day of the loss, in our opinion, raises a presumption that care and vigilance were not exercised. The question of whether, upon the evidence, Wickham was guilty of culpable negligence was properly submitted to the jury, and after an examination of the record we think that their verdict should not be disturbed."

In a late Canadian case the court had occasion to consider the scope of the insurer's liability under a policy covering losses by reason or in consequence of the wilful default or culpable neglect of the "risk" in or arising out of his employment with the insured. It was the duty of the "risk" to inspect every week the accounts of the clerks under him; he neglected to do so, and in consequence the embezzlements of a clerk, extending through a year, were undiscovered, and the insured sustained loss thereby. It was held that the loss was covered by the policy.[1]

§ 47. **Scope of Liability under Policies wherein the "Risk" holds a Position of Public Trust.** — The question of the scope of liability under policies wherein the "risk," therein named, holds a position of public trust, is determined very largely by two elements, — the first being that of time, the second that of character of the acts upon which the claim of liability is predicated.

[1] Colonial Bank *v.* European Insurance & Guarantee Society, 1 Wyatt (Can.), 15; see also Ionides *v.* Ins. Co., 32 L. J. (C. P.) 170.

In its practical form, the question is frequently presented when defalcations of a "risk" under a policy of fidelity insurance have covered not only the period named in such policy, but have antedated such period for a considerable length of time. As observed by the supreme court of Alabama, the question here presented "is one not without difficulty." In passing upon the matter in the case of Fidelity and Deposit Company *v.* Mobile County, that court used these words:[1]

"As against the county or state, there is no presumption that a tax collector has misappropriated, converted to his own use, or embezzled taxes collected by him, from the mere fact that he has failed to pay over such taxes at the time he was required by law to pay them over. To the contrary, if he carries such sums past one day of settlement, the presumption is that he still has the money and will pay it over on the next day of settlement; and if he has such money in hand at any such subsequent time when an additional bond is required of him, given and approved, his failure thereafter to account for and pay over the same as required by a law is a default occurring subsequent to the execution of such bond, for which the sureties thereon are liable, and the fact that he had only a certain sum on deposit at one or two specified banks at the time the bond was given, manifestly has no legitimate tendency to show that he had no other funds of the county at that time, or that he had embezzled the other moneys collected by him.

"It is upon these considerations that we base our conclusion that, to say the least, the additional bond is security for all moneys not actually converted to the principal's own use prior to its approval, and that the fact that moneys were collected and should have been, but were not, paid over prior thereto, and that at the date of approval he did not have such funds on deposit with the banks or persons with whom he usually deposited his collections, are irrelevant to show a conversion and default by him, and in respect of such moneys before the execution of the new and additional bond the tax books de-

[1] 124 Ala. 144; 27 Sou. 386.

livered to Lott (the 'risk') are not set out in the transcript, but enough therein appears to show that they were made out, examined, and corrected and allowed by the board of commissioners, and taken in connection with the evidence of the corrections made by the board, the noting thereof in the books, the extension of the amounts opposite the name of each taxpayer, etc., the certificate appended to the books is a substantial compliance with the statutory requirement in force at the time. It follows that the books having been thus examined, corrected, and allowed by the board, this certificate — assuming the necessity for any certificate — vested in Lott the power and authority to collect the taxes set down in the books, and rendered him liable for failing to collect the same."

Turning now to the character of the acts of the "risk" which come within the scope of liability, it was held in this same case from which quotation has been made, that, "where a tax levy of a board of revenue was erroneously entered in the minutes at a rate less than that fixed by it, and the board thereafter corrected such entry *nunc pro tunc*, and the collector collected the tax at the rate fixed, and paid over taxes to the county in excess of the rate originally entered in the minutes and embezzled the balance, the insurer issuing a policy on such collector is not discharged from liability on the ground that the *nunc pro tunc* order correcting the rate order was void, since such order could not be collaterally attacked."

Since it is not to be presumed that a tax collector misappropriated or embezzled taxes collected by him from the mere fact that he failed to pay them over on settlement day, but the presumption is that he will pay on the next settlement day, the fact that the county collector had taxes in his hands or on deposit which he had collected and failed to pay over on the particular settlement day, after which a new bond was executed, was held not to relieve the insurer from liability thereunder for his failure thereafter to account for and pay over the same as required by law.[1]

The Alabama courts have held that "where tax books

[1] Fid. & Dep. Co. *v.* Mobile Co., 124 Ala. 144; 27 Sou. 386.

were made out, examined, or corrected, and allowed by the board of commissioners, and the taxes extended opposite the name of each taxpayer, and certified, the delivery of such tax books and certificates vested the collector with authority to collect the taxes, and rendered him liable for failure to collect the same."[1]

The case of Independent School District, etc. *v.* Hubbard *et al.*[2] is a leading case on the scope of liability under policies of fidelity insurance covering "risks" occupying or holding public office. The principles of law therein established are so important and far-reaching in their effect that it is proposed to present both the facts and the opinion at some considerable length.

The facts in this case were as follows: One Hubbard was chosen treasurer of a school district in September, 1893, and each year thereafter until March 21, 1898, when a successor was chosen. At this time, according to his books and those of the school district, he should have had on hand ready to turn over to his successor $50,174.31. When this amount was demanded by his successor in office, he failed to turn it over, and an action was instituted for the recovery of that amount against the defaulting treasurer and the American Surety Company, which had issued a fidelity bond on such treasurer for a period of one year only, commencing Sept. 20, 1897, and ending Sept. 20, 1898. The issues raised by the answer of the insurer involved the settlement of Hubbard with the school board in September, 1897, and likewise went to the validity of the bond itself. The court, in its opinion, said: "According to the settlement made, the treasurer should have had in September, 1897, the sum of $48,339.08, and he is presumed to have had on hand at that time all the funds with which he was chargeable. If the settlement of Hubbard was made, and all the funds and property of the district were actually produced as required by law, such settlement in the absence of fraud or mistake is conclu-

[1] Fid. & Dep. Co. *v.* Mobile Co., 124 Ala. 144; 27 Sou. 386.

[2] 110 Ia. 58; 81 N. W. 241.

sive, and no inquiry will be tolerated concerning the source from whence any of the necessary money was derived. This duty of settling and requiring the production of funds before approving the bond, however, is due to the public, and not to the surety. Even in the absence of settlement, he is liable for any defalcation during the life of the bond. The board of directors, as such, were under no obligations to look after the interests of the American Surety Company, or to protect it from liability. But the surety cannot be held liable for funds not produced at such settlement, and which were appropriated by the treasurer during some previous term. As proof of a settlement establishes a *prima facie* case, the burden is cast on the surety to show the failure to produce funds, and their misappropriation prior to the taking effect of his bond. The statutes contemplate the actual production of money belonging to the public in making these settlements. Taxes are paid in money, which is turned over to the school treasurer. He has no authority under the law to invest or deposit it, or to pay it out, save under the direction of the board on orders duly signed for the expense of the district. Having no legal right to change its form, how can he be permitted to produce any balance in his hands, except in the kind he has received?

"It must not be overlooked, however, that these settlements and the production of funds are intended for the security of the municipalities by insuring punctuality and responsibility of public officials, and form no part of the contract with the surety. The surety may insist on the strict construction of his contract, and that no misrepresentation be practised in its procurement. But it is no part of the obligee's duty to furnish him information. This he must ascertain for himself. Even if the board knew the treasurer had been using the money of the district during a prior term, they were not bound voluntarily to warn the surety of his dishonesty. They might remain passive, and, if the bond were sufficient, approve it.

"The authorities relied on by the appellant relate to the duty of individuals or private corporations to sureties, and are not in point. The surety is not in a position to complain, because

of the failure of his principal to produce the money at settlement. The presumption of law is against defalcation, and to overcome this he must go further and show, not that the money was not produced, but that his principal did not at the time liability on the bond attached have it in his possession or control, for if the money was within the keeping of him for whom the surety vouched, there was no misappropriation. The statutes do not authorize the school treasurers to loan or deposit public funds. Nor do they (the board of directors) at their annual settlements with him, treat certificates of deposit, drafts, checks, or other evidences of debt as cash; and as the law contemplates the production of money, the good faith of officials making settlements with custodians of public funds in examining evidences of indebtedness of any kind, ought not to be considered. Their good intention could have no effect upon the treasurer's account, or what he had done with the district's money. In accepting anything other than that required by law they are derelict in the performance of their duty. If, however, they do take into account certificates of deposit and other evidences of debt which actually represent money, and the case could and would have been produced by the treasurer had the board so desired, it is not perceived wherein the surety has suffered harm. In such a case these actually represent money. Had the money been borrowed temporarily for use in settlement, it for the time being would have become the property of the district, and its return in satisfaction of private obligations, when incurred for the purpose of procuring it, would have operated as a new conversion for which the surety on the new bonds would be answerable. Whether it might be followed by the district to the hands of one receiving it with knowledge, we need not now inquire. Whatever may become of money after being produced, for the time being it is a part of the public funds, and should be treated as such. If thereafter used to satisfy private obligations made in acquiring it, this is a conversion after settlement and not before. If the money was in any way brought into the treasury, even though with the intention

to afterwards withdraw it, and it was in fact thereafter abstracted, this surety is responsible."

Again, on this same general subject the court spoke as follows: "As a general rule, the sovereign power is not charged with duties or obligations to individuals, and the exercise of its authority is not controlled by any rights which they may assert, except in the cases where the constitution has expressly fixed limits to such exercise. And where a bond runs to a municipal corporation or a public officer, the obligee is a mere representative of a sovereign power whose rights, powers, duties, and liabilities are fixed by statute, which not only charges the sureties with notice of the extent thereof, but binds them as well as the obligee. Thus the obligee takes no power by intendment, or by his own acts or omissions of any other person; consequently questions between the sureties and the obligee in an official bond are probably to be regarded as part of those which relate to the liabilities rather than the rights of sureties. With reference to the subject of bonds of municipal officers, the United States supreme court in Hast *v.* United States[1] said, the government is not responsible for the torts or the wrongful acts of its officers. Every surety upon an official bond to the government is presumed to enter into his contract with full knowledge of this principle of law, and to consent to be dealt with accordingly. The government enters into no contract with him that its officers shall perform their duties. A government may be the loser by its officers, but it never becomes bound to others for the consequences of such neglect, unless it be by express agreement to that effect."

Finally, an important question is presented in the case of policies covering the acts of public officials, when the form or subject-matter of the policy does not conform to the provisions of the statute regulating the same. This question was gone into at some length by the Maryland supreme court in State to the Use of, etc. *v.* John E. Hill and Fidelity and Deposit Company.[2] The "risk" in this case was secretary and treasurer

[1] 95 U. S. 316.

[2] 88 Md. 111; 41 Atl. 31.

of a board of county commissioners. The policy issued upon him simply provided that he should faithfully pay over and apply all moneys that should come into his hands as treasurer to such persons, and in such manner as said board shall direct. This was in the words of the Maryland statute, except that the statute provided for payment "to such persons and in such manner as said board *may, under the provisions of this article, direct.*"

The words in italics were intentionally omitted by the insurer in writing the policy, its purpose in so doing being to prevent any liability attaching to itself by reason of any mistake made by the board in ordering the payment of any moneys by the "risk." It further appeared that the insurer would not have executed any policy, the effect of which would be to guarantee the legal correctness of the orders of the board in addition to the honesty and integrity of such "risk," his faithful performance of duty, and a strict compliance with the orders of his superiors. On this state of facts the court held to a strict construction of the scope of the insurer's liability, maintaining that such liability was not to be extended by reading the policy in connection with the statute, but depended exclusively on the language of the policy itself. Under this construction, payments of the treasurer, illegally ordered by the board to be made, were held not to be within the scope of the insurer's liability under the policy.

The right to vary the terms prescribed by the statute for the bonds of a public official was before the South Carolina supreme court,[1] which, in passing upon the question, laid down the principle that where one provision of such a bond or policy is in harmony with a statute under which it is given and the other not, force and effect should be given to the one in harmony with the statute.

An instructive case relative to the liability of the insurer on a policy covering a tax collector is that of Walker County *v.* Fidelity and Deposit Company of Maryland.[2] This case came

[1] Walker *v.* Holtzclaw, S. C. ; 35 S. E. 754.

[2] 107 Fed. 851; C. C. A. .

for review before the United States circuit court of appeals for the fifth circuit, on writ of error from the United States circuit court for the district of Alabama.

The Alabama statute provided that a collector of taxes may retain his commissions when he makes payment into the state treasury. They also provided that he must, on or before January 10 and April 10 in each year, account to the auditor under oath for the amount of taxes, etc., and on such accounting shall be allowed by the auditor the amount then due for commissions, etc. It was held, both in view of the statutes and independent thereof, that a defaulting tax collector was not entitled to commissions on money which he failed to pay over, and his surety could not claim a credit therefor.

The Alabama statute further provided that a tax collector should, within five days after each monthly report, pay over taxes collected and provided for a final settlement in July, and require payment of the balance found due. It was held, in view thereof, that a collector's failure to pay over a monthly collection continued the obligation to pay thereafter, particularly as to his final returns in July; and his sureties on a bond executed in the following month were equally liable therefor as for a subsequent default; and even if the obligation did not continue, his use of money collected subsequent to the giving of the bond to make good a delinquency which occurred prior thereto was a misapplication for which the surety was liable.

"On general principles," it was said, "a defaulting tax collector ought not to be entitled to commissions on the amounts he has collected from taxpayers and failed to pay over to the proper authorities. He had not performed the full work for which the commissions were intended to pay, and he is an unfaithful trustee. The sureties on a defaulting tax collector's bond, who refuse to pay up the defalcation and compel litigation, ought not to be entitled to credit for the amount of commissions or any sum the tax collector has collected. The public ought not to be compelled to pay the commissions for

collecting the taxes, and at the same time be at the expense of litigation with the sureties on the defaulting tax collector's bond to recover the same money.

"We think," observed the court, "that sureties are liable for all moneys received after their bond was given, and that they cannot relieve themselves from this liability by showing that their principal used moneys, or a portion thereof, to satisfy past delinquencies to the state. To permit the acts of the 'risk' in that respect to have the effect of an exoneration of his sureties from responsibility would, under the circumstances, be to allow them to make a shield and defence of the fraudulent conduct of an officer whose honest and faithful discharge of the duties of his office they had guaranteed."

It was further held that the failure to pay over the moneys monthly within five days did not make the "risk" an "absolute defaulter for the same by the failure so to do, as there was a continual incumbent duty on him as tax collector to pay it over."[1]

The number of cases adjudicated by courts of last resort bearing upon the construction of such policies as we are now considering are very limited, and for this reason questions as to the extent to which the principles governing private bonds shall be held applicable to policies identical in purpose with such bonds is an open one. With considerable hesitation it has been deemed wise to suggest certain principles well recognized by the courts in construing private bonds of public officials, as being applicable to the construction of fidelity insurance policies of a similar character. These, stated briefly, are as follows:

1. In the *absence of statute* providing otherwise, or of *express provisions in the policy*, the insurer is not liable for defaults of the "risk" occurring before the execution of the policy.[2]

2. There is no legal presumption that moneys which came

[1] See also Fid. & Dep. Co. *v.* Mobile Co., 124 Ala. 144; 27 Sou. 386.

[2] See Fid & Dep. Co. *v.* Commonwealth, 20 Ky. Law Rep. 788; 47 S. W. 579; 49 S. W. 467.

into the "risk's" hands while a former policy or bond was in force were in his hands when the second policy was executed. However, if there is no evidence whatever to determine at what time the default occurred, the law will presume that it occurred during the period covered by the policy issued last in point of time.

3. When it appears that the "risk" has been elected or appointed to a public office, and has not qualified according to law, or his election or appointment is void, but he has taken possession of the office by color of right, he is to be treated as a *de facto* officer or appointee, and the insurer is liable on a policy for his official defaults.

4. The death of the "risk" terminates but does not change the obligation of the insurer under the policy.

5. The giving of a fidelity insurance policy, if voluntary, renders the obligations of such policy enforceable as common law obligations, even if such policies are not in the form required by statute.

6. The insurer is liable only for the "risk's" official acts.

7. As a broad general rule, the subsequent formal imposition of duties by legislative act upon the "risk" will not, as to losses occurring through acts of such "risk" while engaged in the performance of such subsequently imposed duties, relieve the insurer from liability by reason thereof.

8. Misrepresentation, concealment, or laches cannot be asserted by the insurer as against the state to relieve the former from liability under its policy.[1]

9. In general, the insurer is not liable for moneys lost by, stolen from, or invested in insolvent banks by the "risk," under policies covering merely acts of fraud or dishonesty on the part of such "risk."

10. Where a "risk" makes profits out of his public funds, they belong to the state, and the insurer, in the absence of language in the policy expressly excepting itself from a liability of that character, is responsible to the insured for such profits.

[1] Fid. & Dep. Co. *v.* Commonwealth, 47 S. W. 579; 20 Ky. Law Rep. 788.

PART III. — DISCHARGE OF LIABILITY.

CHAPTER VII.

DISCHARGE OF LIABILITY BY RESCISSION AND CANCELLATION OF THE POLICY.

§ 48. **General Remarks on the Discharge of the Insurer's Liability.** — With the policy duly written and delivered to the insured, the question then arises, How may the insurer's liability arising therefrom be discharged? To answer this query in briefest form, it may be said that the insurer may be relieved from liability under a policy of fidelity insurance in any one of the following enumerated ways:

I. By rescission of the policy, either by mutual consent or under provisions in the policy giving such right to the parties thereto.

II. By cancellation of the policy under decree of court.

III. By misrepresentation on the part of the insured.

IV. By concealment on the part of the insured.

V. By breach of warranty on the part of the insured.

VI. By breach of conditions on the part of the insured.

VII. By settlement of the loss, if any, which is made the basis of a liability asserted by the insured against the insurer.

VIII. By release of the insurer's liability through acts of the insured.

§ 49. (I.) **Discharge of Liability by Rescission of the Contract of Fidelity Insurance.** — Voluntary rescission of the contract of fidelity insurance may occur either through mutual consent or under stipulations in the policy inserted for that purpose.[1] Parties to the contract of insurance have undoubtedly the

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

same right to abrogate the agreement that they had to make it, and when they mutually agree to end it, it is to be treated as if it never existed.

Where provisions in the policy are inserted providing for rescission of the contract at the option of either one or both of the parties thereto, such stipulations are unquestionably valid and enforceable in all cases where no liability has been incurred under the policy at the time notice of rescission is sent.[1] Sometimes such a contingency as is here referred to is expressly provided for in the policy by the insertion of some such clause as the following:

"That if the insurer shall so elect, this policy may be cancelled at any time by giving one month's notice to the insured and refunding the premium paid, less a *pro rata* part thereof remaining liable for all or any default caused by the 'risk' up to the date of such determination, and discovered and notified to the insurer within the limit of time hereinbefore provided for."

§ 50. (II.) **Discharge of Liability by Cancellation of the Policy under Decree of the Court.** — Ordinarily, in the absence of mutual acquiescence or express reservation in the policy of the right of withdrawal, neither party to the contract of insurance can withdraw from the engagement thereby entered into.[2] However, there seems to be no good reason why, on application to the court, the insurer might not, prior to the incurrence of liability under the policy, relieve itself from liability under the policy on a number of well-recognized equitable grounds. Among these might be mentioned fraud on the part of the insured in obtaining the policy in the first instance, mistake on the part of such insurer, or the pursuit of a line of conduct on the part of a "risk" with the connivance of the insured, calculated, if continued in, to result in the insurer's becoming liable therefor to the insured under the policy.

But after a loss has occurred, and the liability of the in-

[1] See Am. Sur. Co. *v.* Thurber, 60 N. Y. Sup. 198; 162 N. Y. 244.

[2] Am. Sur. Co. *v.* Thurber, 60 N. Y. Sup. 198; 162 N. Y. 244; People *ex rel.* *v.* Feitner, 166 N. Y. 129.

surer has become fixed within the life of the policy, it is then too late to exercise the right of rescission. Such delay constitutes in law a waiver of any right to rescind which otherwise the insurer may have had, and would render the insurer guilty of such laches as would estop it from the right of cancelling the policy.

In American Credit Company *v.* Wimpfheimer[1] the insurer sought to obtain a decree of the court cancelling a credit insurance bond on the ground of fraud in that the insured concealed material facts from it when the bond was issued. The insurer tendered back the premium and demanded the surrender of the bond. The court in its opinion remarked that "fraud in the suppression of a material fact arises where only one party to the contract fraudulently and intentionally conceals from the adverse party something which he knows and which the other party does not know, and which the first party was bound to state, the suppression of which has induced the adverse party to enter into the contract. *Suppressio veri*, or concealment, will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arms-length on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation to speak, and either may remain silent and be safe."[2]

As already observed, there seems to be no reason why, on proper application to a court having jurisdiction in the premises, the insurer might not be relieved from the liability under its policy on the ground of misconduct on the part of the insured of such a nature as might reasonably be calculated to induce fraudulent and dishonest acts on the part of the "risk."

[1] 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909.

[2] See also A. B. & Tr. Co. *v.* L. W. Va. Gas Co., 95 Fed. 49.

As an example of the character of the acts here referred to, the retention of the "risk" in the insured's employ after knowledge that he had embezzled funds of the insured might be given. Such a course of conduct would certainly prevent the insured from recovering for a loss of funds intrusted to the "risk" after such knowledge had come to him.[1] In this connection it should be observed that no policy can be cancelled for unconscionable conduct on the part of the "risk," unless the insured was a party to the same.

Among the grounds for the seeking of relief either at law or equity from liability under a policy, which are to a greater or less extent open to the insurer, the following may be mentioned:

1st. Fraud in obtaining the policy.[2]

2d. Absence of valid insurable interest in the insured.[3]

3d. Change in the composition of the insured during the life of the policy.[4]

4th. Expiration or forfeiture of the insured's charter, if a corporation, during the life of the policy.

5th. The transaction of illegal business or the performance of *ultra vires* acts on the part of the insured affecting the "risk" named in the policy, during the life thereof.

6th. The insolvency of the insured during the life of the policy.

7th. The insolvency of the insurer, occurring prior to the expiration of the policy.[5]

8th. Incorporation of the insured after the policy is issued to them as individuals.

[1] See Globe Sav. & Loan Co. *v.* Emp. Liabil. Assur. Corp., 15 & 16 Can. Law Jour. 511; Monongahela Coal Co. *v.* Fid. & Dep. Co., 94 Fed. 732; 36 C. C. A. 444.

[2] Tarpey *v.* Security Trust Co., 80 Ill. App. 378; Security Trust Co. *v.* Tarpey, 182 Ill. 52; 54 N. E. Rep. 1041.

[3] McCanna & Fraser Co. *v.* Cit. Tr. & Surety Co., 76 Fed. 420; 24 C. C. A. 11; Mut. Bldg. & Homestead Ass. *v.* Fid. & Dep. Co., 23 Sou. 405; Ger. Am. Tit. & Tr. Co. *v.* Citizens' Tr. & Sur. Co., 190 Pa. 247; 42 Atl. 682; Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790.

[4] Nat. Surety Co. *v.* T. B. T. B. & C. Co., 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938.

[5] See Smith *v.* Ins. Co., 65 Minn. 283; Gray *v.* Reynolds, 37 Atl. 461.

CHAPTER VIII.

(III.) DISCHARGE OF LIABILITY BY MISREPRESENTATION.

§ 51. **Misrepresentations defined and discussed.** — The word "misrepresentation" as herein used will be given a somewhat more restricted meaning than the same term has in other branches of insurance law. As here employed, it may be defined as an oral or written statement preceding the contract of insurance, that is either made directly to the insurer by the insured, or by the "risk" to the insurer with the insured's indorsement as to its truthfulness or his belief in its truthfulness, of some fact material to the proposed assumption of liability, which is either known to be untrue and is stated with intent to mislead, or which is stated positively as true without adequate knowledge as to the same, and which has an inherent tendency to induce the insurer to assume a liability which ordinarily, had the real facts been known, it would have declined. From the foregoing definition it is apparent that the doctrine of misrepresentation is but little more than an extended application to contracts of guaranty insurance of the equitable principles relative to fraud.[1]

It may be stated generally that the doctrine of misrepresentation, so important in other branches of insurance law, has, by reason of a custom now almost universal, but a very limited scope in fidelity insurance. The custom to which reference is here made consists in inserting clauses in all policies of fidelity insurance issued, whereby all representations contained in proposals or applications are thereby transformed into express warranties.

[1] See Am. Cr. Ins. Co. *v.* Wimpfheimer, 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909.

To ascertain what in the law of guaranty insurance constitutes a representation, it is necessary to call attention first of all to certain features of this branch of insurance law not common to all lines of insurance. This is the existence of two sets of representations, one contained in the "application" of the risk, and the other found in the "proposal" of the insured. Where, in accordance with almost universal practice, the application is indorsed by the insured, who in terms declares that the answers in the application made by the "risk" for a guaranty policy are true, to the best of his knowledge and belief, the legal effect is more nearly identical with that of similar statements contained in the proposal, than when the application is unaccompanied by any indorsement thereof on the part of the insured. In the latter case the falsity of the answers in the application cannot, under any circumstances, be held to preclude recovery on the policy. The truth of this is obvious; the insured was not a party to the misrepresentations, if any are therein contained, and is not presumed to know of the existence of the representations contained in the application. Even where the policy itself refers to such application and to such representations it would be necessary, it is believed, in order to avoid liability, for the insurer to show the fact that such application and such representations had been made and were brought to the attention of the insured in some direct manner. The foregoing is clearly established by the decisions.[1]

As herein treated, the doctrine of misrepresentation in fidelity insurance will be strictly limited to statements made prior to the inception of the contract itself. Where "representations" are referred to herein, reference is had exclusively to statements preceding the contract of insurance, and consisting either of such statements when made by the "risk" in his application by and with the knowledge and approval of the insured, or by the latter directly in his proposal for insurance, *none of which are referred to in the policy as the basis of*

[1] Sup. Cl., etc. *v.* F. & C. Co. of N. Y., 63 Fed. Rep. 48; 11 C. C. A. 96; Towle *v.* Nat. Guardian Ins. Co., 7 Jur. N. S. 1109.

the same, or warranted as to their truthfulness in any manner by the terms of the contract subsequently entered into between the parties. For when they are so referred to or warranted, they thereby cease to be mere representations and become warranties, and are thereafter to be treated as such. No better statement of the legal distinction that exists between representations and warranties has been made than that given in the able opinion of Judge Sanborn in Rice *v.* Fidelity and Deposit Company of Maryland.[1] In presenting the opinion of the court in that case, which was an action brought by the insured to recover on a fidelity insurance policy, he used these words: "The terms 'representations' and 'warranties' are imported into this case from the law of insurance. Under the law upon that subject they generally and properly describe statements of existing facts, not promises or prophecies regarding future acts. In insurance a representation is a statement by the applicant to the insurer regarding a fact material to the proposed insurance, and it must not only be false, but fraudulent, to defeat the policy. A representation is a mere declaration of a fact, but it is neither a condition precedent nor a part of the contract. The crucial distinction between a representation and a warranty is that one is not and the other is a part of the contract between the parties, and that the truth of the one is not and the truth of the other is a condition precedent to a recovery on the policy or bond to which they relate."

A few general remarks on the subject of representations in fidelity insurance may be of some service at this point. One salutary rule that seems to prevail is that statements in applications tending to show the extent and scope of liability must be answered with great candor.[2]

A representation which is a part of a copy of the application made to another insurer, and which was true when made, no one being deceived by it, cannot be regarded as false in the sense of being an attempt to deceive.[3]

[1] 103 Fed. 427; 43 C. C. A. 270 (8th Circuit).

[2] See Phil. Horse Car Co. *v.* Fid. & Cas. Co., 160 Pa. St. 350; 28 Atl. Rep. 823.

[3] Tarpey *v.* Security Tr. Co., 80 Ill.

Where the application is not made a part of the contract, and the policy does not make the representations therein contained a warranty, their materiality and truth are for the jury.[1]

Occasionally attempts have been made by legislative bodies to prevent fidelity insurance companies from escaping liability on the ground of misrepresentation. The effect of such legislation was considered in London West *v.* London Guarantee, etc. Company.[2]

The Ontario Insurance Corporation Act, October, 1892, provided that no contract of insurance made or renewed after the commencement of such act should contain any proviso providing that such contract should be avoided by reason of any statement in the application therefor, as inducing the entering into of the contract by the corporation, unless such proviso should be limited to cases in which such statement is material to the contract, and that no contract within the intent of said section of said act should be avoided by reason of the inaccuracy of any such statement unless it be material to the contract. It was held, first, that a policy against loss by reason of fraud or dishonesty on the part of the employee was a contract of insurance; and, secondly, that the same could not be avoided by reason of misstatements in the application therefor, under a stipulation of the contract providing for the avoidance thereof for such misstatements, where there was no provision that the same should be limited to cases in which such misstatements were material to the contract.[3]

Under a statute declaring that no misrepresentation in an application should avoid a policy unless it was either made in bad faith or was material to the risk, an actual intent to mislead or deceive must have existed when the misrepresentation was made. If it was made in the honest belief that it was

App. 378; Security Tr. Co. *v.* Tarpey, 182 Ill. 52; 54 N. E. Rep. 1041.

[1] Penn. L. Ins. Co. *v.* Mec. Sav. Bank & Tr. Co., 72 Fed. 413.

[2] 26 Ont. Rep. 520.

[3] See also Bank of Tarboro *v.* Fid. & Dep. Co. of Md., 38 S. E. 908.

true, it was not made in bad faith, although the ignorance of the fact that it was not true was the result of the grossest carelessness.[1] Finally, attention is called to the principles so clearly stated in Ætna Insurance Company *v.* Simmons,[2] where the court touched upon the subjects of warranty and representation in general insurance law in the following language: "From the foregoing authorities we deduce the following: (*a*) A warranty in insurance law is the assertion by the assured of some fact on the literal truth of which the validity of the policy depends, without regard to the materiality of such fact or the motive which prompted the assertion. (*b*) A representation in insurance law is also the assertion by the insured of some fact, but the validity of the policy does not depend upon the truth of the assertion. (*c*) The falsity of a representation is a defence to a suit on the policy, only when made of a fact material to the risk, and with a sinister motive. (*d*) Whether an assertion made by the insured of the existence of a fact is a warranty or representation is a question of law. (*e*) Where an application is made a part of the policy, the two are to be construed together for the purpose of ascertaining whether the contracting parties intend that statements and assertions made by the insured should be regarded as warranties or representations. (*f*) If a doubt exists whether a statement made is a warranty or representation, it will be held a representation. (*g*) Warranties are not to be created or extended by construction. (*h*) In construing a contract for the purpose of determining whether the statements made therein were intended by the parties thereto to be warranties or representations, the court will take into consideration the situation of the parties, the subject-matter of the contract, the language employed, and will construe a statement to be a warranty only when it clearly appears that such was the intention of the parties; that the mind of each party consciously intended and consented that such should be the interpretation of his statements."

[1] Penn. Mut. L. Ins. Co. *v.* Mechanics' Sav. Bank & Trust Co., 73 Fed. Rep. 653.

[2] 49 Neb. 811; 69 N. W. 125.

§ 52. **The Power to make Representations.** — It was long supposed that the power to make representations as to the character of the risk and the scope of liability was among those implied ones common to all executive officers of corporate bodies. This supposition was very unexpectedly, but none the less effectually, overthrown by the decision of the United States Supreme Court in the case of the American Surety Company *v.* Pauly.[1] The subject itself is so important, and the decision to which reference is made is so wide reaching in effect, that the facts as they arose in this case will be presented at some length. One Collins, who was the president of the California National Bank, made a proposal to the American Surety Company for a policy upon one O'Brien, who was then in the bank's employ, as its cashier. At the time this application was made not only O'Brien, but Collins as well, were guilty of defalcations, and were even then acting together in a conspiracy to defraud the bank. O'Brien made his written application to the "surety company" for a policy, wherein he answered untruthfully certain material inquiries included therein. On this application, Collins, as president (and knowing the falsity of the statements contained therein), indorsed thereon the following certificate: "I have read the foregoing declaration and answers made by George N. O'Brien and believe them to be true. He has been in the employ of this bank during three years, and to the best of my knowledge has always performed his duties in a faithful and satisfactory manner. His accounts were last examined on the 28th day of March, 1891, and found correct in every respect. He is not to my knowledge, at present, in arrears or in default. I know nothing of his habits or antecedents affecting his title to general confidence or why the bond he applies for should not be granted to him." O'Brien defaulted, and a claim under the policy was made on the "surety company" by the receiver for the amount of his defalcation. This claim was repudiated by the company on the ground, among others, that their liability under the policy had been discharged by reason of Collins'

[1] 170 U. S. 133, 160.

misrepresentations as contained in the foregoing certificate. During the trial of the suit which followed, the trial court denied a motion to direct a verdict for the defendant (the "surety company") on that ground. In making the motion the question was argued by and between the counsel for the receiver and those for the "surety company," whether the representations of Collins as president were binding upon the bank (or its representative, the receiver) in the suit then pending. It was contended with great earnestness that the act of Collins in making the representations was the lawful act of the corporation, and one which he had the clear implied power to perform. It was argued further that his own knowledge at the time that the representations were false did not make it any less the act of the bank; this under the well-established rule that any principal, however innocent, is responsible for his agent's fraud in a transaction on the principal's behalf and for his benefit. That no matter how the question may be presented, the rule is the same. If the principal is sued by the defrauded party, he cannot, while retaining the very benefit received by the agent's fraud, escape responsibility for this, however innocent he himself may be. That if, on the other hand, the principal be the plaintiff, and the defence rests upon the fraud of such agent, the former cannot undertake to enforce the contract without becoming responsible for all the instrumentalities by which it was obtained.

A contention directly opposed to the foregoing was made by the counsel for the receiver in opposition to the motion to direct a verdict in favor of the "surety company." It was claimed that the bank was liable only for such acts of the president (Collins) as were within the scope of his general authority; and, further, that the act of Collins in making the representations was not within the scope of his authority, either express or implied. Even were this so, it was argued that, by reason of his criminal knowledge at the time, the bank was not bound by his representations; this last on the theory that the liability of an innocent principal for the frauds and deceits of its agent is restricted to those cases where the latter

acts within the scope of his authority. Finally, it was contended broadly that the power to make such representations is in any event wholly beyond the power of a national bank. The trial court denied the motion for a directed verdict in favor of the "surety company," and the matter came up for review before the federal court of appeals,[1] and later before the United States supreme court. This last-named court, in disposing of this point, made use of the following language:[2]

"Without stopping to consider whether each of the above cases was correctly decided, it may be observed that those relating to sureties on bonds given to corporations arose directly between the sureties and corporations represented *by their board of directors or by some of their officers acting within the authority conferred upon them;* and that those relating to the liability of a principal, by reason of the acts or representations of his agent, arose out of the agent's acts or declarations *in the course of the business intrusted to him.*

"None of the cases cited embrace the present one. In the first place, the procuring of a bond for O'Brien, in order that he might become qualified to act as cashier, was not part of the business of the bank, nor within the scope of any duty imposed upon Collins as president of the bank. It was the business of O'Brien to obtain and present an acceptable bond. And it was for the bank, by its constituted authorities, to accept or reject the bond so presented. The bank did not authorize Collins to give, nor was it aware that he gave, nor was he entitled, by virtue of his office as president, to sign any certificate as to the efficiency, fidelity, or integrity of O'Brien. No relations existed between the bank and the surety company until O'Brien presented to the former the bond in suit. What, therefore, Collins assumed in his capacity as president to certify as to O'Brien's fidelity or integrity was not in the course of the business of the bank, nor within any authority he possessed. He could not create such authority by simply assuming to have it. The circuit court of appeals, speaking by Judge Lacombe, well said that there were many

[1] 72 Fed. 470.

[2] 170 U. S. 133.

acts which the president of a bank may do without express authority of the board of directors, in some cases because the usage of the particular bank impliedly authorized them; in other cases because such acts were fairly within the ordinary routine of his business as president; but that the making of a statement as to the honesty and fidelity of an employee for the benefit of the employee, and to enable the latter to obtain a bond insuring his fidelity, was no part of the ordinary routine business of a bank president, and there was nothing to show that by any usage of this particular bank such functions were committed to its president. It must, therefore, be taken, as between the bank and the company, that the former cannot be deemed, merely by reason of Collins' relation to it, to have had constructive notice that he, as president, gave the certificate in question.

"The presumption that the agent informed his principal of that which the duty and the interest of his principal required him to communicate, does not arise where the agent acts or makes declarations not in execution of any duty which he owed to his principal, nor within any authority possessed by him, but to subserve his own personal ends or to commit some fraud against his principal. In such cases the principal is not bound by the acts and declarations of the agent, unless it be proved that at the time he had actual notice of them, or, having received notice of them, failed to disavow what was assumed to be said and done in his behalf. . . . Other citations of authorities would seem to be unnecessary to support the proposition that if Collins (the president) gave the certificate, that he might, with the aid of O'Brien, his cashier, carry out his purpose to defraud the bank for his own personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests. In our judgment, the circuit court of appeals correctly held that plaintiff's right of action on the bond was not lost because its president, Collins, made to the defendant false representations as to the cashier's honesty. And that when two officers of a corpora-

tion have entered into a scheme to purloin its money for the benefit of one of them, in pursuance of which scheme it becomes necessary to make false representations to a third person ostensibly for the bank, but in reality to consummate such scheme and for the benefit of the conspirators, and not in the ordinary line of routine business of such officers, without express authority, the corporation being ignorant of the fraud, the officers are not, in thus consummating such theft, the agents of the corporation."

There is at least one part of the foregoing opinion which is little more than dicta, and not to be regarded as a final adjudication on this branch of the case if the matter comes up again in the distinguished tribunal which pronounced the decision given in part above.

In explanation of this statement it should be said that the nullification of the effect of the representations made by Collins, the president, rested on other grounds than that of want of authority in the insured's officers to make the representation under which the insurer sought to escape liability. These were, first, the ground that there was collusion between Collins and O'Brien (the "risk"), and, secondly, that the representations complained of were not part of the policy and did not amount to warranties. This being so, the statement by the court, in its opinion, that it was no part of Collins' duty, nor within his authority as president, to sign any certificate as to the efficiency, fidelity, or integrity of O'Brien, was unnecessary to a determination of the case. In fact, the record in the Pauly case showed that the policy itself did not refer to the statements of Collins complained of, nor did it appear that the bank itself provided the policy, nor was it affirmatively shown that the bank was aware of the representations made by its president.

Nevertheless this same subject was considered again in the more recent case of Fidelity and Deposit Company *v.* Courtney,[1] and in entire accord with the decision of the United States su-

[1] Decided by federal court of appeals for the sixth circuit, 103 Fed. 599; 43 C. C. A. 331.

preme court, just cited. Here it was claimed that the trial court erred in excluding a certain letter, signed by the cashier of an insured bank, concerning the duties of the "risk" named in the policy thereafter issued in reliance upon the facts therein stated. This letter was written in response to one addressed to the insured by the insurer just prior to the expiration of a pending policy, and read as follows:

"The Fidelity and Deposit Company of Maryland: This is to certify that on the day of 189 , the books and accounts of J. M. M. in our employ were examined by us and we found them correct in every respect, and all moneys handled by him accounted for. He has performed his duties in an acceptable and satisfactory manner, and we know of no reason why the guarantee bond should not be continued. Signed," etc.

The court in its opinion spoke in reference to the exclusion of the testimony as follows:

"This certificate signed by the cashier was excluded because there was no showing that there had been special authority from the board of directors authorizing or directing the cashier to fill out and send it. It is earnestly argued that the cashier, by virtue of his office and having charge of the correspondence of the bank, had full authority to answer this communication in the way which he did; and, being in the apparent scope of his authority, the bank is bound by it. A majority of the court are of opinion that the case is ruled by Surety Company *v.* Pauly, *ante*, in which the president wrote a similar letter for the cashier, and it was held that the president of the bank, in the absence of express authority, could not bind the bank. There is no showing that the bank authorized the cashier to fill out the certificate and return it. It is not a case of answering a usual letter of the bank in the course of its business. A certificate as to the prior conduct of McKnight was enclosed, and an answer required. Nothing is shown in this case showing express authority, and we do not think such inheres in the duties of the office of cashier without special authority."

In Independent School District *v.* Hubbard and the American Surety Company,[1] the Iowa supreme court had occasion to consider the effect of misrepresentation on the part of the president of a school board to a "surety company," to the effect that the treasurer of the board had last settled in February, 1897, and at that time the funds were counted and found correct. This representation, made prior to the furnishing of the treasurer's bond by the "surety company," was untrue. The court, commenting on this fact, said: "The appellant claims to have relied on the misstatement, and because of its falsity seeks to rescind the contract. The representation was no part of the duty of the president of the board, nor was it ever authorized or ratified by that body. As what he said had no connection with the duties of his office, it must be regarded as his individual act, and not binding on the district."[2]

In this connection we wish to call attention to a principle already briefly referred to,[3] which was clearly enunciated by the United States supreme court in the case of American Surety Company *v.* Pauly.[4] In this case it was claimed that a policy of fidelity insurance was avoided by reason of fraudulent misrepresentations, amounting under the terms of the policy to a breach of warranty on the part of one Collins, acting as president of the insured. It further appeared that Collins, at the time he made such representations, was himself a defaulter, and acting in collusion with the one whose own previous conduct he was charged with misrepresenting. In passing upon the question the United States supreme court approved the charge of the trial court to the jury in the case, which was to the following effect:

"It is said that this bond of indemnity was obtained upon an application which was certified to by the bank [the insured] itself, and that in the application facts were concealed with fraudulent intent on the part of the bank, therefore, that the bond is void. The application was accompanied by a certifi-

[1] 110 Ia. 58; 81 N. W. 241.

[2] See also Supreme Council Catholic Knights of America *v.* Fid. & Cas. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96.

[3] *Ante*, p. 129.

[4] 170 U. S. 133.

cate of Collins, the president of the bank. The only knowledge of any facts which ought to have been communicated, or were misrepresented, the only knowledge which the bank possessed at the time that application was made, was the knowledge of Collins himself. Ordinarily a corporation, like any other principal, is chargeable with the knowledge of any facts which are known to its agents; but in this case all these transactions, if there were any transactions of a fraudulent and dishonest character on the part of the cashier, were transactions for the benefit of Collins, and he was a participator in the fraud, and under the circumstances the law does not infer that the agent or the officer will communicate the fact to his principal, the corporation, and under such circumstances the corporation is not bound by his knowledge. So this defence melts away and there is nothing in it whatever."

After approving the foregoing charge the supreme court said: "The presumption that the agent informed his principal of that which his duty and the interests of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends or to commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent, unless it be proved that he had at the time actual notice of them, and, having received notice of them, failed to disavow what was assumed to be said and done in his behalf. . . . If Collins gave the certificate [as to O'Brien's past good conduct] that he might, with the aid of O'Brien as cashier, carry out his purpose to defraud the bank for his personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests. In our judgment the circuit court of appeals[1] correctly held that plaintiff's right of action on the bond was not lost because its president, Collins, made to the defendant false representations as to the cashier's hon-

[1] 72 Fed. 484.

esty; and that when two officers of a corporation have entered into a scheme to purloin its money for the benefit of one of them, in pursuance of which scheme it became necessary to make false representations to a third party, ostensibly for the bank, but in reality to consummate said scheme, and for the benefit of the conspirators and not in the line of ordinary routine business of such officers and without express authority, the corporation being ignorant of the fraud, the officers are not, in thus consummating such theft, the agents of the corporation."

§ 53. **Representations classified.** — Representations may be classified as either affirmative or promissory.

An affirmative representation has reference to those preliminary facts a knowledge of which is sought in order to enable the insurer to determine whether he will accept the application for a policy in any event, and if at all, at what premium. Again, affirmative representations refer exclusively to events either past or present, and if false at all, become so as soon as made.

Promissory representations, on the other hand, relate exclusively to the future, and in general point out a line of conduct which the prospective insured intends to pursue with reference to the business wherein the proposed " risk " is to be engaged. In some jurisdictions they are said to be the equivalent of a declaration of intention on the part of the insured of the line of conduct he expects to pursue in reference to the business wherein the " risk " whose honesty is to be insured is to be employed.[1]

§ 54. **Affirmative Representations.**— In view of the fact that it is now the almost universal custom to make all representations warranties, by inserting a provision to that effect in the policy, but few cases have arisen where representations as such have been considered and construed. However, the general rules of law in this connection are set out with some fulness by the United States circuit court of appeals in the case of the M. K. & T. Trust Company *et al. v.* German National Bank.[2]

[1] Benham *v.* United Guar. & L. Ins. Co., L. R. 7 Ex. 744.

[2] 77 Fed. 117; 23 C. C. A. 65.

Here a policy of fidelity insurance was issued by a "surety company" to the German National Bank, wherein certain of the latter's employees were named as "risks." The policy was given to insure the bank for a period of twelve months against any loss that it might sustain in consequence of the fraud or dishonesty of said "risks" in the discharge of duty. Among these latter was one Goldman, its paying teller, who converted $14,000 of the bank's money to his own use. An action was brought to compel the insurer to make the loss good according to the provisions of the policy. The insurer relied for its defence to the suit upon a plea that it had been induced to assume liability, so far as Goldman was concerned, upon material false representations made by said Goldman and by the cashier of the insured bank. It alleged in substance that before assuming the liability in question Goldman made an application to the "surety company" to induce the issuance of a policy. That attached to said application (the same being on a printed form furnished by the insurer) was an "employer's declaration," which was signed by Charles M. Clinton, cashier of the insured bank. Clinton therein declared that he had read the declaration and answers made by said Goldman contained in said application, and that to the best of his knowledge the answers made were true; that Goldman was not, to his knowledge, in arrears or in default. It further appeared that in said application Goldman was asked the following questions, and answered them as follows:

"*Q.* Are you engaged in purely speculative transactions, such as stocks, grain, oil, or real estate?

"*A.* Have bought and sold real estate.

"*Q.* Do you owe your employer anything on account whatever? If so, state how much, on what account, and when due.

"*A.* Note, $4,000, due Dec. 2, 1890.

"*Q.* Give particulars and amount of any debt you owe or liability you are under.

"*A.* Yes; $2,000, on real estate."

It was claimed by the insurer that Goldman's answer touch-

ing the amount of his indebtedness to the insured bank was false and fraudulent in that he owed said bank $7,700 in place of $4,000, as stated; and, further, that the declaration made by Charles M. Clinton, as cashier, to the effect that Goldman was not in arrears or in default to the bank, was false and misleading in this, that at the time such statement was made he well knew that said Goldman was in arrears, and owed the bank a large sum in excess of $4,000.

The insured, in reply to this defence, averred, in substance, that after the insurer became aware that Goldman was indebted to the bank in the sum of $7,700, and to other persons in the sum of $5,000, and that the aforesaid statements contained in Goldman's application and in the "employer's declaration" were untrue, it had caused certain deeds of real estate to be executed by Goldman's relatives, to secure it against loss by reason of having executed the aforesaid bond; that it had also brought an attachment suit against Goldman to recover the loss which it had sustained on said bond, and in such suit had recovered a judgment against Goldman in the sum of $10,000; that by such acts it had recognized its obligation on the bond, and had thereby waived whatever defence it might otherwise have urged against a suit to enforce the liability incurred and assumed. The trial resulted in a verdict and judgment against the "surety company" in the sum of $10,000.

One of the questions considered on the appeal was whether the trial court erred in permitting the jury to determine whether Goldman's answer touching the amount of his indebtedness to the bank was substantially true. With reference to that subject the charge of the court below had been as follows:

"We assume, for the purpose of inquiry, that the answer was false, to the knowledge of the bank, that is, to the knowledge of the corporation; and the question upon that is whether this answer is one which was likely to, and did, mislead the insurance company to its prejudice, — that is to say, whether, this answer being false to the extent of about $3,700 or $3,800, the insurance company was induced to enter into

this contract when it would not have done so if the answer had been truthful in respect to these matters. That is regarded as a question of fact which you must decide upon the testimony, — what, in your observation and your judgment as business men, would be the case if the answer had been truthfully made that the man Goldman was indebted to the bank in the sum of between $3,700 and $3,800 more than the amount of $4,000, which was specified in the answer of Goldman? If, upon that, you say that the company would not have made this contract as to Goldman if they had known of this circumstance, then the company may avoid the contract upon that ground, subject to what I shall say to you presently upon the subject of waiver."

Commenting on the above the court of appeals observed: "It is obvious, we think, that the statement made by Goldman concerning the amount of his indebtedness to the bank was not a warranty. In suits founded upon insurance policies which are in all respects analogous to the case at bar, it is held universally that statements made by the insured, to constitute warranties, must enter into and form a part of the contract itself; and where they are contained in the application, they are always construed as representations, unless, by the express provisions of the policy, the application is made a part thereof, and the intent is manifest to give them the effect of warranties. Besides, as warranties must be literally fulfilled, the courts have always manifested a strong indisposition to regard any statement made by the insured as a warranty, unless such was the obvious purpose of the parties to the contract.

"In the present case it appears that the statement made by Goldman touching the amount of his indebtedness to his employer is found in the application only. No reference whatever was made to the application in the bond. It does not recite that it was issued in pursuance of a written application made therefor, or on the faith of the representations or statements therein contained. It is obvious, therefore, that within the rule above stated the statement in question must be

treated as a representation rather than a warranty. Counsel for the trust company insist, however, that even if the statement be regarded as a representation, it nevertheless related to a subject concerning which the trust company, in its printed form of application, had seen fit to make special inquiry, and that it was therefore material representation, and that the court erred in permitting the jury to determine whether it was material or otherwise. This contention, we think, rests upon a misconception of the meaning of that paragraph of the charge which is above quoted. The trial court did not allow the jury to determine whether the representation related to a material matter. It held, as a matter of law, that the representation was material, but directed the jury to ascertain whether it was so far false and misleading as to render it substantially untrue. The trial court instructed the jury, in substance, that the representation would serve to avoid the bond, if they were satisfied that the trust company would not have assumed the risk, so far as Goldman was concerned, had it known the true amount of his indebtedness to the bank. This direction, we think, was right. If a representation relating to a material matter is substantially true, that is to say, if it is so far true that the conduct of the insurer would not have been different if it had known the exact truth, it will not vitiate the policy; and whether it was substantially true or substantially false is a question for the jury. It does not appear to be claimed that the statement contained in the 'employer's' declaration which was signed by the cashier was wilfully false and misleading. The cashier, it seems, signed the declaration in haste, without looking at the books to ascertain the amount of Goldman's indebtedness, believing at the time that Goldman had truthfully answered all the questions propounded to him, and without any intent to deceive or mislead the trust company as to the extent of such indebtedness. Under these circumstances we think that the portion of the charge above quoted stated the law with substantial accuracy, and that the trust company has no just ground for complaint."

A somewhat stricter rule seems to have been laid down by the Virginia supreme court in a recent case. Here the insurer, a fidelity insurance company, by plea alleged that it had been induced to execute a policy on one Hamner as teller of the insured bank by the positive representations in writing made to it for and in behalf of the bank by its cashier to the effect that Hamner never had been in arrears or default to the bank, that his books and securities, including cash securities and vouchers, were last examined in December, 1893, by a committee of the board of directors of the bank and found to be correct, and that but for these representations it would not have executed the policy. It then averred that these representations were false; that Hamner, as teller, was at the time of these representations, and had been long prior thereto, a defaulter, and largely in arrears to the bank, and that the examination of his books and accounts, including cash, securities, and vouchers, which were represented to have been made in December, 1893, was not so made, and that if it had been made, his defalcation would have been discovered. Passing upon the merits of the foregoing plea, the court held that these alleged representations were of existing facts, were material, and presumably within the peculiar knowledge of the bank and its officers, and constituted an inducement to the guaranty company on which it had the right to rely in executing the bond. It was therefore immaterial whether the insured knew that they were false, or honestly believed them to be true. Thus if a party innocently misrepresents a fact by mistake, the effect is the same on the party who is misled by it as if he who innocently made the misrepresentation knew it to be positively false. The real question in such a case is not what the party making the misrepresentation knew or believed, but was the representation false and the other party misled by it?[1]

It has been held that a representation that the "risk" had never been in default was not restricted to the latter's em-

[1] Guar. Co. of N. A. *v.* First Nat. Bank of Lynchburg (Va.), 95 Va. 480; 28 S. E. 909.

ployment by the insured, but applied to third parties as well.[1] Again, in Supreme Council, etc. *v.* Fidelity and Casualty Company of New York[2] it was said that loose parol statements by the insured prior to the issuance of the policy, even if amounting to misrepresentation, did not affect the contract subsequently entered into. The doctrine of the English courts is well represented by the case of Byrne *v.* Muzio.[3] Here the court held that where it is desired to offer evidence showing that the guaranty of the fidelity of a rate collector was entered into by the guarantor in reliance on the statement and representation made by the party guaranteed and the person employed, to the effect that the latter had no balance outstanding at the time the guaranty was given, nor irregularity in his account, it is not sufficient to allege that such representations were untrue. The pleading must go farther, and either allege that the statement was fraudulent, or allege circumstances from which fraud can be inferred as a matter of law. If the word "fraudulently" be omitted, there must be an allegation of fact which necessarily and *per se* amounts to fraud.

§ 55. **Promissory Representations — Declaration of Intention.** — A representation, instead of being a statement of fact, not infrequently embodies merely the expectation, intention, and belief of the insured that certain future events relative to the prospective risk shall or shall not take place. In such a case, even though the representations be material to the risk, if the statements do not embody a warranty, and clearly are intended to represent merely an expectation or belief that certain facts will exist or will happen in a certain way, the insurer is not bound to rely upon such belief or expectation of the insured, but is obligated to make further inquiry before relying thereon. "But," says Mr. Joyce, in his work on Insurance (par. 190), "there is a clear distinction between a case of this character and one where the insured intentionally and fraudulently states that as a matter of expectation or belief, which he then knows to be actually untrue, or which the facts within

[1] Ottawa Ag. Ins. Co. *v.* Can. Guar. Co., 30 U. C. C. P. 360.

[2] 63 Fed. 48; 11 C. C. A. 96.

[3] L. R. 8 Ir. C. L. 396.

his knowledge show to him that it is impossible that the matter stated by him as one of belief or expectation could exist or happen. Here the intent to deceive the insurer is apparent, and there is actual fraud, and the fraud vitiates the contract where the insurer is misled or deceived in acting to his injury when he otherwise would not have so acted; and the rule applies where the statement appears from all the surrounding circumstances to have been one merely of expectation or belief, even though the exact terms thereof would seem to carry the force of a positive statement or a material fact, for no matter what the actual form of expression, yet if it is apparent that the underwriters were not misled, but understood it to impart nothing but a probable expectation or belief, the courts will give the words used the construction intended."

The rule, under the circumstances above referred to, seems to be that these so-called promissory representations are to be treated as mere declarations of an unexecuted intention, and that a failure to comply with such a declaration is not fatal to a recovery upon a contract induced by it.[1]

This subject was discussed at some length in Benham *v.* The United Guaranty and Life Assurance Company.[2] Here the defendants granted to the plaintiff, the treasurer of a literary institution, a policy of guaranty against loss occasioned by the want of integrity of W., the secretary of the institution. The policy recited that, as the basis of the contract for such guaranty, the plaintiff had lodged at the office of the defendants a certain statement in writing, containing a declaration, signed by the plaintiff, of the truth of the answers thereby given to the questions therein contained. This statement contained, amongst others, the following questions and answers:

"1st. Is the applicant at present in your employment, and,

[1] Rice *v.* Fidelity & Deposit Co., 103 Fed. 427; 43 C. C. A. 270; Towle *v.* Nat. Guar. L. Ins. Co., 7 Jur. N. S. 1109; Benham *v.* U. Guar. & L. Ins. Co., L. R. 7 Ex. 744; Regina *v.* Nat. Ins. Co., 13 Vic. L. R. 914; Atty.-Gen. *v.* Ad. L. Assur. Guar. Co., 22 S. A. L. R. 5.

[2] L. R. 7 Ex. 744.

if so, in what capacity; and has he hitherto performed the duties of his situation faithfully and to your satisfaction? — He is secretary of the Marylebone Literary Institution.

"2d. Is the applicant personally known to you or any of your firm; or by whom has he been introduced or recommended to you? — Only as above.

"3d. In what capacity do you intend to employ the applicant? And, with reference to this question, state, as far as circumstances will permit, (A) the nature of his intended duties and responsibilities. (A) He is secretary of the Marylebone Literary Institution, of which I am treasurer. — (C) The checks, which will be used to secure accuracy in his accounts, and when and how often they will be balanced and closed. (C) Examined by finance committee every fortnight. — (D) The salary, or emolument, and when it will be paid to him, and how and when it will be paid. (D) Eighty pounds a year at present."

It was held, that the statement that the accounts would be examined by the finance committee every fortnight did not amount to a warranty, but was a mere representation of the intention of the plaintiff; and, consequently, that he was entitled to recover in respect to a loss arising from the want of integrity of W., although such loss was occasioned by the neglect to examine the accounts in the manner specified.

Finally, in this same connection attention is called to the case of Towle *v.* National Guardian Assurance Society.[1] Here, according to the terms of a proposal by a tax collector — A. — for a guaranty policy, answers were required by the guaranty society not only from the applicant, but also from his intended employers. Those employers were the commissioners of taxes, who, in reply to inquiries from the society, accepted the answer of the overseer of taxes, who, in reply to inquiries from the society, stated that the collector's accounts would be checked weekly, and that he would not be allowed at any time to hold in his hands more than from £100 to £200. A. absconded while in default to the amount of £654;

[1] 7 Jur. N. S. 1109.

and it appeared in evidence that although it had been the practice prior to A.'s appointment to check weekly the accounts of the collector who had preceded him, such practice was not continued after his appointment. Upon a bill by A.'s sureties for the purpose of obtaining payment of the money assured by the policy, it was contended that the statement of the overseer of taxes did not amount to a warranty, inasmuch as it was a representation by a third person, who was not a party to the contract, as to the course intended to be pursued by another person; secondly, that the representation in question being not to a past or existing state of things, but to the future acts of other persons, had no application to the case of a guaranty policy, and as the representation was made fairly and honestly, and was substantially correct, it did not vitiate the policy. But it further appeared that the terms on which the guaranty policy was effected made it compulsory on A. to effect a life policy with the above society, and he accordingly did so. On the life policy a memorandum was indorsed stating its connection with the guaranty policy. The society transferred their business to a life assurance company, which received the premiums on the life policy, and A. also paid the premiums on the guaranty policy to an agent of the latter company. It was held, upon appeal to the Lords Justices, that the policy was void from the beginning, as being founded on misrepresentations amounting in law to a warranty, and on this and on other grounds the bill was dismissed.[1]

[1] See also Regina *v.* Nat. Ins. Co., 13 Vic. L. R. 914; Attorney General *v.* Adelaide L. Assur. Guar. Co., 22 South Aus. L. R. 5.

CHAPTER IX.

(IV.) DISCHARGE OF LIABILITY BY CONCEALMENT.

§ 56. **Concealment defined and discussed.** — Concealment, as that term is here used, has reference solely to a failure on the part of the insured, either while negotiations are pending for the issuance of a policy or during the life thereof, to disclose facts known to him material to the contract about to be entered into, and reasonably calculated to influence the insurer's judgment as to whether the liability shall be assumed or continued, and if so at what premium. It is the suppression of the truth by a withholding of facts concerning which no questions are asked by the insurer of the insured. It is the *suppressio veri,* so often referred to in the books and reports, appearing in a new form in the domain of insurance law.

The doctrine of concealment, in its relation to fidelity insurance, must of necessity be viewed from two distinct standpoints. First, in respect to the effect of concealment when there is no contract obligation requiring the insured to communicate all material facts to the insured either before or after the assumption of liability under the policy. Secondly, the subject must be discussed with reference to those provisions of the policy which customarily provide that any wilful suppression of any fact affecting the liability of the insurer, either prospective or present, shall render the policy void from the beginning. Looked at from the first standpoint above referred to, concealment is but little else than an extended application in the law of fidelity insurance of the equitable doctrine relative to fraud. In its second aspect, as stated above, it is to be treated rather as a condition precedent to the maintenance of continued liability under a policy, that

the insured shall not have been guilty of any wilful or intentional fraud with respect to concealment of facts affecting the liability of the insurer.

The remarks of the court in American Credit Indemnity Company *v.* Wimpfheimer,[1] while uttered in connection with a consideration of a policy of credit insurance, are equally applicable here. In that case it was said that "*suppressio veri*, or concealment, will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arm's length, on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation to speak ; either may remain silent and be safe. Contracts of life and marine insurance stand on somewhat different grounds from other contracts. Although one may have the right to be silent under ordinary circumstances, there are many cases in which the very proposition of a party imply that certain things, if not told, do not exist. This is peculiarly the case in contracts of insurance, where the insured is bound to state all facts within his knowledge which would have influence upon the terms of the contract, and are not known, or may be supposed by him not to be known, to the insurer. In these cases, and in others which come within this principle, the *suppressio veri* has the same effect in law as the *expressio falsi*. But this rule is peculiar to such policies. I find no authority for extending it to all other contracts, and there is authority to the contrary: the rule which prevails in assurance upon ships and lives, that all material circumstances known to the assured must be disclosed, though there be no fraud in the concealment, does not extend to the case of guaranties. In the latter case, the concealment, to vitiate the guaranty, must be fraudulent. We think it is going too far to say that the insured is in all cases, and without being in-

[1] 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909.

quired of, bound to communicate everything that it is important for the insurer to know and that would increase his risk. Under such a rule no one would ever know where he could rely on a bond, and it would lead to a good deal of litigation."

In the words of the United States circuit court of appeals for the sixth circuit, "marine fire and life insurance against the destructive forces of nature is not quite the same thing as insurance against the dangers of dishonesty. The courts must interpret the contracts in view of the difference, applying the words used to the purpose of covering the peculiarities of the risk assumed on the one hand, and on the other intended to be discarded or shifted to others. And if these new contracts, whatever their form, are to be turned into contracts of insurance, the court will be careful not to again perplex themselves with regrettable technicalities of law, such as have sometimes crept into the older contracts of insurance and have required statutes for their removal. In marine, fire, and life insurance it is not an unreasonable assumption that the owner knows more intimately than others can know the conditions which are material to the risk assumed, and it is therefore not unreasonable to require him to disclose these conditions to the insurer, and to hold him strictly to that duty. But in an insurance of this character the insurer and the insured deal at arm's-length with each other, and upon a plane of equal opportunity for information. Indeed, the risk does not depend so much upon conditions of fact as upon a mere judgment about human character in the subject of insurance, the individuality of moral qualities. About this the insurer can inform himself, and the insured is not presumed to know anything as in the case of the owner of a property or a life which has been insured."[1]

Attention has already been called to the fact that the subject-matter of concealment in fidelity insurance permits of a twofold division, for purposes of discussion; one having reference to concealment on the part of the insured both before

[1] Guar. Co. of N. A. *v.* Mec. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; see also Bank of Tarboro *v.* Fid. & Dep. Co., 38 S. E. 908.

and after the policy is entered into when under no contractual obligation to make any disclosures, and the other relating to the duty of the insured when he has bound himself by apt words inserted in the policy to make disclosures to the insurer of the nature described therein. The first of these will now be considered under the head of "the spontaneous disclosure doctrine," while the second belongs properly to the subject-matter of "conditions," and will be reserved for subsequent treatment under that head.[1]

§ 57. **The "Spontaneous Disclosure Doctrine."** — Long before fidelity insurance itself was known, there had been enunciated by the courts a rule of conduct particularly applicable to obligees in private surety bonds. This was then, and still is, known as the "doctrine of spontaneous disclosure." The doctrine, being freely interpreted, may be stated thus: That an obligee in a bond must at his peril tell the obligor (the surety) everything he knows with reference to the proposed liability whether the same is in his judgment material or not. This, too, whether the non-disclosure was fraudulent or not. The foregoing doctrine seems to have had its origin in a dictum of Lord Truro's in Owen *v.* Homan,[2] and has been followed in a respectable number of cases.

However, notwithstanding this fact, it cannot be said at this time that the doctrine of spontaneous disclosure, even in contracts of private suretyship, has been given the broad scope outlined by Lord Truro. The modern rule seems to be, even in the case of private sureties, that the obligee is under no obligation other than that of the exercise of perfect good faith towards his obligor.

The cardinal rule of duty which the obligee in a private indemnity bond owes to the obligor therein is entire good faith. If he discovers acts of dishonesty on the part of the "risk," and retains him in his service without notice to the surety, he is guilty of such fraud and bad faith towards the latter as will discharge the former from liability. Mere negligence on the part of the obligee in failing to discover the defaults of the

[1] See *post,* § 86. [2] 3 Mac. & G. 378.

employed will not release the surety. It does not in any case apply to mere breaches of duty or of contract obligations on the part of the employed, not involving dishonesty on his part or fraudulent concealment on the part of the insured. The concealment of fraud or dishonesty on the part of the employed which will avoid a bond has reference not only to the latter's employment by the obligee therein, but it applies as well to all prior employments.

All the cases proceed on the theory that the ordinary surety is not compensated, and usually has no voice in the contract, and makes no limitations upon the extent of his liability. He signs a bond and leaves it to law to determine the extent of his obligations, and to limit or qualify them accordingly. On the other hand, a fidelity insurance company as a compensated surety prepares the contract; in its every detail determines for itself what it desires or cares to know; puts searching questions to this end; makes provisos and conditions as to its ultimate liability. It leaves nothing to the law except such fraud as may be practised upon it. Therefore it may, perhaps, be argued that the law will presume that it has indicated the immateriality of all matters not communicated, by not asking any questions in regard to them of the insured. Reference is had here, of course, to concealment occurring prior to the issuing of the bond. As to concealment occurring thereafter, and not amounting to fraud or bad faith on the part of the insured, it might here again be argued that if the insurer desired such facts to be communicated, it should have made provision for the same in the policy. The question then presents itself, To what extent, if at all, is the foregoing argument sound? The "doctrine of spontaneous disclosure" had its inception largely in a recognition of the principle that sureties are favorites of the law. The courts have very generally expressly refused to extend this principle to contracts of fidelity insurance. Assuming for the purpose of the argument that this ruling is sound, it might be argued with no little force that the doctrine of spontaneous disclosure, being in effect an extended application of a principle not recognized in

the law of fidelity insurance, has no proper place therein. Few of the courts, so far as investigation shows, have either fully adopted or repudiated the ancient doctrine of spontaneous disclosure in construing fidelity insurance contracts.

The earlier English doctrine on this subject (since repudiated) is clearly set forth by the case of Seaton *v.* Heath.[1] This was an action wherein a guaranty insurance company had for a consideration given a guaranty running to the payee of a promissory note to the effect that the guarantor of such note should be solvent in respect to, and to the extent of, £15,000 sterling. The policy provided that no claim should attach thereto until the said guarantor should have a receiving order in bankruptcy made against him, or should call a meeting of his creditors, or, in the event of the decease of said guarantor before the payment of said promissory note, his estate be insolvent.

The defence set up was that the doctrine was a policy of insurance, and that there had been misrepresentations of fact, and a concealment of material facts by the plaintiff (the payee of the note), by which the defendant had been induced to execute the policy. In passing upon the foregoing issues the court spoke as follows: "There are some contracts in which our courts of law and equity require what is called *uberrima fides* to be shown by the person obtaining them. Of these, ordinary contracts of marine, fire, and life insurance are examples, and in each of them the person desiring to be insured must, in setting forth the risk to be insured against, not conceal any material facts affecting the risk known to him. On the other hand, ordinary contracts of guaranty are not amongst those requiring *uberrima fides* on the part of the creditor towards the surety, and mere non-communication to the surety by the creditor of facts known to him affecting the risk to be undertaken by the surety will not violate the contract, unless there be fraud and misrepresentation; and misrepresentation, undoubtedly, might be made by concealment. But the difference between these two classes of contract does not depend

[1] 1 L. R. Appeal Cases for 1899, 782.

upon any essential difference between the word 'insurance' and the word 'guaranty.' There is no magic in the use of these words. The words, to a great extent, have the same meaning and effect; and many contracts like the one before us may, with equal propriety, be called contracts of insurance or contracts of guaranty.

"Whether the contract be one requiring *uberrima fides* or not must depend upon its substantial character and how it came to be effected. There is no hard and fast line to be drawn between contracts of insurance and contracts of guaranty for the purpose for which I am now considering them, and certainly the rule as to the contracts of insurance is not limited or confined to the three forms of marine, fire, and life insurance. Now, when contracts of insurance are considered, it will be seen that, speaking generally, they have in common several features in their characters and the way they are effected which distinguish them from ordinary contracts of guaranty. Contracts of insurance are generally written speculations where the person desiring to be insured has means of knowledge of the risk, and the insurer has not the means or the same means. The insured generally puts the risk before the insurer as a business transaction, and the insurer of the risk stated fixes a proper price to remunerate him for the risk to be undertaken, and the insurer engages to pay the loss incurred by the insured in the event of certain specified contingencies occurring. On the other hand, in general, contracts of guaranty are between persons who occupy or ultimately assume the positions of creditors, debtors, and surety, and thereby the surety becomes bound to pay the debt or make good the default to the debtor. In general, the creditor does not himself go to the surety, or represent or explain to the surety the risk to be run. The surety often takes the position for motives of friendship to the debtor, and generally not on the result of any direct bargaining between him and the creditor, or in consideration of any remuneration passing to him from the creditor. The

risk undertaken is generally known to the surety, and the circumstances generally point to the steps that, as between the creditors and the surety, it was contemplated and intended that the surety should take to ascertain exactly what risk he was taking on himself. In all the reported cases of guaranty that I have been able to find in which it has been held that the party guaranteed owed no duty to the guarantor as to disclosure of material facts, the contracts when examined are found to have in substance, though of course not in every detail, the characteristics which distinguish contracts of guaranty from contracts of insurance, as above stated. Applying the above consideration to the contract in the case before us, it appears to me that the contract is one which required *uberrima fides* on the part of the insured." [1]

The modern doctrine of concealment, in so far as it is applicable to fidelity insurance, is fully and clearly set forth in National Bank of Asheville *v.* Fidelity and Casualty Company of New York,[2] decided by the federal court of appeals for the fourth circuit. The facts in this case were as follows: One Pulliam was bonded as cashier under a policy which covered acts of fraud or dishonesty on his part committed during the continuance of the term from Oct. 1, 1889, to Oct. 1, 1890, or any renewal thereof. There was no new policy issued, but it was continued in force by the payment of the annual premium. This premium for the year commencing Oct. 1, 1893, was not paid until Jan. 2, 1894, before which time Pulliam, to the knowledge of the bank's officials, had been guilty of dishonesty. This fact was not communicated to the insurer, and the failure to do so was set up in defence of an action on the policy thereafter brought by the insured. In passing upon this contention the court spoke as follows: "This was not a case such as frequently may arise where, through carelessness, the officers of a bank have failed to discover the facts which would exhibit dishonesty of an employee,

[1] The foregoing case was reversed in the House of Lords, in Seaton *v.* Bernand, 1900, L. R. Appeal Cases, p. 135.

[2] 89 Fed. 819; 32 C. C. A. 355.

but the effort of the defendant was to show that the president, when about to obtain a renewal, knew facts which pointed directly to the default; and if he could truthfully say he did not know of the default, it was because he did not draw from these facts the conclusion which a reasonable man would, and did not attempt, as a reasonable man would, to verify the import of these facts by looking at the entries in the bank accounts; in fact, that he wilfully refrained from any investigation or reasoning, in order that he might avoid knowledge. . . .

"It is true that under this class of bonds the surety is not discharged because the employer might, by the exercise of diligence, have known the state of his accounts, or might with more care have sooner discovered the dishonesty and prevented the loss. But that was not the matter in controversy in this case. There were in this case very few material conflicts of testimony. There was, first, the dispute as to whether there had been an agreement in November to renew the bond; second, whether the premium was paid on January 2 or January 4; third, whether the facts known to the bank's officers showed to a person bestowing reasonable care upon the matter that Pulliam was a defaulter; and, fourth, whether these facts were withheld from defendant's agents with a fraudulent purpose. It was possible for the president to say he did not know that Pulliam was a defaulter, notwithstanding he knew the facts connected with his unaccounted-for disappearance with the $5,000 with no statement of where he was going. It was possible for the president to choose to retain his faith in him and to believe there would be some explanation of Pulliam's conduct; but if the jury found under the first issue that a man exercising reasonable care could not, in the face of known facts, in good faith conclude that there was no defalcation, while at the same time he was so influenced in his conduct by the same facts that he sent in haste to pay for and obtain the renewal receipts, then the jury properly answered the first issue, yes. The trial judge instructed the jury that the burden was upon the defendant company to prove that the plaintiff's officers had knowledge of the defalcation, and in

substance told the jury that if they found that the bank's officers were in possession of facts with regard to the defalcations, which, if made known to the agent of defendants, would have stopped them from issuing the renewal receipts, and suppressed those facts with the fraudulent intent to induce the agents of the company to bind their principal with a contract which they would not have made if the facts were disclosed, then they should answer the second issue, yes. The judge several times reiterated to the jury that the question was whether, with the intent to deceive and defraud the defendant, the plaintiff's officers suppressed the knowledge which they had of facts which should have led a reasonable man to know that Pulliam was a defaulter. It is to be observed in this case that the evidence discloses that Pulliam himself had refused to have his honesty any longer guaranteed by the defendant. He was a party to the contract, signed the original agreement, which recited that he had applied to the defendant for the grant by it of the bond, but he declined the offer to renew it. The jury must have found that there was no agreement for renewal until January, 1894, and it is apparent that, as Pulliam had then absconded, the renewal in January was at the solicitation of the bank at a time when there was no obligation of any kind resting upon the defendant, and the case became one where the party to be indemnified solicited the surety to become bound. Under this state of the case it cannot be gainsaid that concealment of facts known to the employers, which would lead a reasonable man to make inquiries or look at entries which would at once disclose the defalcation, would discharge the surety, if the concealment was made with the fraudulent intent to induce the surety to enter the suretyship. The fraudulent intent was inferable in this case from the urgent haste of the bank's president to obtain the renewal receipts as soon as the fact that Pulliam had gone off with the $5,000 and the teller's suspicions became known to him, whereas he had before been indifferent about the renewal, although the fact that the bond had not been renewed had been pressed upon his attention two months before.

Many of the plaintiff's exceptions to the court's charge are apparently based upon the theory that the defence rested upon the neglect of the officers of the bank to use reasonable care in watching the cashier in order to prevent defalcations by him; but that was not at all a question in this case. The question here was, Could the bank officers, by suppressing facts which they did know, get a surety to renew a guaranty so as to cover a defalcation which they had reason to know had already occurred? We think that under the instructions of the court, as a whole, this issue was fairly placed before the jury."

In another case, where a fidelity insurance policy recited that the insured had delivered to the insurer certain statements relative to the duties and accounts of the treasurer, which, it was agreed, should form the basis of the contract expressed in such policy, the court laid down the following as a general principle applicable to all such cases; to wit, that, if such statements involve no misrepresentation or concealment of facts, about which formal inquiries had been made by the insurer to the insured, then the contract could not be affected by concealment of facts about which no inquiry was made, or conduct on which no reliance was placed.[1]

In the case of the Fidelity and Deposit Company of Maryland *v.* Commonwealth,[2] the Kentucky court of appeals used these words: "To sustain this position that the surety is released, counsel for appellant relies upon that principle of law which is to the effect, if a party taking a guaranty from a surety conceals from him facts which go to increase his risk, and suffers him to enter into a contract under false impressions as to the real state of facts, such concealment will amount to a fraud, because the party is bound to make the disclosure; and the omission to make it under such circumstances is equivalent to an affirmation that the facts do not exist. This principle of law is applicable to transactions between individuals, and between individuals and corporations, but does not apply to public officials."

[1] Sup. Cl. Cath. Kn. of Am. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96.

[2] 20 Ky. Law Rep. 788, 1402; 47 S. W. 579; 49 S. W. 467.

§ 58. **What Concealment is effectual to discharge the Insurer from Future Liability under the Policy.** — In view of the general refusal of the courts to apply the doctrine of spontaneous disclosure to contracts of fidelity insurance, the cases are very limited where, in the absence of contractual obligation to speak, concealment on the part of the insured even of material facts has been held to relieve the surety of liability. Particularly is this true in cases where the "risk" occupies an official public position. Here the courts seem disinclined to relieve the insurer on any such ground.[1]

The only case where it clearly appears that the concealment serves to relieve the insurer is in the case of private "risks," where the insured himself solicits the insurance, under circumstances from which an intent on his part may be inferred to defraud the insurer into assuming a liability in fact existing, but which is concealed from it by the insured. In such a case it is presumed that the concealment was with fraudulent intent, and it will serve to relieve the insurer from liability on the policy issued under such circumstances.[2]

So, too, it is believed that, after liability is assumed, actual knowledge of acts of dishonesty on the part of the "risk" covered by the policy, with retention of the "risk" in the insured's employment and concealment of such dishonesty from the insurer, constitutes such fraud and bad faith on the part of the insured as will serve to relieve the insurer from further liability under the policy.

[1] Fidelity & Dep. Co. *v.* Commonwealth, 47 S. W. 579; 20 Ky. Law Rep. 788, 1402; Ind. School Dis. *v.* Hubbard & Am. Sur. Co., 81 N. W. 241; 110 Ia. 58.

[2] See, in this connection, Nat. Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; F. & D. Co. *v.* Commonwealth, 47 S. W. 579; 20 Ky. Law Rep. 788, 1402; Am. Cr. Ins. Co. *v.* Wimpfheimer *et al.*, 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498.

CHAPTER X.

(V.) DISCHARGE OF LIABILITY BY BREACH OF WARRANTY.

§ 59. **Warranty discussed and defined.** — A warranty is a formal assurance, either inserted in the policy or made a part thereof, by the insured to the insurer as to the existence, either past, present, or in the future, of some fact or state of facts material to the contract between the parties. Ordinarily its effect is to induce the insurer more readily to assume the liability imposed by such a contract, by diminishing the estimate he might otherwise have formed as to the chance of being compelled to make good any liability that might be created by reason of his entering into the proposed contract. It is important, in order to avoid confusion, to compare briefly "warranties" with the closely allied subjects of "representations" and "conditions." A warranty in the law of fidelity insurance is a binding agreement that the facts stated by the insured in his proposal for an insurance policy are true.[1] When contrasted with a representation, the latter may be defined as a statement by an applicant for fidelity insurance regarding a fact material to the proposed insurance, which must not only be false, but fraudulent, to defeat the policy.[2] A representation is distinguished from both a warranty and a condition in that it is a mere declaration of a fact and not a part of the contract; neither is its truth a condition precedent to the insured's recovery on the insurance policy. Warranties, on the other hand, are conditions precedent, and, like the more formal conditions, are a part of the contract of insurance.[3]

[1] Rice *v.* F. & D. Co., 103 Fed. 427; 43 C. C. A. 270.

[2] Rice *v.* F. & D. Co., 103 Fed. 427; 43 C. C. A. 270.

[3] Rice *v.* F. & D. Co., 103 Fed. 427; 43 C. C. A. 270; Am. Cr. Ind. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264.

It has been said that a high degree of candor is required of a party in answering inquiries which he knows are to be used as the basis of the contract of insurance which he is about to enter into with the insurance company.[1]

§ 60. **Warranties, how created?** — Speaking in general terms, it may be said that the courts are reluctant to impart terms of warranty contained in the application or proposal for bonds of fidelity insurance into the completed agreement, unless the policy clearly manifests the agreement of the parties to the union of the two instruments in one contract.[2] To create a warranty as to any matter the insurer who prepares the policy must insert therein, as well as in the application and proposal, apt and unequivocal language sufficient to render certain that the parties to the contract intended to transform what would otherwise be mere representations into warranties. Warranties in fidelity insurance are almost invariably evidenced by being set forth only in the application or proposal, which are themselves referred to in the policy as constituting the basis of the proposed fidelity insurance policy and as being deemed warranties between the parties to the contract. Wherever there is a distinct agreement that the application is a part of the insurance contract and the statements in the application upon which such contract is based are expressly declared to be warranties, the intent of the insured to bind himself to exactness of truth in his answers, although the facts which are called for may not seem material, is clearly and adequately manifested, and the contract must then be enforced according to its terms.[3]

Whether the parties to the contract of insurance have made questions and answers in fidelity insurance policies material and in effect warranties is a question of law for the court to determine, by a fair interpretation of the contract.[4]

In this connection it is to be noted, that for purposes of

[1] United States to the Use of Heise, Bruns, & Co. *v.* Am. Bond & Trust Co., 89 Fed. 921, 925; 32 C. C. A. 420.

[2] Am. Cr. In. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671.

[3] Am. Cr. In. Co. *v.* Car. Fur. Mfg. Co., *ante.*

[4] Stensgaard *v.* St. P. R. Es. Tit. Ins. Co., 50 Minn. 429; 52 N. W. 910.

construction by the court it is immaterial whether the statements of the insured in the proposals are called warranties or not. If it is a stipulation embodied in the contract by the parties as to the truth of the matters therein stated, whether relating to past, present, or future events, it is in law a warranty.[1] Where a policy guaranteeing the fidelity of a bank cashier stated that certain statements made by the insured in the application were to form the basis thereof, and that it was granted on condition that insured's business should remain in every particular in accordance with such statements, and that if any change should be made without notice to, and approval by the insurer, it should be void, it was held to constitute a warranty.[2]

In a late case the application was in the form of answers to questions, and by the terms of the policy the statements in the former were to "constitute an essential part and form the basis of the contract." The application expressed that the answers were true to the best of the knowledge and belief of insured, and were to be taken as the basis of the contract. It was held, that such promissory statements amounted to a warranty, notwithstanding the word "warranty" was not used, and that the words, "to the best of the knowledge and belief," of insured related only to such statements as respected facts existing at the time, or previously, and not to the promissory statement.[3]

§ 61. **Does the Doctrine of Warranty prevailing in Fire, Life, and Marine Insurance apply to Contracts of Fidelity Insurance?** — The doctrine of the courts with respect to warranties in fire, life, and marine insurance may be briefly stated as follows: Irrespective of the materiality of the fact or circumstance warranted to the contract about to be entered into, such fact or circumstance, if the warranty respecting the same be violated, will serve to relieve the insurer from all liability under

[1] Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 43 C. C. A. 331.

[2] Dougherty *v.* London Guarantee & Accident Co., 6 Vict. L. R. (law), 376.

[3] Hunt *v.* Fid. & Cas. Co., 99 Fed. Rep. 242; 39 C. C. A. 496.

the policy issued upon the consummation of the contract to which such warranty related. The doctrine under discussion is in effect that all warranties, whether expressed or implied, affirmative or promissory, are in effect conditions precedent to a recovery, the terms of which must be strictly fulfilled by the assured, for upon their non-performance the contract is avoided. No more vital or important question can be raised in the entire field of fidelity insurance than the one now before us. Does the doctrine of warranty as just outlined, in respect to fire, life, and marine insurance, apply as well to contracts of fidelity insurance? The answer to this problem — for such it may be called — is found only in a most thorough and searching review of the decisions of the courts wherein the question has been presented to these tribunals in such a form as to necessitate its determination. In American Surety Company *v.* Pauly,[1] the United States supreme court did not have occasion to consider statements contained in the application in the light of a breach of warranty, for the reason that the insurance policy before the court for construction in that case did not make such statements warranties, and the matter was treated by the court as a case of misrepresentation merely.

In the other federal courts there is a decided conflict of authority, with a clear predominance in favor of applying the doctrine now under consideration to all forms of guaranty insurance. The only case of importance decided by a federal court which militates against such application is that of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company[2] decided by the federal court of appeals for the sixth circuit. The calm judicial spirit in which that court approached the question is evidenced by its preliminary announcement that it would "permit no escape except by lines of retreat or avenues of deliverance clearly defined, well marked, and mutually understood as part of the contract evidenced by the use of unambiguous language for that purpose." In the course of the opinion in this case, the court had occa-

[1] 170 U. S. 133. [2] 80 Fed. 766; 26 C. C. A. 146.

sion to consider the legal effect of an express warranty of a statement made in the insured's "guarantee proposal" wherein, in answer to a question propounded by the insurer, the insured stated that the "'risk's' books and accounts had been examined on a certain date and found correct and that in the future his accounts would be examined not less than quarterly and often monthly by the insured." The policy recited that the insurer in issuing it relied on the truth of the statement and declaration containing the matters just referred to, and in reliance upon the strict performance and observance thereof of the contract thereby created. The policy further provided that any misstatement of a material fact in the declaration should render the same void from the beginning. It also provided "that every written answer or statement made by or on behalf of the insured in regard to or in connection with the conduct, duties, or methods of supervision of the "risk" should be held to be a warranty thereof and to form the basis of the contract of insurance. In the face of all this, the court of appeals for the sixth circuit failed to apply the doctrine of warranty to the facts of the case, which showed the grossest possible sort of a breach of the express warranty created by the policy in respect thereto. The warranty was treated as if it were a mere representation on the part of the insured, and the court dismissed that particular breach of warranty relative to the examination of the "risk's" accounts previous to the issuance of the policy by observing that "however careless the examination may have been, if made in good faith and the examiners believed the accounts correct, they might truthfully so represent them, albeit they were not correct." It was further observed that "the learned judge at the circuit doubted whether, under the strict rule, this contract should be taken as a warranty, but did not decide that point as we do not, since we find that, being treated as a warranty, there has been, when properly construed, no breach of it. . . . The strict rule as to disclosures, which has been imported from the marine insurance law, and which statutes so often have abrogated as unjust, should not be ex-

tended to these new policies; and on this ground all the courts have held that warranties should be strictly construed as we do this." The course pursued by the learned court in the case just referred to illustrates Judge Pardee's remark in Jackson *v.* Fidelity and Casualty Company of New York[1] to the effect that "there is too much tendency on the part of judges to construe away valid provisions in contracts of insurance and indemnity, and thus reach some more equitable conclusion. The result is much 'hard case' law, which is mostly bad law and always variable law." The federal court of appeals stands almost alone in its position on this question. With the possible exception of the supreme court of California and some of the English courts, there has not so far been evinced any clearly defined purpose to adopt the learning, in this respect at least, of the case of Guaranty Company of North America *v.* Mechanics Savings Bank and Trust Company.[2]

On the other hand, there is a very decided tendency on the part of courts of equal standing to engraft without change or qualification into the law of fidelity insurance the doctrine of warranty as it exists to-day in fire, life, and marine insurance. It is difficult to see how the courts can consistently do otherwise. They have almost universally recognized the bonds issued by the "surety companies" as contracts of insurance, and this, too, without qualification or reservation. The moment this much is conceded, the incidents of insurance law should naturally follow. This is certainly true, in the absence of any substantial reason for differentiating fidelity from other forms of insurance, in so far as the application of the doctrine of warranty thereto is concerned. None such have been so far pointed out, and it is difficult to conceive of any.

What is believed to be the truer and better doctrine in this connection is that set forth by the federal court of appeals for the sixth circuit in Rice *v.* Fidelity and Deposit Company of Maryland.[3] The able opinion in that case was written by

1 75 Fed. 359; 21 C. C. A. 394.

2 See Pacific Fire Ins. Co. v. Pacific Surety Co., 28 Pac. 842; McNichols *v.* Canadian Guar. Co., 4 L. N. Can. 78.

3 103 Fed. 427; 43 C. C. A. 270.

Judge Sanborn, who applied the doctrine of warranty, as it exists in fire, life, and marine insurance, to a policy of fidelity insurance. Similar conclusions have been arrived at by so many other courts as to afford a safe basis for the statement that the doctrine of warranty in the form recognized in fire, life, and marine insurance is likewise applicable to fidelity insurance contracts.[1]

§ 62. **Warranties classified.** — Warranties may be properly divided into two classes, affirmative and promissory.

Affirmative warranties relate exclusively to facts as they existed in past or are in present time, and usually form the basis of the contract of fidelity insurance subsequently entered into between the parties.

Promissory warranties, on the other hand, relate exclusively to future events, and arise when the insured expressly covenants to perform some executory stipulation of a nature calculated to limit the opportunities for successful fraud or dishonesty on the part of the "risk." They seek in effect to transform mere naked declarations of intention as to a line of conduct to be pursued by the insured into an express agreement to pursue that line of conduct, at the peril of relieving the insurer of liability under the policy in case it is not so pursued.

§ 63. **Affirmative Warranties discussed.** — An affirmative warranty, like certain of the covenants in a warranty deed, if breached at all, becomes so as soon as made.

They arise, as do all warranties in this branch of insurance law, by the insertion of apt words in the body of the policy, whereby certain material facts as set forth either in the proposal or application are incorporated into and become a part of the policy itself. Thus, for example, a clause reading like

[1] Indemnity Co. *v.* Wood, 19 C. C. A. 264; 73 Fed. 81; Am. Cr. In. Co. *v.* Carroll Fur. Mfg. Co., 36 C. C. A. 671; 95 Fed. 111; Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 36 C. C. A. 441; 94 Fed. 732; Hunt *v.* Fid. & Cas. Co. of N. Y., 99 Fed. 242; 36 C. C. A. 496; Harbor Comm'rs *v.* Guar. Co., 22 Can. Sup. Ct. 542; London West *v.* London Guar. & Accid. Co., 26 Ont. Rep. 520; Stensgaard *v.* St. Paul Real Es. Fid. & Ins. Co., 50 Minn. 429; 52 N. W. 910.

the following has the effect in law of transforming mere affirmative representations as contained in a proposal or application into affirmative warranties: "Whereas the insured has delivered to the insurer certain statements and declarations relative to the duties and accounts of the 'risk,' the manner of conducting the business of the insured, and other matters which do and shall constitute warranties and form the basis of this contract."

The statements and declarations here referred to are the proposals and applications for policies filed respectively by the insured and the "risk" with the insurer, and which themselves usually contain the express provision that all matters therein contained are to be considered warranties, and shall form the basis of the guarantee therein applied for. Just what these affirmative warranties consist of, it will be our purpose now to state. They customarily relate to the following matters:

1. Age of "risk" and place of birth.
2. Statement as to whether "risk" is married or single.
3. Business history of "risk."
4. Financial condition of "risk."
5. Amount of life insurance carried by "risk."
6. Whether "risk" has been in arrears in previous employment either by the insured or third parties.
7. Whether "risk" has been required to and given bonds in previous employments.
8. Whether application for policy has ever been refused or not.
9. Membership of "risk" in secret organizations.
10. Amount of outstanding debts and liabilities.
11. Date of last auditing of "risk's" accounts, and condition of same at that time.
12. Whether "risk's" accounts have been examined and found correct just prior to the time the policy or its renewal was applied for.

It can readily be seen from even a cursory examination of the foregoing matters that they do not all have the same equal

and direct bearing on the nature and extent of the liability the insurer is asked to assume. Age, family, and social ties, financial condition, business history, and ability to procure policies from other companies, while each has some bearing on the extent of the liability that the insurer is requested to bear, yet their chief value is an aid to the determination of the question as to whether the application for a policy shall be acted upon favorably or not.

On the other hand, those questions which relate to the existence of arrears in previous employments, to the correctnest of the prospective "risk's" accounts, or to an examination occurring just prior to the filing of an application for a policy, all have a direct and immediate bearing as being material to a determination by the insurer of the probable chance of ever being compelled to make good a defalcation of such "risk," if the policy requested be issued. Such questions go to the very heart of the theory upon which guaranty insurance is based; that is, the weighing in the aggregate of a large number of premiums against possible loss from being compelled to make good a part of the liability assumed on an equal number of average "risks." The information sought in the case of these last mentioned questions is material, is peculiarly within the knowledge of the party seeking the insurance, and must be truthfully stated, in order that the insurer may know whether the liability he is asked to assume be extra-hazardous or not.[1] Returning now to the general subject of affirmative warranties, they may be classified as follows:

(A) Warranty as to previous personal and business history of the "risk."

(B) Warranty as to the financial status of the "risk."

(C) Warranty as to previous applications for policies of fidelity insurance, and as to whether the same have been required in previous employments.

(D) Warranty as to the absence of defaults of the "risk" when in the previous employ of the insured or of a third party.

[1] See Seaton v. Heath, L. R. 1 App. Cas. for 1899, p. 782.

(E) Warranty as to the condition of the "risk's" accounts at the time of the issuance of the policy or of any renewal of the same.

§ 64. (A) **Warranty as to the previous Personal and Business History of the "Risk."** — In view of the fact that the moral element is so prominent in the domain of fidelity insurance, it follows that knowledge as to the previous personal and business history of the proposed "risk" is a matter of no small moment to the insurer. It is necessary for him to carefully weigh all the chances of probable loss as against the premium which is to be received from the insured in case the application and proposal for policy are accepted. The insurer knows that strong home ties of an agreeable nature are strong deterrents against the commission of crime. The insurer also recognizes the fact that other things being equal, the man with a past unblemished reputation is less likely to fall into dishonest ways than the one who has acquired an unsavory reputation in various business connections had from time to time. As a matter of practice, married men are generally preferable to single men as "risks" under fidelity insurance policies. Connections with fraternal organizations are regarded favorably by insurers as being likely to conduce towards honesty on the part of the "risk."

For all the foregoing reasons the warranties as to the previous personal and business history of the "risk" are of material value to the insurer more as a means of determining whether to write the policy or not, rather than as affording a possible defence to an action on a policy subsequently commenced by the insured thereunder. The reason for this lies largely in the wording of the insured's statement in respect to these matters, out of which the warranty itself arises. The statement here referred to is usually in the following form: —

"Replies of the applicant for a fidelity insurance policy herein are, to the best of my knowledge and belief, correct. The applicant has always, to the best of my knowledge and belief, given satisfaction in his personal conduct, in the performance

of his duties wherever employed, and kept his accounts faithfully and without default. He has not, so far as I know or believe, made any errors or default either in our employment or in any previous service. I know of nothing concerning his habits or antecedents affecting his title to confidence, and I know of no reason why the guaranty policy hereby applied for should not be granted."

It will be seen from the foregoing wording of the insured's warranty, in respect to the matter now before us, that it is made "merely to the best of the insured's knowledge and belief." It is these words, doubtless, so materially limiting the effect of a breach of promissory warranties in regard to the matters covered by them which have led some few of our courts to hold that no act on the part of the insured not amounting to actual fraud or the grossest bad faith is sufficient to avoid the policy, on the ground that the same constitutes a breach of warranty.[1] The qualifying words here referred to are said, however, not to affect promissory warranties.[2]

§ 65. (B) **Warranty as to the Financial Status of the "Risk."** — One of the determining factors which controls the insurer in passing upon the question whether to accept or decline the application for a policy is that of the proposed "risk's" financial condition. In deciding upon what premium, if any, to accept an application for a policy, the insurer in every instance counts upon the chance of obtaining reimbursement from the "risk" in case any liability is incurred under the policy issued in his behalf to the insured. The chances for obtaining such reimbursement, of course, are largely dependent upon the financial condition of the "risk." Therefore, all things being equal, those policies are held in the highest esteem wherein the "risk" is a man of some financial ability. The greater the amount of property possessed by the "risk" at the time the policy is issued, the less likely is the insured to have to make good the liability of the "risk" to the insured without being able

[1] Guar. Co. of N. A. v. Mec. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146.

[2] Hunt v. F. & C. Co. of N. Y., 99 Fed. 242; 36 C. C. A. 496.

to recoup himself in a measure at least from the property of the "risk." As in the case of other insurance contracts, it is the financial responsibility of the insurer which affords the real guaranty of the insured, so here it is the solvency, present and continued, of the "risk," which in itself affords at least a possible source of indemnity in case the insurer is compelled to make good its liability under the policy.[1]

§ 66. (C) **Warranty as to Previous Applications for Policies of Fidelity Insurance and as to whether the Same have been required in Previous Employments.** — The purpose of requiring such a warranty as is above referred to is obvious. It aims to secure for the insurer the entire benefit of previous inspection as to the "risk's" character and antecedents on the part of some other guaranty insurance company which has resulted in the latter's declination of the "risk's" application for a policy. The "surety companies" are very conservative in matters of this kind and are usually loath to issue a policy on any "risk" whose application has been theretofore refused by rival concerns. Such a line of conduct as is here referred to is by no means arbitrary or unreasonable, but is based on the assumption, which is usually sound, that the previous application for a policy would not have been refused without there having been some substantial ground for such refusal. Then, too, investigation as to reasons which induced other companies in the same line of business to refuse to issue a policy on this particular "risk" might lead the insurer to act likewise. But in this as in other connections of a like nature, it is important to remember that to constitute a breach of warranty it is not sufficient that the statement that the applicant had never been refused a policy by other companies be contained in the application of the "risk" alone. To have that effect the representation on which such alleged breach of warranty is predicated must in any event be made with the insured's approval and indorsement.

[1] See United States to the use of Heise, Bruns & Co. *v.* Am. Bonding & Trust Co., 89 Fed. 925; 32 C. C. A. 420; Fertig *et al.* *v.* Henne, 47 Atl. Rep. 840 (Pa.).

§ 67. (D) **Warranty as to the Absence of Defaults of the "Risk" when in the Previous Employ of the Insured or a Third Party.** — The chronic defaulter, for the purpose of becoming a "risk" under a fidelity insurance policy, is *persona non grata* to the insurer. The "surety companies," as a matter of prudence and business policy, invariably decline a "risk" who has been guilty of serious arrears in any previous employment. The reasonableness of this position has never been questioned, either by the courts or the public, so far as we are aware. This matter is a very important one in fidelity insurance, and the effect of concealment in this respect is often a very serious matter so far as the insurer is concerned.

In a case in the federal courts, brought on a fidelity insurance policy, it was claimed by way of defence on the part of the insurer that the "risk" named therein was a defaulter to the insured at the time the policy was issued, and that this fact was known to the insured at that time and concealed from the insurer. It was further claimed that the insured represented to the insurer that the "risk's" accounts had been examined and found correct, when in truth the "risk" was a defaulter at the time the policy was issued, as the insured well knew or could have known by the exercise of diligence. The court in its opinion said: "The policy refers to certain statements or declarations relative to the duties and accounts of O'Brien, which it recites had been theretofore delivered to the company and constitute and formed the basis of the contract hereinafter expressed. This statement, so referred to and made part of the contract, was in writing. It consisted of a series of questions and answers propounded to Mr. Coleman, president of the association, and answered by him. Thus the parties put in writing statements and declarations of the plaintiff which were to be treated as the basis of the contract. None of the pleas of the insurer undertake to make issue upon the representations so elicited and made part of the agreement. If that statement involved no misrepresentations or fraudulent concealment, then the contract would not be affected by loose parol statements or by concealment of facts about which no

inquiry was made nor by conduct upon which no reliance was placed."[1]

In Ætna Life Insurance Company *v.* American Surety Company[2] the insurer certified that, so far as his knowledge went, the "risk" had always faithfully performed his duties and that he was not then at the time the policy was issued in arrears or default. It was also stated that his accounts were last examined June 13, 1884, and found to be correct in every respect. This certificate bore date June 16, and the policy June 15, 1884. As a matter of fact the "risk" was then in the insured's debt $150.00, on a draft which he had drawn on the insured in March, 1884, and which it had paid, but had required an explanation and demanded repayment. It was held that the unpaid draft was not arrears or default, within the meaning of the certificate, which referred to collection accounts, and that the insured was not guilty of such laches as would discharge the insurer from liability on the policy for a subsequent defalcation.

The Canadian rule on this subject appears to be very strict and distinctively in favor of the insurer. It was there held that the representation that the "risk" had never been in arrears or default applies to a time antedating the latter's employment by the insured, and that a misrepresentation amounting to a breach of warranty as to such matters avoids the insurer's liability under the policy.[3]

§ 68. (E) **Warranty as to the Condition of the "Risk's" Accounts at the Time of the Issuance of the Policy, or of any Renewal of the Same.** — It is customary to insert in all policies and proposals for policies a specific statement, either directly signed or approved by the insured, to the effect that the "risk's" accounts in the insured's previous employment had been kept faithfully and without default, and that when last examined or audited by the insured, at a certain date named in such application or proposal, all his accounts were verified and ex-

[1] Sup. Council Cath. K. of Am. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96.

[2] 34 Fed. 291.

[3] Ottawa Agr. Ins. Co. *v.* Canadian Guar. Ins. Co., 30 U. C. C. P. 360.

amined and found to be correct. The cases bearing on this question are in their conclusions so diametrically opposed to each other as to be impossible of reconciliation.

Attention is called first to a case wherein the court refused to apply the general doctrine of warranty as it exists in other branches of insurance law to the case before it. Reference is here made to Guarantee Company of North America *v.* The Mechanics Savings Bank and Trust Company.[1]

Here a policy had been issued by a "surety company" on the cashier of the Mechanics Savings Bank and Trust Company, whose name was Schardt. The policy recited that Schardt had been appointed cashier at Nashville, Tenn., in the service of his employer, and had been required to furnish security that he should not be guilty of any fraudulent act in the performance of his duties in said capacity, by which his employer should suffer any pecuniary loss. The policy had been issued in response to such requirement, and by its terms undertook to assume a liability arising from any act of fraud committed by Schardt in connection with the duties of his said appointment, and constituting embezzlement or larceny. It also contained, among others, the following five clauses:

(1) "Said company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as employer's guaranty papers, No. ——, dated Jan. 10, 1893, and signed by Lewis T Baxter, president (of said surety company) on behalf of said employer, and lodged with the said company at the office in Montreal, and in the strict performance and observance hereafter by the said employer of the contract thereby created, does hereby, etc."

(2) "Provided always, that this bond and guaranty hereby created or undertaken shall be subject and liable to the terms and conditions hereupon endorsed."

(3) "Any misstatement of a material fact in the declaration within mentioned, in any claim made under the bond, will render the bond void from the beginning."

[1] 80 Fed. 766. See also same case reported in 68 Fed. 459, 100 Fed. 559, 173 U. S. 582; 26 C. C. A. 394; 40 C. C. A. 542.

(4) "That any written answer or statements made by or on behalf of said employer in regard to, or in connection with the conduct, duties, accounts, or methods of supervision of the said employee, delivered to the company either prior to the issue of this bond or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee or of its continuance."

(5) "That the said employee has not, to the knowledge of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur said employer's censure previous to the issue of this bond."

The policy was issued upon what is known as an "employer's guarantee proposal," which was signed by Baxter as president of the insured bank, and which contained, among other matters, the following:

"*Ques.* 3. Has Schardt ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment? *Ans.* No.

"*Ques.* 4. Have you known or heard of anything unfavorable as to his habits or associations, past or present, or of any matters concerning him, about which you deem it advisable for the company to make inquiry? *Ans.* No.

"*Ques.* 13. When were Schardt's books and accounts, including cash securities and vouchers (if any), last examined, and by whom? *Ans.* Dec. 31, 1892, by finance committee of bank, and found correct.

"*Ques.* 14. In case of Schardt's handling cash, or securities, how often will the same be examined and compared with the books, accounts, and vouchers, and by whom? *Ans.* Not less than quarterly and often monthly, by finance committee.

"*Ques.* 16. Will Schardt's handling funds or securities not be subject to the routine check of periodical examinations? If so, please describe their nature. *Ans.* No."

To the foregoing Baxter affixed his signature as president of the insured, under the following words: "The above an-

swers and representations are true to the best of my knowledge and belief."

It was the contention of counsel for the "surety company" at the trial, that the policy was avoided by reason of breach of warranty, as contained in the foregoing answers to specific questions, which it was claimed the evidence fully supported. Specifically it was charged, first, that the insured represented that it did not know of, and had not heard of anything unfavorable as to Schardt's habits or associations, past or present, yet at the time the insured and its officers making the statement knew that Schardt had been engaged in speculation and had been a partner in a gambling concern while occupying a position of trust in the bank, and no effort was made to verify his statement; that he had sold out his interest in the bucket shop and had ceased speculation. Second, it was charged that the insured procured the issuance of the Schardt policy by representing that the books and accounts of Schardt, who had been in this same bank for five years, had been examined and found correct to the end of his term of office; yet, at that time, the books and accounts of the bank showed a default of $73,715 in a bank with a capital of only $50,000.

On this presentation of facts the court of appeals spoke as follows: "The argument [of the attorneys for the guaranty company] goes upon the assumption that all that was indicated by these questions and answers, and which fixes, ascertains, or suggests the kind of supervision in contemplation, is nugatory, and that the whole field is open and the power placed in the hands of one of the parties to dictate the extent of the supervision by some other custom more efficient to have prevented this loss. We think this cannot be done. Precisely the same consideration disposes of the alleged misrepresentation founded on the use of the words 'examined' and 'verified,' as contained in the certificate made previously to the renewal of the teller's bond, that his books and accounts as teller had been examined and found correct, and upon like words as stated in the proposal or statement made in the

application for the cashier's bond when Schardt was promoted to that employment. As before, the argument proceeds upon the same assumption, that an ordinary, prudent, and careful examination would have developed the stealings that Schardt had covered up. This may or may not be so, for we know that such defaulters are very expert in covering up by false entries and appearances, and often none but the most expert examinations and examiners discover the frauds, and we must, in looking at these certificates, take the appearances as then existing, and not as now uncovered, after their discovery by such experts.

"The defendant company was competent to pursue such an investigation. It had a manager or agent at Nashville for the purpose of keeping up and procuring information, and yet was contented to rely, for reasons we will presently suggest, upon those vague and indefinite representations as to that which was done. Now that it appears that the accounts concealed a fraud which close scrutiny behind their face would have developed, we are asked to imply that these words were used to represent that such a close scrutiny had been made in fact, which representation, it is argued, must have been false, because the frauds were not discovered. This is substantially construing the contract as a guarantee to the defendant company against the bank's carelessness in making the examinations or that of its agents. However careless the examination may have been, if made in good faith, and the examiners believed the accounts correct, they might truthfully so represent them, albeit they were not correct. The position of the defendant company leaves no margin here, and holds the bank to absolute truthfulness, not of the fact of examination made in good faith and a belief in correctness, but of the soundness of Schardt's entries and accounts and their freedom from fraud, no matter how skilfully a fraud may have been concealed by him. The facts do not show any such intentional representation, and the words do not define such a complete assurance. The words 'correct' and 'verified' may mean that, but also less in any degree. One verifies an account by

merely adding up or doing the other work of mathematical calculation and finding the figures correct, or by such comparison of entries and items as one may make and find correct, and any extent of this is examination, however superficial. Those representations do not say that the examination was skilful or extensive, or by comparison of books and trial balances, but only that such examination as was made disclosed no error or fraud, and if this was done in good faith, as there is no doubt it was, it fully meets the representations made, unless we are to imply that the parties intended such a thorough examination as would save the insurer harmless, and this we think was not contracted for in plain and unambiguous language, as it might have been, if intended. As was remarked by the learned judge at the circuit, 'So long as the bank officers and the committee acted in good faith, such examination as the appointed committee thought proper and sufficient for the protection of the bank and its stockholders would satisfy the requirements of the contract as made,' and we may add, would be truthfully within these representations: and, if anything more was wanted, it was a matter for specific agreement."

It is difficult to reconcile the doctrine of the foregoing case with that enunciated by the federal court of appeals for the fifth circuit in Monongahela Coal Company *v.* Fidelity and Deposit Company of Maryland.[1]

In this case the insured, prior to the renewal of a guaranty insurance policy, gave to the insurer the following certificate: "To the Fidelity and Deposit Company of Maryland: This is to certify that on the 17th day of March, 1897, the books and accounts of A, in our employ as agent, were examined by us and we found them correct in every respect, and all moneys handled by him accounted for. He has performed his duties in an acceptable and satisfactory manner, and we know of no reason why the guaranty bond should not be continued. His salary is now commissions and he is employed as agent." (Signed.)

[1] 94 Fed. 732; 36 C. C. A. 444.

The officers of the insured at the trial admitted that the books had not really been examined as stated in the certificate. At the trial the court, on request, instructed the jury to find for the insurer. The court at that time said: "The certificate must be taken as true so far as this 'surety company' has a right to take it, as to them, whether as a matter of fact it was false to the insured or not. There was nothing done by the 'surety company' to mislead the insured into giving this certificate.

"The enclosing the blank was a mere form, but it was asserted that he should give the certificate if he expected the renewal of the contract of indemnity. Therefore, he chose to give it. It may have been false that he never examined the books, but the indemnity company had a right to take the fact stated as true, and the suggestion that it was a trick of the indemnity company does not count for anything unless it be shown that the insured was misled into a condition of things which does not appear by the testimony. It was a voluntary contribution of the insured. He could have declined to send it, or that he would not send it, because he had not examined the books, but when he did say that he had examined the books and found them correct, the indemnity company had the right to take that part to be true, and did take it for true and acted upon it.

"Unquestionably as between the contracting parties, the insured is estopped from denying that certificate in law. He cannot be heard to deny it to screen himself from it in law as between the two contracting parties. Of course, that would cover all antecedent matters. But, further, the inducement to the surety company to enter into a second contract was a false inducement. That inducement was in the statement of the insured that the books had been examined and found correct. I think there must be a verdict for the indemnity company."

On appeal the foregoing instruction was assigned as error by the insured, but in this contention it was not sustained by the court of appeals, which affirmed the judgment of the court below.

Finally attention is called to the case of Pacific Fire Insurance Company *v.* Pacific Surety Company.[1] In this case an agent in California of an insurance company in New York, under a contract requiring him to remit payments within fifty days from the end of the month in which they are payable, failed through tardiness and neglect, but with no wrongful intent, to remit premiums until from sixty to one hundred and twenty days after the end of such month, and this action was acquiesced in by the company as a substantial compliance with the contract. The contract between the company and the agent further required the latter to remit the premiums of each month on or before the 20th of the second month afterwards. A certificate was made by the insured to the insurer, one day after the premium became due and unpaid, stating that the agent was not in arrears.

Also certificates were furnished by the insured to the insurer, averring that the agent had never been in arrears, when the payment of premiums was sometimes delayed for two or three months, although such payment was accepted by the insured as a substantial compliance with the contract. It was held by the court that neither of said certificates was fraudulent, and did not have the effect of relieving the insurer from liability by reason of any of the statements therein contained.

§ 69. **Promissory Warranties Classified.** — Inasmuch as the liability of the insurer in fidelity insurance is a continuing one, and measured by the life of the policy, it follows that all warranties which look for their performance to the future rather than to the past are likewise continuing. These, as has already been observed, are called promissory warranties.[2] Ordinarily, such warranties are found, not in the body of the policy itself, but solely in the proposal or application. The principal promissory warranties there found may be classified as follows:

(A) Warranty as to amount of additional security re-

[1] 28 Pac. 842; 93 California, 7.

[2] See Regina *v.* Nat. Ins. Co., 13 Vic. L. R. 914; Att.-Gen. *v.* Ad. L. Ass. Guar. Co., 22 S. A. L. R. 5.

quired of the "risk" during the period of liability under the policy.

(B) Warranty as to the salary of the "risk," and manner of payment of same.

(C) Warranty as to the nature of the "risk's" duties and powers.

(D) Warranty as to responsibility of the "risk."

(E) Warranty as to the method of conducting the business of the insured in so far as it may concern the "risk."

(F) Warranty as to the number and duties of the assistants of the "risk."

(G) Warranty as to the manner, time, and method of checking the "risk's" accounts.

(H) Warranty as to mode of supervision on the part of the insured of the "risk."

(I) Warranty as to the "risk" having other business than that of his employment with the insured.

§ 70. (A) **Warranty as to Additional Security required of the "Risk" during the Period of Liability under the Policy.** — The purposes of the insurer in requiring the insured to state in the proposal what additional security, if any, will be required of the "risk" during the period of liability under the policy are two-fold: first, the information thereby sought may be important in determining whether or not to issue a policy at all; second, the purpose may be found in a desire on the part of the insurer to thereby procure a contingent asset of some material value, which becomes available through the insurer's right of subrogation, either expressed or implied, and which arises on the payment of any loss to the insured under the policy. In other words, the insurer seeks, in this manner, to make it obligatory upon the insured to retain the additional security referred to intact during the life of the policy, so that in cases of the incurrence of liability thereunder, such additional security may become an asset in the hands of the insurer whenever his right of subrogation becomes perfected through payment of loss under the policy to the insured. Whether or not the release of such additional security as had

been represented to be held by the insured during the life of the policy, and prior to the occurrence of loss, would have the result of relieving the insured from liability *pro tanto* is a question which has not yet been decided, so far as careful investigation shows, by any court in construing a fidelity insurance policy.

When the policy is issued upon the faith of the statements made by the insured that it holds certain additional securities, then this would seem to establish the insurer's right to require that all prior securities remain unchanged during the life of such policy.[1]

In order to release such securities and at the same time not have it affect the liability of the insurer under the policy, the latter's consent to such release must first be secured. But the same rule does not appear to obtain in the case of release by the insurer of securities given it by the "risk" to secure it against loss by reason of the issuance of the policy.[2]

Sometimes the policy expressly provides for notice of other insurance if taken by the insured during the life of the policy. But the failure to give such notice by the insured does not constitute a breach of the warranty so as to avoid the policy.[3] In any event, when other insurance is held by the insured at the time the policy is issued, and this fact is known to the insurer at that time, then the existence of such other insurance does not serve to avoid liability under the later policy, even where this latter expressly prohibits it.[4]

The true rule in this connection would seem to be that the insurer is discharged (either wholly or *pro tanto* according to circumstances) when by the act of the insured any rights of subrogation in reference to securities held by the insured at the time the representations were made have been lost or impaired.[5]

[1] See Bank of Monroe *v.* Gifford, 41 N. W. 558; 79 Ia. 300; but see Bank of Tarboro *v.* Fid. & Dep. Co., 38 S. E. 908.

[2] See Fertig *et al.* *v.* Henne, 47 Atl. (Penn.) 840.

[3] F. & C. Co. of N. Y. *v.* Carter, 57 S. W. 315 (Tex. App.).

[4] Western Assur Co. of Toronto *v.* Phelps, 27 Sou. 745 (Miss.).

[5] Mut. Buil. & Home Ass'n *v.* Fid. & Dep. Co., 23 Sou. 405 (La.).

§ 71. (B) **Warranties as to the Salary of the "Risk" and Manner of Payment of the Same.** — There is usually a statement in the proposal as to the amount of salary to be paid the "risk," together with the manner of payment of the same. In connection with this there is usually found in the body of the policy itself a provision "that the remuneration of the 'risk,' except as to increase thereof, shall remain and continue during the life of the policy as set forth in said proposal." It may be said, generally, that the amount of remuneration to be paid the "risk" by the insured is an element of considerable importance in determining whether or not a proposal for a policy shall be acted upon favorably on the part of the insurer. Still, again, it is a matter of importance to the insurer to have a "risk's" remuneration paid him in such a manner as to leave no question as to the relationship that exists between the "risk" and the insurer; as, for example, a change from a fixed salary to be paid to the "risk" by the insurer to a remuneration based upon the profits of a business conducted by the "risk" for the insured. For this last might give to the former the rights of a partner, and thus transform what under the former arrangement might have been a criminal act into a mere civil liability. Under the old-time private bonds a change in either the amount of the remuneration or mode of payment of the same frequently had the effect of relieving the surety from liability. Such a rule has not so far obtained generally in fidelity insurance.[1]

§ 72. (C) **Warranty as to the Nature of the "Risk's" Duties and Powers.** — To a large extent the scope of the insurer's liability is dependent upon and controlled by the statements in the proposal and application for a policy with respect to the nature of the powers and duties of the "risk," wherein it is agreed that they shall remain and continue during the entire life of the policy as set forth in such proposal and application. It needs but little elaboration to show the importance of the warranty here referred to. The chances of liability for the insurer under the proposed policy depend largely upon the na-

[1] See Mut. Buil. & Home Ass'n *v.* Fid. & Dep. Co. of Md., 23 Sou. 405 (La.).

ture of the "risk's" duties and the authority which he will have while performing such duties. It may be said that the question as to the scope of the "risk's" authority is ordinarily a question of law. In a Pennsylvania case the insurer claimed that it was for the court, in the first instance, to determine as a matter of law whether or not the insured's loss was covered by the policy issued by the insurer. On this point the court said: "The counsel for the insured urges most strongly that the duties imposed upon the 'risk' were conferred by the by-laws of the insured association, and that he had only such duties in the way of supervision and general management of the business of the corporation as were incident to that position, and that he had nothing to do with the financial operations of the corporation, and that all matters relating thereto were covered by the duties of the treasurer. It is claimed that the contract between the parties shows such to be his duties, and that it should have been so construed by the court, and the question as to his duties should not have been submitted to the jury. We cannot agree with the learned counsel. It is true, as he suggests, that the liability of a surety is not to be extended by implication beyond the terms of his contract, and that any material alteration therefrom may discharge the surety. Ferris, the 'risk,' was appointed general manager of the association, and as such gave bond to secure his employer against any fraud or dishonesty in the performance of the duties of his position. But what were those duties? They were not specifically defined in the contract itself, so that the court could, as a matter of law, ascertain and determine them. This, then, became the duty of the jury under the evidence of the case."[1]

In this same case it was held that parol evidence as to the duties of the "risk" and as to the amount of money received and embezzled by him is admissible. This on the theory that it amounted simply to showing that the duties of the "risk" were the receipt and temporary custody of the funds of the insured. The court remarked that such "testimony in no way

[1] H. S. & L. Ass'n v. U. S. F. & D. Co., 46 At. 910 (Pa.).

changed or enlarged the liability of the insurer to the insured; nor did it show any duties or responsibilities different from those set forth in the statement of the insured's president, on the faith of which the policy was issued, or different from those prescribed in the by-laws." There seems to be no valid reason why the rule applied in the case of alleged liabilities under policies covering persons occupying positions of public trust should not be held equally applicable to private "risks." That is, that the question of the insurer's liability should depend very largely upon the determination of the question as to whether the "risk" was acting within the scope of his employment as designated in the application or proposal, when the loss occurred for which it is sought to make the insurer liable.

In a late English case the policy provided that the "risk" (clerk of a city council), who had been appointed to carry out all the ordinary duties of his position, should faithfully discharge the duties of his office, and in particular should faithfully, honestly, and punctually account to the council for all sums of money which he should receive while holding such office. It appeared that during the life of the policy certain work was being carried out by the council under the supervision of an engineer who received the money and paid the men. The engineer resigned, and the "risk" later received the money for the purpose of paying the men, and misappropriated part of it. It was held that it was not part of the ordinary duty of the "risk" to make payments of this kind; that in giving the money, as it had, to the "risk" for the payment of employees, the insured had increased his duties without the knowledge or consent of the insurer, and that in consequence the latter was discharged from liability under the policy.[1] The doctrine here enunciated commends itself as being in thorough accord with general insurance rules and principles.

In Fidelity and Casualty Company *v.* Gate City National

[1] Wembley Urban District Council *v.* Poor Laws, etc. Guar. Ass'n, 17 T. L. R. 516.

Bank,[1] a policy was issued by which the insurer bound itself to make good to the insured to a specific extent "such pecuniary loss as the latter might sustain by reason of the fraud or dishonesty of the 'risk' in connection with his duties as receiving teller, or the duties to which, in the employer's service, he might be subsequently appointed or assigned." It was held that the insured had the right, without notifying the insurer, to confer upon the "risk" the office of assistant cashier in addition to that of receiving teller, and upon this being done, the insurer is as much bound to make good to the bank loss occasioned during the period covered by the policy by reason of the "risk's" fraud or dishonesty while acting in the capacity of assistant cashier as in that of receiving teller. In passing upon this question the court said: "In view of the comprehensiveness of the language of the policy, it would be difficult to hold that the insured was not a surety for the 'risk' in the capacity of assistant cashier as well as that of receiving teller; he was certainly appointed subsequently to the execution of the bond to the office of assistant cashier. As such, he had duties to perform in his employer's service, and by a violation of these duties brought loss to his master. We think the language of the contract covers the precise state of facts which arose, and that the insurer is as much bound to the insured for the consequences of the 'risk's' dishonesty in the latter capacity as in the former."[2]

A case somewhat analogous to the foregoing is that of MacNichols *v.* Canadian Guarantee Company,[3] where it was held that a policy worded so as to clearly cover the defaults of an official assignee, covers those committed while acting under an unofficial appointment to that position by the consent and direction of creditors.

In another case the secretary of an insurance company gave a bond faithfully to perform his duties as such secretary, and to account for all moneys which should come

[1] 97 Georgia, 631; 25 S. E. 392.
[2] See also Am. Surety Co. *v.* Pauly, 72 Fed. 467.
[3] 4 L. N. Can. 78.

into his hands in such position. On this state of facts it was held: first, that if the secretary was intrusted with the funds of the company, notwithstanding it was also the prescribed duty of the president to receive the money paid to the company, and to deposit the same, and he was responsible for any failure of duty on his part, that did not relieve the secretary from responsibility for the faithful disposition of any funds confided in his care, the unauthorized act of the president in intrusting funds to the secretary could not discharge the secretary from the faithful preservation thereof; second, that the stipulation of the bond was an undertaking for the fidelity and honesty of the secretary commensurate with the scope of his duties; and the enumeration in the by-laws of certain things to be performed by him did not supersede the obligation which pervaded every department of his official functions. The insurer had the right, under this stipulation, to insist upon indemnity for any deviation from the line of his duty to its prejudice.[1]

A case involving a somewhat different question, and yet directly connected with the matter of the "risk's" duties, is that of Fidelity and Casualty Company of New York *v.* Lawler.[2] In this case the insured had made a written application to the insurer for a policy on one Lawler, who was designated in the "proposal" as its buyer and receiving agent at Kindred, N. Dak., and a policy was issued covering his acts and defaults while fulfilling the duties of the aforesaid position. In construing this policy, in an action brought by the insurer on a counter-bond against the sureties thereon, the court, among other things, decided that the latter covered only the performance of duties by the "risk" at Kindred, in the absence of any agreement on the part of the surety to be bound for acts of Lawler while employed at any other place.

We shall cite here one case involving the construction of a private surety bond. This is Blair *v.* Perpetual Insurance

[1] Engler *v.* People's F. Ins. Co., 46 Md. 322.
[2] 64 Minn. 144; 66 N. W. 143.

Company,[1] which contains some features of value in this immediate connection. It was there held that, where an insurance company had no right to engage in banking, one who became surety for the fidelity of an agent for such corporation was not bound for an embezzlement by the agent of the funds of the corporation while such agent was engaged in the business of banking for the corporation.

In general, the true test in all cases to be applied to determine whether there has been a material alteration of the policy seems to be to ascertain whether the alteration complained of is as to the policy itself, or merely in the separate collateral contract of the "risk" with the insured. Unless this last is written expressly or impliedly into the policy, alteration of its terms cannot affect the liability of the insurer.[2]

§ 73. (D) **Warranty as to Responsibility of the "Risk."** — The warranty just referred to is in many respects analogous to the one which has just preceded it. It has reference more particularly to the extent in a pecuniary sense of the opportunity for dishonesty, which shall be afforded the "risk" by reason of the responsibilities of his position, rather than by reason of his holding any specific position, considered separate and apart from the responsibilities thereby involved. The questions contained in the proposal and application are so framed as to bring out fully and in great particularity the responsibilities of the "risk" while in the employ of the insured.

In the case of Harrisburg Savings and Loan Association *v.* United States Fidelity and Guaranty Company,[3] the policy provided that it should secure the "risk's" honesty in the performance of his duties in the position of general manager of the plaintiff's association. It guaranteed the insured against loss by any act of fraud or dishonesty on the part of said "risk" in connection with the duties of his said office.

It was held that the receipt and temporary custodies of

[1] 10 Mo. 560.

[2] U. S. Glass Co. *v.* Matthews, 89 Fed. 828; 32 C. C. A. 364; State Loan & Trust Co. *v.* Cochran, 62 Pac. 466.

[3] 46 Atl. Rep. 910.

moneys of an association by the general manager is contemplated as one of his duties, where a policy is given to secure his honesty in the performance of his duties as such manager; and it may be shown to be one of the duties performed by him with the ratification and approval of the board of directors, in the course of which he embezzled the money, he having in the application for the policy stated, as to the nature and duties of his position, that such duties were set forth in the by-laws of the association; that his position was partly clerical in character, no executive powers being vested in him; that itemized reports were made to the directory at each meeting of all cash received in office; that moneys received in payment of dues were deposited in bank each day, and did not exceed $500 and $600 at a time; that a complete system of credit slips was used, the books were subject to inspection by the directors at all times, and periodical examinations of all accounts were made by the state banking department, and that said by-laws declared it the duty of the manager, subject to the direction of the directors, to have supervision of the affairs of the association, and that he should perform such duties in the detail work of the association as should be prescribed from time to time by the board of directors.

The defence was specifically interposed, that the duties of the general manager had been changed and enlarged subsequently to the execution of the policy, and that the loss sustained by the insured did not occur while the "risk" was in the performance of his duties as general manager, and therefore was not covered by the policy. Commenting on this defence, the court spoke as follows: "The insurer requested the trial court to charge that, if the jury believed that the duties and responsibilities of the 'risk' were enlarged after the execution of the policy, by permitting him to receive moneys, which under the by-laws should have been paid to the treasurer, — an entirely different office with different duties and greater responsibilities, — and no notice of such enlargement of duties and responsibilities was given to the insurer, it was such a variance of the

terms of the policy as would discharge the latter from liability under the policy. The learned court below very properly, as we think, submitted to the jury to determine whether the receipt of the money of the association was a part of the duties of the 'risk' as understood by the parties when the insurer entered into the contract of suretyship, with the instructions that, if it was, the insured could recover; but if it was not, there could be no recovery. The practical effect of the insurer's request in the point under consideration was that if, subsequent to the execution of the policy, other duties were imposed upon the 'risk' than those contemplated in his contract, the defendant was not responsible for his defalcation, regardless of the question, whether the money was embezzled while the 'risk' was in the charge of such additional duties. But if the moneys embezzled were received by him under the appointment, and in pursuance of his duties, the faithful performance of which was secured by the policy, the mere fact of the imposition upon him of other greater duties and responsibilities, in no way interfering or modifying those imposed by his original appointment, would not discharge the surety."

§ 74. (E) **Warranty as to the Method of conducting the Business of the Insured in so far as it may concern the "Risk."** — The foregoing warranty is closely related to that which has reference to the mode of supervision by the insured of the "risk's" accounts. It however has no reference to specific methods for checking accounts at regular intervals, but has reference more particularly to the standard of excellence maintained by the insured in the general conduct of its business. Such warranties tend to show the presence or absence of modern business methods as well as the general opportunities to be found thereunder for the commission of acts of fraud and dishonesty on the part of the "risk." The policy usually specifically provides that the manner of conducting the business of the insured shall remain during the entire life of the policy as set forth in the proposal.[1]

[1] See Ætna L. Ins. Co. *v.* Am. Sur. Co., 34 Fed. 291; Harbor Commissioners *v.* Guar. Co., 22 Sup. Ct. Rep. (Can.), 542; Molsons Bank *v.* Guar.

Sometimes in an attempt to make the warranties in the proposal of more practical benefit to the insurer than what they otherwise might be, a provision is inserted in the policy requiring the insured specifically to observe and enforce all rules and regulations which may now, or may be at any time made for the guidance and well ordering of the "risk" in his duties or for the prevention and detection of default.

A case in point in this connection is that of Rice *v.* Fidelity and Deposit Company.[1] Here a policy had been issued by the Fidelity and Deposit Company to the insured, upon one Perry, who was in the latter's employ. Perry was guilty of illegally drawing out funds from the bank account of his employer for his own use, without their knowledge. Suit was brought on the policy on account of such withdrawals by Perry, and the insurer pleaded as a defence to such suit that the insured had agreed with it that all checks drawn by Perry on the insured's bank account during the life of the policy should be countersigned by their bookkeeper, and that they had entirely failed to keep this stipulation of the contract. There was a trial of this issue and a verdict and judgment for the insurer. On appeal the court discussed the legal question thus presented at the trial, as follows: "The first complaint which counsel urge against the action of the court below upon the trial is that it received in evidence, over their objection, a certain written instrument signed by Rice Bros. & Nixon (the insured) and dated Aug. 30, 1895, to the effect that the countersignature of John W. Gibble (the bookkeeper) would be invariably required on all checks drawn by Perry in their behalf, and that the court charged the jury that if they believed this instrument was made and delivered to the company before

Co. of North America, Montreal Law Reporter, 4 Sup. Ct. Reports, 376; Haworth *v.* Sickness & Accident Assur. Ass'n, 28 Scottish Law Reports, 394; Globe S. & L. Co. *v.* Employers' Liability Assurance Co., King's Bench, Manitoba, April 24, 1901; 15 & 16 Can. Law Jour. 511; Board of Education *v.* Citizens' Ins. Co., 30 U. C. C. P. 132; Protestant Board *v.* Guar. Co. of N. A., 31 L. Can. J. 186; European Assur. Soc. *v.* Bank, 7 Rev. Leg. 57; 14 L. Can. J. 186; Ward *v.* Law Prop. Assur. Soc., 4 W. R. 605.

[1] 103 Fed. 427; 43 C. C. A., 270.

the bond was delivered, and that the plaintiffs permitted Perry to draw checks on their behalf without the countersignature of Gribble, these facts constituted a complete defence to the action. The argument of counsel is that these rulings were erroneous because the statement in the written instrument that the checks drawn by Perry should be countersigned by Gribble was a representation, and not a warranty, and hence a failure to comply with it constituted no defence to the action, unless the statement was not only false, but fraudulent, and material to the risk, and because the proof was that this instrument was not made or delivered until the bond had been delivered, and there was no evidence to the contrary. For the purpose of the determination of the question presented by this argument, the evidence of the plaintiffs in error will be considered to be true, and the claims of their counsel relative to the facts of this case will be assumed to be well founded. Under this concession and assumption, these are the facts material to the issues now under discussion.

"Before the bond upon which this action is founded was delivered to the obligees, and before it became effective, the company requested them to answer in writing several questions, and they did so. Two of those questions, together with the contract at the foot of the instruments containing the answers, read in this way:

"'10. (*a*) Will he (the employee, Perry) be authorized to sign checks on your behalf? *Ans.* Yes.

"'(*b*) Will the countersignature of any other person be invariably required? If so, whose? *Ans.* No.

"'It is agreed that the above answers are to be taken as conditions precedent, and as the basis of the said bond applied for, or any renewal or continuation of the same that may be issued by the Fidelity and Deposit Company of Maryland, to the undersigned upon the person above named.'

"This instrument was dated Aug. 9, 1895, and was signed by the plaintiffs in error. After the bond had been made and delivered the company again requested answers in writ-

ing to the same questions, and in response to that request the plaintiffs in error made the following answers, and signed and delivered to the company the instrument dated Aug. 30, 1895, which is the subject of the controversy in hand. That instrument contained the following questions, answers, and contract:

"'10. (*a*) Will he be authorized to sign checks on your behalf? *Ans.* Yes.

"'(*b*) Will the countersignature of any person be invariably required? If so, whose? *Ans.* Yes. John W. Gribble, bookkeeper.

"'This is to certify that the answers herein given to No. 10, *a* and *b* are to be substituted for any other prior statements that have been made by us in relation to the application of Walter J. Perry for a bond in the penalty of ten thousand dollars as manager in our employ at South Omaha, Neb. No other statements except No. 10, *a* and *b* shall be affected by this certificate. It is agreed that the above answers are to be taken as conditions precedent and as the basis of the said bond applied for, or any renewal or continuation of the same that may be issued by the Fidelity and Deposit Company of Maryland to the undersigned upon the person above named.

"'Dated at Chicago, Ill., this 30th day of August, 1895.
Signature of employer: RICE BROS. AND NIXON,
By W. H. RICE, Member of Firm.'

"This instrument was delivered to the defendant in error before any of the acts of fraud and dishonesty on account of which this action was brought had been committed by Perry. The bond contains this recital:

"'And whereas the employer has delivered to the Fidelity and Deposit Company of Maryland, a corporation of the state of Maryland, hereinafter called the "Company," a statement in writing relative to the responsibilities, and checks to be used upon the employee in said position, and other matters. Now, then, in consideration of the sum of $100 paid as a

premium for the period from July 25, 1895, to July 25, 1896, a twelve o'clock noon, and upon the faith of the said statement as aforesaid, by the employer, it is hereby declared and agreed that the company will indemnify the obligees on certain conditions named in the bond.'

"The first contention to be considered on this state of facts is the claim of counsel that the plaintiff's statement and agreement contained in the instrument of Aug. 30, 1895, to the effect that the countersignature of Gribble, the bookkeeper, would invariably be required on Perry's checks on their account, and that this statement should be taken as a condition precedent and as the basis of the bond, together with their complete failure to comply with this provision of their contract, constituted no defence to the action because the statement and agreement were representations and were not warranties. The terms 'representations' and 'warranties' are imported in this case from the law of insurance. Under the law on that subject, they generally and properly describe statements of existing facts, not promises or prophecies regarding future acts. In insurance a representation is a statement made by the applicant to the insurer regarding a fact material to the proposed insurance, and it must not only be false, but fraudulent to defeat the policy. Warranty in the law of insurance is a binding agreement that the facts stated by the applicant are true. It is a part of the contract, a condition precedent to a recovery on it, and its falsity in any particular is fatal to an action upon the policy.

"A careful examination of the case in hand disclosed the fact that it has all the attributes of a warranty, and essential characteristics which clearly distinguish it from a representation. A representation is a mere declaration of a statement in fact, but it is neither a condition precedent nor a part of the contract, while a warranty is both. The statement in issue that the countersignature of Gribble will be invariably required on the checks of Perry on the account of the plaintiffs is a part of the contract between the parties to this suit, and a condition precedent to recovery upon it, because the

bond recites that it rests upon the faith of this statement, and because the plaintiffs expressly agree in the written instrument of Aug. 30, 1895, that their statement contained therein shall be taken as a condition precedent and as the basis of the bond. This conclusion has not been reached without a careful consideration of the argument of counsel for the plaintiffs in error, that the statement in this instrument is a mere declaration of an unexecuted intention, and that the failure to comply with such a declaration is not fatal to a recovery upon a contract induced by it. . . . The crucial distinction between a representation and a warranty is that the one is not, and the other is, a part of the contract between the parties, and that the truth of the one is not, and the truth of the other is, a condition precedent to a recovery upon the policy or bond to which they relate. In the cases cited by the plaintiffs in error which we have been reviewing, there was no agreement of the parties that the declarations which they contained were parts of their contracts, no binding agreement that they should be true, no contract that their truth should constitute a condition precedent to a recovery upon them. In the case at bar the parties expressly agreed in writing that the statement of the employers was a part of their contract; that it should be not only the basis of the bond, but a condition precedent, without compliance with which there could be no recovery upon the obligation. The conclusion is irresistible that under this agreement the declaration in this case was of the nature of a warranty, and not of a representation, and our conclusion is: A written statement made by employers to the obligor in a bond of indemnity against the dishonest acts of their employee to the effect that they will invariably apply certain checks to his action, which the parties expressly agree, by the statement itself and by the bond, shall be the basis of the latter, and a condition precedent to a recovery upon it, is in the nature of a warranty, and not of a representation, and a failure to comply with the promise it contains is fatal to an action upon the bond. . . .

"There are other propositions of law which are fairly applicable to this contract that lead to the same result. The complaint alleges and the fact was that the plaintiffs made an agreement of employment with Walter J. Perry at the time this bond was made, under which he became liable to them for the losses which they claimed to have sustained through his dishonest and fraudulent acts. The bond of the fidelity company in suit recited this employment, and gave to the plaintiffs further indemnity to the amount of $10,000 against these losses. The legal effect of these contracts was to create the relation of principal and surety between Perry and the fidelity company. The plaintiffs were necessarily aware of this relation. They agreed in so many words by the instrument of Aug. 30, 1895, that the countersignature of their bookkeeper on the checks of Perry against their account should be a condition of a liability of this surety; and the general rule is that if a condition, known to the obligee, upon which a surety agrees to be bound is not complied with, the surety is discharged."

Again in Harbor Commissioners *v.* Guaranty Company,[1] the facts were as follows: A guaranty policy insuring the honesty of the "risk" had been granted upon the express condition that the answers in the application contained a true statement of the manner in which the business was conducted and accounts kept, and that they would be so kept, and that the insured should immediately upon its becoming known to it give notice to the insurer that the "risk" had become guilty of any criminal offence, entailing or likely to entail loss upon the insured and for which a claim was likely to be made under the policy. There was a defalcation in the "risk's" accounts, and the evidence showed that no proper supervision had been exercised over the "risk's" accounts and the insurer was not notified within a week after the insured had knowledge of the defalcation and after the "risk" had left the county. It was held that as the insured had not exercised the stipulated supervision over the "risk" and had

[1] 22 Can. Sup. Ct. Rep. 542.

not given immediate notice of the defalcation, he could not recover under the policy.[1]

In Globe Savings and Loan Company *v.* Employers' Liability Assurance Corporation,[2] it was held that a condition requiring "all reasonable verification of the statements in the proposal and of compliance therewith" was binding and that "compliance therewith" meant subsequent compliance with the indicated course of conducting the business. Where the course of business outlined in the application is incorporated in the policy, then, upon principles of equity, irrespective of whether a warranty is thereby created, the insurer should be discharged by a departing from that course materially contributing to the loss insured against.

§ 75. (F) **Warranty as to the Number and Duties of the Assistants of the "Risk."** — In view of the difficulty that sometimes might be met with by the insurer in ascertaining the proximate cause of a loss which is claimed by the insured to have arisen under the policy through the direct fraudulent acts of the "risk," it is important for the insurer to know the number and duties of the latter's assistants in order to rightly estimate the probable chance of loss under the policy. For this reason questions are inserted in the proposal and application having reference to the number and duties of the "risk's" assistants. Such questions are important in that they have a direct bearing upon the extent of the liability which the insured asks the insurer to assume. In explanation of this statement it may be stated that while nearly all policies contain provisions to the effect that the insurer shall be liable "only for the personal acts of the risk," nevertheless where subordinates are acting under the orders of the "risk," or in collusion with him, in the commission of fraudulent acts, such inquiries as are here referred to have a material bearing upon the question of the extent of the insurer's liability under the proposed policy.[3]

[1] See also Bank of Tarboro *v.* Fid. & Dep. Co., 38 S. E. 908.

[2] King's Bench, Manitoba, 1901, 15 and 16 Can. Law Journal, 511.

[3] See Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co., 23 Sou. 405 (La.).

§ 76. (G) **Warranty as to the Manner, Time, and Method of Checking the "Risk's" Accounts.** — It is rare indeed when the insured is not required to make some warranties with reference to the manner, time, and method of checking the "risk's" accounts. This matter is usually referred to both in the proposal for and in the policy itself. These policies frequently provide that there shall be an inspection or audit of the accounts and books of the "risk" by the cashier at least once in every six months during the life of the policy. The modern doctrine on this subject has been nowhere more clearly set forth than by the United States circuit court of appeals in the case of Hunt *v.* Fidelity and Casualty Company of New York.[1]

Here an action was brought upon a policy of insurance issued by the Fidelity and Casualty Company to the People's Fire Insurance Company indemnifying the latter against any loss that might occur through the embezzlement of one Kingman, its general agent in the city of New York. The policy was issued upon the declaration signed by the insured containing statements in the form of answers to questions relative to the subject matter of the policy. These statements were by the terms of the policy to constitute an essential part and form the basis of the contract. The declaration also stated that the answers were true to the best of the knowledge and belief of the insured and were to be taken as the basis of the contract between the insurer and the insured. The material statements contained in said declaration were the following: "*Q.* How will moneys reach his (Kingman's) hands? *A.* Paid to him in the course of business for transmission to the company. *Q.* How often and by whom will cash be compared and verified with accounts and vouchers? *A.* Monthly." The court below directed a verdict for the defendant upon the ground that it was established that there had been no monthly examination of the cash and accounts of the agent in compliance with the terms of the insurance. The appellate court in its opinion spoke as follows:

[1] 99 Fed. 242; 39 C. C. A. 496.

"Reading the several statements of the insured together, it is plain that the statements that the cash would be compared and verified monthly with accounts and vouchers meant that the insured would monthly examine the accounts of its agent and compare and verify them with the cash in his hands, in order to ascertain the correctness of his accounts. Such an examination would have shown what he had received by way of premiums, what he had disbursed by way of expenses, what he had transmitted to his principal and how the balance compared with the moneys on hand. A monthly verification of that character would tend to exercise a salutary check upon the transactions of the agent in dealing with the funds of his employer and might prevent as well as reveal any irregularities or dishonest manipulation on his part. It was, to some extent at least, to have been a safeguard to his employer, and to the insurer who was to become responsible for any defalcation of the agent. Corporations engaged like the insured in the business of fire insurance generally conduct their business in different places by local agents, under the supervision of the general agent. It would seem to be the meaning of the statements that the office of the New York agent of the insured should be subject to this supervision for the purpose of verifying his accounts. But if this is not its meaning, it is at all events a promise that either at the New York office or at its general office or at some other place the insured would attempt to make a monthly examination in order to ascertain if the cash in its agent's hands corresponded to the balance which should be there according to his accounts. Promissory statements having been made a part of the contract between the parties by the terms both of the policy and the declaration, it was in effect a warranty which the insured was bound to fulfil in substance according to its meaning.

"It is quite immaterial that the statement is not called a warranty. It is a stipulation embodied in the contract by the holders of the policy for the performance of future acts and as such is an express warranty.

"Undoubtedly the language of the declaration that the an-

swers were true to the best of the knowledge and belief of the insured qualifies the effect of several of the warranties, restraining them to a breach of such representations as were not honestly made by the insured. Several of the statements were in respect to facts existing at the time and previous, and as to those the insured did not stipulate unconditionally, but the language has no reference to the warranties for subsequent acts, *because as applied to them it would be meaningless.* It appeared at the trial that his promise to examine his agent's cash monthly had not been fulfilled by the insured. The monthly comparison of the checks sent to it by this agent with the accounts and vouchers sent by him two months previously was not a comparison of the cash in his hands with his receipts and disbursements. It was merely a comparison of a part of it, the part which he had transmitted, and did not involve any examination of his accounts in order to ascertain whether his cash on hand corresponded with the premiums received during the past two months. No attempt was made to ascertain this by the insured. What was done was of no value in comparing the cash actually in the agent's hands with the amount which he ought to have on hand at that time. In ruling that the promises of the insured had not been fulfilled and the defendant was therefore entitled to a verdict the court below was clearly correct."[1]

The matter now before us brings up for consideration the question whether what was known in the old time law of private suretyship as the "doctrine of laches" has any application to contracts of fidelity insurance. From what has been said by the courts in certain English cases, it might be supposed that the doctrine of laches was in all respects applicable to such contracts.[2]

In the case of Board of Education *v.* Citizens Insurance Company,[3] the proposal for a guaranty policy contained a statement

[1] See also Haworth & Co. *v.* Sickness & A. Assur. Ass. Lim., 28 Sc. L. R. (Sc. Ct. Sess. 1891), 394; Towle *v.* Nat. Guar. Assur. Soc. 7 Jur., N. S., 1109; 30 L. J. Ch. 900.

[2] See Byrne *v.* Muzio, Law Rep. Ir. 8 C. L. 396; Guardians of Westport Union *v.* O'Malley, Law Rep., Ireland, 8 C. P. 412.

[3] 3 Upper Can. C. P. 132.

which was made a warranty to the effect that the books of the "risk" should be balanced at the end of each year, and the cash and securities appearing to the credit of the insured at each balancing time would be examined by its auditor, and the evidence showed that this was not done. Another warranty was to the effect that money should be drawn from the bank by the "risk" only by authority of the insured. The course actually pursued was for the chairman of the insured as its secretary to sign orders to the "risk" directing him to pay bearer so much money. The "risk" then drew his check for the amount without this being signed by any officer of the insured and without attaching the order. Consequently there was nothing that prevented the "risk" from overdrawing moneys for his own use, which he did. It was held by the court that the terms of the policy had not been complied with, and that the cashier had been guilty of such laches as would release the insured from liability under the policy. However, in a later case[1] it was held that the insured's right to recover was not affected because the insured placed extraordinary confidence in the "risk," such confidence involving no violation of the express terms of the policy.

The courts in this country have almost uniformly refused to adopt the English doctrine of laches as the same has been applied in the courts of that country to contracts of fidelity insurance.

Attention is first called to the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company.[2] The opinion in this case has already been quoted from at length, and it is not necessary to reproduce the same here in this connection.[3] There are however certain parts of this opinion which merit repetition at this point. "It is not unreasonable," observed the court, "to hold the insurer to his risk in the broadest sense that is required to indemnify the insured for any loss by dishonesty which fairly falls within the employment of the person whose honesty is guaranteed,

[1] London Guar. Co. *v.* Hochelaga Bank, 3 Quebec, Q. B. 25.

[2] 80 Fed. 766; 26 C. C. A. 394.

[3] See *ante*, § 3.

and to permit no escape except by lines of retreat or avenues of deliverance clearly defined, well marked, and mutually understood as part of the contract, evidenced by the use of unambiguous language for that purpose. . . .

"An employer would need no insurance against that close and relentless vigilance which makes stealing impossible, and under these contracts he is bound to no watchfulness except that which he has contracted to use for the benefit of the insurer. The old form of bond and other security was usually without covenants for watchfulness or inspection by the employer or obligee, and as that is the highest measure of liability of which the business is capable, it is that which the obligee would naturally seek for his protection, always desiring presumably to provide for some such guaranty even against his own negligence or careless business habits. The nature of the risk forbids the idea of any implied or general limitations upon the guaranty against loss by dishonesty, and in our judgment these contracts are not to be construed as imposing any new burdens by mere inference of an understanding between the parties that the business will be conducted with either ordinary or any degree of diligence or prudence as to watchfulness. The insurer gets what he contracts for and nothing more; and he must provide by express stipulation for even ordinary prudence on the part of the assured in taking measures for minimizing or lessening the broad risk we have indicated as that most desirable to the assured and, therefore, that which is intended to be covered by the words of insurance in these contracts, except so far as the 'provisos and condition therein contained' shall have limited that broad liability."

In the case of Ætna Insurance Company *v.* American Surety Company,[1] P., the general agent of a life insurance company, having on his own motion applied to defendant, a "surety company," to furnish to his employer a guaranty policy, that company forwarded to the secretary of the insurance company a certificate which, when filled out and signed by him, recited

[1] 34 Fed. 291.

that the agent, "so far as the secretary's knowledge went," had always faithfully performed his duties, and that he was not then "in arrears or default." It also stated that his accounts "were last examined June 13, 1884, and found to be correct in every respect." This certificate bore date June 16, and the bond June 15, 1884. As a matter of fact P. was then in the company's debt $150, on a draft which he had drawn on the company in March, 1884, and which it had paid, but had required an explanation thereof and demanded repayment. He had had correspondence with the secretary about renewal receipts, the natural inference from which was that the money which they called for had been paid. The company did a very large business, its cash premium income for 1884 being about $2,400,000; and P.'s agency was a comparatively small one. It was also its practice to leave accurate investigation of such agencies until the annual examination, which was had in December. It was held that the unpaid draft was not "arrears or default" within the meaning of the certificate, which referred to collection accounts, and that the secretary was not guilty of such laches as would discharge the "surety company" from liability on the policy for a subsequent defalcation. P. thereafter continued the same system; sending his June report August 4, his July report August 24, and his August report September 29. He was written to October 1, his attention being called to the matter and an explanation demanded. He thereupon returned about October 8, a list of outstanding renewal receipts, and in his September report, which was sent October 29, accounted for all the older collections. His October report came in November 14, and contained nothing but September collections. The insurance company did a very large business, and P.'s agency was a small one, the accurate investigation of which it was the custom to leave until the annual examination, which took place in December. It was held that the company was not guilty of laches in not communicating P.'s delays to the "surety company."

The court said in passing on the question that "the remaining branch of this case is, did English, secretary of the

insured, have adequate reason to know of P.'s defalcation or unfaithfulness? For, although he did not know the facts as to the agent's conduct, yet if his ignorance arose from gross negligence in not ascertaining facts which were within his means of knowledge, he is chargeable with misrepresentation. I cannot find that English ought to have known these facts, or that he was guilty of laches in not knowing them. A requirement which should compel an employer, who is merely stating his opinion, to use, for the benefit of a proposed surety, great vigilance in regard to the accounts of an employee, and greater vigilance than the successful employer uses himself in his own large business, and which has heretofore apparently proved to be adequate, is one which neither law nor good reason demands.

"It is the business of the surety to see that his principal keeps within the guaranty of the bond and not that of the employer. The employer is not called upon to be diligent and watchful in order that the surety may not suffer loss."[1]

In National Bank of Asheville *v.* Fidelity and Casualty Company of New York,[2] the court observed that it was true in the case of fidelity insurance policies that the insurer is not discharged because the insured might by the existence of diligence have learned of the existence of dishonesty on the part of the "risk," and thus by the exercise of more care have sooner discovered the loss.

In Fidelity and Casualty Company of New York *v.* Gate City National Bank,[3] it was held that although the contract may have required the bank, upon the discovery of any fraud or dishonesty on the part of such employees, to give notice thereof to the company, and also immediately after knowledge by the bank of the occurrence of any act on his part involving a loss to the company of more than $100, to notify the company of the same, yet where such contract contained no stipulation making it in the least degree incumbent upon the

[1] See also Pac. Fire Ins. Co. *v.* Pac. Surety Co., 28 Pac. 842; 93 Cal. 7.

[2] 89 Fed. 819; 32 C. C. A. 355.

[3] 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392.

bank to exercise any diligence or care in inquiring into or supervising the conduct of this particular employee, or of any of his co-employees in its service, and imposed upon it no duty of vouching for the fidelity or efficiency of the latter, or of requiring them to watch and report upon his actions and doings, information or knowledge on the part of the bank's cashier — he being only such a co-employee — as to the matters concerning which the company had stipulated for notice would not, relative to it, be, under these circumstances, imputable to the bank itself.

Finally attention is called to the case of Fidelity and Casualty Company of New York *v.* St. Matthews Savings Bank.[1] This was an action wherein a policy had been issued by a guaranty insurance company upon one Zimmerman as cashier for the insured bank. Zimmerman, the " risk," defaulted and suit was brought on the policy by the insured to recover the sum of $10,000 from the insurer. The latter interposed, among other defences, breach of warranty and misrepresentation on the part of the president of the insured bank, as well as negligence and want of due care on the part of the insured in not sooner discovering the defalcations of the "risk" which covered a considerable period of time. The case was referred to a master for findings of fact and conclusions of law, and the latter found for the insured and assessed damages against the insurer in the sum of $7,047.85. These findings were approved by the trial court, and an appeal was taken thereafter to the United States court of appeals for the fourth circuit. This court affirmed the findings of the referee and the order for judgment of the lower court in favor of the insured. In reviewing and approving these findings the court spoke as follows: "The defendant's (the insurance company) exceptions were, in substance, that the master erred in finding as a conclusion of law that the proof was not sufficient to show negligence and want of due care on the part of the plaintiff and its officers in the supervision of the bank and cashier as would relieve the defendant from liability on its guaranty bond ; that

[1] 104 Fed. 858; 44 C. C. A. 225.

the master erred in holding that he was not prepared to extend to a surety in a cause like this the same leniency which the law extends to a surety on a personal bond, because the latter assumes the risk through feelings of kindness, and the former as a matter of business, for a pecuniary consideration and for the purpose of profit." The court further said in this connection, " the order referring the case to a special master directed him to hear and decide all matters of law and fact involved in the case. His findings are clearly within the scope of the order. The court below gave them the weight to which they are entitled under the principles well settled by the decisions to which we have referred. The circuit court was correct in holding that the findings of the master could not be disturbed except for gross error or fraud or misconduct on his part. No evidence of such error or misconduct appearing in the record, the judgment of the circuit court is affirmed."[1]

§ 77. (H) **Warranty as to the Mode of Supervision, on the Part of the Insured, of the " Risk."** — Fidelity policies usually provide that the insured shall observe or cause to be observed all due and customary supervision over the " risk " for the prevention of default on his part. Such a provision of the policy as is here referred to was discussed at great length in the case of the Guaranty Company of North America *v.* The Mechanics Savings Bank and Trust Company.[2] There the court spoke as follows :

" Coming now to a critical examination of these contracts, we find that one of them provides that the employer shall observe or cause to be observed all due and customary supervision over the said employees for the prevention of default, and in the other that the said employer shall use all due and customary diligence in the supervision of said employee for the prevention of default, etc. Much proof was taken to show what kind of supervision is ordinarily and prudently taken by

[1] See generally, on the question of laches, De Jernette *v.* Fid. & Cas. Co. of N. Y., 98 Ky. 558; 33 S. W. 828; Jackson *v.* Fid. & Cas. Co. of N. Y., 75 Fed. 359; 21 C. C. A. 394.

[2] 80 Fed. 766; 26 C. C. A. 394.

other banks, and generally in the banking business to prevent default, it being assumed that there was a contract here for that kind of supervision, or at least that which ordinary prudence in any business would require. Certainly these words may mean that, but not necessarily. They may mean less; for example, they may mean that 'due and customary supervision' which obtained in this particular bank, not over all employees, but over the teller; not over all its business in every direction, but only over that which he did. It may mean that which was in vogue when the contract was made, or that coming subsequently into use as affording a better mode of detection. If that supervision which it was customary for the authorities of this bank to keep over the teller was careless and ineffective for detection, it would be none the less 'due and customary,' and that which they took 'to prevent default.' The point is argued here as if this were a contract for effective supervision; indeed, as if it were a sort of guaranty by the assured that the insurer shall not suffer loss because he would take care of him by that kind of effective supervision which would be sure to prevent, thus reversing the real relation of the parties. And we are told in the brief and in the argument how readily the default could have been detected if other supervision had been given than that which was made. After the fact, we can see how easily these frauds could have been prevented if those who were the victims had suspected Schardt, and had watched him and his books, instead of relying on his honesty and these policies guaranteeing it. But all this is beside the question, which is whether the words of the contract required any other supervision than such as was given. The words of either of the bonds we have quoted are ambiguous, may embrace any degree or acts of supervision, from the highest and most certainly effective to those which are least so, as long as they were 'customary' or 'due.' The standard of excellence or efficiency is not definitely mentioned, nor is any rule or custom definitely prescribed, whether of this bank or of all banks, or of any business in which cashiers and tellers are employed.

By the rule we have laid down, the defendant company should have been more specific in defining the supervision they required; and the contract should have added, if that was the intention, all due and customary supervision in use in the best managed banks, or generally in use by banks conducted with ordinary prudence and skill, or some words sufficiently designating the general custom, now sought to be relied on, if there were at that time any such general custom prevailing in the management of banks; not words applicable to any prudent supervision in many differing ways, but those pointing out a custom of supervision in the particular way now insisted upon. We might rest the point here, but there are facts in the case which indicate quite satisfactorily what was meant by these words.

"The defendant company in its preliminary investigations undertook by examination with written questions and answers, to inform itself of the 'custom' of this bank in regard to frequency of inspections, and it was fully informed by the answers as to that 'custom.' It is, in our opinion, in accordance with familiar, general rules of technical interpretation to read these words by the light of the fact and to hold that this was the 'due and customary' diligence in supervision referred to in these bonds and provided for by the contracts; and by the particular rule we have already announced, if any more diligent or other customary supervision was embraced it should have been specified by apt words showing that intention. Courts may acquaint themselves with the persons and circumstances that are the subjects of the written agreement, and place themselves in the situation of the parties who made the contract; view the circumstances as they viewed them, 'so as to judge of the meaning of the words and of the correct application of the language to the thing described.'[1] Here, on the face of this policy, the parties were making these particular inquiries and answers a part of the contract, and presumptively they were referring to these particulars in the phraseology to which naturally they might be applied.

[1] Goddard *v.* Foster, 17 Wall. 123, 143.

'When we have satisfied ourselves,' says Mr. Justice Miller, 'that the policy is susceptible of a reasonable construction on its face, without the necessity of resorting to extrinsic aid, we have at the same time established that usage or custom cannot be resorted to for that purpose.' Again: —

"'An express contract of the parties is always admissible to supersede or vary or control a usage or custom, for the latter may always be waived at the will of the parties. But a written and express contract cannot be controlled or varied or contradicted by a usage or custom, for that would not only be to admit parol evidence to control, vary, or contradict written contracts, but it would be to allow mere presumptions and implications properly arising in the absence of positive expression of intention to control, vary, or contradict the most formal and deliberate written declarations of the parties.'[1]

"Here, as there, the argument made goes upon the assumption that all that was indicated by these questions and answers, and which fixes, ascertains, or suggests the kind of supervision in contemplation, is nugatory, but that the whole field is open and the power placed in the hands of one of the parties to dictate the extent of supervision by some other custom more efficient to have prevented this loss. We think this cannot be done.

"It is to be observed that the inquiries made by the defendant company did not explore the bookkeeping processes of the bank, nor inquire as to the method employed in the bank; and yet the defendant urges persistently that any departure from the method in use, and by carelessness in bookkeeping, whereby Schardt was enabled to conceal his frauds, is conclusive evidence that the examination and supervision stipulated for was not that which was due and customary, which is to say again that, with proper supervision, stealing is impossible, and which must come at last to mean that the defendant company did not in fact assure anything. It is also said that Schardt, as part of his scheme to defraud, had ordered certain trial balances to be discontinued, and that they were not

[1] Insurance Co. v. Wright, 1 Wall. 456, 470.

taken, as they ought to have been, and that by a comparison of different books and original entries and trial balances the frauds were afterwards, and might have been before, discovered. It is a sufficient answer to all this to say, that these contracts did not specifically bind the bank to this efficient bookkeeping, and that it is the common plan of these defaulters to adjust the bookkeeping to the service of their concealment. It is the kind of fraud insured against. Schardt had authority, or usurped it, to order discontinuance of trial balances; and it was as much a method of his stealing as the false entries, or the putting of the money in his pocket, and in itself it was an act of spoliation like the rest. If it had been the policy of the bank to rely on this vigilance as its sole protection, it would need no bonds or insurance; and, if it had been the policy of the insuring company to protect itself by the eternal vigilance in bookkeeping which is the price of safety, it could easily have stipulated for it as a condition of its insurance, not by dragnet generalities to catch any misprisions, but by determinate regulation. It did not do this; and there is a reason for it. If these new companies engaging in this new line of insurance should insist on perfect protection against loss, and demand a stringent, efficient, and unceasing vigilance that would make these frauds next to impossible, they could do no business, and there is no reason why they should exist, or why any one should pay premiums for such limited risks. Business men would prefer the old style of bonds, which ask no questions and give a broader indemnity. Hence these solicitors for the new insurance use these vague, indefinite, ambiguous, and — tested by the implications now demanded — misleading words and phrases, that customers may not be deterred by too much visible limitation on the risk; and thus they become what Mr. Circuit Judge Lacombe, in one of the cases we have cited, quoting from the books, calls a 'snare for the unwary.' The law does not tolerate the spreading of the net, nor help it to enmesh its victims.

"If we were to concede that the officials of the bank could

not have failed, by ordinary prudence, to have discovered these frauds, or that without some negligence the losses could not have occurred, it would not follow from this that this company, which had guaranteed to the bank and its stockholders the fidelity of the teller and cashier, can escape its liability, because of such negligence. It has not limited its risk to one arising only when the bank officials act without negligence. If it wishes to do that, it should use apt words in its policy, and say so in plain and unambiguous terms, and then its customers would know that they were paying for insurance against losses that could not occur; for 'due and customary' diligence, in the sense of the argument we were considering, means that kind which always brings discovery the moment the stealing begins. We hold that the proof shows, in respect of this, that all was done which the contract stipulated should be done, and possibly more, since the policy only stipulated for an inspection or audit to be made at least once in twelve months, and those stipulated to be customary in this bank were made quarterly, as the insurer was informed. Possibly the one enlarges the other, but that point is immaterial, since the greater number of inspectors includes the less, and either is thus satisfied." Finally, attention is called in this immediate connection to the ruling of the supreme court of North Carolina as presented in Bank of Tarboro *v.* Fidelity and Deposit Company of Maryland.[1] In this case it was held that the kind of supervision required of the insured under policies of fidelity insurance is such as ordinarily prudent business men would give under similar circumstances.

§ 78. (I) **Warranty as to the "Risk" having other Business than that of his Employment with the Insured.** — This warranty, like some of the others that have preceded it, is evidently called for more with a view of enabling the insurer to determine whether the proposal for a policy shall be accepted or not, than as affording a basis for avoiding liability in case of any subsequent breach thereof. From a practical standpoint the warranty is inserted so as to make sure that the

[1] 38 S. E. 908.

"risk's" attention shall be given solely to the employment contemplated by the policy, and that he shall not become involved in outside business transactions which might cause him to get into financial difficulties, impair his financial status, or even lead him to commit an act of fraud or dishonesty in one employment to make good losses incurred in another.

CHAPTER XI.

(VI.) DISCHARGE OF LIABILITY BY BREACH OF CONDITIONS.

§ 79. **Conditions defined, classified, and discussed.** — A condition in the law of insurance is a formal alternative statement of a provision inserted in the body of the policy, which operates to suspend, limit, or avoid the principal obligation of the insurer to the insured, in case the latter fails to comply with its terms. Conditions differ from representations in that they form part of the contract of insurance, and are inserted as such therein. They differ, on the other hand, from warranties in that they are inserted directly in the policy, and do not arise by reference to previous statements contained in the application or proposal, which are made part of the contract only by reference thereto in the policy subsequently issued in compliance with such application or proposal.[1] Conditions may be divided, in the first instance, into two general classes: to wit, first, those inserted in specific terms in the policy and known as "express conditions;" and, secondly, those that arise by implication of law and are known as "implied conditions."

As the effect of a breach of the conditions of a policy on the liability of the insurer is, generally speaking, to suspend, limit, or avoid liability thereunder, the courts have adopted the rule of construing all such "defeasance clauses" strictly in favor of the insured, and against the insurer.[2]

With the acceptance of the policy by the insured, all conditions therein become covenants which serve to define and regulate the duties of the insured to the insurer. With this

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

[2] Strouse *v.* Am. Cr. In. Co., 91 Md. 244; 46 Atl. Rep. 328; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 At. 12; Am. Cr. In. Co. *v.* Cassard, 83 Md. 272; 34 Atl. Rep. 703.

state of facts in mind, it may be said that as between the parties to the contract a faithful observance of all the covenants of the policy applicable to the insured is essential on the latter's part if he desire to enforce fulfilment of the reciprocal covenants on the part of the insurer. For he who commits the first substantial breach of a contract cannot maintain an action against the other contracting party for a subsequent failure to perform.[1]

With respect to the necessity of at least substantial performance of all the conditions of a policy of fidelity insurance, in order to keep the same alive, the remarks of the court in Robertson *v.* United States Credit System Company are directly in point.[2] "It is undoubtedly a general rule," observed the New Jersey court in this case, "that if a party enter into an absolute contract, without any qualification or exception, and receives from the party with whom he contracts the consideration of such engagement, he must abide by the contract and either do the act or stand the consequences." No matter how harsh and apparently unjust in its operation this rule may appear, it cannot be denied that it has its foundation in good sense and inflexible honesty. There, however, seems to be a tendency on the part of the courts, by the adoption of the substantial compliance rule, to give all conditions a liberal construction. This for the purpose of giving effect to the supposed intention of the parties, so as to carry out rather than defeat the purpose for which they were inserted. From this standpoint it appears just that conditions in policies of guaranty insurance should neither on the one hand be so narrowly or technically interpreted as to frustrate their obvious design, nor on the other hand be construed so loosely or inartificially as to relieve the insurer from a liability fairly within the scope or spirit of the policy.[3]

§ 80. **The "Doctrine of Waiver" in its Application to Breach of Conditions, as between the Insurer and the Insured.** — In no other

[1] Rice *v.* Fid. & Cas. Co., 103 Fed. 427; 43 C. C. A. 270.

[2] 44 Atl. Rep. 966; 55 N. J. Law, 12.

[3] Am. Cr. In. Co. *v.* Cassard, 34 Atl. Rep. 703; 83 Md. 272; Jaeckel *v.* Am. Cr. Ind. Co., 34 N. Y. Appl. Div. 565; 54 N. Y. Sup. 505; 59 N. E. 1124.

branch of fidelity insurance law has the "doctrine of waiver" a wider or more important bearing than with reference to the subject of conditions and alleged breaches thereof. For no matter how great may have been the violation of the condition on the part of the insured, the right to avoid the policy by reason thereof may be waived by the insurer, either directly or indirectly. A waiver, as the term is here used, is either the result of an intentional relinquishment of a known right or an estoppel from enforcing it. To constitute a waiver there must be an intention to relinquish the right, or there must be words or acts calculated to induce the other contracting party to believe, and which deceives him into the belief that the holder of the right has abandoned it; and the party deceived must have acted on this belief, so that an assertion of the right will inflict upon him a loss he would not have sustained if its holder had not appeared to relinquish it.[1] The question whether or not a breach of the condition of a policy has been waived or not is ordinarily a question for the jury.[2]

The federal court of appeals for the eighth circuit said on the general subject of waiver that "it is now well settled by the weight of authority that an insurance company may waive a forfeiture or a defence to an action on an insurance policy by acts *in pais*, from which an intention to waive may be inferred, and that such a waiver need not be based on a new consideration or amount to a technical estoppel. If after a loss has happened and the fact becomes known to the insurer that a defence thereto exists or that a forfeiture has been incurred, it takes affirmative action, amounting to a confession of its liability, which induces the insured to believe that the loss will be paid, and to do acts based on such belief which are attended with some trouble or expense, such conduct will amount to a waiver. The rule is, that where an insurance

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427. See also Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; M. S. & L. Ass. *v.* M. K. & T. Tr. Co., 73 Mo. App. 161; Am. Cr. Ins. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340; Am. Cr. Ins. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

[2] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; M. K. & T. Tr. Co. *v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65.

company becomes aware that all rights under a policy have been lost, it cannot, for an indefinite period, disguise its purpose to resist payment of the loss by affirmative action which would rationally lead the insurer to believe that it admits its liability and intends to discharge it." [1]

In a Missouri case the insured sought to avoid the effect of a stipulation providing for immediate notice of any loss that might give rise to liability by the claim made that the insured afterwards waived this provision of the contract. It seems that in March, 1893, the insured's attorneys wrote to the insurer asking upon what ground it declined to indemnify the insured for the "risk's" defalcation. In answer thereto the insurer wrote that "*among many other reasons*" why he thought the company was not liable was that the agent at the time and in the act of embezzling the insured's funds was acting beyond and without the scope of the duties contemplated in the policy. In passing upon the question of "waiver" the court spoke as follows: "We do not think that their letter can be treated as a waiver or abandonment of all defences save and except the one that the 'risk' was at the time acting beyond the scope of employment for which the policy was given. Waiver has been defined as an intentional relinquishment of a known right. Or as said by a learned judge, to make out a case of abandonment or waiver of a legal right, there must be a clear, unequivocal, and decisive act of the party showing such a purpose or acts amounting to estoppel on his part. In Stiepel *v.* Life Association,[2] Judge Rumbauer says that 'waiver' depends solely upon the intention of the party against whom it is invoked, and it is in that respect different from estoppel. It is not meant by this, however, that every secret understanding is to control, for a party's intent will be construed from his acts or what he may do or write. The point here is that there was nothing in defendant's letter of March, 1893, which could reasonably lead

[1] M. K. & T. Trust Co. *v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65; see also Nor. Ev. Luth. Beth. Cong. *v.* U. S. Fid. & Guar. Co., 81 Minn. 32; 83 N. W. 487.

[2] 55 Mo. App. 224.

the insured to believe or infer that defendant rested his defence solely on the alleged ground that the agent had embezzled insured's money while employed outside the work contemplated in the policy. The letter does not specify this, but rather insists that the insurer has other reasons for delaying liability; the letter mentions this 'among many other reasons' which are specified."[1]

§ 81. **Express Conditions.** — For the purposes of treatment herein, conditions in policies of fidelity insurance may be divided into seven general classes, as follows:

First. Conditions in the nature of warranties.

Second. Conditions precedent to the creation of liability under the policy.

Third. Conditions precedent to the maintaining of continuous liability under the policy.

Fourth. Conditions by way of absolute limitation on the liability of the insurer to the insured under the policy.

Fifth. Conditions excepting in specific terms certain perils for which the insurer shall not be liable under the policy.

Sixth. Conditions subsequent necessary to the fixing of liability upon the insurer after the occurrence of a loss involving a contingent liability under the policy.

Seventh. Conditions determining the extent of liability, after the same has become fixed save as to amount.

§ 82. (I.) **Conditions in the Nature of Warranties.** — A custom quite general in its scope has grown up among the guaranty insurance companies of incorporating in the form of express conditions in the body of the policy a number of matters referred to in the proposal and application which are themselves made warranties. In no instance do they differ materially from those affirmative and promissory warranties that have already been considered at length, and the only purpose of inserting them specifically in the policy arises from an effort on the part of the insurer to give to their breach a wider effect in law than they might perhaps otherwise have, if they existed only as warranties.

[1] M. S. & L. Ass. *v.* M. K. & T. Tr. Co., 73 Mo. App. 161.

The following are the four principal conditions in the nature of warranties:

(A) A condition providing that the business of the insured shall continue to be conducted and the duties, powers, and remuneration of the "risk" shall remain in accordance with the statements contained in the "proposal;" and that if, during the continuance of the policy, any circumstances shall occur, or change be made which shall have the effect of making the actual facts differ from such statements or any of them, without notice thereof being given to the insurer, and its consent and approval in writing being obtained, the policy as to such "risk" shall be void from the beginning.

(B) A condition providing that if any material change shall occur or be made during the term of the policy with respect to the method of checking the "risk's" accounts, or in reference to a supervision of the same by the insured as set forth in the proposal for the policy as theretofore made, then the policy shall thereupon cease, and become null and void as to such "risk."

(C) A condition that the policy shall become void from the beginning if the "risk" has within the knowledge of the insurer been a defaulter at any time during any prior service with the insured or with third parties.

(D) A condition to the effect that any wilful suppression of a material fact by the insured in any statement or declaration to the insurer shall render the policy void from the beginning.

§ 83. (A) **Conditions providing that the Business of the Insured shall continue to be conducted and the Duties, Powers, and Remuneration of the "Risk" shall remain in accordance with the Statements contained in the Proposal; and that if during the Continuance of the Policy any Circumstances shall occur or Change be made which shall have the Effect of making the Actual Facts differ from such Statements or any of them, without Notice thereof being given to the Insurer, and its Consent and Approval in Writing being obtained, the Policy as to such "Risk" shall be Void from the Beginning.** — In its nature

the foregoing condition is closely akin to a warranty, and under the provisions thereof any failure to observe its terms is said to render the policy void from the beginning. To properly construe and apply such a condition as the foregoing, it must be borne in mind that the contract of insurance had between the insurer and the insured is always entered into with direct reference to the terms of a collateral contemporaneous contract existing between the insured and the "risk."[1]

The condition stated above may perhaps be considered as a formal recognition by the insurer which drafted the policy of the principle, that in order to release the insurer from liability by reason of material alterations in the contract had between the insured and the "risk," such last named collateral contract must be written into the policy in order that material alterations therein shall have the effect of releasing the insurer from liability under its contract with the insured.[2] The condition refers to and is based upon written representations made by the insured to the insurer prior to the issuance of the policy which are themselves made the subject of a warranty by the insured. They constitute promissory warranties, and the fact that the insurer in drawing the contract has not seen fit to trust to the courts to treat them purely as promissory warranties and not as conditions, might possibly lead to the supposition that the insurers themselves regard breaches of promissory warranties and breaches of conditions as calculated to give rise to different legal results. Therefore, the insurers have sought, as it were, to define the legal effect of such breach of warranty, by transforming such warranty into a condition of the policy itself, and providing that any breach thereof shall render the policy void from the beginning. Such conditions as those now under consideration seem — so far as the effect of

[1] Am. Bond & Trust Co. *v.* Milwaukee Har. Co, 91 Md. 733; 48 Atl. 72; Ger. Am. Title & Trust Co. *v.* Citizens Trust & Sur. Co., 190 Pa. 247; 42 Atl. 682.

[2] U. S. Glass Co. *v.* Matthews, 89 Fed. 828; 32 C. C. A. 364; State Loan & Trust Co. *v.* Cochran, 52 Pac. 466.

a breach thereof is concerned — to be entirely in accord with the principle laid down in the United States to the use of Anniston Pipe and Foundry Company *v.* American Surety Company,[1] to the effect that contracts of guaranty insurance being given to secure the faithful performance of a contract, that any material change made in the contract as between the insured and the "risk" will have the effect in law of discharging the insurer from liability under the policy.[2]

§ 84. (B) **Conditions providing that if any Material Change shall occur or be made during the Term of the Policy with Respect to the Method of checking the "Risk's" Accounts or in Reference to a Supervision of the same by the Insured as set forth in the Proposal for the Policy as theretofore made, then the Policy shall thereupon cease and become null and void as to such "Risk."** — The foregoing condition closely resembles the one just preceding it, and its general purpose is the same; that is, it seeks to transform a promissory warranty into a condition.

A condition of a policy providing that the "risk's" accounts should be checked and supervised in a particular manner was held not to have been violated by the failure of an employee of the insured to carry out his instructions in this respect.[3]

§ 85. (C) **Conditions that the Policy shall become void from the Beginning if the "Risk" has within the Knowledge of the Insurer been a Defaulter at any Time during any Prior Service with the Insured or with Third Parties.** — The foregoing condition differs from the two that have preceded it in that it attempts to transform an affirmative warranty into a condition precedent. It seeks likewise to engraft into the law of fidelity insurance that principle of private suretyship which is so universal in its application, to the effect that the procuring of a bond covering the acts of an employee who has been guilty of previous dishonesty — such dishonesty being known to the employer and not to the obligor in

[1] 92 Fed. 549; 34 C. C. A. 536.

[2] See also House *v.* Am. Sur. Co., 21 Tex. Civ. Appeals, 590; 54 S. W. 303; United States *v.* Am. Bond & Trust Co., 89 Fed. 921; Globe Sav. & Loan Co. *v.* Emp. Liability Assur. Corp., King's Bench, Manitoba, 15 & 16 Can. Law Journal, 511.

[3] Dougherty *v.* Lond. Guar. & Acc. Co., 6 Vic. L. R. 376.

the bond — constitutes such a breach as will relieve the obligor from any liability whatsoever under his bond. Such conditions are unquestionably valid, and any material violation thereof will serve to discharge the insurer from liability.

§ 86. (D) **Conditions to the Effect that any Wilful Suppression of a Material Fact by the Insured in any Statement or Declaration to the Insurer shall render the Policy void from the Beginning.** — The foregoing condition is closely connected with the subject of "concealment" in fidelity insurance law, and seeks to impose the duty upon the insured of stating all material facts known to him at the time the policy is issued upon penalty of releasing the insurer from any liability under the policy in case he fails to do so. Such a condition is classified as one in the nature of a warranty simply because there always exists an implied warranty that the insured, in his declarations or representations to the insurer, has acted at all times with entire candor, and is actuated with an intention to reveal to the insurer the truth, the whole truth, and nothing but the truth with reference to the "risk," whose faithful conduct in the employ of the insured is to be secured through the instrumentality of a policy of fidelity insurance. In general, it may be stated that under such a condition as the foregoing it would seem as if little short of the grossest bad faith or fraud would suffice to affect the insurer's liability under the policy on the ground of breach of the foregoing condition. It has been claimed frequently, and sustained by courts of acknowledged eminence, that in respect to such matters as are here being considered, the insurer and the insured stand upon a plane of equal opportunity for information, and that the latter is not held strictly to the duty of voluntarily disclosing at his peril all matters material to the assumption of liability on the part of the insurer, even when required by the policy so to do, so long as in the discharge of said duty the insured acts in good faith and is not guilty of actual fraud.[1]

[1] Guar. Co. of N. A. *v.* Mec. Sav. Bank & Trust Co., 68 Fed. 459; 80 Fed. 766; 26 C. C. A. 146; Supreme Council Catholic Knights of America

§ 87. (II.) **Conditions Precedent to the Creation of Liability under the Policy.** — The conditions above referred to may be classified as follows:

(A) Condition requiring the payment of the premium as a prerequisite to the creation of the insurer's liability to the insured under the policy.

(B) Condition making the procuring by the insured from the "risk" of a contract to indemnify the insurer against any loss under the policy, a prerequisite to the creation of any liability thereunder.

(C) Condition making the furnishing of suitable receptacles for the storage and protection of property belonging to the insured, and in the "risk's" possession or under his control, a prerequisite to the creation of liability on the part of the insurer under the policy.

§ 88. (A) **Conditions requiring the Payment of the Premium as a Prerequisite to the Creation of the Insurer's Liability to the Insured under the Policy.** — It is frequently provided that no insurance, whether original or continuing, shall be considered in force until the premium is actually paid to the insurer, or as it is sometimes stated, such payment shall be essential to the currency of the policy and a condition precedent to the right to make claim thereunder. With reference to such provisions as have just been referred to, it is sufficient to say that the same are unquestionably valid, and are enforceable as against the insured, unless the insurer has in some manner estopped itself from asserting the validity of such a condition.[1]

In this connection it may be stated incidentally that it has been held that the failure to pay the agreed fee or premium to an insurer which had issued a guaranty policy on an assignee in insolvency was sufficient ground for the removal of such assignee.[2]

v. F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; Ætna Life Ins. Co. *v.* American Sur. Co., 34 Fed. 291; Nat. Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; Am. Sur. Co. *v.* Pauly, 170 U. S. 133.

[1] See Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Watrous *v.* M. V. Ins. Co., 35 Ia. 582.

[2] Nelson *v.* Am. Sur. Co., 77 Minn. 402; 80 N. W. Rep. 300; see also Fid. & Cas. Co. of N. Y. *v.* Johnson, 72 Miss. 333; 17 Sou. 2.

In a late case bearing on this immediate subject, it appeared that the insured had given a small note for a renewal premium which was subsequently paid by check payable to the insurer, who cashed the check and retained the money. A renewal policy was issued reciting the receipt of the premium, and in an action on the two policies the answer admitted the execution of the second policy. It was said that under such circumstances the insurer could not deny to the second policy the same effect as though the premium had been paid in cash at the time the note was given.[1]

The possession by the insured of the policy sued upon is *prima facie* evidence of the payment of the premium, and upon a demurrer to the evidence is conclusive.[2]

§ 89. (B) **Conditions making the Procuring by the Insured from the "Risk" of a Contract to Indemnify the Insurer against any Loss under the Policy, a Prerequisite to the Creation of any Liability thereunder.** — It is sometimes provided that upon the insurer becoming liable under a policy for the acts of any "risk," the insured shall forthwith procure and deliver to the insurer an application for the policy from such "risk," embodying within it an express agreement on the part of said "risk" to indemnify the insurer in case the latter is compelled to pay out any moneys by reason of the issuance of a policy pursuant to such application.

As to whether a failure to procure such an application and indemnity agreement as has just been referred to would be in itself, without any further steps on the part of the insurer, sufficient to avoid the policy, it is somewhat difficult to say. The most that should be affirmed in this connection is that undoubtedly a notification on the part of the insurer to the insured prior to the incurrence of any liability under the policy, that unless the condition above referred to was complied with the insurer would cancel the policy within a certain designated time, and refuse to assume any further liability thereunder, would be sufficient to relieve the insurer from any

[1] Am. Cr. Ind. Co. *v.* Champion Coated Paper Co., 103 Fed. 699.

[2] Fid. & Cas. Co. *v.* Chambers, 93 Va. 138; 24 S. E. 896.

further liability under the policy until such indemnity agreement was furnished. Unquestionably the contractual right to obtain indemnity from the "risk" after payment of a loss is, together with the payment of the premium, the main inducement for the insurer's issuing a policy on any "risk." Therefore the procuring of a policy without the knowledge of the "risk," as evidenced by an application for a policy signed by the latter, considered in connection with the absence of any express agreement by the "risk" to indemnify the insurer, might deprive the latter of a most valuable right.[1]

In Blackmore *v.* Guarantee Company of North America,[2] the court had occasion to construe a policy containing a provision to the effect that it was essential to the validity of such policy that the "risk's" signature should be subscribed thereto. This signature was not procured, though the "risk" was named as one of the parties to the contract of insurance, and in an action brought thereon by the insured against both the "risk" and the insurer, recovery was refused mainly on the ground of the insured's failure to procure the signature of the "risk" to the policy.

§ 90. (C) **Condition making the Furnishing of Suitable Receptacles for the Storage and Protection of Property belonging to the Insured, and in the "Risk's" Possession or under his Control, a Prerequisite to the Creation of Liability on the Part of the Insurer under the Policy.** — The foregoing condition is not by any means a common one in the writing of guaranty insurance policies. It is seldom found except in cases where the "risk" is engaged in some business either requiring long continued possession on his part of valuable property belonging to the insured, or where he is intrusted with the storage of grain, salt, coal, and other commodities which are subject

[1] The fact that the insurer might still have a remedy against the "risk" through the medium of the right of subrogation, in no wise impairs the value of the foregoing condition to the insurer. For the remedy by subrogation is by no means as full and complete as that afforded by an express contract of indemnity running from the "risk" to the insurer, as in the former case the right might be limited in its operation by reason of equities existing in favor of the "risk" as against the insured.

[2] 71 Fed. 363; 18 C. C. A. 77.

to loss, not only through acts of fraud or dishonesty on the part of the "risk," or third parties, but likewise from the action of the elements. Such a provision is inserted in policies as a proper and reasonable safeguard both for the protection of the "risk" and the insurer as well, and a failure to comply therewith might with justice be offered as a legal justification under proper circumstances for a refusal to acknowledge liability under the policy on the part of the insurer.

§ 91. (III.) **Conditions Precedent to the Maintenance of Continuous Liability under the Policy.** — The following may be enumerated as the principal provisions of fidelity insurance policies in the nature of conditions precedent to the maintenance of continuous liability under the policy:

(A) Condition making the consent of the insurer to any material change in the position of the "risk" necessary to the maintenance of continuous liability on its part.

(B) Condition making notification by the insured to the insurer of any information in his possession relative to the "risk's" being engaged in gambling or indulging in any disreputable habits or pursuits, necessary to the maintenance of continuous liability under the policy.

(C) Condition requiring immediate notice to the insurer by the insured of any act on the part of the "risk" that may involve liability to the insurer under the policy.

(D) Condition relieving the insurer of any liability under the policy in case of condonation by the insured of any act of fraud or dishonesty on the part of the "risk."

§ 92. (A) **Condition making the Consent of the Insurer to any Material Change in the Position of the "Risk" necessary to the Maintenance of Continuous Liability under the Policy on its Part.** — The foregoing condition has already been considered under the general subject of promissory warranties.[1] The same purpose which is sought to be accomplished by way of warranty may be attained with at least equal success by inserting in the policy an express condition that if the "risk" is permanently assigned to perform other duties than those properly belong-

[1] See section 72.

ing to the position named in the proposal, notice of such change of duty shall be given to the insurer in writing in order to effect a continuance of the latter's liability under the policy. The rule in regard to such changes when made under the old time private surety bonds was enforced with great strictness in favor of the surety.[1]

The tendency, however, in the case of guaranty insurance policies seems to be towards a less strict application of the rule here referred to.[2]

§ 93. (B) **Condition making Notification by the Insured to the Insurer of any Information in his Possession relative to the "Risk's" being engaged in Gambling or Indulging in any Disreputable Habits or Pursuits necessary to the Maintenance of Continuous Liability under the Policy.** — The foregoing condition has been fully considered in the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company.[3] It will be necessary to state some of the facts in this case before quoting from the court's opinion therein. It appears that when one Schardt was about to be employed as cashier in a bank (after having been bonded as teller for some years) the president of this institution answered certain questions propounded to him by the "surety company" and warranted them to be true to the best of his knowledge and belief. These questions and answers, so far as material to the present matter, were as follows:

"*Q.* Have you known or heard of anything unfavorable as to Schardt's habits or associations, past or present, or of any matters concerning him about which you deem it advisable for the company to make inquiry?

"*A.* No."

It appeared in evidence that Schardt was a heavy speculator. Within less than two years his losses amounted to more than

[1] See in this connection Weir Plow Co. *v.* Walmsley, 110 Ind. 242; Muller *v.* Stewart, 9 Wheat. 680; First Nat. Bank *v.* Gerke, 68 Md. 449; Bank *v.* Dickerson, 41 N. J. L. 448; Germ. Am. Bank *v.* Auth, 87 Penn. St. 419; Detroit Bank *v.* Ziegler, 49 Mich. 157; Rochester Bank *v.* Elwood, 21 N. Y. 88; Pycur *v.* Gibb, 6 El. & Bl. 902.

[2] See H. S. & L. Ass. *v.* U. S. F. & G. Co., 197 Pa. St. 177; 46 Atl. 910.

[3] 80 Fed. 766; 26 C. C. A. 146.

$100,000. So imbued was he with the fever of speculation that he became part owner of a "bucket shop," or brokerage concern. In the summer of 1892, during the time the last renewal of the teller's bond was in force, and before the issuance of the cashier's bond, Sykes, then cashier of the bank, was informed of the conduct of the teller in this regard, and at once notified Baxter, the president of the bank. Schardt was questioned on the next day and admitted that at one time he had been interested in such concern, but had sold out his interest. He also admitted that he had been speculating to some extent, but had ceased to do so. Substantially the same things were stated by Schardt to Eatherly, a director and member of the finance committee of the bank. Some time thereafter and prior to Jan. 1, 1893, when the cashier's bond was issued, Sykes, the cashier, received an anonymous letter again informing him that Schardt was speculating. This was also laid before the president of the bank. Eatherly also received an anonymous letter giving him similar information, which he showed to the president. In view of these facts it was claimed that the guaranty company was released on the ground of breach of the aforesaid condition of the policy issued by it to the bank upon Schardt as the "risk" therein named.

The policy specifically provided "that the insured should at once notify the insurer on his becoming aware of the said 'risk's' being engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits." It was argued in behalf of the insurer that "both the letter and the spirit of the contract were violated in this question of speculation and bucket shop dealing on the part of the 'risk,' which were not reported to the insurer. The condition of the policy in this regard was claimed to be reasonable, having for its purpose the protection of the insured as well as of the insurer. To construe it into a meaningless jumble of words or into meaning such an improbable thing as notice only when the 'risk' is apprehended in the very act of making a speculative deal, would not, it was asserted, be in keeping with the ordinary meaning of the words used, nor with the purpose had in view

by the insured and the insurer in the placing of this condition in the policy. In construing the clause quoted above, the United States circuit court of appeals (sixth circuit) spoke as follows: "The next defence to be considered is that relating to the 'bucket shop speculations' of Schardt, as it is designated in argument. It applies to both bonds, but in a somewhat different form. The language of the condition in the teller's bond is that of a stipulation to notify the insurer of such conduct and that of the cashier's bond is a representation, or rather the defence is that of the misrepresentation of a fact. It is somewhat difficult without displaying all the proof, with a commentary on the credibility of the witnesses and their opportunities of knowledge, to exhibit the fullest justification of our impression that this defence rests on circumstances comparatively inconsequential, which have become formidable only because of the subsequent developments of Schardt's vast gambling in exchanges called 'futures,' the knowledge of which he concealed from all who were interested, including the agent of the defendant company, who was one of the community where these transactions took place and who was there to watch the habits and associations of customers of defendant company, like Schardt. But we cannot take the time here to do this and therefore forego it. There is no proof that Schardt ever confessed to speculation or gambling except that of Sykes, who is somewhat discredited because he has a litigation with the bank, and an apparent animosity towards it. He is also quite indefinite as to time and circumstances, and does not impress us with the certainty of his recollection, although he uses the language of positive statement. He may confuse what Schardt did admit with what he thus testifies as to his admissions. All the witnesses were speaking about long past circumstances, which evidently did not make a serious impression commensurate with that importance which these circumstances now assume in the light of Schardt's defalcations. Sykes recommended him to be cashier in succession to himself, and asked for renewals of his bond; and evidently, if he be an honest man, these admissions and circumstances did not

affect his own belief in Schardt's freedom from serious objection in this employment. There is not the least evidence of any bad faith on the part of any of these officers of the bank, including Sykes, the old cashier, in not making a disclosure of what was known, but only of bad judgment in not being more considerably affected by their information. It may be conceded that it was negligence on the part of the officials of the bank when they first heard of what they did hear, and knew what they did know, not to investigate Schardt's books and accounts with most rigid scrutiny; and not to have immediately discharged him, unless such an investigation should justify his retention, may have made them and the bank liable to those of their customers who suffered by him; and that to be a broker for those who speculate and gamble, even in so small a way as Schardt confessed that he was a broker, or to be a partner of such a broker, or to be interested in a 'bucket shop' if you please, in any way as a broker or customer, is for all bank employees a 'discrediting habit and association.' We agree to all that is said about this in the cases cited. But this defendant company had not contracted for such a guaranty against negligence as had the depositors and bailees who sustained an action of damages in those cases, and this suggested analogy is neither a legal nor a fair test of the contract duty of the bank to its insurer against Schardt's dishonesty in the premises. Here again it must be strictly limited to the words it has used in defining that duty, and none is owed beyond the words by any kind of implications energized by any indignation at the negligence of the bank in not protecting itself, or indignation at the immoral conduct of Schardt. This insurer was insuring the bank for its protection in just such emergencies and against just such negligence, unless the words of this policy speak to the contrary, and had received the consideration for it, while the depositors of the bank in the cases cited had contracted for either common prudence, ordinary vigilance, or against gross negligence. It is a reversion of the attitude we have here and it is a perversion of that principle to apply it here.

"If Sykes ever told Baxter, the president, that Schardt had admitted in 1892 that he had been speculating in a small way but had stopped it, as the learned judge of the circuit court remarks, that was a 'past event;' and as, by the same story, he had stopped it, the president may have thought it in itself unimportant, and dismissed it as the cashier, Sykes, himself did. It may have been gross negligence towards the depositors of the bank to so treat the information, but as he was not then engaged in 'speculation or gambling' (according to the information but not according to the stupendous fact, as we now know it) or was not then 'indulging in any disreputable habits or pursuits' (if these words apply to 'gambling' habits that were before so fully provided for by the stipulation, which may be doubtful), there was no obligation under the stipulation of the teller's bond to report it to defendant company, whatever may be thought of the obligation to protect the bank in the future by investigating Schardt, and discharging him as a duty to depositors who otherwise might sue for negligence. If that which was told was, as Eatherly states it, that Schardt had put $200 in the bucket shop as one of the partners or stockholders, that was not 'speculation or gambling,' or engaging in it in a strict construction, such as we must make here, but only being the agent of those who were speculating and gambling. It may be considered a 'disreputable habit or pursuit,' but however regarded and whether it be broadly and liberally interpreted as 'gambling' or not, it was, too, 'a past event,' when the bank became 'aware' of it and the habit had been abandoned, again according to the information, but not the fact unfortunately for all concerned. If, also, that which Sykes tells was told to Baxter, it is to be now considered in its relation to the representation made preliminary to the cashier's bond. We have an impression that Sykes is mistaken, and confuses or enlarges what was known and done after the anonymous letter; but take it as he tells it and it does not appear that Baxter in bad faith withheld the information. He was answering to the 'best of his knowledge and belief' and the warranty is not absolute with such a lim-

itation, and cannot be, necessarily. If, in good faith, he did not believe what he heard to be unfavorable because Schardt had ceased to deal in the 'bucket shop' or in like good faith did not deem it advisable that the insuring company should make inquiry, surely his answer was true, because he is made the judge of what is 'unfavorable' or what was 'advisable' at least within the limits of what reasonable men think about it. Moreover it is to be observed that, unlike that which appears in the teller's bond, which we have just considered, no mention is made of 'gambling' or 'speculation' in this question. It is 'habits' or 'associations,' past or present, that are called to mind; and we doubt if 'dealing in futures' had come to be considered 'gambling' in that 'plain, ordinary, and popular sense' of which Mr. Justice Jackson has spoken in the quotation we have made so as to bring it within the common thought expressed in 'habits and associations,' as gambling at cards, for instance, surely would be, or if 'speculation' had come to be considered 'unfavorable.' A bank president surely should know that 'dealing in futures' was 'unfavorable,' but *non constat* that a single dealing or small and insignificant dealing which had ceased was a 'habit,' or that it was advisable for the insurer to inquire about it if it had ceased, and he was informed it had.

"If the information he got was, as Eatherly described it, going only to show that Schardt had been a partner in the brokerage agency, then what we have said about the other applies with greater force. Possibly a reasonable man might limit this inquiry to such 'habits' and 'associations' and 'matters' as the moralists ordinarily condemn as involving turpitude or as disgraceful and opprobrious, and not include the business sin of wasting one's own money in speculative trading, even in a 'bucket shop.' If the money be one's own, and not fiduciary money as to which there was no information, it is still ordinarily by those not casuists regarded as more excusable than the common games of chance. At all events, any indefiniteness or uncertainty of language used is to be resolved in favor of the assured, and against the insurer; and certainly

this 'warranty,' whatever force it has, leaves the quality of being 'unfavorable' or 'advisable' to some kind of construction by the mind of him who is answering the question. It is not precisely within the rulings in Insurance Company *v.* Gridley,[1] nor in National Bank *v.* Insurance Company,[2] because it does not depend wholly on the knowledge of the facts, as there, but is a representation as to what has been heard by the one answering. Yet, considering the subject matter, the principle decided is analogous, since the respondent is left to exercise his own judgment about what he has heard, and there is no warranty that that judgment shall be of the best, or an absolutely correct judgment, and that is what we are asked to include within the warranty by this defence. On the authority of Moulor *v.* Insurance Company,[3] and Insurance Company *v.* Raddin,[4] the learned judge at the circuit doubted whether, under the strict rule, this contract should be taken as a warranty, but did not decide that point, as we do not, since we find that, being treated as a warranty, there has been, when properly construed, no breach of it. Baxter, the president of the bank, had heard what we can now see was unfavorable, and that it would have been advisable for the company to inquire about it; but, under the then circumstances, it cannot be said that he reasonably should have known that it was unfavorable, or advisable to make inquiry, and this was left to his determination by the contract. This was a limitation on the warranty itself, and lessened its scope otherwise. We may add to what the learned trial judge said, that under the rulings in Penn Mutual Life Insurance Company *v.* Mechanics Savings Bank and Trust Company,[5] the strict rule as to disclosures which has been imported from the marine insurance law, and which statutes so often have abrogated as unjust,[6] should not be extended to these new policies; and *on this ground all the courts have held that the warranties shall be strictly construed, as we do this.*

[1] 100 U. S. 614.
[2] 95 U. S. 673.
[3] 111 U. S. 341; 4 Sup. Ct. 466.
[4] 120 U. S. 183; 7 Sup. Ct. 500.
[5] 19 C. C. A. 286; 72 Fed. 413.
[6] See Van Cleave *v.* Union Cas. & Sur. Co., 82 Mo. App. 668.

"After the anonymous letter was received, and Schardt had been called before the bank officials, and, denying the charge that he had been speculating, had produced witnesses to disprove it, there may have been rumors afloat, as the witnesses testify, perhaps all traceable to that source; but there was no duty on the bank to run down this kind of information, or to report it. It had not assumed the business of a detective agency by the contract. It was held in Surety Company *v.* Pauly,[1] under a policy similar to this, but under another clause, which is also found in this, requiring notice in writing of any act which may involve a loss coming to the knowledge of the employer, that 'knowledge' and 'suspicion' are not synonymous terms; that the bond does not call for notice of suspicions, but only of a knowledge of some specific fraudulent or dishonest act. The same rule is applicable to the disclosure required under the clause we have in hand, so far as it calls for 'knowledge,' and to the clause in the teller's bond requiring notice on 'becoming aware' of speculation and gambling. Mere rumors and suspicions are not included, certainly, in the teller's bond, and, for the reasons we have indicated, we think not in the other, although it is broader, in requiring notice of things 'heard' as well as things known. It is not everything heard that is required to be told, but only unfavorable habits and associations, or matters important enough for inquiry. We have already stated why these are not included, and the proof shows nothing more formidable than what we considered in that connection. In the case of Supreme Council Catholic Knights of America *v.* Fidelity and Casualty Company (before cited),[2] the contract could not be affected by loose parol statements or concealments of facts, about which no inquiry was made, or by conduct upon which no reliance was placed, but only by misrepresentation or fraudulent concealment provided against as a part of the agreement. Everywhere this rule is found that it is open to the insurer to be specific, and, therefore, mere entrapping generalities will not be tolerated."

[1] 18 C. C. A. 644; 72 Fed. 470, 476. [2] 11 C. C. A. 96; 63 Fed. 48, 57.

§ 94. (C) **Condition requiring immediate Notice to the Insurer by the Insured of any Act on the Part of the "Risk" that may involve a Loss for which the Insurer is responsible under the Policy.** — The foregoing condition in most policies reads substantially as follows: That the insurer shall be notified in writing at its home office of any act on the part of the "risk" which may involve a loss for which it is responsible under the policy as soon as practicable after the occurrence of such act shall have come to the knowledge of the insured. The foregoing condition has been considered in a number of cases, some of which differ widely in the legal conclusions therein reached. Speaking generally, they may be divided into two classes, one adopting a strict construction favorable to the insured, and the other interpreting such conditions liberally with a view to holding the insured to the express terms of the contract assented to by him when he accepted the policy. Turning now to the first line of decisions above referred to, attention is called to the case of the American Surety Company *v.* Pauly.[1]

The policy contained a provision to the effect that the insured should within three months next after notice, accompanied by satisfactory proof of loss, as hereinafter mentioned, had been given to the company, make good and reimburse to the employer all and any pecuniary loss sustained by the employer of moneys, securities, or other personal property in the possession of the employee, or for the possession of which he was responsible, by any act of fraud or dishonesty, on the part of the employee, in connection with the duties of the office or position hereinbefore referred to, or the duties to which, in the employer's service, he may be subsequently appointed, and occurring during the continuance of the policy, and discovered during said continuance, or within six months thereafter, and within six months from the death or dismissal or retirement of the employee from the service of the employer. It being understood that a written statement of such loss certified by the duly authorized officer or representative

[1] 170 U. S. 133; 42 Law Ed. 977.

of the employer, and based upon the accounts of the employer, shall be *prima facie* evidence thereof. It was further provided that the company should not be liable by virtue of said policy for any mere error of judgment or injudicious exercise of discretion on the part of the employee in and about all or any matters wherein he shall have been vested with discretion either by instruction or rules and regulations of the employer. It was further expressly agreed that the company should in no way be held liable to make good any loss which might occur to the employer by reason of any act or thing done or left undone by the employee in obedience to or in pursuance of any direction, instruction, or authorization conveyed to and received by him from them.

The question now before us is of so much importance that there is reproduced here a full statement of the facts as presented in the case just referred to. The policy there sued upon had in it the identical clause above referred to. It was dated July 1, 1891, and was issued by the American Surety Company, as the insurer, upon George N. O'Brien, as the "risk," to the California National Bank, as the insured. The latter was organized in 1888. In January, 1891, one J. W. Collins, who had been cashier from the organization of the bank, became its president, and one George N. O'Brien, who had been a clerk, was appointed cashier. On the application of the latter the policy was given, the limit of liability being $15,000. On Oct. 12, 1891, Collins, the president of the insured bank, was in New York, and effected a loan from the Western National Bank of that city to the California Bank. The loan was made on the note of the California Bank for $20,000, and on the security of promissory notes belonging to the California Bank amounting to $36,250. The proceeds of the loan were credited by the Western National Bank to the California Bank, and subsequently drawn out by the latter. The loan was to the California Bank, and not to Collins. A proper record of this transaction upon the books of the California Bank would have been a credit of the amount to "bills payable" and a debit of the same to the Western

National Bank. The actual entries were a debit to the Western National and a credit to Collins in his individual account, and no credit to bills payable. The result of such entries was that the proceeds of the loan obtained on the credit of the California Bank, and by pledge of its securities, and which should have remained subject only to its disposal, were left subject to the order of Collins by his personal check. On the 13th of October, 1891, O'Brien filled up in his own handwriting a deposit tag which represented that by telegraphic dispatch Collins had that day made a deposit in the California Bank of $20,000. On Oct. 12, 1891, and the following day similar transactions took place between Collins and the United States National Bank of New York, whereby commercial paper belonging to the California Bank was rediscounted for that bank by the United States National, and placed to the credit of the California Bank. On the latter day, by means of a similar false deposit tag, the transaction was falsely entered, as in the case of the Western National, and the proceeds, amounting to $24,500, placed to the individual credit of Collins. It thus appeared that as a result of O'Brien's acts in filling up the deposit tags with statements which were false in fact, Collins's account with the bank was increased in his favor in the amount of $44,500. There was also another item in the account of Collins for $500 obtained from the United States National in the same way, making in all $45,000, which appeared on the books of the California Bank to the credit of Collins. When the bank suspended payment there were standing to his credit only $11,420.90. This sum deducted from the $45,000 fraudulently credited would leave a loss to the bank of $33,579.10; for had it not been for the false credits his account would not have been sufficient to pay checks subsequently drawn upon it, and presumably they would not have been honored. On Dec. 29, 1891, the California National Bank being insolvent, Pauly took possession of all its assets as receiver thereof. The latter, it appears, having knowledge of the acts of O'Brien, failed to give such notice to the company until the 1st of July,

1892, when he submitted his proof of claim for loss. At that time the above-mentioned acts of O'Brien and other acts of similar character were for the first time notified to the company. At the trial a letter from the receiver to the insurer, of date May 23, 1892, was given in evidence, which letter was assumed to be a compliance with the provision for notice of any act that might involve loss, and was treated by the trial court as evidence of such compliance to be passed upon by the jury. This letter read as follows:

AMERICAN SURETY COMPANY,
160 BROADWAY, NEW YORK, N. Y.

DEAR SIR, — I write to notify you that the California National Bank held a bond to the amount of $20,000 in its favor for the faithful performance of duties by J. W. Collins, its late president, also in favor for the faithful performance of duties by Geo. N. O'Brien, its cashier, for $15,000. I therefore notify you that a discovery of fraud has been made of sufficient amount to require the payment of those indemnity bonds to the undersigned, receiver of the California National Bank. I therefore ask that you forward us the necessary blank to make the claim or claims in proper form.

Respectfully yours,

FREDERICK N. PAULY,
Receiver.

During the trial it was contended by counsel for the insurer that the condition now under consideration had a much broader meaning than the insured were willing to give to it. This contention, all important to insurers in this branch of insurance, was substantially as follows: That this provision of the policy, requiring notice to be given of acts that may involve loss, is really but an expression of the duty recognized and enforced at common law requiring an employer, irrespective of contract, to notify his guarantor of the fraud or dishonesty of an employee covered by the guaranty. This duty, by the presence of the provision of the policy providing for its

observance, lies at the very foundation of the contract. The thing to be notified is the act, any act that *may* involve loss, not any act that *must* involve loss. The duty depends exclusively upon the character of the act. It must be an act that may involve loss. As none but fraud or dishonesty under the contract could involve loss, the act must be such as may involve fraud or dishonesty. Of course an act carrying on its face fraud and dishonesty, and hence loss, may not be in fact what it appears to be. That, however, is not the question, but on the contrary the question is whether the act may be what it imports to be on its face, and hence may involve loss. The duty depends upon the inherent character of the act presented to the mind of the insured, and the natural and ordinary consequences of the act, and how far in common experience it is consistent with the integrity of the risk. The provision was presented for the benefit of the insurer. It was one of the provisions upon which it undertook to issue the policy, and a broad construction in favor of the insurer, while it would impose no hardship upon the insured, would secure merely a reasonable degree of protection to the company. There are many degrees of suspicion, and all of them are, of course, short of absolute knowledge. The duty to give notice does not depend upon the insured's suspicion in the narrow sense of that word. It does not demand that guilt shall be inferred from slight evidence. It simply demands that the insured exercise that degree of judgment which any man of reasonable mind should exercise upon acts which come to his knowledge, if such acts, reasonably considered, might involve fraud or dishonesty.

The Supreme Court of the United States disposed of the foregoing contentions adversely to the insurance company in the following manner: As to the construction of the clause of the policy requiring notice of acts, that might involve loss to the insured, the court quoted with approval the following instruction of Judge Wallace to the jury at the trial below: "Under that condition of the policy the defendant is entitled to notice in writing of any act of the cashier which came to

the knowledge of the plaintiff of a fraudulent or dishonest character as soon as practicable after the plaintiff acquired knowledge. It is not sufficient to defeat the plaintiff's right of action upon the policy that it be shown that the plaintiff may have had suspicions of dishonest conduct of the cashier; but it was plaintiff's duty under the policy, when it came to his knowledge, when he was satisfied that the cashier had committed acts of dishonesty or fraud likely to involve loss to the defendant under the bond, as soon as was practicable thereafter to give written notice to the defendant. Now the written notice, the first written notice, was given on the 23d day of May, 1892. And in considering this issue you are to inquire first when it was that the plaintiff became satisfied that the cashier had committed dishonest or fraudulent acts which might render the defendant liable under this policy. He may have had suspicions of irregularities, he may have had suspicions of fraud, but he was not bound to act until he had acquired knowledge of some specific fraudulent or dishonest act which might involve the defendant in liability for misconduct. Now when was it he acquired such knowledge? A good deal of testimony has been introduced here upon that issue. After acquiring it, it was his duty, not as soon as possible to transmit information of it to the defendant, but to do it with reasonable promptness. He was not bound the first day or the next, necessarily, to give notice, but he was to give notice within a reasonable time; and it is for you to say, upon a consideration of all the circumstances of the case, whether he did, within a reasonable time after acquiring such knowledge, send the letter of May 23. It might be reasonable under one state of facts; it might be unreasonable under another. What might be very great diligence under one set of circumstances might be very dilatory under another. Now, first, you are to determine when he really acquired the knowledge. I am not going to recapitulate the testimony. It is claimed upon his part that he did not acquire the knowledge until the close of the examination by the expert, and that was only within a day or two

of the time of mailing the notice ; and so testimony has been given to show that such examination commenced on the first of April and was continued until the latter part of May. On the other hand, it is claimed that he must have acquired knowledge much earlier than this. Now, there is a circumstance of some significance. It is hardly to be supposed that this receiver, holding an official trust, would retain in his employ a cashier after he had become satisfied that by the dishonesty or the fraud of that cashier the bank had sustained serious loss. He did retain him until the 2d day of March. And it may be that while he and those associated with him were entirely satisfied that there had been irregularities, and even perhaps that there had been frauds on the part of the president, they were not aware of any specific acts which could be designated as fraudulent or dishonest on the part of the cashier until the investigation had progressed for a considerable length of time. On the other hand, you have heard the plaintiff's testimony as given in depositions taken in the West. Various extracts have been read, and it is insisted upon the part of the defendant that he must have known of these acts as early as the early part of February, 1892. Now, I charge you, as a matter of law, that if the facts were discovered in the early part of February, and notice was not given until the latter part of May, that was not notice given with reasonable promptness. But if you come to the conclusion that the discovery was not made until the middle or latter part of May, then, in view of the situation of the plaintiff, you may reasonably come to the conclusion that he exercised proper diligence in sending the notice."

Commenting on these instructions, the supreme court said: "We perceive no error in these instructions. They are entirely consistent with the terms of the contract. Much stress was laid in argument upon the words 'which may involve loss' in the above extract from the bond. But when those words are taken with the words in the same sentence, 'as soon as practicable after such act shall have come to the knowledge of the employer,' it may well be held the 'surety company' did

not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not merely suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty. If the company intended that the bank should inform it of mere rumors or suspicions affecting the integrity of O'Brien, such intention should have been clearly expressed in the bond. It was left to the jury to determine when the receiver first acquired knowledge of acts indicating fraud or dishonesty on O'Brien's part, and they found in effect that he had no knowledge of any such act until after the report by the expert bookkeepers, made about or a few days before May 23, 1892. The trial court went far enough when it said, in response to an inquiry by a juror, that notice given May 23, 1892, of a fraud by the cashier, discovered as early as March 2, — the day on which O'Brien left the receiver, — was not as soon as practicable after the receiver acquired knowledge of the facts."[1]

Another case of value in this connection is that of the Fidelity and Deposit Company *v.* Courtney (decided by the United States circuit court of appeals for the sixth circuit),[2] where an action was brought by the insured (a bank) to recover upon a policy given to indemnify the insured against loss by the fraudulent acts of one J. M. McKnight, its president. It appeared in evidence that on June 1, 1894, McKnight was elected vice-president of the bank, and procured a guaranty policy for one year from that date. Upon June 1, 1895, he was elected president, and the policy was then renewed, and was later again renewed for the further period of one year. In the petition in the case filed by the insured defaults aggregating $18,742 were set up. The answer of the insurer set up, among other things, as a defence to the action, that no notice of McKnight's defaults was ever given as required by the

[1] See discussion of this same question along similar lines in the second case of same title as above, reported in 170 U. S. 160. See also same case decided in the U. S. Circuit Court of Appeals, 72 Fed. 487; 18 C. C. A. 644.

[2] 103 Fed. 599; 43 C. C. A. 331.

policy; that the bank did not observe due and customary supervision over McKnight; that the vice-president of the bank knew of the embezzlements of McKnight, and yet the insurer was not notified of the same until long after the bank was closed and a receiver appointed; that the receiver did not file his claim against said company until the 18th of February, 1897; that this notice did not give the particulars of McKnight's default, and that defendant did not fully know the same until the 2d of July, 1897; that Rudolph Reutlinger was teller and cashier, and as such had charge of such financial affairs as pertained to said offices; that Adolph Reutlinger was vice-president, and was daily in the bank, and thoroughly familiar with all its business affairs, and with the acts and defaults of said McKnight as president; that the directors were also familiar with McKnight's overdrafts; that McKnight's defaults and embezzlements were known to the directors, who allowed them to go on without the knowledge of the Fidelity and Deposit Company; that during the time McKnight was in office the books were out of balance about $3,000; that the directors and officers allowed McKnight to be constantly overdrawn in his personal account; that his overdraft, Jan. 18, 1896, was $1,340.14, and on June 8, 1896, it was $626.23, and that, day in and day out, he was overdrawn, of which fact the directors had knowledge, and these irregular acts and defaults were not known to said defendant, otherwise it would have cancelled the policy; that before the renewal thereof, in 1895–96, it wrote the bank to ascertain if McKnight had been conducting himself properly, and was informed by the cashier that McKnight had discharged his duties faithfully; that such statements were made with the knowledge of the directors, but that said statements were false and fraudulent, which at the time was unknown to said defendant; and that thereby the company was led to renew the bond, which otherwise would have been cancelled. When the case went to trial, testimony was offered tending to show various transactions of McKnight's in the course of his business in the bank; among other things the overdrafts of

McKnight, and that checks were given by him, and carried by the cashier as cash items, at the direction of McKnight, for a considerable length of time. There was also testimony tending to show that McKnight, while a candidate for office of mayor in the city of Louisville, which office was to be filled by the council of said city, obtained $1,000 for one Edmunds in bills of $100 each, which money was obtained on Edmunds's check, he at the time having no account at the bank as an individual, but Edmunds & Co. had an account there. Edmunds testified he understood the check was to be taken care of by McKnight. It was also testified that a loan was procured of $2,000 to Britt and Reeder, which money was obtained at the bank after banking hours, and that McKnight said he had a big scheme on hand, and it appeared this money was given for the purpose of obtaining an illegal contract with the councilmen as to possible legislation which might come before them. McKnight, on being asked for an explanation of the matter, claimed that it was all right; that the note was good; that the matter was brought before the board of directors, where McKnight made an explanation to the same effect, and that it seemed to satisfy the board.

There was a verdict against the Fidelity and Deposit Company, and an appeal was thereafter taken to the federal court of appeals.

The court, in its opinion on this appeal, spoke as follows: "It is unnecessary to enter into a detailed account of the various defaults, or comment upon the knowledge thereof of the bank directors, as there was a conflict of testimony upon the subject, upon which the court charged the jury as follows: 'There was also evidence tending to show that J. M. McKnight was president of the bank, and the other officers of the bank, including the directors, had entire confidence in his honesty and integrity up to the time the bank was closed; that none of them had any knowledge that any act of his in the management of said bank was fraudulent or dishonest, until after the closing of the bank; that said bank had a discount committee, who regularly examined and passed on the papers of the

bank, as required of such committee, and the directory of said bank undertook to make a monthly investigation — sometimes twice a month — of the affairs of said bank, and required the president to go through the same with them, and make a full report thereon; that some of the directors were in the bank almost daily, inspecting its affairs, and that they did at all times observe due and customary supervision over said president for the prevention of default; that none of the officers of said bank, including the directory, had any knowledge of the various checks set up in the petition as fraudulent, and that were charged to the account of other parties than those drawing them, or on whom they were drawn, except the clerks who charged them up to said account as stated, and there was evidence tending to show that they charged them up to such accounts by the direction of McKnight, the president, and except, further, R. E. Reutlinger, the cashier and teller of said bank, knew of said checks when they came into said bank, and was instructed to hold them as cash items by McKnight, but further than this he had no knowledge. As to the $2,000 Britt and Reeder note, there was also evidence tending to show that R. E. Reutlinger was required to stay at the bank until after banking hours, and was directed by McKnight to, and did pay out the $2,000 on said note to said parties, but that further than this he had no knowledge thereof. There was also evidence tending further to show that said R. E. Reutlinger informed his father, Adolph Reutlinger, vice-president, of the payment of this $2,000 that night, and that said Adolph Reutlinger made inquiry of McKnight to explain the transaction; that thereupon McKnight told him that said parties were good and solvent, and the note was regularly discounted and all right, and that, if required, Gaulbert or Whallen would sign same with them, and that he (McKnight) would guarantee the payment thereof; that the parties were obliged to have the money that night, and he so kept the bank open to let them have it. There was evidence tending further to show that said Adolph Reutlinger then went before the directory, and told them what McKnight had said in regard

to this note, and said to them that he had made some investigation, and could not find that these parties had any property; that he was unable to say whether or not they were good, and that thereupon McKnight came before said directory and made the same statement to them that he had made to Adolph Reutlinger, assuring them that the note was good, and that said directors believed him and relied on his statement, and so passed the note; that there was no other evidence tending to show any further knowledge of said note, or its true character, by the officers or any of the directors of the bank, than is herein stated, except in the testimony of Jacob Reisch, one of the directors, that some short time after the execution of said note Adolph Reutlinger told him what he had learned thereof as herein stated, and further he says that said Reutlinger told him that the money was used in the mayor's race. This latter statement Adolph Reutlinger denied in his evidence.'

"Upon the subject of the duty of the bank, under these circumstances, to notify the company of these transactions, that it might end its obligations under the bond, if it saw fit to do so, the court charged the jury:

"'Now, I suppose in this case, if the bank had known that McKnight was making these drafts for these various fraudulent purposes, such as buying up councilmen, buying up aldermen, paying his own personal debts, — if the bank had known that, and consented to it, there would not have been a fraudulent act by McKnight for which the bank could recover against this company. But if you believe, from the evidence, that the bank did not know of the fraudulent purposes for which the overdrafts were made, if the overdrafts were made in connection with this matter, — if you believe the bank did not know the fraudulent purposes, — then that changes the result, because, if the bank did not know, and still consented to it, it would not relieve the act of McKnight from the character of being a fraudulent act. So that, as I view the case (you must remember, however, that you are the sole judges of the evidence in this case and its credibility), as I view this

case, however, there would be no fraudulent acts upon McKnight's part (limiting my observations now to the overdrafts), there would be no fraudulent acts upon his part merely in an overdraft, if there were no fraudulent intent behind it, which was concealed from the bank.'

"We think this instruction as favorable as the company was entitled to, and under it, if the jury found that the bank had knowledge that McKnight was doing the acts in question for fraudulent purposes, there could be no recovery upon the bond. We must remember that this obligation was intended to secure the bank against the fraudulent conduct of McKnight in the performance of the duties of his office or position; that McKnight's action, in order to require notice to the company, must have been 'of the discovery of a default or loss under the bond.' While McKnight might have been guilty of reprehensible conduct, it would not require notice unless such as might result in the loss of security or money or personal property of the bank by fraudulent conduct in the performance of his duties to the bank. Such conduct as amounts to a default under the bond the employer is bound to report, and if he condones or continues the employee in his service, without written notice to the company, the latter would be discharged from responsibility. Misconduct which would not amount to a fraudulent act affecting the duties of the officer of the bank would not require notice unless it came within that clause of the bond which requires the employer to notify the company when the employee engages in gambling or speculation, or indulges in disreputable or unlawful habits or pursuits. Whether McKnight's conduct was of this character the court left to the jury to determine. They must have found that there was no such misconduct as would avoid the bond while the bank was in operation, and which it was the duty of the bank to report to the company. In this connection it is averred that the court erred in saying that this knowledge must be the knowledge of the bank, intending thereby to exclude the knowledge of individual directors. In the charge above quoted, as to the knowledge of the bank directors,

we have already said we find no error. We have carefully examined the record, and find no knowledge brought home to the directors individually, or the cashier in his individual capacity, which was not brought to the attention of the board, which would amount to a default under this bond. Such knowledge, in order to be binding upon the bank, must have been acquired in the course of business of the bank transacted by such officer or director.

"The testimony shows no such knowledge of McKnight's conduct, acquired in the bank's business by individual directors or officers of the bank, and not known to the board, as would entitle the company to notice. As was said in Surety Company *v.* Pauly:[1]

"'It may well be held that the surety company did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not simply suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty. If the company intended that the bank should inform it of mere rumors or suspicions affecting the integrity of O'Brien, such intention should have been clearly expressed in the bond.'"

In Pacific Fire Insurance Company *v.* Pacific Surety Company[2] it was held that where an agent in California of an insurance company in New York, under a contract requiring him to remit payments within fifty days from the end of the month in which they are payable, fails through tardiness and neglect, but with no wrongful intent, to remit the premium until within from sixty to one hundred and twenty days after the end of such month, and this action is acquiesced in by the company as a substantial compliance with the contract, failure of the company to give notice of such delay to the insurer indemnifying against losses caused by the agent's fraud or dishonesty is not a breach of a condition of the bond that the insured shall report to the insurer any act of omission or

[1] 170 U. S. 147; 18 Sup. Ct. 558; 42 L. Ed. 982.

[2] 93 California, 7; 28 Pac. 842.

commission on the part of the agent that might involve a loss for which the latter is responsible thereunder.

On this same subject the court in Ætna Life Insurance Company *v.* American Surety Company[1] spoke as follows: "The next question of fact relates to the non-disclosure to the defendant (the insurer) of Patrick's (the 'risk') remissiveness in not making returns. The obligation of the defendant (insurer) was to pay to the plaintiff any pecuniary loss which it had sustained during the specified time by any act of fraud or dishonesty on the part of Patrick, in connection with his duties as agent. The plaintiff (the insured) was obliged to promptly notify the defendant of any act of omission for which the company is responsible hereunder. It cannot be supposed that this provision calls upon the employer to notify the defendant of every act of laches or delay or inefficiency on the part of the agent which ultimately may create a loss to the employer. It means that the defendant shall be notified of acts which may create a loss for which it is responsible; that is, a loss arising from fraud or dishonesty. It is not necessary to undertake to define affirmatively what kind or class of acts must be communicated, and whether or not this obligation compels the employer to notify the defendant of that kind of conduct of the employee, outside of his business, which experience has shown may probably result in dishonesty. It is sufficient to say that mere laches or inefficiency of the employee in the business, which is consistent with integrity, was not required to be communicated. This defence involves the question whether the plaintiff knew or had adequate reason to know, from August to November, that Patrick was a defaulter. I am by no means certain that the plaintiff is to be charged with the duty of communicating, during the life of the bond, facts which it did not know, but which by the exercise of due diligence it could have known. Assuming that such an obligation rested upon the employer, the question whether its officer ought to have known of Patrick's defalcation depends in a great degree

[1] 34 Fed. 291.

upon the same considerations which have heretofore been stated in regard to their knowledge on June 15 (the date when the policy was issued). Greater vigilance or a larger clerical force would have caused the criticism which Webster (vice-president of the insured) made on Oct. 1 to have been made earlier, and would have earlier sent an examiner to St. Louis, but a demand of that grade of vigilance on the part of the employer would speedily result in a cessation of business on the part of the defendant. The conduct of Patrick in not remitting was equally consistent with great remissiveness in collecting or with a lack of integrity. The vice-president evidently did not adopt the theory of want of integrity. I do not find that the plaintiff had knowledge of such circumstances as to compel a knowledge of Patrick's default prior to Dec. 4, when the superintendent visited St. Louis."

In Bank of Tarboro *v.* Fidelity & Deposit Company of Maryland [1] a somewhat different principle from any that has already been given is presented. Here it was said that the insured is not required to give notice of acts that may involve loss under a policy of fidelity insurance upon mere suspicion that the "risk" is guilty of defaults. It is only when it has actual knowledge of such facts as would justify the charge of default against the "risk" that notice to the insurer thereof must be given. In this connection it was asserted by the court that the insured is always entitled to a reasonable time in which to investigate the condition of the "risk's" accounts, if such investigation be necessary to ascertain the facts which would justify the charge of fraud or embezzlement. The insured is not required to act upon mere suspicion in preferring so grave a charge as fraud or embezzlement.

We come now to a consideration of the second line of cases referred to above in this immediate connection. The first of these is that of California Savings Bank *v.* American Surety Company.[2] Here attention was called by the court to the fact "that the policy in suit therein expressly provided that the

[1] 128 N. C. 366; 38 S. E. 909. [2] 87 Fed. 118.

insurer should be notified in writing, at its office in the city of New York, of any act on the part of the 'risk' which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act should have come to the knowledge of the employer." The fraudulent acts of the "risk" were discovered by the insured within six months next after March 7, 1892, and yet the written notice of such acts was not given to the insurer until Dec. 16, 1895, more than three years after the time within which, according to the terms of the bond, it should have been given. The question before the court had reference to whether this was such a failure of performance on the part of the insured as would defeat a recovery by it under the policy in suit.

In disposing of this question the court spoke as follows: "The insured contends that the requirement of the policy as to notice was 'formal,' that is 'immaterial.' Notice of the fraudulent acts of an employee involving a loss is quite a different thing from proof of the loss; and, as shown by the terms of the contract in the case at bar, the parties themselves deemed such notice 'material,' although they may have intended otherwise as to proof of loss. With reference to the latter, — that is, proof of loss, — the policy merely provides that the company's liability shall accrue ninety days after the proof has been furnished; and this provision, according to many authorities, does not require proof to be furnished within any particular period, but merely postpones the right of the action until such proof is furnished. Notice, however, of the fraudulent acts of the employee, is placed upon an entirely different footing. The contract or policy provides that such notice shall be given as soon as practicable after the occurrence of the fraudulent acts comes to the knowledge of the employer, and the importance, the materiality, of prompt notice, as a matter of protection to the company, is clearly suggested in a subsequent provision of the policy as follows:

"'That the employer shall, if required by the company, and as soon thereafter as it can reasonably be done, give all such aid and information as may be possible (at the cost and ex-

pense of the company), for the purpose of prosecuting and bringing the employee to justice, or for aiding the company in suing for and making effort to obtain reimbursement, by the employee or his estate, of any moneys which the company shall have paid or become liable to pay by virtue of this bond.'

"Against the proposition that notice is material, plaintiff quotes as follows: 'In case of loss upon an insurance against fire, an insurer is exonerated, if notice thereof be not given to him by some person insured or entitled to the benefit of the insurance, without unnecessary delay.'[1] The insured's argument is that, because the provisions of this section are limited to fire insurance, therefore under the maxim, *expressio unius*, etc., the failure to give notice without unnecessary delay in the case of any other kind of insurance does not exonerate the insurer, and, consequently, that in all other kinds of insurance policies the requirements as to notice of loss, etc., are immaterial provisions. This last part of the argument, as shown in defendant's reply brief, is a *non sequitur*. Said section does not purport to construe or deal with contracts which expressly require notice to be given, but it makes notice obligatory upon the insurer, in fire insurance, where the contract fails to provide therefor. Whether or not in other kinds of insurance notice is essential depends upon the contracts which the parties make. Said section, however, does emphasize, in the strongest possible manner, the materiality of notice in the case of fire insurance; and it is believed that in fidelity insurance, which is of recent origin, notice of the fraudulent acts of the employee is of equal, if not greater, importance, for the reason that prompt notification may often enable the insurer to avoid, or secure indemnity for losses which otherwise would be inevitable or irremediable.

"The allegation of the complaint that the defendant was, in the month of May, 1892, advised and informed of the breaches of the bond, and the loss resulting therefrom, do not, in my opinion, excuse plaintiff's failure to give the

[1] Civ. Code Cal. § 2633.

prescribed written notice of the fraudulent act of the employee, and said failure is such non-performance of the contract on the part of the plaintiff as to defeat its recovery."

Again, in Michigan Savings and Loan Association *v.* Missouri, Kansas, and Texas Trust Company[1] the "risk" was local agent for the insured at Denver, Col., and appropriated $1,000 of his employer's funds to his own use. The policy was executed Feb. 2, 1891, and provided that the insurer should make good to the insured "any loss which it might sustain because of any misconduct or misappropriation of the 'risk.'" The evidence showed that on July 1, 1891, the insured became aware of the defalcation of the agent and made repeated and futile attempts to get the "risk" to settle, and finally on Dec. 18, 1891, gave notice to the insurer of the "risk's" embezzlement. The defence was that the insured did not give due and timely notice of the "risk's" misconduct. The policy provided that "as soon as any act of omission or commission on the part of the 'risk' tending to fix a liability on the part of the insurer shall come to the knowledge of the insured, the former should cease to be liable under the policy for any future act of the 'risk' in said employment, and it shall be the duty of the insured at once to notify the insurer in writing of said act and to make its claim for any loss from any of said acts within six months after the same shall have been discovered; and on failing to give such immediate notice, or to make such claim within the said time, the policy should be void." The court, in sustaining the said defence, spoke as follows: "It must be seen that the insured so delayed giving notice to the insurer of the 'risk's' misconduct as clearly to bring the case within the conditions above quoted. The insured came to the knowledge of the 'risk's' misappropriation of the money in his charge six months before he notified the defendant company thereof. This was a clear violation of the terms of the policy which required immediate notice in writing to the insurer. This was a reasonable condition of the contract and must be enforced

[1] 73 Mo. App. 161.

according to its terms, which are that upon the insured's 'failure to give such immediate notice, that then the policy shall be void.'"

There seems to be no well settled rule on this subject either in England or Canada. In proof of this statement, attention is here called to a number of cases bearing on this question, decided by English and Canadian courts. In Ward *v.* Law Property Assurance Society[1] a guaranty policy against the criminal conduct of the insured's servants from May 7 for one year thereafter had been issued. It was provided therein that the insured was to give notice in six days after any liability had been incurred on the policy; on the 17th day of May after the expiration of the policy the insured heard of an embezzlement by a servant who received each week large amounts trusted to his care, and it was held that the above words, "any liability had been incurred" by the insurer meant any that it might be clearly responsible for, and if it were not clear that the insured would have been liable had the default been committed before May 7, he might properly examine in order to find out whether it had been committed after or before May 7.

In another case where the policy stipulated that the books should be kept in a certain manner and would be so kept, and that immediate notice be given the insurer, upon the employers' ascertaining the fact of any criminal offence entailing, or likely to entail, loss to the employers and for which a claim was liable to be made under the policy, and the evidence showed no proper supervision of the books and that the insurer was not notified of a loss until a week after the employee's defalcation and after he had left the country, a recovery was refused.[2]

But a condition in a policy of guaranty insurance that the insured should, within ten days after discovery of any fraud or dishonesty of the employee whose honesty was insured, give notice to the company and send as far as possible an

[1] 4 W. R. 605.

[2] Harbor Comm'rs *v.* Guarantee Co. of North America, 22 S. C. R. (Can.) 542; 30 Can. L. J. N. S. 215.

account of the particulars, and that the insurer should not be liable for any fraud subsequently committed, was held to be intended as the basis of a claim, and not as a condition compelling the insured to notify the insurer of a fraud that had occurred prior to the issue of the policy or committed by the employee under another employment.[1]

Where a policy required the insured to give notice immediately of any offence of the "risk" whose good conduct is insured, entailing loss for which a claim might be made under the policy, and the insured knew of a defalcation on the 25th of the month but did not give notice of it until two days later when the employee had fled the country, it was held that the notice was not given in time.[2]

In Commercial Mutual Building Society *v.* London Guarantee and Accident Company[3] it was said that where the insured has stipulated to immediately notify the insurer of irregularities in the "risk's" accounts, that failure to do this will relieve the insurer of liability under the policy. In this particular instance a defalcation was discovered on April 6, and notice was not given until April 17, when the employee had left the country.[4]

§ 95. (D) **Condition Relieving the Insurer of any Liability under the Policy in Case of Condonation by the Insured of any Act of Fraud or Dishonesty on the Part of the "Risk."** — The condition above referred to is found incorporated in fidelity insurance policies in many forms, of which the following is as good an example as any which might be given, to wit: "That if the insured shall at any time during the currency of this policy condone any act of default on the part of the 'risk' which would give the insured the right to claim thereunder and shall continue the 'risk' in his service without notification to the insurer of such condonation, the said insurer will not be responsible hereunder for any default which may occur

[1] Bryne *v.* Muzio, L. R. 8 Ir. 396.

[2] Molson's Bank *v.* Guar. Co. of N. A., 4 Mont. L. R. (Sup. Ct.) 376.

[3] 21 Rev. Leg. 275; 7 Mont. L. R. Q. B. 307.

[4] See also generally Mut. Bldg. & Home. Ass. *v.* Fid. & Dep. Co. of Md., 23 Sou. 405 (La.).

subsequent to such act or default of said 'risk' so condoned." The foregoing condition was considered at length in the case of the Fidelity and Casualty Company *v.* Gate City National Bank,[1] where the doctrine of "constructive notice" on the part of the insured of acts of fraud or dishonesty on the part of "risk" is expressly repudiated.

Here the Fidelity and Casualty Company undertook by its policy to make good to the Gate City National Bank such pecuniary loss, not exceeding $10,000, as it might sustain by reason of the fraud and dishonesty of one Lewis Redwine in connection with his duties as receiving teller, etc. The main question in this case was whether or not, under the stipulation expressed in the contract, the knowledge of the bank's cashier of fraud and dishonesty on the part of Redwine or of any act done by him involving a loss to the company of more than $100 was imputable to the bank itself. The court, in its opinion, spoke as follows: "This case does not fall within the general rule applicable to banks in their dealings with the general public. Much of the bank's business is necessarily intrusted to its subordinate officials or servants and in a large number of instances it will, upon the doctrine of constructive notice, be held to know what comes to their knowledge. This rule is founded upon necessity, and has for its object the protection of those who deal with and trust the bank. The transaction out of which this bond grew was of an altogether different kind than those usually occurring between the bank and its customers. The contract was not made for the purpose of protecting the company in any dealings it might have with the bank, but, on the contrary, the company undertook to protect the bank in the matter of delegating some of its duties it owed to others to Redwine for performance in its behalf. In other words, the company agreed to save the bank from loss to a limited extent by reason of its thus trusting Redwine. And as naturally incident to a contract of this nature the company stipulated that the bank should gain no benefit thereunder if it continued in its service an employee known

[1] 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392.

to be unworthy of trust without prompt notice to the company after he had been discovered by the bank to be untrustworthy. There is not a syllable in the contract, however, bearing the construction that the bank should exercise any degree of diligence in inquiring into or supervising the conduct of Redwine in order that the company might be saved from loss through his misconduct. The bank did not undertake to exercise reasonable care and diligence to find out if Redwine had become untrustworthy, but as to this matter the company in effect invited the bank to repose in peace, for it guaranteed that Redwine would remain honest and faithful. Only after knowledge had actually come to the bank that he was or had become otherwise was it under any duty to the company, and then it was only required to immediately notify the company of what it had ascertained. This bank, it seems, was conducting its business in the manner usual with such institutions, having a cashier, assistant cashier, receiving and paying tellers, bookkeepers, etc. It was not, so far as the company was concerned, under any duty to keep itself informed of the conduct of Redwine. The company must have known and contemplated that the bank's business was to be carried on through its employees, including Redwine, and yet it entered into a contract which does not even suggest that it should be protected if any of these employees other than Redwine should fail in the duties they undoubtedly owed to the bank of informing it of any misconduct on his part. Evidently the company chose to rely solely upon the care which the bank would most probably exercise in protecting itself, and consequently did not require any fixed supervision over Redwine; being willing to content itself with the assurance that the interests of the bank would necessarily require such supervision of him as would in all probability enable the bank to obtain actual knowledge of any fraud, dishonesty, or negligence of which he might be guilty. In the light of the foregoing considerations we cannot think that the parties to this contract contemplated that the bank would be bound to act upon mere constructive notice of Redwine's shortcomings.

The knowledge referred to meant actual knowledge. Constructively whenever Redwine — he being an employee of the bank handling its money — misapplied the same, the bank would have immediate notice of the fact, for his knowledge as a servant of the bank would, if the doctrine of constructive notice were applicable, be its knowledge. Surely the contract cannot be considered as contemplating any such knowledge as this. Again, suppose another employee was colluding with Redwine in concealing his shortage, the knowledge of such other employee would be constructively the knowledge of the bank. Or suppose Redwine and another employee, also under bond, were both misappropriating the bank's funds and each found the other out; could it be said in defence to a suit on Redwine's bond that the other employee's knowledge was knowledge of the bank, or when suit on the other employee's bond was entered, that Redwine's knowledge was constructive notice to the bank and the legal equivalent of the knowledge referred to in the company's bond? In the absence of any guaranty of the bank that its other employees would be honest and faithful, and in view of the purpose of the condition inserted in the bond, it would seem that the better construction of it would be that the bank only obligated itself to act in good faith and impart only actual knowledge on its part. The bond indeed would be of no practical protection, if in order to realize its benefit the bank had to insure not only the honesty and fidelity, but the faithful and conscientious attention to duty of the dozen others of its employees. Stupidity of an employee in not comprehending the effect of ordinary acts and circumstances, which would be equivalent to actual knowledge if within the knowledge of the bank itself, might lead to a forfeiture of the bond, while forgetfulness or mere negligent inattention to duty on the part of such employee would bring about the same result. The cashier, according to the undisputed testimony in this case, was a mere employee. Unless the bank obligated itself to use his eyes and ears, it had no knowledge of Redwine's conduct. . . . The doctrine of constructive notice has no application to

transactions such as that in the present case. Not having required the bank to insure the fidelity of all its other employees as a condition precedent to recovery on Redwine's bond, the company cannot take advantage of the failure of duty on the part of one of the bank's employees. Undoubtedly it was the duty of McCandless, the cashier, to inform the bank as to any misdoings of Redwine which he knew. This was, however, a duty he owed to the bank and not to the company, which could only derive benefit therefrom by an express stipulation in its contract to the effect that it should be entitled to have such duty of McCandless to the bank faithfully performed. The bank suffered from such neglect to a far greater extent than did the company, whose liability under the bond was limited in amount, and surely the bank is not equitably estopped from claiming the benefit under the bond which it had expressly stipulated for."[1]

Again, it should be observed that there can be no such thing as a legal condonation of dishonest acts on the part of the "risk" by the insured, where knowledge of such acts is held only by an officer of the insured, who is himself in collusion with such "risk."[2] However, there can be no question that when the insured has actual knowledge of acts of fraud or dishonesty on the part of the "risk" — and in the face of such knowledge continues him in his employ — that as to losses occurring thereafter no recovery can be had by the insured from the insurer under the policy. This not only because of the express conditions of the policy so providing, but as well on principles of equity and justice.[3]

§ 96. (IV.) **Conditions by Way of absolute Limitation on the Liability of the Insurer to the Insured under the Policy.** — The foregoing absolute limitations to which reference is here made may be enumerated as follows:

(A) Conditions limiting the liability of the insurer to the insured to losses occurring during the life of the policy.

[1] See also Globe Sav. & Loan Co. *v.* Emp. Liability Assur. Corp., 37 Can. Law Journal, 511.

[2] Am. Sur. Co. *v.* Pauly, 170 U. S 133.

[3] See Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 43 C. C. A. 331.

(B) Conditions limiting the liability of the insurer to the insured to all claims for loss discovered and filed within a certain designated time after the expiration or cancellation of the policy.

(C) Conditions limiting the liability of the insurer to the insured to all claims for loss filed within a certain designated period after the death, suspension, dismissal, or retirement of the "risk."

(D) Condition limiting the right of the insured to make and file claims under the policy to a certain designated period, after the insolvency of, or discontinuance of business by, the insured.

(E) Conditions excluding from the liability of the insurer to the insured all claims for money used by the "risk" within the period of liability to repay or refund moneys taken by the "risk" from the insured prior to the commencement of the insurer's liability under the policy, or prior to a designated period next before the time of giving notice to the insurer by the insured of a claim thereunder.

§ 97. (A) **Conditions limiting Liability of the Insurer to the Insured to Losses accruing during the Life of the Policy.** — The foregoing is usually found in the policy in the form of a provision, "that the insurer shall not be liable thereunder for any fraudulent act committed, or for any moneys or property misappropriated or not accounted for by the 'risk' prior to the date designated for the commencement of the policy." A case in point in this connection is that of Dorsey *v.* Fidelity and Casualty Company of New York.[1] Here the Fidelity and Casualty Company, as insurer, issued a guaranty policy on several employees of the insured, covenanting that during the continuance and force of the policy certain specified employees of the insured should faithfully and honestly discharge their duties in their several capacities, and also should faithfully and truly account for all moneys and property, etc. One of the employees, named in the schedule attached to the policy, made a wrongful delivery of freight,

[1] 98 Ga. 456; 25 S. E. 521.

in consequence of which the insured was compelled to pay the value of such freight to its true owner, the wrongful delivery having occurred before the policy was executed. The court in its opinion says: "It seems to me absolutely free from doubt that under the contract between the insurance company and the receiver it was never contemplated that the company should be in any manner responsible or liable for any breach of duty or misfeasance on the part of any employee of the insured which occurred before the policy was issued. The company simply undertook to guarantee the faithful and honest discharge of duties by the employees named in the bond from and after its date. The contract as to its operation related exclusively to the future, and not to the past. We do not see that it makes a particle of difference that one of these employees, in consequence of a past act of negligence, has become liable to the receiver, and is still liable at the termination of the employment to respond in damages to his master. This was a matter with reference to which the insurance company did not covenant with the insured, and there is no more reason for holding the company responsible for such damages than there would be in making a surety on a promissory note liable for a pre-existing indebtedness of his principal which the surety had never in any manner contracted to be or become liable for."

§ 98. (B) **Conditions limiting the Liability of the Insurer to the Insured to all Claims for Loss discovered within a certain designated Time after the Expiration or Cancellation of the Policy.** — It is customary to provide that in the event of the expiration or cancellation of a policy the right of the insured to make a claim thereunder shall cease at the end of ninety days next after the date of such expiration or cancellation. Such a condition as the foregoing was considered by the court in DeJernette *v.* Fidelity and Casualty Company of New York.[1] Here the discovery of the fraud or dishonesty of Ramsey, the "risk," was not made, according to the allegation of the petition, until the third day of May, 1893, and on the 20th

[1] 98 Ky. 558; 33 S. W. 828.

of the same month notice thereof was given to the company. By the express terms of the policy, it was provided that within three months after such discovery as aforesaid, and within three months after the expiration of the bond, the employer shall give full particulars of any claim thereunder to the company. This was not done for more than three months after the expiration of the renewal of the bond and for more than one year after the expiration of the bond. In passing upon the question of the insurer's liability under such a state of facts the court observed that "the company desired by these provisions to require vigilance on the part of the employer to discover and give notice of the fraud and dishonesty of the employed. It was of the utmost importance that this be done. The company could protect itself to some extent by having such information. It required and had the right to expect vigilance on the part of the employer. . . .

"The evidence showed defalcations between Jan. 19, 1891, and Jan. 19, 1893, but knowledge thereof never came to the insured until May 3, 1893. The employer was guilty of gross negligence in failing to make a discovery of the fraudulent conduct of his deputy. Doubtless he was unaware of the terms of the guaranty bond, requiring him to make the discovery within a given time, still he is presumed to know its provisions and was bound by them. . . . The liability of the insurer for an act committed during a given period must be determined by the terms of the contract in force at the time of its commission, and a subsequent renewal does not extend the time for the disclosing of the wrong and the enforcement of the liability therefor. . . . The discovery must be made within three months after the expiration of the contract during the currency of which the act was committed."

In an English case a policy was issued, guaranteeing the insured against loss by the fraud of the "risk" which should be committed and discovered during its continuance. The policy terminated at the end of one year, was subject to conditions precedent requiring immediate notice on the discovery of any fraud on the part of the "risk." It further provided that all

claims should be made within three months after discovery thereof, and that it should only cover losses incurred within twelve months before notice of claim. It was held that the insurer was not liable for a fraud committed within the year, but not discovered until after the expiration of the policy.[1]

§ 99. (C) **Conditions limiting the Liability of the Insurer to the Insured to Claims for Loss filed within a certain designated Time after the Death, Suspension, Dismissal, or Retirement of the "Risk."** — The customary provision of policies in this connection is to the effect that in the event of the death, suspension, dismissal, or retirement from the position scheduled of the "risk" while in the employment of the insured, the right to make a claim thereunder as to such "risk" shall cease at the end of ninety days next after either of such events, whichever shall first happen. The foregoing condition has been many times before the courts for judicial construction. A leading case on this immediate subject is that of Lombard Investment Company *v.* American Surety Company,[2] the facts of which were as follows: The American Surety Company executed to the Lombard Investment Company four guaranty insurance policies for one year each, covering the years intervening between Nov. 1, 1888, and Nov. 1, 1892, and in each of these bonds one Russell was named as the "risk." Russell remained continuously in the employment of the insured until June 18, 1892, when he retired. The insured did not discover the loss occasioned by the dishonest acts of Russell until August, 1892. On Aug. 26, 1892, a written notice was sent to the American Surety Company of the loss resulting to the insured by reason of the embezzlements of Russell during the first, second, and third terms of the indemnity policies, the last of which losses occurred March 7, 1891. The policy provided that at the cessation of the "risk's" employment he should deliver over to his employer all books, documents, effects, money, etc.,

[1] Fanning *v.* London Guar. & Acc. Co., 10 Vic. L. R. Law, 8; see also Com. Mut. Bldg. Soc. *v.* London Guar. & Acc. Co., 7 Montreal L. R. Q. B. 307.

[2] 65 Fed. 476.

belonging to the latter. The court construed the term "cessation of employment" to mean the end of the term of twelve months named in the policy as the period of liability thereon, unless the same should be sooner ended. The policy further provided that the insurer should make good all loss occurring during the continuance of the policy and discovered during the said continuance or within six months thereafter, or within six months from the death, dismissal, or retirement of the employee from the service of the employer. With reference to this clause the court said: "The simple meaning of this clause is that the insurer shall be responsible for such defaults as may be discovered within twelve months' term, and if not so discovered before the first day of November, 1889, the end of the term, six months' grace is accorded for making of such discovery; or if the employee should die, or be dismissed, or retire from the service of the employer before the expiration of the term of twelve months, then within six months from the date of such death, dismissal, or retirement. Had the conditions of the bond stopped here, it would give color and force to the contention of the insured, that this would have been simply a covenant contract, which, under the state statute, would carry the right of action thereon over a period of ten years from the day when the right of action accrued.[1] But the contract contains this further provision: 'As a part of this bond, that no suit or proceeding at law or in equity shall be brought to recover any sum hereby assured, unless the same is commenced within one year from the time of the making of any claim on the company.'

"To make still more apparent the intent and meaning of the contract as to the time within which an action for default thereon might lie, the succeeding paragraph imposes certain duties upon the assured to entitle him to a right of action for any default. This provision is as follows: 'That the company shall be notified in writing, addressed to the president of the company, at its office in the city of New York, of any act or omission on the part of said employee, which may involve a

[1] Rev. St. Mo. 1889, Sec. 6774.

loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act shall have come to the knowledge of the employer.'

"This paragraph does not stop at this point, but proceeds as follows: 'That any claim made in respect of this bond on said employee shall be in writing, addressed to the president of the company as aforesaid, as soon as practicable after the discovery of any loss for which the company is responsible hereunder; in case of death, dismissal, or retirement of said employee within six months thereafter; and in all other cases within six months after the expiration of this bond, as aforesaid, or within six months from the death, dismissal, or retirement of said employee.'

"From all of which it seems clear to my mind that a period of six months is accorded for the discovery of a default, after the expiration of the term of twelve months; and that in case of a default occurring within the term, and the employee shall die, or be dismissed, or voluntarily retire from service during the term of twelve months, notice and claim of loss must be made within six months after the event of death, dismissal, or retirement. There could be no dismissal or voluntary retirement of the employee save during the continuance of the term; and the term 'in case of death' must be known by its associates, and be interpreted in connection with the words 'dismissal or retirement,' and in consequence it means a death occurring during the existence of the twelve months' term, as there could have been neither sense nor meaning in making a provision respecting a death which did not occur during the term. The evident object of this provision was that, in case of death, dismissal, or retirement, which must occur inside of the twelve months' term, the period of the six months in which to make claim of loss should date from that event, and not from the first day of November, 1889, the end of the term of service under the contract; and if claim of loss, in case of death, dismissal, or voluntary retirement from service, must be made within six months from the event, the conclusion is irresistible that, where the term of twelve months' service expires by lapse

of time, likewise must claim of loss be made within six months thereafter.

"Had all the bonds for the successive years been executed at one and the same time, contemplating and providing for a term of service extending over a period of three or four years, there would be persuasive plausibility in the contention of the learned counsel for the insured that the term 'expiration,' as employed in the contract, might be construed to refer to any time during the four years' term when the employee retired from such service. But the first contract was a separate and independent contract, — the only one during the twelve months in existence and in force, — and its provisions in the particular under consideration must be construed in respect of the twelve months' term contracted for by the insurer. The paragraph last above referred to concludes with these words: 'And upon the making of any such claim, on account of any employee, this bond shall wholly cease and determine, as regards any liability for any act or omission of such employee committed subsequent to the making of such claim.'

"This presupposes that a claim of loss might be presented during the running of the year of the term of employment, as there could be no continuance in service, in contemplation of the contract, after the end of the year, without a renewal contract. On the expiration of the term under the first bond, Nov. 1, 1889, the insurer executed to the insured a like bond, assuring it against loss for the year ending Nov. 1, 1890. This bond contains in legal effect the same recitals and conditions as its predecessor, except in the particulars now to be noted. Within it occurs this provision: 'That the company, upon the execution of a stipulated amount of risk or insurance, under the terms of this bond, in behalf of any employee, shall not thereafter be responsible to any employer under any previous insurance of said employee; it being mutually understood that it is the intention of this provision that but one (the last) insurance of the employee shall be in force at one time, unless otherwise provided.'

"Then follows this clause: 'The schedule hereto annexed is hereby declared to be a part of this bond.'

"This schedule referred to contains the following recitations: 'Whereas the schedule bond issued Nov. 1, 1888, by the American Surety Company of New York, in favor of the Lombard Investment Company of Kansas City, Mo., on certain employees therein mentioned, and others subsequently bonded and guaranteed subject to its provisions, expires Nov. 1, 1889; and whereas said bond allows six months from said date of expiration in which to make claims for losses thereunder, the provisions contained in lines 91 to 95 of the bond hereto attached are hereby modified so as to recognize the right of the employer to make claim within six months from the expiration of the bond first mentioned, for any loss occurring thereunder; but with the understanding that the aggregate liability of the said American Surety Company for the acts of any employee under both the bonds herein mentioned shall not during said period exceed the amount of the last guaranty or bond, upon the employee for whose acts a claim may be made.'

"This is an express declaration and claim on the part of the insurer as to its understanding of the effect of the provisions of the first bond in respect of the time within which any claim thereunder for loss should be made, to wit, within 'six months from said date of expiration,' which was Nov. 1, 1889, unless, as we have shown, the period of expiration was earlier brought about by reason of the death, dismissal, or retirement from service of the employee. Therefore, in order to preserve to the insurer the benefit of the provision respecting the six months' time accorded in the first bond, this saving clause was added, qualifying the effect of the words contained within the lines from 91 to 95 in the preceding part of the last-named bond.

"When the plaintiff accepted this second bond, with its expressed provision of the limitation intended by the first bond, it thereby recognized and adopted such construction. Aside from the recognized rule that in construing a contract, weight

will be given to the common understanding of the parties as to its effect, evidenced by their acts and admissions, when the plaintiff accepted from the defendant the second bond containing the explicit statement that only six months was allowed from the expiration of the first bond, to wit, Nov. 1, 1889, with the further stipulation that the liability of the assurer for any loss occurring under either or both bonds should in no event exceed the sum guaranteed under the bond, which was $20,000, it created an estoppel against any claim based on a longer period of limitation, or for the liability of $40,000, the aggregate of the two bonds. When the second bond was presented, the plaintiff had the right to refuse to accept it, with the recitation contained in the schedule, and to demand a modification thereof. Failing to do so, by accepting the bond he left the assurer during the whole term of its duration relying upon the fact that the plaintiff understood the provision as to the time within which any claim for loss could be presented under the first bond, as stated in said schedule, as also that the extent of defendant's liability under both bonds did not exceed $20,000. Under such circumstances, the just rule of law applies, that he who remains silent when he should speak, shall not be heard to speak when he should be silent. No person will be allowed to adopt that part of a contract which is favorable, and reject the rest, to the injury of him from whom he derives the benefit. As no claim was made under the first bond of any loss for more than three years after its expiration, the court, on the agreed statement of facts, declares the law to be that the plaintiff is not entitled to recover under the first count of the petition. While there is some variation in phraseology in the third bond, it in no essential manner differs from the legal effect of the second bond; and as the last two bonds, covering the terms, respectively, from Nov. 1, 1889, to Nov. 1, 1890, and from Nov. 1, 1890, to Nov. 1, 1891, are in their substantive effect the same, and no claim of loss under either was made prior to August, 1892, the same result must follow, that under the agreed statement of facts, the court declares the law to

be that the insured is not entitled to recover under either the second or third counts of the petition; and the issues are found for the insurer." Let us turn next in this connection to the case of Guarantee Company of North America against Mechanics Savings Bank and Trust Company.[1] The United States court of appeals, in its opinion therein, said: "A separate defence is made on the teller's bond, that it limits the risk to a loss sustained 'and discovered during the continuance of the currency of this bond and within six months from the employee ceasing to be in the said service.' As the bond is written, it plainly covers any discovery within the next ensuing six months after Schardt had ceased to be teller, provided, of course, the default occurred while the bond was current. The liability on the bond would cover only such theft as occurred while he was teller under the bond, and when he quit that employment the 'said service' would cease. No other service can be meant, or applicable to the contract, except a service as teller under the bond. If the twelve months of the bond expire, and the teller continue in the employment of teller without a renewal of the bond from this company, yet in contemplation of this contract 'said service' has ceased; for it means that service which has been insured by this bond and its renewals, and no other service, either as teller or otherwise. That ceases whenever the bond ceases. This relieves the absurdities suggested in the argument based on the quotations from the bond, and a misconception that the discovery must be made while the bond is current, and also prevents the suggested prolongation of the limitation as to the time. Whether, if the teller should leave the position of teller so early during the twelve months' duration of the bond that the six months allowed for discovery would expire before the bond itself expired, the time for discovery would, nevertheless, by the terms of the bond, continue to the end of the bond, we need not decide. But if he leave so late that the six months' limitation would continue beyond the duration of the bond,

[1] 80 Fed. 766; 26 C. C. A. 394.

we have not the least doubt that a discovery made within six months from his actual quitting would be within the limitation. Schardt was elected cashier Jan. 1, 1893. The teller's bond expired Jan. 16, 1893, and the discovery was made in April, 1893. Whether we count the six months from January 1 or January 16 seems immaterial, on any facts we know, for either would be within the limitation by a discovery in April next ensuing. If, after his election as cashier, he continued to act as teller, and fraudulently appropriated any money before January 16, the defendant company would still be liable, but not for any default as teller after that date. The discovery must have been made within six months from that date, at the very latest, whether he had then quitted the service of teller, in fact, or not. He had then quitted the service which had been insured, and the bond should read as if it had been written 'within six months from the employee's ceasing to be in said service under this bond or its renewals.' Perhaps we should notice that the insuring terms of the bond immediately preceding the above-quoted clause cover defaults 'in connection with the duties of said office or position, or with any other duties assigned to him by the employer in the said service.' But obviously this does not affect the ruling we have made. It does not enlarge the import of the words 'said service' in the limitation clause, as we have construed it. Whether he acts as 'teller,' strictly so called, or is assigned to 'other duties,' no matter what, they, being all covered by the bond, are within the service under the bond, and any acts of any character constitute 'said service;' but in either clause, as used, these words do not mean the general service as employee at any and all times whatever, but only that gèneral service as an employee of the bank, in any kind of duty assigned to the 'teller and collector,' during the twelve months covered by the bond, that twelve months' of service being the 'said service' meant in either of these stipulations. It might be difficult, under the terms of the bond, to start the running of the six months by any 'ceasing of said service,' while the employee remained at work in the bank in

any capacity, because of the very broad insurance of all duties assigned to him; and possibly all that the defendant company can certainly claim under the words the company itself has chosen to define the limitation for its protection, as applied to the facts of this case (and to them we confine our judgment), is that the six months shall commence not later than the expiration of the bond, and they shall be bound for no discoveries after six months from that date. Again it is obvious that. under the rules of interpretation we have been applying in this case, it was the duty of the insurer, by plain and unambiguous words, to have fixed any other limitation it intended than this, which is most favorable to the assured on the words that are used, and most consistent with the general purpose both parties had in view, namely, to protect twelve months of the service of Schardt in this bank, giving a reasonable time for terminating that liability by a limitation fixed by the contract and not depending on the ordinary statute of limitations, based on public policy, and measuring that limitation of time from the discovery of the frauds, and not from the date of their commission and concealment of the fact. On the one hand, it might be unreasonable to so construe the words 'ceasing to be in said service' as to include a service after the bond had expired, thereby prolonging the limitation on discovery indefinitely in its relation to the termination of the twelve months covered by the bond, and on the other to so construe the words 'discovered during the continuance of this bond, and within six months from ceasing to be in said service,' as including only a discovery within the twelve months, thereby cutting off any possible liability for a fraud committed within the last minute of the duration of the bond, or so late as to furnish no time for investigation; but it is an entirely reasonable construction, which, consistently with the words, avoids either of these extremes, and fairly requires the assured, at the very latest, to find the faults within six months from the termination of the bond. Counsel for the plaintiff denounce these perplexing stipulations as designed to mislead, and they are clearly not definite, open, and unequivocal, as

they should be to express a distinct purpose; but we may point to the fact that our construction is analogous to similar provisions in the ordinary contracts of insurance, and conforms to similar stipulations of this very contract, giving three months for discovery after cancellation, and to the stipulations of its cashier's bond, terminating its liability within three calendar months from the expiring of its bond."

A conclusion in line with the foregoing was arrived at by the United States supreme court in American Surety Company *v.* Pauly.[1] Here a fidelity insurance policy had been issued containing a provision reading as follows: "Notice of loss shall be in writing, addressed to the company as soon as practicable after the discovery of any loss for which the company is responsible, and within six months after the expiration or cancellation of this bond, as aforesaid." In this case the bond expired by its limitation at the end of one year, and also by the death, dismissal, or retirement of the employee from the service of the employer, and within six months thereafter the claim of loss was required to be made. The court, in its opinion, spoke as follows: "We have seen that by the terms of the bond in suit the company agreed to make good and reimburse a loss to the bank, caused by any act of fraud or dishonesty on the part of O'Brien, in connection not only with his duties as cashier, but in connection with the duties to which in the employer's service he may be subsequently appointed, and occurring during the continuance of this bond, and discovered during such continuance, or within six months thereafter, and within six months from the death, or dismissal, or retirement of the employee from the service of the employer.

"The frauds to which the verdict of the jury referred occurred in October, 1891, during the continuance of the bond. The bank suspended Nov. 12, 1891. The company insists that within the meaning of the bond, O'Brien's 'retirement' occurred when the bank ceased to do business and closed its doors, and the bank examiner entered upon an investigation

[1] 170 U. S. 133; 18 Sup. Ct. Rep. 558; 42 Sup. Ct. Law Ed. 982.

of its affairs; consequently, it was argued, the discovery of the fraud was not within six months from the 'retirement of the employee from the service of the employer.'

"Undoubtedly, the company did not agree to be liable for any fraudulent or dishonest act of the cashier not discovered until after six months from retirement from the service of the bank. But is it true, that within the meaning of the bond, O'Brien retired from the service of the bank when it suspended business on Nov. 12, 1891? We think not. The bank was in existence under its articles of association while the examiner, under the order of the comptroller of the currency, was engaged in the investigation of its affairs. Such investigation did not of itself have the effect to discharge O'Brien from its service. It is true that when the bank suspended business, and the investigation of the examiner commenced, O'Brien ceased to perform the ordinary duties of a cashier. But within the meaning of the bond, O'Brien did not retire from, but remained in the service of the employer during at least the investigation of the bank's affairs and the custody of its assets by the national bank examiner, which lasted until the appointment of a receiver and his qualification on the twenty-ninth day of December, 1891. Certainly, the six months 'from the death or dismissal or retirement of the employee from the service of the employer,' within which his fraud or dishonesty must have been discovered in order to hold the company liable, did not commence to run prior to date last named. The bond prescribed at least three limitations of time: first, the company was entitled to written notice of any act of fraud or dishonesty on the part of the employee, which might involve loss to it, as soon as practicable after the occurrence of such act should come to the knowledge of the employer; second, it was to be liable only for an act of fraud or dishonesty occurring and discovered during the continuance of the bond, and within six months thereafter; third, it was not liable, in any event, for any act of fraud or dishonesty, even if committed during the continuance of the bond, unless it was discovered within six months from the

death, dismissal, or retirement of the employee from the service of the employer. Of course, O'Brien's death would have terminated his employment as cashier. But he was never dismissed, for his dismissal could only have occurred by the act of the bank or of some one who represented it before or after it suspended business. His 'retirement,' which would arise from his voluntary act, occurred either when he took service under the receiver, or when he voluntarily left that service on the second day of March, 1892. Whether within the meaning of the bond O'Brien was in the 'service of the employer' while he was in the service of the receiver, we need not say. It is sufficient for this case to hold that he was in the service of the employer at least up to the time of the receiver's appointment and qualification, which occurred within six months prior to the discovery of his fraud and dishonesty, and the giving of notice thereof. We, therefore, hold that the acts of fraud or dishonesty were discovered during the continuance of the bond, and within six months after the retirement of the employee from the service of the employer."

A conclusion, differing somewhat from that reached by the court in the foregoing case, was arrived at by the federal court of appeals in Florida Central and Peninsular Railroad *v.* American Surety Company.[1] In passing on this same question the court there said: "The remaining question of the proper construction of the contract relates to that portion of Thompson's defalcations which were discovered three or four months after March 15, 1896, and before Thompson left the service of the railroad company. The contract indemnifies the employer against loss by dishonesty or culpable negligence of the named employee, which loss shall be discovered during the continuance of his insurance and within six months after the death, dismissal, or retirement of the employee causing such loss. The loss must be discovered during the year for which indemnity was given if the employee is still in the position for which his fidelity has been guaranteed; but if the employee died, was dismissed, or retired during

[1] 99 Fed. 674; 41 C. C. A. 45.

the year, it must be discovered within six months after such retirement. Cases may easily be imagined of hardship under the stringent terms of this policy, and what would be the result in the case of loss happening during the last days of the life of the contract when discovery was impossible during its life is a question which does not arise here. The loss which was the subject of the fourth item (of Thompson's defalcations) commenced before Jan. 1, 1896, when there was a balance against Thompson of $1,177.56, and continued until Aug. 1, 1896, when it had been reduced to $1,047.64. He had apparently drawn the railroad checks for the payment of his previous bills from time to time during the period of his treasuryship, but the company's system of audit was very lax and the state of the cash account was unknown and not examined, — a condition of affairs which was intended to be guarded against by the narrow terms of the contract of indemnity. Inasmuch as the annual renewal of the contract of indemnity ceased on March 15, 1896, when Thompson was acting as treasurer, the liability ceased as to all losses which had not been discovered. If Thompson had ceased to be treasurer before March 15, 1896, the facts of the case would have corresponded with those in Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company,[1] in which fifteen days before the employee's yearly insurance ended he was retired by promotion from the position which he held and the loss was discovered about three months after his retiracy, in which case the court held that the six months commenced to run at the time of the retirement and continued without reference to the termination of the annual period, — a conclusion which is justified by the terms of the contract."

In a Canadian case the insurer's policy provided that it should make good to the insured such pecuniary loss as he might sustain by reason of the dishonesty of the "risk" committed and discovered during the life of the policy and within the three months from the death, dismissal, or retire-

[1] 80 Fed. Rep. 766; 26 C. C. A. 394.

ment of the "risk." It was held that the insurer was not liable thereunder for the defalcation of such "risk" discovered four months after the policy lapsed.[1]

§ 100. (D) **Condition limiting the Right of the Insured to make and file Claims under the Policy to a certain designated Period after the Insolvency of, or Discontinuance of Business by, the Insured.** — It is usually provided that in the event of the insolvency or discontinuance of business on the part of the insured, the right to make a claim under the policy shall cease at the end of ninety days after either of such events, whichever shall first happen. The theory upon which it would undoubtedly be contended that the foregoing condition should be sustained as valid would be this: That the contract of fidelity insurance being a personal one, the insolvency of the insured, throwing the latter into the hands of an assignee or receiver, changes the personality of the insured. Besides this, the discontinuance of that line of business on the part of the insured, which is designated in the proposal for the policy, amounts in a certain sense to an absence of that particular or identical insurable interest possessed by the insured before the business passed into the hands of an assignee or a receiver, who represents creditors as well as the insured. Even in the absence of the foregoing condition, there could be no liability on the part of the insurer after such insolvency or discontinuance of business on the part of the insured had occurred.

The word "insolvency," in this connection, probably has reference to the time when the insured is declared insolvent by some court of competent jurisdiction, or makes a voluntary assignment for the benefit of creditors.[2]

The term "discontinuance" has relation to the act of the insured, either voluntary or as an act consequential thereof.[3]

§ 101. (E) **Condition excluding from Liability all Claims for Money used by the "Risk" within the Period of Liability to re-**

[1] Com. Mut. Bldg. Soc. *v.* Lond. Guar. & Acc. Co., 7 Montreal L. R. Q. B. 307.

[2] See *post*, § 154.

[3] Am. Indemnity Co. *v.* Cassard, 83 Md. 272; 34 Atlan. 703.

pay or refund Moneys taken by the Latter from the Insured prior to the Commencement of the Insurer's Liability under the Policy or prior to a Designated Period next before the Time of giving Notice to the Insurer by the Insured of a Claim thereunder. — To give rise to the above condition referred to, framers of guaranty insurance policies usually insert some such clause as the following: "That the insurer shall not be liable thereunder for or on account of moneys or property used or applied by the 'risk' within a period of twelve months before the time of giving notice to the insurer by the insured of a claim thereunder or for property taken from the insured by the 'risk' prior to such twelve months or prior to the date of the commencement of the policy in each case."

The general purpose of the foregoing condition is to prevent the insured taking advantage of any processes of dishonesty or forced bookkeeping employed by the "risk" to conceal his fraudulent and dishonest acts, and which, if treated as conclusive between the insurer and the insured, would have the effect of making the former liable for acts which occurred at a period not covered by the policy under which claim of loss is made by the insured. The leading case on this subject is that of the Supreme Council of Catholic Knights of America *v.* Fidelity and Casualty Company of New York.[1] In this case the insured placed a claim of loss with the insurer, claiming that one O'Brien, who was named as the risk in the policy, had embezzled money belonging to the insured. In support of this claim evidence was offered showing that during the "risk's" preceding term he had failed to pay certain drafts drawn during that period. These drafts he carried forward into his new term (covered by the bond in suit) and then paid them during this last term out of current receipts. The contention of the insured at the trial was that these drafts should have been paid out of the balance which should have been in the "risk's" hands at the end of the preceding term; that, if the funds which ought to have been in his hands for that purpose had been theretofore embezzled

[1] 63 Fed. 48; 11 C. C. A. 96.

he could not make good a former defalcation out of the funds of his new term, and that the payment of these obligations out of the funds which came to his hands during the new term was in itself such a misappropriation as fixed the liability of his surety for the new term. The court, in its opinion in this case, said: "The business of the insured was not conducted in such a way that the obligation of the order was discharged when an assessment was made sufficient to meet it. Assessments were made from time to time of amounts deemed sufficient to meet death loss accruing, pay expenses, and provide a sinking fund. The liability of the order was not *extinguished* by the misappropriation of the fund thus assessed to meet accruing and fixed obligations. The funds coming to O'Brien's hands were not so earmarked as to amount to an appropriation of a particular dollar to the payment of a particular claim. If assessments were made sufficient to meet certain death claims and the fund came to the hands of O'Brien, these claims were not thereby extinguished. If O'Brien embezzled the funds so appropriated, the association was not thereby relieved of liability. The claims were obligations of the order and continued to be obligations until paid. When these obligations were paid out of subsequent funds of the order, it was only a case where the debt of the association was paid out of its own funds. No species of reasoning can make the application of plaintiff's money to the payment of its own obligations either embezzlement or larceny. The fund which had been provided for the payment of these claims had already been embezzled. The loss thus sustained should be borne by the bond in force when the default occurred. For that loss the new bond is not responsible."

With the ruling in the foregoing case in mind, attention is called to the decision of the United States court of appeals (third circuit) in Fidelity and Casualty Company of New York *v.* Consolidated National Bank.[1] Here a guaranty policy was issued on Sept. 30, 1889, to the Consolidated National Bank on one Baker as paying teller thereof. The

[1] 71 Fed. 116; 17 C. C. A. 641.

policy was regularly renewed and extended to Sept. 30, 1894. On Jan. 10, 1894, it was discovered that Baker was guilty of fraud and dishonesty. Under the terms of the policy the insurer was bound to make good to the insured such pecuniary loss as the latter had sustained by reason of Baker's defaults, committed within twelve months next preceding that date. During that period he had embezzled $5,000, for which the insurer admitted liability. During this period the "risk" had falsified the books and balance sheets of the bank, and at the trial the jury was instructed, that if the "risk's" misconduct prevented the discovery of previous embezzlements, and thus prevented the recovery on this account from the insurer of money which it otherwise would have recovered, the insured was entitled to recover the loss sustained during a period of twelve months preceding the time when such embezzlements would have been discovered but for this concealment. Commenting on the foregoing instruction, the court spoke as follows: "Waiving any question as to whether such prevention of recovery constituted such a pecuniary loss as should be taken to be covered by the covenant for reimbursement, if that covenant were to be read and separately considered, we have, upon careful examination of the writing as a whole, been fully convinced that the covenantor's engagement cannot be so construed. Throughout the document, the frauds as to which indemnification is undertaken are so mentioned in connection with the subject of their discovery as to repel the assumption that steps taken for the avoidance of detection were themselves to be regarded as independent, fraudulent acts, the commission of which would have the effect of extending the time allowed for discovery of the primary and principal defaults. One of the express conditions upon which the policy was issued, when understood as we think the parties must have understood it, absolutely forbids that assumption. We refer to the provision, that any claim made under the policy should embrace and cover only acts and defaults committed within twelve months next before the discovery of the act or default upon which such claim is based. That the officer of

the bank which accepted this policy, as well as those of the corporation which issued it, well understand the nature of the hazard to which it relates, may be safely assumed. They knew that the commission of fraud is generally supplemented by precautions for its concealment, and that the teller of a bank, who embezzles the money, is very likely to tamper with its accounts to prevent their disclosure of his wrongdoing. Can it be then said that they intended that, if timely discovery should be prevented by such means, the prevention so occasioned would itself constitute a distinct basis of claim? To so interpret the condition would be to render it unavailing in the event of that being done, which, as we have said, must have been foreseen, and which, there being no expression to the contrary, must have been regarded as, at least, one of the contingencies which might cause the condition to become operative. The manifest intent was to create a bar, and to the provision inserted for that purpose there cannot be annexed an exception or qualification not warranted by its terms, and the implication of which the circumstances of the case forbid. The object was to preclude liability for a number of defaults, extending over a longer period than one year, and yet the present claim is that in addition to $5,000, the amount of the embezzlements within such period, the indemnifying company is chargeable with the amount of other embezzlements which had been committed during a prior term. We cannot sustain this demand, because to do so, we think, would involve a misconstruction of the condition and the defeat of its purpose. The bank's position rests upon the assumption that it would have recovered its earlier losses, by action upon this policy, but for the fraudulent postponement of their discovery. Let this be conceded, still it is obvious that reasonable discovery of the preceding dishonest acts would have rendered the perpetration of the succeeding ones impossible, and that hence the entire liability now asserted is one which could not possibly have occurred, if discovery of the earlier embezzlements had been made within the prescribed time; and it is not possible to hold, in the face

of a condition limiting liability by a requirement of discovery, that by reason of non-discovery, the liability so limited was extended or enlarged."[1]

In Banque Nationale *v.* Lesperance[2] it was held that where the evidence showed that a teller of a bank indorsed on a parcel of bank notes the amount which it was supposed to contain, and it was subsequently discovered that the parcel was $9,300 short, and it was also ascertained that a deficiency of the same amount existed in the teller's account, and had been during several years skilfully covered up and concealed from the authorities of the bank, who made the usual inspection, that the insurance company which had issued a policy guaranteeing the fidelity of the teller was liable for the deficiency, but only for so much thereof as accrued after the policy was issued.

§ 102. (V.) **Condition excepting in specific Terms certain Perils, for which the Insurer shall not be held liable under the Policy.** — The only perils here referred to are those which by the express language of the policy are excluded absolutely as a basis for any claim of loss on the part of the insured against the insurer. These excepted perils are not so numerous but that the principal ones may be here in terms set forth. They are as follows:

(1) The insurer shall in no way be held liable, by virtue of this policy, to make good any loss that may accrue to the insured by reason of any act or thing done or left undone by the said "risk" in obedience to or in pursuance to any directions, instruction, or authorization conveyed to and received by him from said insured.[3]

(2) The insurer shall not be held liable, by virtue of this policy, for any mere errors of judgment or injudicious exercise of discretion on the part of the "risk" in and about all or any matters wherein he shall have been vested with discretion either by instructions, or rules and regulations of the insured.

[1] See also F. C. & P. R. R. *v.* Am. Sur. Co., 99 Fed. 674; 41 C. C. A. 45.

[2] 4 Leg. N. Quebec, 147.

[3] See Hey *v.* Guarantors Liability Ind. Co., 181 Pa. St. 220; 37 Atl. 402.

(3) The insurer shall not be held liable, by virtue of this policy, to make good any loss by fire, robbery, theft, or otherwise, that said insured may sustain, except when occasioned by the felonious or fraudulent acts of the "risk."[1]

(4) The insurer shall not be held liable for any losses that the insured may sustain, except by the direct personal act of the "risk," or by his connivance.[2]

(5) The insurer shall not be liable, under this policy, for the value of property intrusted by the insured to the "risk" for purpose of sale, and sold by the latter on credit, or for collections thereof outstanding, even though such sale be made in express violation of the rules and directions of the insured.[3]

(6) The insurer shall not be liable, by virtue of this policy, for any loss arising from wrongful independent acts of subordinates of the "risk."[4]

In all cases where it is claimed that the insurer is relieved from liability by reason of the loss for which indemnity is claimed by the insured, coming within any of the excepted perils designated in the policy, the burden of proving that such losses are within the said exception lies with the insurer.[5]

It must not be inferred that the exceptions to liability here referred to cover every liability or claim which might accrue in favor of the insured against the "risk" during the period of time named in the policy, for such is by no means the case. The liability of the insurer to the insured is fixed and determined by the terms of the policy; that of the "risk" to the insured is fixed solely by the contract of employment had between them. It is thus apparent that the test of liability in each case are the provisions of separate and distinct contracts. While the liability of the insurer to the insured (in

[1] Walker *v.* British Guar. Ass., 18 Q. B. 277.

[2] See Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790; Mut. Bldg. & Home. Ass. *v.* Fid. & Dep. Co., 23 Sou. 405.

[3] See Dougherty *v.* London Guar. & Acc. Co., 6 Vic. L. R. 376.

[4] London Assur. Corp. *v.* Bold, 6 Ad. & El. 523.

[5] Dennis *v.* U. M. L. Ins. Co., 84 Cal. 570; 24 Pac. 120.

order to be valid and enforceable) must necessarily be based upon a corresponding liability identical in nature and amount of the "risk" to the insured, the same is not true in the reverse sense.[1]

[1] See Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; 36 C. C. A. 444.

CHAPTER XII.

(VII.) DISCHARGE OF LIABILITY BY SETTLEMENT OF LOSS.

§ 103. (VI.) **Conditions Subsequent, the Performance of which is necessary to the fixing of Liability of the Insurer under the Policy after the Occurrence of a Loss involving Contingent Liability under the Policy.** — The conditions here referred to may be subdivided into the following classes:

(A) Conditions relative to notice and proof of loss.

(B) Conditions relative to the prosecution of the "risk" after the liability is incurred.

(C) Conditions governing the right of subrogation as between the insurer and the insured.

(D) Conditions relative to arbitration of the question of liability between the insured and the insurer.

(E) Condition limiting the liability of the insurer to the insured with respect to suits brought for the purpose of enforcing liability for losses to those actions only which shall be commenced within a designated period after the first discovery of the act or default upon which such action may be based.

§ 104. (A) **Conditions Relative to Notice and Proof of Loss — Notice of Loss.** — It is customary to provide in all policies of guaranty insurance that notice of loss shall be given to the insurer by the insured within a certain designated time. The time here referred to is usually controlled by the use of such phrases as "immediate notice," "notice forthwith," "as soon as practicable," "as soon as possible," etc. These phrases have practically one and the same meaning, to wit, that the insured shall, with all promptitude considering the probable amount of the loss, and the probability of the "risk's" endeavoring to escape, give notice to the insurer of the

occurrence of the loss. With respect to giving notice of loss, the object sought to be obtained thereby is not so much the particulars of the loss as the mere naked fact that a loss has occurred, for which under the policy as claimed by the insured the insurer is liable.

The cases bearing directly on policies of fidelity insurance wherein the question as to what constitutes sufficient and timely notice of loss within the provisions of a guaranty insurance policy are not numerous. In Commercial Mutual Building Society *v.* London Guaranty and Accident Company,[1] where the policy provided that notice should be given to the insurer of the "risk's" fraud or dishonesty, and the defalcation was not discovered until after the policy had expired and the company was not notified thereof until eleven days after the discovery of such defalcation, when the "risk" had then left the country, a recovery was denied. It has been suggested in a recent case that the insured is entitled to a reasonable time in which to investigate the question as to whether or not the "risk" has been guilty of such defaults as give rise to a liability under the policy before giving notice thereof to the insurer.[2]

With respect to the character of the notice of default required under a policy wherein was contained a clause providing "that the insured should immediately give the insurer notice in writing of the discovery of any loss or default thereunder, and should file with the insurer his claim thereunder, with full particulars thereof as soon as practicable thereafter," the case of Fidelity and Deposit Company of Maryland *v.* Courtney[3] is in point. Here a notice of loss was given referring to the policy by number, and informing the insured that the "risk" had been found in default to the insured, and that the full amount of indemnity named in the policy would be required of the insurer. The notice was held to be sufficient, inasmuch as its purpose

[1] Montreal L. R. 7 Q. B. 307.
[2] Bank of Tarboro *v.* Fid. & Dep. Co. of Md. 128 N. C. 336; 38 S. E. 909.
[3] 103 Fed. 599; 43 C. C. A. 331.

was to enable the insurer to terminate its liability and to obtain such remedies as it might see fit to adopt against the defaulting "risk." While the notice sent was general in its character, it advised the insurer of the default, claimed the full amount of indemnity, and no objection as to its sufficiency was made by the insurer when received. In this same case the further question was considered as to what constitutes the giving of notice as soon as practicable after the discovery of a default. On this subject the court spoke as follows:

"Upon the question of notice of McKnight's default it is strenuously argued that the notice given by the receiver after he took possession of the bank is not such notice as is required, and for that reason there can be no recovery upon the bond. The bank was closed on the 17th of January, 1897. The receiver was appointed on the 22d of January, 1897. On the 18th of February the receiver gave the following notice:

"LOUISVILLE, KY., Feb. 18, 1897.

"To the Fidelity and Deposit Company of Maryland, Baltimore, Md. — Gentlemen: Referring to the certificate No. 4,043, issued from your security department, guarantying the fidelity of Jacob M. McKnight, president of the German National Bank, under your bond to him, No. 5,002, issued June 1, 1894, in favor of such bank, we hereby notify you that said Jacob M. McKnight, as president, has been found in default to this bank, and that you will be required to make indemnity to me as receiver to the extent of said bond.

"Yours truly,

"R. H. COURTNEY, Receiver, German National Bank.

"When this notice was offered in evidence, it was objected to, the attorney for the defendant stating: 'We have no doubt he sent it [the notice], and make no point on that, but we desire to object to the admission of it, as not being the notice required in the contract, and therefore we received no notice whatever.' . . .

"If they began to discover the shortages two or three

weeks after the bank was closed, that would mean the discovery was first made between the 2d and 9th of February, 1897. The court left this question to the jury under the following instructions:

"'The defendant insists upon this clause of the contract between it and the bank that "the employer shall immediately give the company notice in writing of the discovery of any default or loss hereunder, and shall file its or their claims hereunder, with full particulars thereof as soon as practicable thereafter, and no claim which shall not be so filed by the employer with the company within six months after the expiration or cancellation of its bond, or within six months after the employee shall have ceased to be in the employer's service, shall be payable hereunder." In considering that clause of the contract between these parties, I do not think the word "immediately" should be given such construction as that it would mean instantly, but I believe it conforms with the views of the supreme court and the authorities generally to tell you that it means that it was the duty of plaintiff in this case to give, as soon as reasonably practicable, and with promptness, notice of the discovery of any default. It did not mean that as soon as one was suspected that notice should be given; but if you believe, from the evidence, that within a reasonable time after the receiver in this case (and you must remember that he is the receiver merely, and that he knew nothing about the management of the bank, nothing of its affairs, until he was appointed), if you believe that, within a reasonable time after he discovered — actually discovered — a default, he gave the notice of the 18th day of February, 1897, you are at liberty to infer that that part of the obligation of this bond has been performed.'

"We think there was not such a lapse of time from the time the receiver began to discover these defaults until he gave the notice of Feb. 18, 1897, as would require the question to be taken from the jury. We have already said no notice is required until the bank had knowledge of facts which would justify it in charging dishonesty. . . .

"Unless the lapse of time is so long as to be obviously a non-compliance with the contract, the question is one for the jury. . . .

"The word 'immediate' is certainly no stronger than the word 'forthwith,' or the expression 'as soon as possible.' . . .

"Assuming that the defalcations were becoming apparent to the experts so that they began to discover them two or three weeks after the bank was closed, we cannot say, as a question of law, that such facts had been discovered as would justify a prudent man in charging another with dishonesty so as to require notice, and we think the question was properly left to the jury under the instructions given. Some cases have been cited in which it seems a more restricted view of this requirement is taken, but we think the opinion here expressed is more consonant with the intention of the parties and the purposes of indemnity contracts. In Bouvier's Law Dictionary it is said of the word 'immediate:' 'Strictly it implies not deferred by any lapse of time, but as usually employed it is rather within reasonable time, having due regard to the nature and circumstances of the case.'

"Nor do we think there is any reasonable objection to the form of the notice given. The purpose of the notice was to enable the indemnity company to terminate its liability, and to obtain such remedies as it might see fit to adopt against the defaulter. The notice sent was general in its character. It advised the company of the default, claimed the full amount of indemnity, and no objection was taken to it."[1]

§ 105. **Proof of Loss.** — The following is a common provision with reference to the furnishing of proof of loss by the insured to the insurer, to wit: "That the insurer, within three months from the date of the discovery of any act or default of the 'risk' that may give rise to a claim under the policy, shall deliver to the insurer an itemized account of any loss or damage covered by this policy, thereby caused to the insurer,

[1] The general subject of notice of acts on the part of the "risk" which may involve loss under this policy is considered at length, *ante*, § 94, which see.

together with an affidavit in writing by the proper officer of the insured, confirming the correctness thereof, and if required, shall produce in support thereof for investigation by the insurer or its representative all appropriate books, vouchers, and such other evidence as may be reasonably required by the insurer, and until such books, vouchers, and evidence (if required) have been furnished to the insurer no claim shall be payable under this policy by the insurer to the insured." There can be no doubt but what the furnishing of a satisfactory proof of loss, as required by the policy, is a valid condition precedent to any attempted enforcement of liability under such a policy by the insured as against the insurer.[1]

In view of the foregoing fact, it is important to ascertain within what time such proof of loss must be furnished. Here the policy can be referred to for the purpose of ascertaining when the proof of loss should be filed with the insurer. With respect to this the date of the discovery of the loss by the insured is usually named as the date of commencement of the time limited for furnishing proof of claims. Another common provision in this same connection is that one requiring proof of loss to be furnished in any event within a certain period of time after the expiration or cancellation of the policy. All such provisions, while unquestionably reasonable and valid, are to be liberally construed so as not to work unnecessary hardship upon the insured.[2]

In the case of the Fidelity and Deposit Co. *v.* Courtney,[3] the court observed: "It was further objected at the trial that the proof of claim, which was required by the policy to be made out as soon as practicable after the default, was not furnished in time. This claim was filed in July, 1897. During all the intervening time the investigation was going on and the books of the bank were being examined. So far as the testimony discloses, the full particulars of the claim were not developed until July, so as to be capable of proof."

[1] F & Cas. Co. of N. Y. *v.* Gate City Nat. Bank, 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392; Sloman *v.* Mer. Cr. Guar. Co., 112 Mich. 258; 70 N. W. 886.

[2] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133.

[3] 103 Fed. 599; 43 C. C. A. 331.

On this state of facts the court held that the foregoing was a sufficient compliance with the conditions of the policy requiring that the insured should present and file all claims under the policy as soon as practicable after notice of default. Again it was said in the case of the Fidelity and Casualty Company of New York *v.* Gate City National Bank,[1] that where the policy contained an express stipulation, providing for proof of loss satisfactory to the insurer, and that notice, with full particulars of any claim arising under the policy, should be given in writing to the insurer within a specified time, and the declaration filed by the insured in an action on the policy alleged compliance with the foregoing terms of the policy, but did not allege that there had been any waiver of the requisite proof of loss, and the evidence entirely failed to show that the same had been duly furnished, that this was sufficient to justify a nonsuit in favor of the insurer under the terms of the policy in suit. In a late federal case it was held that notice of default referring to the policy issued by the insurer and informing the insured generally that the "risk" was a defaulter to the full amount of the policy, is sufficient in form to meet all the requirements of the policy, providing that upon the discovery of any default the insured should give notice to the insurer in writing.

The purpose of the notice, as we have seen, is to enable the indemnity company to terminate its liability, and to obtain such remedies as it might see fit to adopt against the defaulter. The notice sent, though general in its character if it advises the insurer of the default, and claims the full amount of the indemnity, is sufficient.[2]

In Globe Savings and Loan Company *v.* Employers' Liability Assurance Corporation [3] one of the conditions of the policy required that on discovery of fraud or dishonesty on the part of the "risk" the insured should immediately give notice in writ-

[1] 33 L. R. A. 21; 97 Ga. 634; 25 S. E. 392.

[2] Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 43 C. C. A. 331; see also Molson's Bank *v.* Guaranty Co. of N. A., Montreal, L. R. 4 Sup. Ct Rep. 376; Harbor Comm'rs *v.* Guar. Co. of N. A., 22 Sup. Ct. Rep. 542 (Can.).

[3] King's Bench, Manitoba, 1901, 37 Can. Law Jour. 511.

ing to the insured, stating the number of policy, cause, nature, and extent of loss and the address, if known, of the "risk." No formal notice was sent, but information of the loss was communicated to the insurer, and it took steps to ascertain fully the facts, and this was held to constitute a waiver of this condition of the policy. It was further held that the condition of a policy requiring the furnishing of proof to the satisfaction of the insurer did not require the insured to establish to the satisfaction of the insurer the absolute liability of the latter and the absence of any defence.[1]

In a Canadian case, where the condition of a guaranty policy required the employer to give notice immediately to the guarantor of any criminal offence of the employee entailing loss for which a claim was liable to be made under the bond, and the employer, although aware of a defalcation on the 25th, did not give notice thereof to the guarantor until the 27th, after the employee had fled the country, it was held that the policy was forfeited.[2] In general it may be said that whether notice of loss was given within a reasonable time is a question of fact for the jury.[3]

An interesting case on the probative and legal effect of evidence tending to establish proof of loss in suits brought by the insured against the insurer is that of Supreme Council of Catholic Knights of America *v.* Fidelity and Casualty Company of New York,[4] where the facts were as follows: On the reappointment of the treasurer of a beneficial association for a new term, a surety company gave to the association its bond to make good such pecuniary loss, if any, as might be sustained by the employer by reason of fraud or dishonesty of the employed in connection with his duties referred to, amounting to

[1] See also dissenting opinion of White, J., in Am. Sur. Co. *v.* Pauly, 170 U. S. 160.

[2] Molson's Bank *v.* Guar. Co. of N. A., Montreal Law Rep. 4 Sup. Ct. Rep. 376.

[3] Har. S. & L. Ass. *v.* U. S. Fid. & Gr. Co., 46 Atl. 910; 197 Pa. St. 177; Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133, 165; Fid. & Cas. Co. of N. Y. *v.* Weise, 80 Ill. App. 499; see generally Hall *v.* U. S. F. & G. Co., 77 Minn. 24; 79 N. W. 590; Guar. Co. of N. A. *v.* Mut. Bldg. & Loan Ass., 57 Ill. App. 254; Am. Sur. Co. *v.* Pauly, 170 U. S. 133, 160.

[4] 63 Fed. 48; 11 C. C. A. 96.

embezzlement or larceny which was committed and discovered during the continuance of such term or renewal thereof. It was contended, on the part of the insured, that in an action on the bond certain entries, receipts, and reports, made by said treasurer during the life of the bond, in the ordinary course of his duty as treasurer, charging himself with certain items, was conclusive against the insurer as to the time when such items were received. On this point the circuit court of appeals (sixth circuit) spoke as follows: "Undoubtedly there may occur cases in which the official should be estopped by his entries and reports in consequence of several circumstances appearing constituting estoppel *in pais*. In such cases the surety would be bound by the evidence which concluded his principal, but such estoppel should only arise on bonds conditioned on the faithful performance and discharge of the duties of the office. So under bonds obligating the surety for the faithful discharge of official duties by his principal, the evidence offered to show fabricated entries or false representations may show such official dereliction or fraud as in itself would constitute breach of the obligation of the bond. The bond now in suit is not the bond of a sworn public officer, and in a more important particular still is it distinguishable from public official bonds. It is this: All those bonds bind the sureties for the faithful performance of the duties of the office occupied by their principal. The bond in suit is remarkable in that the only obligation of the surety is that it will make good and reimburse such pecuniary loss, if any, as may be sustained by the employer by reason of fraud or dishonesty of the employed in connection with the duties thereof and amounting to embezzlement or larceny which may be committed and discovered during the continuance of the term or any renewal thereof, and within three months from the death, dismissal, or retirement of the employed. No circumstances tending to make out an estoppel *in pais* appear in this case. The general secretary of the order, who audited the claims and who drew the drafts on the treasurer for their payment, was not dependent alone upon the reports of the treasurer as to either the amounts or

dates of his receipts. Under the laws of the association the subordinate lodges, called branches, sent to the secretary duplicates of all letters of remittance to the treasurer on printed forms required to be issued. From this duplicate notice the treasurer was enabled to learn when and what remittances had been received by the secretary. The insistence of the plaintiff is barren of all circumstance which would tend to move the conscience of the court, and is, in substance, this: 'It may be true that the $21,000 with which I seek to charge you, in addition to the sum adjudged against you, did not come to O'Brien's hand during the term covered by your bond, and that he in fact embezzled that sum before you undertook to guarantee his honesty, yet he has made entries on my books, executed receipts and written letters of advice while you were on his bond, whereby he admitted this sum did come to his hands during the currency of the bond, and you should not be allowed to show that he did not receive and embezzle that money at the dates he has admitted that he did receive it.' There is neither sound morals nor natural justice in this effort to shut out the truth and fix the liability on the defendant for a defalcation occurring before it became obligated as a surety. Neither is there any principle of public policy or settled law which would close the door on the truth under a bond such as that here involved."

The probative effect of a judgment previously obtained by the insured against the "risk," upon the question of the insurer's liability for the same claim evidenced by such judgment, is discussed at length in Union Guaranty and Trust Company *v.* Robinson,[1] which, though a case relating to a policy of contract insurance, is not without its application here.

A policy had been given by a "surety company" conditioned upon a due payment of all its obligations in the state of Arkansas by a foreign fire insurance company doing business in that state. Judgment was obtained by one of the beneficiaries under the policy against said company on a fire

[1] 79 Fed. 420; 24 C. C. A. 650.

insurance policy issued in Arkansas. It was held that such judgment was, if not conclusive against the "surety company," at least *prima facie* evidence of its liability under the policy to such beneficiary. The court, in its opinion, said: "When one is responsible by force of law or by contract for the faithful performance of the duty of another, a judgment against that other for a failure in the performance of such duty, if not conclusive, is *prima facie* evidence in a suit against the party so responsible for that other. If it can be made to appear that such judgment was obtained by fraud or collusion it will be wholly set aside, but otherwise it is a *prima facie* evidence, to stand until impeached or controlled in whole or in part by countervailing proof."

It goes without saying that the insurer is not bound to accept the insured's unsupported statement that a certain loss has occurred, but may, of course, insist that all claims shall be supported by competent proof, according to the rules of evidence, or under the provisions of the policy relative to such matters. Thus it is usually provided that full particulars of all claims under a policy, accompanied by an itemized account of the same, shall be furnished. To this is sometimes added the further provision that all claims shall be accompanied by an affidavit in writing by the auditor or proper officer of the insured confirming the correctness of such claims, and if required, there shall be produced in support thereof, for investigation by the insurer, all appropriate books, vouchers, and such other evidence as may be called for. The reasonableness of such provisions is obvious for the following reasons:

1st. It is right that the insurer should know that the claim filed is a valid one, based upon fact.

2d. The insurer should know whether the insured has in his possession sufficient evidence to establish a loss beyond the point where it ceases to be conjecture, and becomes an established fact.

3d. It is of material benefit for the insurer to have pre-

sented to him all the evidence of loss in the insured's possession that he may take immediate steps, with this in hand, to secure reimbursement from the "risk" for the amount of the claim which it is under a legal liability to pay. Yet in this connection it should always be remembered that proofs of loss in guaranty insurance should always be construed liberally and not closely, with the same degree of legal and technical accuracy as pleadings.[1]

Sometimes a policy makes a provision that a certain form of proof shall be *prima facie* evidence of liability under the policy. Thus the following clause is found inserted in some guaranty policies at the present day, to wit: "Now, therefore, in consideration," etc. . . . "it is hereby declared and agreed that subject to the provision herein contained, the company shall, within three months next after notice, accompanied by satisfactory proof of loss, as hereinafter mentioned, has been given to the company, make good and reimburse to the employer all and any pecuniary loss sustained by the employer of money, securities, or other personal property in the possession of the employee, or for the possession of which he is responsible, by any act of fraud or dishonesty on the part of the employee in connection with the duties of the office or position hereinbefore referred to, or the duties to which, in the employer's service, he may be subsequently appointed, and occurring during the continuance of this bond, and discovered during said continuance, or within six months thereafter, and within six months from the death or dismissal or retirement of the employee from the service of the employer. It being understood that a written statement of such loss, certified by the duly authorized officer or representative of the employer, and based upon accounts of the employee, *shall be prima facie evidence thereof.*"

Such a provision as the foregoing was construed by the United States supreme court in the case of the American Surety Company *v.* Pauly.[2] It appeared that the trial court

[1] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133, 160.
[2] 170 U. S. 160.

below had instructed the jury as to the meaning of the *prima facie* clause as follows: "Now there is a provision in the policy to the effect that a written statement of loss, certified by the duly authorized officer or representative of the employer (receiver of the bank in this case) and based upon the accounts of the employer, shall be *prima facie* evidence thereof. In view of that condition of the policy, I instruct you that the plaintiff has established a *prima facie* case against the defendant, because he gave the written statement of loss and subsequently transmitted to the defendant a copy of the account upon which it was based. Nevertheless the plaintiff has offered additional evidence. He might have rested his case upon the proof that he had complied with this condition of the policy which I have read to you, and insisted then that it was incumbent upon the defendant to show that the bank had not sustained a loss within the terms of the policy. But the plaintiff has seen fit to produce further evidence."

This instruction was claimed to be erroneous, and it was for this reason reviewed by the appellate court as follows: "The surety company insists that the provisions of the bond referring to the written statement of loss relate exclusively to the presentation of the claim to the company, and its acceptance or rejection thereof, and not to the use of such statement as independent evidence, in any suit brought for the recovery of such loss; in other words, it is argued, the company was willing, in its consideration of the claim of loss, to accept as *prima facie* proof of the claim the statement of loss duly certified, and based upon the account of the employer, but did not waive its right, if sued, to demand such proof as was necessary in law to sustain it. The bond may be susceptible of this construction. But is it not also susceptible of the construction placed upon it by the trial court? If the surety company intended that the written statement of loss certified by the duly authorized officers or the representatives of the employer, and based upon the accounts of the employer, should be *prima facie* evidence only of the right of the employer to bring suit on the bond if its claim of loss was not

paid, it should have expressly so declared. But that was not done. The company agreed to pay any loss covered by the bond within the three months next after notice accompanied by satisfactory proof of loss. But that no doubt might arise as to what was satisfactory proof of loss, and that the obligee might be assured of the prompt settlement of any claim it might make under the bond, if accompanied by proper proof of loss, care was taken to express the understanding that the written statement of such loss, duly certified and based upon the accounts of the employer, should be *prima facie* evidence thereof, that is, evidence of such loss. In our judgment the circuit court of appeals correctly held that the interpretation placed upon the bond by the trial court was the natural one. The company might well have agreed that in the event of a suit, a written statement of loss arising from the fraud or dishonesty of the employee, and based upon the accounts of the employer, should be sufficient, nothing appearing to the contrary, to establish the loss; and this for the reason that such accounts, if the claim was disputed and made the subject of suit, would be open to examination by the company. The employer would not base its statement on its own accounts, and then withhold such accounts from inspection by the obligor of the bond.

"If the latter construction of the bond be not clearly right, it cannot be said to be inconsistent with its provisions. And it would be going very far to say that the construction given to it by the company was so clearly right that a different construction would be unreasonable or entirely inadmissible. We have then a contract so drawn as to leave room for two constructions of its provisions, either of which may be conceded reasonable, — one favorable to the company, and the other favorable to the bank, — and most likely to subserve the purposes for which the bond was given. In such a case the terms used must be interpreted most strongly against the party who prepared the bond, and delivered it to the party for whose protection it was executed. It has been so held in the case just decided." In this same case it was said to be sufficient

proof of loss to state (under a policy having the *prima facie* clause above referred to) by way of proof "that on the thirteenth day of October, he, the said J. W. Collins (the 'risk'), obtained from the United States Bank of New York a loan of $5,000, upon a note of the California National Bank (the insured), and by rediscounting certain individual notes, being of the assets of said bank, took and applied said sum of $25,000 to his individual use and embezzled said sum."

It is now proposed to offer some general rules relative to the subject of the manner and mode of proving loss under policies of fidelity insurance. These are now presented as follows:

(1) The proof of loss must be reasonably full and complete, or liability under the policy may be avoided under the customary clause, which provides that until such proof is furnished no claim shall be payable under the policy.[1]

(2) Where a verification of proof is provided for in the policy, it must be made, if required by the insurer.

(3) The best possible proof, consistent with the nature of the loss and existing circumstances, must be furnished.

(4) All books and accounts, entries, reports, and admissions of the "risk" are admissible in support of the insured's claim, in so far as the same relate to the matter in issue.[2]

(5) If the insured, in support of his claim, proves that the "risk" has received a certain amount as a sum total, and that he has returned or accounted for a less amount only, this shifts the burden of proof and becomes conclusive, if not rebutted.[3]

(6) All provisions of the policy, as to mode and manner of proof, are binding upon both the insurer and the insured. Yet, unless made exclusive, they do not forbid other competent proof of the loss.

[1] See Am. Sur. Co. *v.* Pauly, 72 Fed. 470.

[2] Hall *v.* U. S. Fid. & Guar. Co., 77 Minn. 24; 79 N. W. 590; Ind. School Ins., etc. *v.* Hubbard *et al.*, 110 Ia. 58; 81 N. W. 241; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 571; 21 Ky. Law Rep. 399.

[3] Walker *v.* Br. Guar. Ass., 18 Q. B. 277; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 571; 21 Ky. Law Rep. 399; Fid. & Cas. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351.

§ 106. (B) **Conditions relative to the Prosecution of the "Risk" after Liability is incurred.** — Most fidelity insurance policies contain a provision that the insured shall if required by the insurer, and as soon thereafter as it can seasonably be done, give all such aid and information as may be possible (at the cost and expense of the insurer) for the purpose of prosecuting and bringing the "risk" to justice, or for aiding the insurer in suing for and making an effort to obtain reimbursement by the insured of any moneys which the insurer shall have paid, or become liable to pay, by virtue of the issuance of any policy. To the foregoing is sometimes added a provision that the insurer shall, if it so elects, have the entire charge of the prosecution of the "risk" on account of any act of fraud or dishonesty covered by the policy. Then, as if to make the foregoing conditions extremely rigorous, the policies usually provide that prosecution to conviction of the "risk" by the insured, when required by the insurer, shall be a condition precedent to the recovery of the amount of any claim under the policy. The question now arises, whether such provisions as have been just referred to are valid to the extent of depriving the insured of any right of recovery under the policy, upon his refusal to make a complaint before the proper officer of the law for the purpose of obtaining the issuance of a warrant for the arrest of the "risk," thereby displaying an unwillingness to use due diligence in prosecuting the "risk" criminally. Of course, the question has a twofold aspect; one when reference is had particularly to criminal prosecutions, and the other in its relation to the prosecution of a civil suit by the insured against the "risk." The question now before us has rarely come before the courts for judicial determination. In London Guaranty Company *v.* Fearnley,[1] it was held that the failure to prosecute criminally, when requested, was a condition precedent to a recovery by the insured against the insurer under the policy, although that part of the condition which referred to assistance in the prosecution of a civil suit was a condition subsequent.

[1] Law Reports, 5 House of Lords Appeal Cases, 911.

A condition assented to by the insured, to use due diligence in prosecuting the person whose fidelity is guaranteed for criminal defalcation, does not require that the former shall bring the latter back from without the jurisdiction of the court.[1]

A provision in a policy insuring the fidelity of employees, that the employer shall, if required by the insurer, but at its expense, if a conviction is sought, use all diligence in prosecuting the employee to conviction for any embezzlement committed, is reasonable; and no recovery can be had from the insurance company where the employer fails, on request, to prosecute the defaulting employee.[2]

§ 107. (C) **Conditions governing Right of Subrogation as between the Insurer and the Insured.** — To preserve the right of subrogation intact to the insurer, it is usually provided that, in case of loss under the policy, the latter shall be subrogated, to the extent of its interest, to all claims of redress belonging to the insured in respect to such loss, and that the insured shall execute any and all papers required to secure to the insurer the said rights.[3]

The right of subrogation here reserved in express terms to the insurer is most valuable, and such provisions should be freely enforced by the courts.[4]

§ 108. (D) **Conditions relative to Arbitration of the Question of Liability between the Insurer and the Insured.** — Like other policies of insurance, the guaranty insurance policy usually provides that any question as to the liability of the insurer to pay to the insured any claim under the policy shall, if the insurer or the insured requires it, be referred to arbitration, the expense of such arbitration to be borne equally by the insurer and the insured.

[1] Dougherty *v.* London Guar. & Acc. Co., 6 Vict. T. R. Law, 376.

[2] La Canadienne Compagnie Assur. Sur. la Vie *v.* London Guar. & Acc. Co., 9 Rap. Jud. Quebec B. R. 183; 16 Rap. Jud. Quebec C. S. 78. See also generally Globe Sav. & Loan Co. *v.* Employers' Liability Assurance Co. King's Bench, Man. 37 Can. Law Journal, 511.

[3] See Dunne *v.* Am. Sur. Co., 43 N. Y. App. Div. 91; 34 N. Y. Misc. 584.

[4] See Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270. See on the right of subrogation, *post*, §§ 194, 195, 196, 197.

The general subject of arbitration is one common to all branches of insurance law, and reference is made to general treatises on that subject for an extended discussion of the matter.[1]

§ 109. (E) **Condition limiting the Liability of the Insurer to the Insured with Respect to Suits brought for the Purpose of enforcing such Liability to those Actions only which shall be commenced within a Designated Period after the Discovery of the Act of Default upon which such Action may be based.** — Nearly all policies provide "that no proceeding at law or in equity shall be brought or arbitration required to recover any amount thereby insured, unless the same is commenced and the process served within a period of twelve months next after the first discovery of the act or default upon which such claim is based." The foregoing was considered in Jackson *v.* Fidelity and Casualty Company of New York.[2]

The facts of this case were that the "risk" had fraudulently and dishonestly appropriated money to his own use between April 29, 1893, and July 1, 1893. It was provided in the policy that no suit should be brought thereon unless the same should be commenced within twelve months next after the discovery of the dishonesty on which it was based. Suit was not brought upon the policy until Feb. 1, 1895, and as reason for the delay in bringing suit and of avoiding the limitation in the policy it was alleged that the insured bank suspended payment on July 24, 1893; that on July 26 the comptroller of the currency, by the bank examiner, took possession of all the books and assets of the bank, and on August 14 appointed a receiver; that the bank examiner alleged sundry frauds against the bank officials, of which the receiver gave notice to the insurer, but that the bank itself did not, and could not, then discover the fraud, but immediately after the suspension of the bank its officials and the majority of its directors were arrested and put

[1] See Excelsior Life Ins. Co. *v.* Employers' Liability Assur. Corp., 37 Can. Law Jour. 755.

[2] 75 Fed. Rep. 359; 21 C. C. A. 394.

under bonds on criminal charges, whereby there were no officials of the bank to make investigations or institute proceedings; that on May 24, 1894, the bank resumed business and its assets were restored to it by the receiver, though its books were retained by the district attorney, and that on May 31 the bank instituted investigations and discovered the fraud and within twelve months brought suit. It was also averred that after notice of the frauds was given to the insurance company by the receiver, the company was also notified that it was impossible to give full particulars of the claims within three months. With reference to these allegations of the petition, the case coming to the court on demurrer, the latter spoke as follows: "It is argued by the learned attorney for the defendant that the twelve months' limitation commenced to run from the first discovery of the fraudulent acts made by the bank examiner on Aug. 14, 1893. Whatever may be said in support of the contention that a receiver appointed by the comptroller under the act of Congress in such cases ought to be considered as the representative of the bank so as to charge it with his laches in the collections of its debts, certainly no such contention can be successfully maintained as to the bank examiner. He is strictly the officer and representative of the government, and not of the bank. It was further urged, however, that the allegations are that the receiver formally acted upon the discovery of the fraud which the bank examiner alleged he had made. These averments, however, must be taken in connection with the other allegations, which show that while the receiver may, and did, have notice of the fraud committed, of which he properly gave notice to the defendant, he did not have notice of the character, extent, and details of the fraud, or, in other words, he had not made such discovery of the fraud as would have enabled him to make definite claims or bring suit, and it is only after such a discovery that the statute begins to run. Of course there are cases where the insured may be charged with full knowledge of the fraud, whether there was actual knowledge of the details or not, as where the

insured, after notice of the fact that some kind of fraud had been committed, through negligence failed to possess itself of the details at its command. This, however, as we shall presently see, does not apply to this case under the allegations of the declaration. These allegations are, that 'after due and proper notice of the discovery of the fraudulent acts of the "risk" was given to the defendant by the receiver of said bank, the said defendant was, through its agent in Jacksonville, Fla., duly notified that, by reason of the nature and character of the said fraudulent and dishonest acts of the said "risk" it was impossible to give in writing the full particulars of the claim made within three months after the discovery,' and that the facts were stated showing why it was impossible to get at the knowledge by details necessary to bring the suit within twelve months from the discovery of the existence of fraud made by the examiner. If the fact that the receiver made such a statement be taken as true, as it must be on the demurrer, the truth of the statement itself will be presumed. The receiver, an officer of the government, will be presumed to have done his duty unless the contrary appears, although, like a receiver of the court, he may, in another sense, also be a representative of the parties to the suit. Even conceding that the receiver was such a representative of the bank as that the limitation against the bank in the contract would commence to run from the time when the receiver made a full discovery of the fraud, there is no admission in the declaration, when fairly construed, which shows any such discovery or knowledge on his part; and without such admission the defence, under the Florida statute, must be made by plea, and not by demurrer. The facts averred in the declaration, however, are peculiar, and seem to take this case outside of the ordinary rule which would make a receiver the representative of the bank as to the running of the period of limitation in favor of the defendant.

"The pertinent portion of the act of June 30, 1876 (19 Stat. 63), under which Stockton was appointed receiver, on Aug. 14, 1893, provides that 'whenever the comptroller shall

become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, . . . appoint a receiver, who shall proceed to close up such association,' etc. The act further provides the method of procedure by which the affairs of the bank are to be closed up. Instead of closing up the business of the association in the method pointed out by the statute for insolvent banks, the allegations of the declaration are, that on May 21, 1894, by consent and authority of the comptroller, the bank resumed business, and the money and property of the bank were restored and redelivered to it. No authority can be found in the statute for this action of the comptroller if the bank were really insolvent. In the light of the action of the comptroller, the inference from the allegations is drawn that the suspension of payments by the bank was caused by the defalcation of the officers against which the defendants had insured the plaintiff; that acting upon the fact of suspension of payments and irregularities discovered, the comptroller appointed Stockton receiver; that after giving the affairs of the bank that 'due examination' contemplated by the statute, he came to the conclusion that the bank was not insolvent and that it was not a case for a receiver, as provided by statute. We have no right to infer from the allegations of the declaration that Stockton was anything more than a temporary or provisional receiver, who was never duly vested with the powers intended to be exercised by receivers of insolvent banks. The nature of such a receivership, resulting from the very thing insured against, made it impossible for the plaintiff to obtain the knowledge necessary to make the claim and file suit at an earlier date. The character of the policies insuring the fidelity of the principal officers of the bank would prevent any laches being attributed to the bank by reason of its failure to exercise what, under other circumstances, would be diligence in getting full knowledge of such a fraud after the first suggestion of its existence is made. The fact that a majority of the directors were arrested and placed in a

position where they were powerless to protect the interests of the bank under the allegations of the declarations raises no presumption against them. They are presumed to be the innocent sufferers from the acts of the guilty president and cashier until the contrary appears, and the failure of the plaintiff to act at once is due to the fact that the United States attorney took and kept possession of the books and papers of the bank to be used as evidence in a criminal case. This delay is chargeable to the government. Justice requires that the case should be treated as one in which the running of the limitation was stopped by the conduct of the insurer itself, since the delay was the direct result of the evil conduct from which the insurer contracted to protect the insured."

In the case of the California Savings Bank *v.* American Surety Company,[1] the court, in construing a somewhat similar provision, said: "No case in point has been called to my attention, although the parties have cited many decisions, hereinafter referred to, construing the requirements of the bonds or policies respectively involved as to notice and proof of loss. Under the peculiar terms of the bond in the case at bar, however, I think no other than an affirmative answer to the question above stated is possible. Said bond provides 'that no suit or proceeding at law or in equity shall be brought to recover any sum hereby insured unless the same is commenced within one year from the time of the making of any claim on the company.' This provision, without doubt a material one, is valid. In order to be effective, however, according to the obvious intent of the parties, it must be aided by the other requirement, now under consideration, that any claim in respect to the bond shall be made as soon as practicable after the discovery of the loss, and within six months after the expiration of the bond. Thus the parties, by their contract, have made the requirement, as to the time within which the claim for a loss shall be presented, a material provision. To hold that said re-

[1] 87 Fed. 118.

quirement is immaterial would, in effect, annul the former unquestionably material clause, limiting the time for the commencement of suit. The bond expired June 30, 1892. No claim was made upon the company until Dec. 16, 1895, so that the only claim made upon the company was made three years after the time when, by the contract, it should have been presented. The failure of the plaintiff to make claim within the time prescribed by the bond I think fatal to the case."

In Paris Board of Education *v.* Citizens Insurance and Investment Company,[1] it appeared that on Jan. 1, 1879, the insured made their claim, under a policy covering only losses occurring within twelve months prior to claim being made thereunder. At the end of 1877 the default was $674, which was increased during the first two months of 1878 to $1,261.57, but in the next four months the deficiency was reduced to $292.85, after which it again increased until at the end of 1878 it was $844.22.

It was held, in accordance with the general rule as to appropriation of payments, that, in the absence of any specific appropriation, the payments must be appropriated to the earliest item of the default, so that the whole amount of $844.22, due at the end of 1878, must be deemed to have accrued within that year; and that plaintiff was entitled if at all to recover that amount.

In McCallum *et al. v.* National Credit Insurance Company *et al.*,[2] it was said that when an insurance company settles and adjusts a loss with the policyholder and promises and agrees to pay the amount agreed upon such settlement, such adjustment becomes a new and independent contract, and the period fixed by the terms of the policy for bringing action thereon does not apply to the action brought upon the settlement.

§ 110. (VII.) **Conditions determining the Extent of Liability after the Same has become fixed save as to the Amount.** — The conditions here referred to may be divided into the following three classes:

[1] 30 U. C. C. P. 132.

[2] 86 N. W. 892 (Minn.).

(A) Conditions limiting liability to the amount designated in the policy.

(B) Conditions to the effect that if a claim shall be made on account of the acts or defaults of any "risk" for whom the insurer shall have been successively surety in more than one position, or for more than one amount, or for whom the insurer shall have successively issued more than one policy or renewal thereof, the insurer shall in no case be liable for the acts or defaults of such "risk" committed in more than one position, nor shall it be liable for any greater sum than the amount for which it shall have last been surety for the "risk" in the one office or position as to which a claim is made.

(C) Conditions providing that if the insured shall at the date of the policy or at any time thereafter hold any other policy or other security against the loss covered thereby in addition to such policy, the insurer shall, in the event of loss, be liable to pay only such proportion thereof as the amount of its policy bears to the amount of such other policy and other securities taken together.

§ 111. (A) **Conditions limiting Liability to the Amount designated in the Policy.** — It is a universal custom among fidelity insurance companies to insert in policies some such clause as this: "That the entire liability incurred by the insurer during the continuance of this policy or any renewal thereof, for the acts and defaults of the 'risk' herein named, shall not exceed the amount expressed in the proposal of the insured for the issuance of this policy." Under a strict wording of the foregoing clause there can be no liability on the part of the insurer that shall exceed in the aggregate the amount designated in the policy.

The principle which limits the liability of the insurer to the amount designated in the policy, as the maximum thereof, inheres intrinsically in the nature of its engagement. The insurer does not undertake to perform the duties of the "risk," whether they be of a private or public character, and is not permitted to control their performance and cannot in any event legally assume the functions of that "risk." The under-

taking of the insurer is essentially a pledge to make good the misfeasance or non-feasance of the "risk" to an amount not in excess of that named in the policy.

§ 112. (B) **Conditions to the Effect that if a Claim shall be made on Account of the Acts or Defaults of any "Risk" for whom the Insurer shall have been successively Surety in more than one Position or for more than one Amount or for whom the Insurer shall have successively issued more than one Policy or Renewal thereof, the Insurer shall in no Case be liable for the Acts or Defaults of such "risk" committed in more than one Position, nor shall it be liable for any greater Sum than the Amount for which it shall have last been Surety for the Risk in the one Office or Position as to which a Claim is made.** — The condition above set forth is in no wise ambiguous and its legal effect is not difficult to explain. In effect it is a valid and effective barrier to cumulative liability arising either through the issuance of renewal policies or by reason of the holding of dual or successive positions by the "risk" during the period of liability. It is to be construed in the light of that other provision of the policy wherein the total amount of liability is limited to the amount named in the policy itself.[1]

The legal effect of such conditions is set forth at some length in the case of Florida Central and Peninsular Railway Company *v.* American Surety Company of New York.[2]

Here the American Surety Company on March 14, 1891, issued to the Florida Central and Peninsular Railway Company a policy of insurance against loss through the defalcation of its employees, among whom was one Thompson, its treasurer. By this policy the railroad company was insured against loss by Thompson's dishonesty or culpable negligence in the sum $25,000. Before issuing the policy of date March 14, 1891, the surety company had been in the habit of issuing annually to the railroad company a new bond of indemnity, but after that date no new bond was issued. The policy then issued provided, among other things, as follows: "It is hereby agreed that, subject to the conditions herein contained, the company

[1] See *ante*, § 111. [2] 99 Fed. Rep. 674; 41 C. C. A. 45.

does hereby insure the employer to the extent of the insurance on each employee against any and all pecuniary loss sustained by the employer of moneys, securities, or other personal property in the possession of said employees, or for the possession of which any of them is responsible, by dishonesty or culpable negligence on the part of any of said employees, in the position hereinbefore referred to or the duties in the employer's service which he may hereafter be called upon to perform during the continuance of his insurance under this policy, and which loss shall be discovered during said continuance or within six months after the death, dismissal, or retirement of the employee causing such loss, but in no event shall the company be liable for a greater sum than that for which the insurance on the employee is granted, and which insurance and the period thereof are stated in the schedule register hereinbefore mentioned, opposite each employee's name, and the company shall pay to the employer, within sixty days after the receipt of satisfactory proof of the loss under this policy, the amount of such loss, but not exceeding the extent of the insurance on the employee or employees whose dishonesty or culpable negligence occasioned such loss; provided that the company shall not be liable under this bond for the amount of any balance that may be found due the employer from the employee which may have accrued prior to the date of said insurance and which may be discovered within the period of said insurance, it being the true intent and meaning of this bond that the company shall be responsible as aforesaid for moneys, securities, and other personal property diverted from the employer within the period specified in said insurance; and it is agreed further, that the company, upon the execution of the stipulated amount of risk of insurance under the terms of this bond in behalf of any employee, shall not thereafter be responsible to the employer under any previous insurance of said employee, it being the mutual understanding that it is the intention of this provision that but one (the last) insurance of an employee shall be in force at one time, unless otherwise provided. The right to make any claim under this policy shall cease at the expira-

tion of six months from the date at which the defaulting employee shall cease to be in the employ of the employer or the date on which the company shall elect to terminate the insurance on such employee, as hereinbefore provided."

Each year the "surety company" furnished to the railroad company a book called a schedule register, and had in its office a copy or abstract of this book in which were entered the names, occupations, and locations of the employees for whose conduct security was required and the amount of the indemnity which was agreed to be furnished. At the expiration of each year from and after March 14, 1891, until March 14, 1895, the railroad company made out a new and similar schedule of the employees against whose misconduct they were to be indemnified and the amount of insurance per each, paid the annual premium and forwarded the schedule or copy of it to the security company, which accepted the same and gave notice of its acceptance. The last notice, dated March 18, 1895, which was substantially like the preceding notice, was as follows: "You are informed that subject to the conditions of the guarantee contract executed March 14, 1891, by the American Surety Company to the Florida Central and Peninsular Railroad Company, the said American Surety Company hereby guarantees the employees of said railroad company as follows, and from the dates herein specified to March 14, 1896."

Thompson continued to be insured until March 15, 1896. The railroad company applied, as usual, in March, 1896, for new insurance, but as the insurance company required an increase of rate no renewal was had.

In July, 1896, the railroad company notified the "surety company" of the discovery of defalcations on the part of Thompson. The latter ceased to be the treasurer for the railroad company on Aug. 1, 1896, and died some two months later. Claims were filed with the "surety company" by the railroad company alleged to have arisen from defalcations by Thompson, occurring at different periods of time between Dec. 15, 1893, and Aug. 1, 1896. None of the defalcations were

discovered until three or four months after March 15, 1896. It was contended by the "surety company" at the trial that it was not liable for any of Thompson's misappropriations for the reason that a large part of the same occurred prior to March 14, 1895, the date of the beginning of the last year of the insurance, and for the further reason that the defalcations of Thompson were not discovered until three or four months after March 14, 1896. The railroad company, on its part, insisted at the trial that the guaranty of Thompson's fidelity was effected by the bond of March 14, 1896, that the contract was a continuing one through the payment of the annual premiums so long as his name remained in the schedule register, and that Thompson's name having remained on that register continuously from March 14, 1891, to Aug. 1, 1896, the indemnity was a continuing one for Thompson during this entire period. The court, in its opinion in this case, said: "It is evident that it must have been known to the railroad company that the intention of the contract was to make the indemnity of a limited character, and it is also plain that the contract was blindly and clumsily drawn; but so far as it relates to the circumstances of this case we think it is capable of being understood. The bond states no time for its duration and gives the name of no person for whose conduct there is to be indemnity. To make the contract intelligible it must be read in connection with the schedule register and the notice of acceptance, and from them it appears that annually a new list of employees was entered on the schedule which was sent to the surety company and was accepted by it as the list of employees whose fidelity was to be guaranteed from the date of the termination of the pre-existing contract of March 14, for the succeeding year. Some of the names of the preceding list have probably disappeared. New names have taken the place of those who have been dropped, a new annual premium had been paid for those whose names are on the new schedule.

"The course of business between the parties, as well as the policy itself, shows that there is to be an annual designation

of the employees on the schedule and an annual selection and acceptance of the names by the 'surety company,' and that the new schedule will in all probability contain the names of employees whose fidelity has been guaranteed by previous contracts. Such being the case, the meaning of the part of the contract which declares that upon the execution of the stipulated amount of risk or insurance in behalf of an employee the company shall not be responsible for any previous insurance for said employee becomes clear, and is that, when the new schedule of the amount of insurance in behalf of any employee formerly on the schedule has been executed or completed and actually or constructively accepted, the old or previous insurance against losses previously committed by him is at an end, and that for these losses the company is no longer liable. The contract further declares that only the last insurance of the employee shall be in force at one time. These provisions are inconsistent with the theory that it was the intention or idea of the parties that a continuing liability for all undiscovered losses in continuous previous years was being piled up in each renewed contract. The bond also provides that it is its intent that the surety company shall be responsible for property diverted from the employer within the period specified in said insurance. The word 'insurance' has different meanings in the contract. Sometimes it means the amount of indemnity and sometimes it means the contract of insurance. The latter meaning is the one intended in the clause just referred to. For the period specified in the contract of insurance reference must be had to the two other papers which, with the bond, form the contract and which indicate very plainly that the liability was confined to loss in the current year."

§ 113. (C) **Conditions providing that if the Insured shall at the Date of the Policy or at any Time thereafter hold any other Policy or other Security against the Loss covered thereby in Addition to such Policy, the Insurer shall in the Event of Loss be Liable to pay only such Proportion thereof as the Amount of its Policy bears to the Amount of such other Policy and other**

Securities taken together. — Provisions against concurrent or additional insurance are common alike to fire, marine, and guaranty insurance; but nowhere do they possess the peculiar features to be met with in the last-named branch of insurance law. For here, in addition to the covenant against liability in excess of the proportionate share in a reduced liability, there are others which become effective whenever the insured holds any other security (insurance or otherwise) to secure him against loss in case of default on the part of the "risk." It will be our purpose, first, to consider briefly the case where the insured holds other insurance only, and then turn to the case where he holds other securities not in the nature of insurance. The other insurance referred to in the above condition means, it would seem, concurrent insurance, outstanding at the time the loss occurred. To be concurrent, the insurance must operate at the same time upon the same property, and look to the indemnity of the insured in case of its loss or destruction from a casualty insured against.

While it is true that the policy does provide that the holding of other insurance at the date of the policy or at any time (whether at the time of loss or otherwise) shall have the effect of reducing proportionately the insurer's liability in case of loss, it is perhaps doubtful whether such a provision would under all circumstances be literally enforced by the courts; as for example, where the insured has made no representation as to the existence of other insurance as a basis or an inducement for the issuance of a second policy and a loss is incurred that exceeds in amount in the aggregate the face of all outstanding policies. One of the few cases of strict fidelity insurance where this question has come up for judicial construction is that of Ætna Insurance Company *v.* American Surety Company.[1] Here a general agent of a life insurance company had on April 1, 1884, delivered to it a policy issued by a "surety company" for the faithful performance of his duties so long as he should have continued in that office. On June 15, 1884, he procured and handed over another policy of

[1] 34 Fed. 291.

similar purport for one year, which the insured accepted with the understanding that liability thereunder was limited to defalcations committed during that time. The old policy, however, was retained. One provision of the new policy was to the effect that if the insured should hold concurrently with it any other bond, the loss, if any, should be apportioned. It was held that as to any loss resulting between June 15, 1884, and June 15, 1885, the two policies were not concurrent, and that the last policy could be proceeded against for the whole.[1]

Turning now to the case where the insured holds "other security" not of the character of insurance, it is probable that in all cases where such security is outstanding and available to the insured at the time a loss occurs, the condition will be given full force and effect by the courts. However, it is by no means clear just what may properly be included under the phrase, "other security." Is it broad enough to include that class of securities from the sale of which moneys might be realized for the reimbursement of the insured? Doubtless this is so, and the amount of reduction to which the insurer would be entitled, under such a condition, might in this way always be ascertained. In case the insured simply held a private surety bond, this would doubtless have to be sued on and an execution issued before the amount of deduction to which the insurer was entitled could be definitely ascertained. Again, it should be observed that the right of subrogation secured to the insurer by an express provision in the policy to that effect may have an important bearing on the construction to be given by the courts to the condition now under discussion. This holding of other security by the insured has many points of resemblance to the case of a creditor, in ordinary private suretyship, who takes new and additional security. Here the benefit of such additional security could only be available to the surety as a matter of legal right, after he had paid the debt; while under the conditions above set forth it would, if the same were held valid, be available to a proportionate extent at once.[2]

[1] See also Am. Cr. Ind. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

[2] See, however, *post*, § 118.

Where a policy of fidelity insurance contains a provision to the effect that, if the insured took out other insurance, he should immediately report the same to the insurer, it is safe to say that the obligation not to take further insurance without notice would not be construed as imposing a forfeiture.[1] At this point attention is called to some few cases not bearing directly on the immediate subject now under consideration, but so closely connected with it as to justify reference thereto.

The general subject of co-insurance is considered at length in City Trust Company *v.* Fidelity and Casualty Company of New York.[2] It was there held that, where the insurance policy provided that the insurer therein named should reimburse the insured therein for losses occurring under the terms of the policy at the expiration of three months next after proper proof of the said losses had been made, the fact that the insurer settled such losses prior to the expiration of the period named, did not deprive the insurer of the right to enforce the policy of reinsurance. The court construed such a provision as an option, given the insurer for its own protection merely, and that whenever it saw that a legal liability had been incurred, it was at liberty to disregard such time limit; but the court, however, held by implication at least, that if notice of claim of loss and of payment thereof is required by the conditions of the insurance policy, such conditions must be complied with in order to enforce the reinsurer's liability under such policy. There is no question as to the right of fidelity insurance companies to secure themselves, if they see fit to do so, by taking counter-security from the "risk."[3] The right to retain such collateral security, however, may be impaired by reason of latent equities existing in favor of a third party.[4] Where there are two sets of insurers as to the same liability, the question as to which set is liable is said to be largely a

[1] F. & C. Co. *v.* Carter, 57 S. W. 315; see also Union Cas. & Sur. Co. *v.* Bailey, 61 Pac. Rep. 452.

[2] 58 N. Y. App. Div. 18.

[3] See March *v.* Fid. & Dep. Co., 79 Md. 309; 29 Atl. 521; Fid. & Cas. Co. *v.* Lawler, 64 Minn. 170; Union Sur. & Guar. Co. *v.* Sire, 34 N. Y. Misc. Rep. 220.

[4] Milbank *v.* Am. Sur. Co., 14 App. Div. N. Y. 250; Guar. Co. of N. A. *v.* East Rome Town Co., 23 S. E. 503.

question of fact.[1] The right to hold counter-security, however, ceases as soon as the "risk" has satisfied all his lawful obligations to the insured.[2]

The right of the insurer to seek full indemnity from one or several "risks," against each of whom the right of subrogation exists in his favor, is not affected by any agreement between such "risks" to which the insurer was not a party, and the insurer has the right to release any one of the "risks" from the whole or a part of their liability to indemnify it, without affecting its right to enforce indemnity from the balance of such "risks."[3]

It seems that an extension of time given by the insured to a party liable on an indemnifying bond as a co-insurer will not discharge the other co-insurer where the latter is not in any manner prejudiced by the extension. Where time is given to the "risk" without the consent of the insurer, the latter may be discharged, but the mere giving of time to a co-insurer whose obligation is equal will not discharge the other if not prejudiced thereby.[4]

Where the insurer grants an indemnity policy to one of three sureties upon an official bond, and thereafter brings an action against all of them to enforce an alleged right of indemnity, such insurer has no right to compel contribution against the other two sureties in its favor even where the surety to whom the policy was issued makes a formal assignment of such right to the insurer by whom the indemnity was furnished, for the reason that the law holds the insurer's indemnity policy in trust for the other sureties.[5]

In Fidelity and Casualty Company *v.* O'Brien *et al.*,[6] it appeared that in a suit against an insurer on a bond given by a corporate officer, where the defalcation of the latter had mostly occurred under a prior bond on which suit was also pending,

[1] Lincoln Trust Co. *v.* Tracey, 77 Mo. App. 96.

[2] State *ex rel.* *v.* Nl. Surety Co., 76 Mo. App. 227.

[3] Am. Sur. Co. *v.* Thurber, 121 N. Y. 655; 30 N. Y. St. Rep. 489.

[4] Am. Sur. Co. *v.* Crow *et al.*, 17 N. Y. App. Div. 634.

[5] Gibson *et al.* *v.* Shean *et al.*, 28 L. R. A. 400; 5 Court of App. Dist. of Col. 391.

[6] 38 S. W. (Tenn.) 417.

and the sureties on the prior bond (private), learning of the testimony in the other case (on the "surety company" bond), had effected a compromise of their suit by agreeing that a judgment should be entered against them for $25,000 instead of $30,000 (the amount of the bond), and that execution should be held up for six months, that defendant should pay $5,000 cash, that certain trust deeds given by the "risk" for their benefit should be foreclosed, and that if they should purchase the property the "surety company" should buy it from them for $25,000, and credit that amount in full satisfaction of the balance of the judgment, it was held that such compromise was not such a fraud on the "surety company" in the other suit, as would estop the sureties on the prior bond from claiming their rights under the deeds of trust.[1]

§ 114. **General Rules Determinative of the Extent of the Insurer's Liability under the Conditions of the Policy.** — It is somewhat difficult to gather from a cursory reading of a policy the conditions therein which directly determine the amount of the insurer's liability thereunder after a loss has been incurred by the insured through acts of fraud or dishonesty on the part of the "risk."

In general these conditions may be outlined as follows:

(A) That the basis of the loss for which the insurer shall be held liable shall be limited to moneys, securities, and other personal property in the lawful possession of the "risk," either belonging to the insured, or for the possession of which he is legally responsible.

(B) The loss for which liability is sought to be enforced against the insurer must in itself constitute what would be an enforceable liability in favor of the insured as against the "risk" in a separate action as between the parties just named.

(C) The contract as between the insurer and the insured is one of indemnity, and thereby may give rise under certain

[1] The trust deeds here were for the benefit of both sets of sureties, and it was claimed that they should share and share alike with the private bondsmen. See also Bubb *et al.* *v.* Am. Bond & Tr. Co., 30 Pittsburg Legal, Journal, 361.

circumstances to the right of set-off in favor of the insurer as against the insured, as well as necessitate the payment of interest by the former to the latter after the time provided for in the policy, within which claims must be paid, has expired.

(D) The liability of the insurer, if admitted to be within the scope of liability named in the policy, is an absolute one, and the right of enforcement thereof by the insured does not depend upon the latter's first making use of securities held by it as security for possible loss through acts of the "risk."

(E) The burden of proof rests with the insured to show that the loss occurred during the life of the policy.

§ 115. (A) **That the Basis of the Loss for which the Insurer shall be held liable shall be limited to Moneys, Securities, and other Personal Property in the Lawful Possession of the "Risk," either belonging to the Insurer or for the Possession of which he is legally responsible.** — To attain the result aimed at by the foregoing, there is sometimes inserted in the policy a clause reading substantially as follows: "The insurer shall make and reimburse to the insured to the extent of ——— dollars, all and any pecuniary loss sustained by the insured through fraudulent or dishonest acts of the 'risk' with respect to moneys, securities, or other personal property in the lawful possession of such 'risk' belonging to the insurer or for the possession of which he is legally responsible." The provision here set forth is doubtless inserted for the purpose of showing the nature of the insurable interest of the insured in the policy, as well as to assist, in case of loss, in determining the extent of the insurer's liability under the policy.

§ 116. (B) **The Loss for which Liability is sought to be enforced against the Insurer must in itself constitute what would be an enforceable Liability in favor of the Insured as against the "Risk" in a separate Action as between the Parties just named.** — It is only after the principal debtor, or the "risk," as he is called in insurance law, has made default that the liability under the policy accrues. If the "risk" has not made de-

fault, the insurer is not liable.[1] So again, the indemnity which it is incumbent upon the insurer to make to the insured has been said to be full indemnity within the scope and limitations of the policy, — nothing more and nothing less.[2]

In general, there can be no recovery had by the insured against the insurer under a policy unless there is in existence at the same time a valid and enforceable claim against the "risk" for the same cause in favor of the insured.[3] The reason of this is obvious. Fidelity insurance is a contract of indemnity only, and further it is an indemnity against loss arising from acts of the "risk" in breach of his own contract obligations to the insured. Thus an unquestioned limitation on the insurer's liability is that the claim shall be a valid and enforceable one against the "risk" in favor of the insured. Were this not so, the valued right of subrogation would be worthless to the insurer, as he could not in any event recover of the "risk" the amount he had paid to the insured on an invalid and unenforceable claim.[4]

The foregoing rule removes, of course, from the scope of the insurer's liability all cases where the loss is induced through the active connivance of, or collusion on the part of, the insured with the "risk." [5]

§ 117. (C) **The Contract between the Insurer and the Insured is one of Indemnity, and thereby may give rise under certain Circumstances to the Right of Set-off in Favor of the Insurer as against the Insured, as well as necessitate the Payment of Interest by the Former to the Latter after the Time provided for in the Policy, within which Claims must be paid has expired.** — Whether the policy makes provision for it or not, the

[1] Walker *v.* British Guar. Co., L. R. 18 Q. B. 77.

[2] See Guar. Co. of N. A. *v.* Mechanics Sav. Bank, 80 Fed. 776; 26 C. C. A. 146; Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. Car. 320; 38 S. E. 908; 128 N. C. 366.

[3] Am. Sur. Co. *v.* United States to the use of Barrett, 126 Ala. ; 28 Sou. Rep. 664; but see School Comm'rs *v.* Guaranty Company, 31 Lower Canada Jur. 254; see also *ante*, § 30.

[4] See Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. Car. 320; 38 N. E. 908; 128 N. C. 366.

[5] Pac. Ins. Co. *v.* Pac. Sur. Co., 28 Pac. 842; Monongahela Coal Co *v.* Fid. & Dep. Co., 94 Fed 732; 36 C. C. A.; 444; State *ex rel.* *v.* Surety Co., 76 Mo. App. 227.

insured has probably the right to deduct, in settlement of claims, any moneys due the "risk" from the insured by way of salary in the identical employment in which the policy was furnished. Likewise by an insertion of such a provision in the policy, the right to retain any unearned portion of the current premium after payment of loss is secured. In Liverpool Starr Bowkett Building Society *v.* The Travellers' Insurance Society,[1] it was held that amounts credited to the employee should be deducted from the £150 embezzled, and not from the £100, the amount of the policy. Also that the £100 must be paid first and that the insured must hold what was found to be due the "risk" from the society for the insurer in reduction of the £100 liability of the latter to the insured. The question sometimes arises as to whether, in settlement of claims, the insurer has the right, if he chooses so to do, to set off any valid claims that may exist in favor of the "risk" against the insured, to reduce the latter's claim against it. In case of ordinary suretyship the right seems to clearly exist. As to whether it exists in fidelity insurance is at least a matter of some doubt. In the case of Guaranty Company of North America *v.* Mechanics Savings Bank and Trust Company,[2] it was held that under guaranty insurance policies, interest should be allowed independent of statute, from the date of embezzlement or from the end of each year to the filing of the proofs of loss; but on this amount there can be no interest after that time where, by the terms of the policy, a loss is not due until three months after filing proof of loss. "Neither do we see," observed the court, "any objection to the interest allowed. It is urged that it does not appear that the bank could have made six per cent on the lost money if it had not been stolen, since it did not discover the thefts until 1893, and that the only basis for adding interest is to make good the loss of the use of the money in the mean time. This is a mistaken view of the law of interest. The Tennessee code allows interest on bonds.[3] If a policy of

[1] 9 Times L. R.

[2] 80 Fed. 766; 26 C. C. A. 146.

[3] Mill & V. Code Tenn. par. 2702.

insurance be not included in this statutory allowance when it takes the form of a bond, as this does, it may be allowed by the jury or the chancellor as 'damages' for money detained. Here the defendant company agreed to make good the loss sustained by the fraudulent acts of the employee, and if Schardt had been sued the jury or chancellor could have allowed interest against him as part of the damages or 'loss,' and this the defendant company assured. Interest should be allowed from the date of embezzlements, or from the end of each year if the jury or the chancellor choose, as he did here, to the filing of the proof of loss, up to the penalty of the bond but not beyond it, of course. Then on this amount there could be no interest for three months, since that sum is not due by the terms of the contract until three months after filing proof of loss. But if not then paid it bears interest as a debt due from that date if allowed by the jury or chancellor, when not given by a statute. We think it should be allowed in this case, whether given by statute or not. Being allowed, it should be calculated to the date of the decree, as in other cases. It will be so allowed here."

The mere fact that after a loss has occurred under a policy, the insured recovered from the "risk" a part of its moneys stolen exceeding in amount the insurer's liability under the policy, does not relieve the insurer from liability thereunder so long as the total loss exceeded the sum insured. Neither does the fact that after loss has been incurred the insurer communicates with the absconding "risk" relieve the insurer from liability.[1]

§ 118. (D) **The Liability of the Insurer, if admitted to be within the Scope of Liability named in the Policy, is an absolute one, and the Right of Enforcement thereof by the Insured does not depend upon the Latter's first making use of Securities held by it as Security for possible Loss through Acts of the "Risk."** — It is an obvious truth in fidelity insurance law that the act of making indemnity by the insurer to the insured necessarily has reference to certain preliminary acts on the

[1] London Guar. Co. *v.* Hochelaga Bank, Quebec L. R. 3 Q. B. 25.

part of the insured which are conditions precedent to the payment of loss by the insurer. In a certain sense the liability of the insurer to the insured is secondary to that of the "risk" to the insured, and therefore arises only after default on the part of the latter. But when this has been said it does not follow that in respect to the right of enforcement the obligation of the insurer under the policy is in any respect dependent upon the exhausting of any remedies on the part of the insured that he may have as against the "risk." This question was conclusively settled in American Surety Company *v.* Lawrenceville Cement Company.[1] Here it was claimed that the insurer was entitled to require the insured to exhaust the property of the "risk" before enforcing the obligation of the policy, and it was further claimed that before paying the insured the amount due it on its policy the insurer could require the insured to wait collection of indemnity by the insurer from the "risk." Both these claims of right were denied absolutely, and the right to demand indemnity forthwith after the occurrence of the loss was sustained.[2]

§ 119. (E) **The Burden of Proof rests with the Insured to show that the Loss occurred during the Life of the Policy.** — The proposition here stated came up for consideration in the case of the Standard Oil Company *v.* Fidelity and Casualty Company of New York,[3] where it was claimed by the insured that all that it was necessary for it to do in order to establish liability against the insurer under the policy was to show that the "risk" collected more than he had accounted for. In passing upon the question the court impliedly gave its sanction to the proposition that the burden of proof is on the insured to show that the loss occurred in its entirety during the life of the policy. This undoubtedly is the correct rule.

§ 120. **When Losses become payable.** — The policy usually provides that within three months next after the notice, accom-

[1] 96 Fed. 25; 110 Fed. 717.

[2] See also in this connection Am. Bonding & Trust Co. *v.* L. & W. V. Gas Co., 95 Fed. 49; Central Trust Co. *v.* Louisville Trust Co., 100 Fed. 545; Ellicott *v.* U. S. Ins. Co., 8 Gil. & J. 166.

[3] 21 Ky. Law Rep. 399; 51 S. W. 571.

panied by satisfactory proof of a loss, has been given to the insurer, the latter shall make good and reimburse to the insured all and any pecuniary loss sustained by the latter through acts of the "risk" as specified in the policy. It is true that the ninety days here allowed for voluntary payment of claims can only run after notice and proof of loss of the character specified as "satisfactory."[1] So, too, the insured is not entitled to interest on its claim during the running of this ninety-day period.[2]

[1] See Am. Sur. Co. *v.* Pauly, dissenting opinion of Justice White, 170 U. S. 179; City Tr. S. D. & Sur. Co. *v.* Fid. & Cas. Co. of N. Y., 58 N. Y. App. Div. 18.

[2] *Id.*

CHAPTER XIII.

IMPLIED CONDITIONS.

§ 121. **General Consideration of Implied Conditions.** — In fidelity insurance the subject of implied conditions is comparatively of small importance, owing to the custom of inserting at great length numerous express conditions in the body of the policy. These cover so fully the entire subject matter of conditions as to render the raising of conditions by implications of law almost unnecessary. It will answer all purposes to merely state the principal implied conditions, with citations of authorities in support thereof.

§ 122. (A) It is one of the implied conditions in contracts of fidelity insurance that the insured shall not require nor suffer the " risk " to do any illegal acts in the performance of the duties of the position in connection with which the policy of fidelity insurance was issued.[1]

§ 123. (B) From the very nature of a policy of fidelity insurance, which is at all times a contract of indemnity, it follows as one of the implied conditions of the policy that the insured shall continue throughout the life of the policy to have an insurable interest therein. The recognition of such an implied condition is sometimes termed the " doctrine of continuity of interest."[2]

§ 124. (C) It is customary to designate in the policy the place where the " risk " is to be employed during the period of liability covered by the policy indemnifying the insured

[1] McKenna-Fraser Co. *v.* Citizens' Trust & Sur. Co., 76 Fed. 420; German-American Title & Trust Co. *v.* Citizens' Trust & Sur. Co., 46 Atl. 682; B. & A. R. R. *v.* Mer. Trust & Deposit Co., 34 Atl. 778; Lyman *v.* Schermerhorn *et al.*, 53 App. Div. N. Y. 32; 167 N. Y. 113; Lyman *v.* Kane *et al.*, 57 App. Div. N. Y. 549.

[2] See Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co., 23 Sou. 405; 50 La. 291; see *ante*, § 30.

against loss through acts of such "risk" while in said employment. While in general policies do not contain any express conditions to the effect that the "risk" shall remain in such place during the period of liability covered by the policy, nevertheless such a condition is implied by law where such place is specifically designated in the application, and this implied condition must be observed by the insured if he desires at any subsequent period to enforce the insurer's liability under the policy.[1]

§ 125. (D) One of the implied conditions of all policies of fidelity insurance is that the "risk" shall continue to occupy the position in the employ of the insured designated in the proposal or application for the policy. Unless the policy expressly provides for changes in such employment, as, for example, expressly authorizing employment in more than one position or changes from one position to another, there can be no recovery had by the insured from the insurer on account of defaults of the "risk" occurring while performing duties of a position materially different from that designated in such proposal or application. The reason which induces the courts to imply such a condition as the foregoing is that fidelity insurance companies write policies for certain designated premiums which vary in amount according to the nature and extent of the risk incurred. If, for example, the insured asks the insurer to write a policy on a person employed as bookkeeper in a bank, the insurer might be willing to do this at a very low premium, owing to the small chance of its ever being required to make good any losses occasioned by such person's dishonesty while occupying the position of bookkeeper for the insured. However, if it lay within the power of the insured to change the employment at will of such person, and immediately after issuing the policy he should appoint him cashier instead of bookkeeper, it would amount to little less than a

[1] See Fid. & Cas. Co. of N. Y. *v.* Lawler *et al.*, 64 Minn. 144; 66 N. W. 143; United States to the use of Anniston Pipe & Foundry Co. *v.* National Surety Co., 92 Fed. 549; 34 C. C. A. 526; United States to the use of Heise, Bruns & Co. *v.* Am. Bonding & Trust Co., 89 Fed. 921-5; 32 C. C. A. 420.

fraud upon the insurer to hold the latter liable for his acts while in the employ of the insured as cashier, with additional and increased responsibilities, not in contemplation of both parties at the time the policy was issued.[1]

§ 126. (E) Another implied condition of fidelity insurance policies — but not universally recognized — is that there shall be no change in the composition of the insured or in the personality of the "risk" during the life of the policy. Fidelity insurance is a personal contract, and there should be no alteration permitted either as to parties insured, or as to the "risk," without the consent of the insurer. To just what extent the foregoing implied condition will be sustained by the courts it is at present impossible to say. A practical opportunity to enforce the condition is likely to occur when there is an attempt made by the insured to assign the policy, or where partners are admitted or changed or where a copartnership is merged into a corporation, or where an attempt is made to substitute new or additional "risks,"[2] all without the knowledge or consent of the insurer.

A recent case where the question was briefly considered in connection with a policy of commercial insurance is that of National Surety Company *v.* T. B. Townsend Brick and Construction Company.[3] Here, after the policy was issued, the insured formed a copartnership with a third party. It was argued that by reason thereof there was no privity of contract between the new parties and the insurer, and that there was a concealment of parties, and that the policy was therefore void. This proposition was regarded very unfavorably by the court. This on the ground that such change in the composition of the insured did "not *necessarily affect* the contract between the 'risk' and the insured." In the appellate court it was said that there was no element of estoppel involved, for it could not

[1] Wembley Urban District Council *v.* Poor Law, etc. Guar. Ass., 17 T. L. R. 516.

[2] See Solvency Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17; London Assur. Co. *v.* Bold, L. R. 6 Q. B. 514; Am. Cr. Ind. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264; Strouse *v.* Am. Cr. Ind. Co., 91 Md. 244; 46 Atl. 328, 1063.

[3] 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938.

be said that the insurer was in any way misled or defrauded at the time it issued the policy and in no way prejudiced by it afterward. No injustice resulted to it either by that fact or its concealment. The doctrine of the case just referred to is certainly opposed to the general rule above stated. By way of comment thereon, the following may be said. However the courts may hereafter decide as to the effect of changes in the composition of the insured after a policy has been issued, it seems clear that where there has been a change made in the personality of the "risk" during the life of the policy by the insured, without the knowledge or consent of the insurer, the legal effect is necessarily to relieve the latter from any liability that might otherwise accrue, after such change occurred. This for the cogent reason that the act which caused the loss would not, under such circumstances, be the act of the party whose personal acts alone constitute the basis of the insurer's liability under the policy.

§ 127. (F) Another important implied condition which has been touched upon in other parts of this work is that all claims sought to be enforced by the insured against the insurer under the policy must be such as would in themselves be legally enforceable in favor of the insured against the "risk."[1]

So, too, the foregoing principle, if admitted, would prevent recovery, wherever the insured has given to the "risk" a valid release of any claim against him personally by reason of the claim afterwards asserted against the insurer. It is likewise true that where there has been a settlement of loss directly between the insured and the "risk" the former cannot exact indemnity from the insurer under the policy.

§ 128. (G) Finally, it may be said that the law implies from policies of guaranty insurance the condition, irrespective of express conditions in the policy to that effect, that the liability of the "risk" to the insured after a loss has occurred, for which the insurer is liable to the insured under the policy, shall not be changed in any material respect. This on the principle that the inchoate right of subrogation belonging to

[1] See *ante*, § 30; State *ex rel. v.* Surety Co., 76 Mo. App. 227.

the insured under such circumstances is a valuable right, and that for this reason no material change in the status of the "risk" with respect to the latter's liability to the insured, as it existed at the time the loss occurred, will be permitted. This question was touched upon at considerable length in a case involving a contract of commercial insurance wherein a principle was established, that is perhaps applicable to contracts of fidelity insurance. Reference is made to the case of the United States to the use of Heise, Bruns & Company *v.* American Bonding and Trust Company.[1] In this case the insured had extended the time of payment of certain claims due from the "risk" to the insured, and for the payment of which it was sought to make the insurer liable. In an action brought by the insured against the insurer to enforce such liability under the policy, the insurer claimed that it had been released from liability under its policy through an extension of time by the insured to the "risk," whereby the insurer was deprived of the opportunity of compelling appropriation of certain payments made by the United States government to the insured on claims for materials. The court, in its opinion, said in reference to this condition: "The law of suretyship forbids that there shall be such dealings between the debtor and the creditor of which the surety is kept in ignorance as shall put the surety in a situation of peril. Looking to the opportunity for protecting himself which the surety has if the debt for the materials is due when the final payment is made by the government, it seems but reasonable, that if the material man designedly extends the time of payment beyond that time, he should be held to have released the surety and to have elected to look solely to the debtor."[2]

[1] 89 Fed. 921–925; 32 C. C. A. 420.

[2] See generally La Canadienne *v.* London Guarantee, 9 Quebec Q. B. 183.

CHAPTER XIV.

DISCHARGE OF THE INSURER'S LIABILITY BY RELEASE THEREOF THROUGH ACTS OF THE INSURED.

§ 129. (VIII.) **Discharge of the Insurer's Liability by Release thereof on the Part of the Insured.** — As has already been observed in preceding sections of this work, the policy issued by the insurer to the insured always presupposes and has reference to the existence of a collateral contract subsisting between the insured and the "risk." As fidelity insurance is a contract of indemnity pure and simple, it would cease to be such if there could at any time be said to exist a liability under the policy on the part of the insurer to the insured, when there was not in existence at the same time a coexisting liability on the part of the "risk" to the insured.[1]

Therefore, it is proper to apply in this connection a well-established principle of law that whenever the principal thing is discharged (here the obligation of the "risk" to the insured) the incidents thereto (in this connection the liability of the insurer to the insured) are discharged.

With respect to liability, the contract of the "risk" with the insured existing contemporaneously with the contract of insurance entered into between the insurer and the insured is at all times — if not in its entirety, at least partially — to be deemed part and parcel thereof.[2] For the foregoing reasons the effect of any release, either absolute or partial on the part of the insured, whereby the liability of the "risk" to such insured is extinguished, may have the effect in law of releasing *pro tanto* the liability of the insurer to the insured under the policy. However, the effect is not necessarily such as has here been stated, for it is rare indeed when the policy issued by the insurer covers every liability or claim which may accrue in

[1] See *ante*, § 30.

[2] See Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; 36 C. C. A. 444.

favor of the insured against the "risk."[1] For this reason to operate as a release of the insurer's liability to any extent, the act of the insured in releasing the "risk" must relate to some liability of the latter which is covered by the policy.[2] The release of liability which will here be considered has reference, not to acts of the insured which by operation of law have the effect under the wording of the policy, of releasing the insurer's liability to the insured, but reference is had to a direct and intentional release of the "risk's" liability by the insured. Such a release may be brought about in one of the three following ways:

(A) By a formal release of liability, either absolute or partial, running from the insured to the insurer.

(B) By a formal release of the "risk's" liability to the insured, running from the insured to such "risk."

(C) By a release of securities held by the insured and procured by it either through the "risk" or a third party, given for the purpose of indemnifying the insured against loss occurring through acts of unfaithfulness on the part of the "risk" while in the insured's employ.

§ 130. (A) **Formal Release of the Insurer's Liability by the Insured.**— Inasmuch as the right of enforcing liability under the policy exists solely in favor of the insured, it follows as a matter of course that such liability may always be discharged by formal release thereof running from the insured to the insurer. This release of liability may be either total or partial, and the granting of such release has no effect whatever upon the liability of the "risk" to the insured.

§ 131. (B) **Discharge of Insurer's Liability by Formal Release of the "Risk's" Liability running from the Insured to such "Risk."** — Fidelity insurance is pre-eminently a contract of indemnity. Therefore there can be no legal liability incurred by the insurer under a policy of fidelity insurance, unless there exists at the same time a liability at least as coextensive on

[1] See Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; 36 C. C. A. 444.

[2] See Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. Car. 320; 38 S. E. 908.

the part of the "risk" to the insured. Furthermore it follows that when, by the voluntary release on the part of the insured "risk's" liability to the former, such release has the effect in law of releasing the insurer from liability — if such exists — to the insured on account of the matter covered by the release of the "risk" by the insured. A similar result is arrived at whenever the liability of the "risk" to the insured is satisfied by payment f the debt represented by such liability. In other words, the principal obligation — that of the "risk" to the insured — being satisfied, the incidental obligation — that of the insurer to the insured — is likewise discharged.

It is doubtless true that even where the insured secretly receives from the "risk" the full amount of the insurer's liability on account of a loss covered by the policy, he will be held in law, under a well-recognized rule of subrogation, to hold such payment in trust for the insurer, as the law will not permit him to profit by the recovery against both the insured and the "risk."[1]

§ 132. (C) **The Discharge of Liability by Release of Securities held by the Insured as Indemnity against Loss through Acts of the "Risk."** — It may be stated that if the insured obtains control of money or property of the "risk" to which it is not otherwise entitled and which he may lawfully apply to the discharge of an existing obligation of the "risk" to him, and thereafter, without the consent of the insurer, voluntarily surrenders or releases such securities, so that the insurer loses the benefit of the same, the latter is discharged from liability under the policy to the extent of the value of the securities thus surrendered. The rule above stated has no application to the case where the insurer holds security or counter indemnity given by the "risk" to it, as in such case as long as it remains solvent the insurer does not have to obtain the insured's consent to release it.[2]

[1] See in this connection Am. Sur. Co., *v.* Lawrenceville Cem. Co., 110 Fed. 717; C. St. L. & N. O. Ry. Co. *v.* Pullman Sou. Car Co., 139 U. S. 79.

[2] See Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717; Fertig *et al.* *v.* Henne, 47 Atl. Rep. 840 (Pa.); Bubb *v.* Co., 30 Pitts. Legal Journal, 361.

PART IV.—COMMERCIAL INSURANCE.

CHAPTER XV.

CONTRACT INSURANCE.

§ 133. **Commercial Insurance defined and classified.** — Commercial insurance is an agreement whereby, for an agreed premium, one party, termed the insurer, agrees to indemnify another, termed the insured, in a stipulated amount against losses sustained by the latter through breaches of contract on the part of a third party — hereinafter referred to as the "risk" — sustaining a non-fiduciary contractual relationship to the insured. The general subject of commercial insurance may be divided into three classes — that of "contract," "credit," and "title" insurances.

Each of these will be given separate consideration.

Commercial insurance may be differentiated from fidelity insurance through the absence of that distinctive moral element arising from the existence of a fiduciary relationship between the insured and the "risk." On the other hand, it is easily distinguishable from judicial insurance in that it has no relationship whatever to the administration of justice by the courts, — from which fact judicial insurance takes its name.

The rapid development and broad field of the business of commercial insurance bids fair to render this branch of guaranty insurance one of great and increasing importance.

§ 134. **Contract Insurance defined and discussed.** — Contract insurance is that branch of commercial insurance whereby, for an agreed premium, the insurer agrees to indemnify the insured in a designated amount against loss or damage arising

through a failure on the part of third parties to specifically perform contracts of a non-fiduciary character, entered into by the latter with the "insured." The third parties here referred to constitute the "risks" in such insurance contracts and sustain to the insured the relationship of contractors to contractees. The agreements formulated for the purpose of evidencing the contracts thus entered into are in common parlance almost universally referred to as "indemnity bonds." The best known of such instruments are those furnished for contractors, common carriers, warehousemen, apprentices, shipowners, importers, depositaries, public bidders, owners of lost instruments, bankers, etc. The nature of the obligation here referred to, while in form a simple contract of indemnity, is in legal effect a contract of insurance.[1]

Such contracts are never to be regarded as a guaranty of the ability of the "risk" to perform the contract which is the subject matter of the insurance, according to its terms, nor is it a guaranty of the "risk's" solvency. It is to be regarded as a guaranty that the "risk" will faithfully fulfil the obligations of his contract with the insured.[2]

§ 135. **Validity of Contract Insurance.** — It may be asserted with entire confidence that there can be no doubt at this late day as to the validity of contract insurance.[3]

§ 136. **Construction of Contract Insurance Bonds.** — So far there has been no marked tendency on the part of the courts, in matters of construction, to treat the contract of the "surety company" differently from that of the bond of the private surety. In a recent case, the United States circuit court of appeals (eighth circuit) touched upon the matter of the con-

[1] Union Tr. Co. *v.* Citizens' Trust & Sur. Co., 185 Pa. St. 217; 39 At. 886; Field *v.* Citizens' Insurance Co., 11 Mo. 50; Stillwell *v.* Commercial Ins. Co., 2 Mo. App. 22; German Am. Title & Tr. Co. *v.* Citizens' Tr. & Sur. Co., 190 Penn. 247; 42 Atl. Rep. 682; Dane *v.* Mortgage Ins. Co. (1894), 1 Q. B. 254.

[2] Union Trust Co. *v.* Citizens' Tr. & Sur. Co., 185 Pa. St. 217; 39 Atl. 886. See also Central Trust Company *v.* Louisville Trust Co., 100 Fed. 545; 40 C. C. A. 530.

[3] See American Sur. Co. *v.* Raeder *et al.*, 15 Ohio Cir. Ct. Rep. 47; Am. Sur. Co. *et al. v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. 793; Samuels *v.* Fid. & Cas. Co. of N. Y., 1 N. Y. Sup. 850; 49 Hun, 122.

struction of this class of insurance contracts as follows: "It is a familiar rule of law that the contract of the surety must be strictly construed, and that it cannot be enlarged by construction."[1]

In another contract insurance case the court observed "that a contract of suretyship should be strictly construed and not extended by implication. . . . There can, in our judgment, be no doubt of the correctness of this statement of law. When the rights of the sureties are involved they are only bound by the contract which they have signed and have a right to look to a literal and strict construction of the same, and not that such contract shall be extended either by implication or as a consequence of what others may do in matters of which they have no notice and with which they are not connected."[2]

In American Surety Co. *v.* Thorn-Halliwell Cement Company,[3] it was said that "it is contended that the contract must be strictly construed in favor of the surety. If there was in the contract any doubt, any ambiguity as to the obligations assumed by the surety, the rule contended for would be applied."

The Wisconsin supreme court, in construing a similar contract, observed that "it is elementary that sureties are favorites of the law and have a right to stand upon the strict terms of their obligations when ascertained. Beyond the burdens thus taken upon themselves they are not bound."[4]

From the foregoing citations of authorities, it is entirely clear that so far there has been no well-defined disposition evinced by the courts to treat the compensated sureties in contract insurance in any wise different from those who assume the burdens of suretyship gratuitously.

While recognizing the fact that the compensated surety's agreement is in itself a contract of insurance, it has seldom seemed to occur to the judicial mind that the principles and

[1] U. S. to the use of Ann. Pipe & Foundry Co. *v.* Nat. Sur. Co., 92 Fed. 549; 34 C. C. A. 526.

[2] U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond & Tr. Co., 89 Fed. 921 and 925; 32 C. C. A. 420.

[3] 57 Pac. 237.

[4] Electric Appliance Co. *v.* U. S. F. & Guar. Co., 110 Wis. 434; 86 N. W. 648.

rules of insurance law rather than those of suretyship should be applied to contracts of this nature.[1]

§ 137. **Attachment and Duration of Liability.** — In contract insurance, questions as to the attachment and duration of liability are not so likely to arise as in other branches of insurance law. The policy is issued with direct reference to the provisions of a collateral contract, the faithful performance of which it is intended to secure. So ordinarily the life of this contract itself determines the question of the duration of the insurer's liability; this in the absence of clauses in the policy itself providing otherwise.[2]

It has been said in this connection that in the case of policies issued to contractors, for the benefit of material men, that the failure to name any definite period of liability in such policies gives rise to the conclusion that as between the contractor and such material men only cash transactions were contemplated by the insurer when it furnished the indemnity to the insured against losses arising through the failure of the "risk" to pay for materials furnished.[3]

§ 138. **Scope of Liability.** — Any proper discussion of the scope of the insurer's liability in contract insurance must address itself to two main lines of inquiry. These are, first, the ascertainment of the persons for whose express or implied benefit the policy is issued; secondly, the determination of the nature and extent of the perils insured against. Both of these lines of inquiry will now be taken up for separate consideration.[4]

§ 139. **Who are the Beneficiaries under Policies of Contract Insurance?** — Any proper investigation looking towards the ascertainment of the parties for whose express or implied benefit policies of contract insurance are issued is certain to develop

[1] See Am. Sur. Co. *et al.* *v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. Rep. 793.

[2] U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond & Tr. Co., 89 Fed. 921; 32 C. C. A. 420.

[3] U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond & Tr. Co., 89 Fed. 925; 32 C. C. A. 420. See generally Anderson *et al.* *v.* Nl. Sur. Co., 196 Pa. 288; 46 Atl. 306.

[4] See generally Union Guar. & Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650.

the fact that there are two lines of decision in apparent though not, it is believed, in real opposition one to the other on this question. The first of these, and the one which states the rule in accordance with well recognized insurance principles, is represented by the opinion of the supreme court of Wisconsin in the case of Electric Appliance Company *v.* United States Fidelity and Guaranty Company.[1] This case involved the construction of a policy of contract insurance issued upon the application of a contractor who had undertaken contract work for a city. Under the contract entered into between the city (the insured) and the contractor (the "risk"), it was provided that the latter should provide a policy not only securing to the city the faithful performance of the contract according to the specifications, but it was also provided that it should be drawn so as to secure the payment of all claims for material furnished or labor performed. The contractor furnished a policy which contained no specific clause providing for the payment by the insurer of labor and material claims. It was contended, however, that there was an implied right on the part of laborers and material men to sue on the policy under the provisions of the original contract above referred to, on the theory that the laborers and material men were the real parties in interest rather than the city, so far as the right of action thereon was concerned. The supreme court of Wisconsin, in denying this contention, laid down the rule that to entitle a third party to recover under a policy of contract insurance, in some way there must appear therein an intent to secure a benefit thereby to a third party; that as between the latter and the "risk" named in such policy there must be an existing and legally enforceable promise which the court said did not exist in that case, owing to the fact that there was no privity of contract as between the city and the material man who was seeking to enforce the insurer's liability under the policy of contract insurance furnished. The court further held in this case that a party furnishing materials to a "risk" who had contracted to erect and deliver a lightning plant to

[1] 85 N. W. 648; 110 Wis. 434.

a city, cannot sue on a policy of contract insurance procured by said "risk" where it is clear that the policy was taken for the individual benefit of the insured, and without any intent to secure the claims of third parties.

The Alabama courts seem inclined to go nearly as far as those of Wisconsin in refusing to allow laborers and material men to sue on policies of contract insurance given under the circumstances above referred to. There the courts seem inclined to make the test of liability in all cases depend upon the question whether there exists, at the time the insurer's liability is sought to be enforced by third parties, a coexisting liability for the claims of such third parties on the part of the "risk" to such third parties. In American Surety *v.* United States to the use of Barrett,[1] it was held that under a policy of contract insurance the insurer was not liable for labor and material furnished to a subcontractor, since the contractor himself was not liable to the parties furnishing such labor and material. To sustain the contention of such parties absolutely, the court said, would be to impose a liability on the "risk" to the insured for a personal liability for goods sold to a third party, for which the "risk" therein was in nowise responsible.

Another line of decisions is illustrated by the case of the United States to the use of, etc., *v.* National Surety Company.[2] Here the United States court of appeals for the eighth circuit held that the contractor's bonds contemplated by the United States revised statutes[3] are intended "in the first place to secure to the government the faithful performance of all obligations which a contractor might assume towards it; and in the second place to protect third persons from whom the contractor obtained materials or labor. Viewed in the latter aspect the bond, by virtue of the operation of the statute, contained an agreement between the obligators therein that they shall be paid for whatever labor or materials that they may supply to enable the principal in the bond to execute his

[1] 28 Southern, 664; Ala.
[2] 92 Fed. 549; 34 C. C. A. 526.
[3] 28 U. S. Stat. 278, c. 280.

contract with the United States. The two agreements which the bond contains, the one for the benefit of the government, and the one for the benefit of third persons, are as distinct as if they were contained in separate instruments, the government's name being used as obligee in the latter agreement merely as a matter of convenience." [1]

A somewhat similar view of the question was taken in the case of the American Surety Co. *v.* Lawrenceville Cement Company.[2] The holding there was to the effect that these policies of contract insurance are intended, first, to secure the faithful performance of the contract entered into between the insured and the "risk;" and, secondly, to protect third persons from whom the "risk" may obtain labor and material in the performance of his contract with the insured. In this latter aspect the insured is to be considered as a voluntary trustee alike for its own interests and for the interests of third parties who are in turn made beneficiaries of the insurance. It was specifically held in this case that the clause with reference to the parties to be benefited by a contract insurance policy should be liberally construed. Under this rule it was said that the statute under which it is furnished is not to be construed strictly like mechanics' lien statutes, nor on the other hand should it be extended to claims for labor and materials which only incidentally relate to the prosecution of the work, such as the construction or permanent improvement of the plant or equipment of the "risk," which are capable of use in other work, or to the ordinary claims of a public carrier for freight, for which the law gives a lien. But the foregoing limitation does not apply to those parties making incidental repairs to equipment or to parties who transport materials for short distances, and who, although having a lien, are not expected, in the usual course of business, to exact payment before delivery.

[1] See also Union Guar. Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Am. Sur. Co. *v.* U. S. to the use of Melton Hardware Co., 76 Miss. 289; 24 Sou. 388; Fewell *v.* Am. Sur. Co., 28 Sou. 755.

[2] 96 Fed. 25; 110 Fed. 717.

In this connection the Kansas court of appeals has laid down the rule that with respect to the scope of liability under the conditions of a policy of contract insurance, the latter will not be treated as repugnant to or as rendered nugatory by the recitals thereof. This principle was applied to a case where the conditions of the policy expressly provided for the payment of laborers and material, but the "risk's" contract with the insured contained no such provision and the recitals in the policy referred to such contract only. Nevertheless it was held that the insured was bound to pay for such labor and material.[1]

It may be said that the attitude of the courts on the question now under discussion seems to depend upon the particular view they happen to take with reference to the right of third parties to sue for breach of contract entered into by others for their implied benefit.[2]

Having now briefly reviewed the decisions relative to the question, it only remains to comment thereon as follows. The rule adopted by the supreme courts of Wisconsin and Alabama seems, in the absence of special statute at least, to be the true one and the only one that adapts itself to the universal principle of insurance law, that in order to recover under the policy the insured must have what is known as an insurable interest therein.

The federal decisions, when the facts of each case are examined, so far do not seem to question the correctness of this rule, although they are necessarily governed by a special federal statute, giving the right of action on such policies to labor and material men, even when they run in name to the United States alone. The decisions of the Kansas courts do not appeal to us as a correct or well considered exposition of the rule on this subject.[3]

[1] Am. Sur. Co. *v.* Thorn-Halliwell Cement Co., 57 Pac. 237. See also Nl. Surety Company *v.* T. B. T. Br. & Con. Co., 176 Ill. 156; 52 N. E. 938.

[2] Am. Sur. Co. *v.* Raeder *et al.*, 15 Ohio Cir. Ct. 47.

[3] See generally on this subject the following cases: Fewell *v.* Am. Sur. Co. *et al.*, 28 S. 755 (Miss.); Anderson *v.* Nat. Sur. Co., 196 Pa. St. 288; 46 Atl. Rep. 306; Nat. Sur. Co. *v.* T. B. Townsend Nat. Brick and Contracting

§ 140. The Scope of Liability under Policies of Contract Insurance. — Ordinarily the scope of the insurer's liability in policies of contract insurance is coextensive with the liability of the "risk" to the insured under a contract entered into between them, and to secure the faithful performance of which the policy of contract insurance is issued.[1] By way of illustration attention is called to the case of American Bonding and Trust Company *v.* United States.[2] This involved the construction of a policy of contract insurance, and the court, in construing the same, held that on the failure of the "risk" to pay material men in accordance with the contract entered into between them, the material man may regard such contract as rescinded and maintain an action against the insured on the policy issued by the latter, where it contains a provision providing for the payment of persons furnishing labor and materials for the value of the materials furnished; this, too, although the contract provided that the payment of a certain percentage of the contract price should be postponed until the completion of the work. The right to maintain such an action was sustained in the face of evidence tending to show that subsequent to the failure of the "risk" to pay for such materials furnished, the material man refused to resume the delivery of the material and the "risk" was thereby compelled to purchase it at an advanced price.[3]

Again, where a policy insured the owner of real estate from all loss or damage by reason of liens, or incumbrances charged on the property at its date, saving such liens or incumbrances as were excepted in a schedule attached to the policy (show-

Co., 52 N. E. 938; 176 Ill. 156; U. S. to the use of Heise, Bruns & Co. *v.* Am. Bonding & Tr. Co., 89 Fed. 925; 32 C. C. A. 420; Am. Bonding & Tr. Co. *v.* U. S., 15 Appl. D. C. 397; Union Guar. & Trust Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Am. Sur. Co. *v.* Lawrenceville Cement Co., 96 Fed. 25; 110 Fed. 717; Am. Sur. Co. *et al.* *v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. Rep. 793; Herrick *v.* Guarantors Finance Co., 58 N. Y. App. Div. 30.

[1] See Am. Sur. Co. *v.* Woods, 105 Fed. 741; 45 C. C. A. 282; see also same case, 106 Fed. 263.

[2] 15 Appeals Dis. of Col. 397.

[3] See also Young *v.* Trustee Assets and Investment Insurance Co., 21 Rettie, Scotch Sessions Cases, 222; Laird *v.* Securities Ins. Co., 22 Rettie, Scotch Sessions Cases, 452; Am. Sur. Co. *v.* Woods, 105 Fed. 741; 106 Fed. 263; 45 C. C. A. 282; Anderson *et al.* *v.* National Sur. Co., 196 Pa. 288; 46 Atl. 306.

ing liens, charges, and incumbrances on the property described "which do or may now exist and against which the insurer does not agree to insure or indemnify"), it was held that the schedule was not to be regarded as setting out all the incumbrances or liens, but as specifying only those which are excluded from the protection of the policy; that if any lien or incumbrance was omitted intentionally therefrom it is not to be inferred that it did not exist; the inference goes no further than that the insurer is willing to assume liability for any loss resulting to the insured because of the existence of the omitted lien or incumbrance.[1]

§ 141. **The Liability of the Insurer in Contract Insurance — How discharged.** — The discharge of the insurer's liability under policies of contract insurance may be accomplished in any one of the following ways:

First. By cancellation or rescission of the contract.

Second. By misrepresentation, concealment, or breach of warranty.

Third. By breach of conditions.

Fourth. By alteration of the contract entered into between the insurer and the "risk," without the consent of the insurer.

Fifth. By settlement of the loss under the policy by the insurer with the insured.

§ 142. **Discharge of Liability by Rescission or Cancellation.** — The same principles and rules are applicable here that have been set forth in previous sections of this work. For a discussion of these subjects, reference is invited thereto.[2]

§ 143. **Dischage of Liability by Misrepresentation, Concealment, or Breach of Warranty.** — The insured, under and prior to the issuance of a policy of contract insurance, was asked whether he knew of any outstanding liabilities of the "risk," and in reply stated that he did not know of any outstanding liabilities at the time. It appeared that when this statement was made the "risk" was indebted to the insured. In holding

[1] Fid. Ins. Tr. & Safe Dep. Co. *v.* Earle, 23 Pa. Co. Ct. 449. See generally, Am. Surety Co. *et al. v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. Rep. 793.

[2] See *ante*, §§ 49, 50.

that this misrepresentation served to release the insurer, the court said that "a high degree of candor is required of a party answering such inquiries, who is to profit by the liability about to be assumed by the insured. . . . The answer as to the outstanding liabilities was not a matter of opinion, but a misstatement of a material fact, of which the party answering had knowledge, and the existence of which, if disclosed, was well calculated to influence the insurer to decline to go upon the bond, or to see to it that the money paid by the government to the contractor was applied to the payment of the debtor for the materials for the payment of which the company became liable as surety."[1] In another case on the application of the insured, the insurer wrote an instrument in the form of a contract insurance policy, whereby it guaranteed the solvency of a person who was surety for the repayment by the borrower of money lent by the insured. The insurer made no inquiry as to the rate of interest payable by the borrower, or as to the circumstances of the loan, and no information was given him on these points. In fact, the interest was over thirty per cent and the borrower was unable to pay the loan. In an action on the policy the jury found that the transaction was not one of exceptional risk. It was held, on appeal, that the non-disclosure of the rate of interest and of the circumstances of the loan did not constitute a defence, there being no evidence that those facts were material to the only risk undertaken by the respondent, namely, the solvency of the surety, and that the insurer made no inquiries as to the circumstances under which the loan was made.[2]

§ 144. **Discharge of Liability by Breach of Conditions.** — A policy of contract insurance provided, as a condition of liability thereunder, that the insurer should be notified of any act on the part of the "risk" which might involve loss to the insurer. The Louisiana supreme court held that the clause

[1] U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921.

[2] Seaton *v.* Bernand, 1900 Appeal Cases, 135, reversing Seaton *v.* Heath (1899), 1 Q. B. 782. See also Nl. Sur. Co. *v.* T. B. T. Br. & Con. Ct., 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938.

was subject to the "substantial compliance rule," and that, therefore, a failure to notify the insurer of the dissolution of the firm of the contractors, named as the "risk" in the policy, did not operate to discharge the insurer from liability. It was said that such dissolution was not of a character such as to impress upon the insured the necessity of notifying the insurer thereof. The court further held the insurer to be bound after as well as before the dissolution for the fulfilment of the terms of the policy where due notice had been given to the insurer of the "risk's" subsequent abandonment of the contract work.[1] The broad, general principle was laid down in this same case that the insurer is discharged (presumably as a violation of one of the implied conditions of the policy) when, by the act of the insured, the subrogation of any of the rights of the insured against the "risk" as they existed before such act occurred is lost to the insurer.

In adopting the rule of substantial compliance, with reference to contract insurance policies, the court said that the act required to be done in order to comply with the condition must be of a character to impress one as material.[2]

In Electric Appliance Co. *v.* United States Fidelity and Guaranty Company,[3] it was held that where the policy provided that the insured, before making final payments on the contract price to the "risk," should present receipts in full for labor and material, and the insured paid the "risk" in full without requiring such receipts, such conduct had the effect in law of releasing the insurer from liability under the policy to the extent of the claims unpaid by the "risk." "That this stipulation," it was said, "was of importance to the surety admits of no doubt. That it was broken by the insured admits of no doubt. No successful attempt can be made to resolve the undertaking of the surety into different factors and say that they are independent, and one subsists for the benefit of the plain-

[1] Mutual Building and Homestead Assn. *v.* Fid. & Dep. Co., 50 La. 291; 23 Sou. Rep. 405.

[2] See however, in this connection, Nl. Sur. Co. *v.* T. B. T. Br. & Con. Co., 176 Ill. 156; 52 N. E. 938.

[3] 85 N. W. 648; 110 Wis. 434.

tiff and another may fail because of the conduct of the assured. So far as this case is concerned, the obligation of the surety is a unit, and no liability can be predicated thereon, except in accordance with the terms of the contract."

§ 145. **Discharge of Liability by Alteration of Contract existing between the Insurer and the "Risk."** — In a leading case on the subject of contract insurance, it was said that "it is elementary that sureties are favorites in the law and have a right to stand upon the strict terms of their obligations, when ascertained. The surety has the right to rely upon the fact that the insured will hold the 'risk' to strict fulfilment of his obligation, and any variations therefrom to the detriment of the surety by the insured will work the former's discharge."[1] In holding that a contract of compensated suretyship should be strictly construed and not extended by implication, the federal court of appeals for the eighth circuit went into the question at length as to what acts of the insured and of the "risk" will serve to relieve the insurer from liability.[2] "When the rights of sureties are involved," observed the court, "they are only bound by the contract which they have signed, and they have a right to look to a literal and strict construction of the same, and not that such contract shall be extended either by implication or as a consequence of what others may do in matters of which they have no notice and with which they are not connected. . . . A surety is bound by the terms of his contract, and if a creditor, by agreement with the principal debtor without the concurrence of the surety, varies its terms by the enlargement of the time of performance, the surety is discharged." In this particular case certain material men furnished materials to a government contractor. The latter from time to time paid them sums of money, which was employed by them without notice to the "surety company" in paying a prior indebtedness of the contractor covered by the bond, running to a period later than the date set for the com-

[1] Electric App. Co. *v.* U. S. Fid. & Guar. Co. *et al.*, 85 N. W. 648.

[2] U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921-5; 32 C. C. A. 420.

pletion of the contract and until after the contractor had become insolvent. It was held that, as to the "surety company," the material men were bound to apply such payments on the indebtedness arising under the government contract, and the failure so to do relieved it from liability *pro tanto*.

In arriving at this conclusion the court called attention to the fact that the insured knew of the existence of the policy and upon the faith thereof furnished material and sold the same upon the understanding that they were to be paid for their material as the money was received by the "risk" from the government. They thus knew of the situation in which the insurer was, while the latter did not know that materials were being furnished by the insured to the "risk" on account of this work. It would be manifestly unjust and unfair, it was said, to require the insurer to make good to the insured a debt that would have been worthless but for the application thereto of money received from the government, which might have been applied to the payment of the debt for which the insurer was bound under the policy.

In House *v.* American Surety Company,[1] it was held that generally under a building contract alterations in the specifications are allowable. But where, by a supplemental agreement over the protest of the surety on a contractor's bond, an additional story was to be added to a building which formed the subject matter of the original contract, it was held that the agreement for the alteration being such as was not in contemplation of the parties when the contract was made discharged the surety. Where, however, alterations are made in a building contract, which expressly provides for certain changes, and such changes are made conformable thereto, the surety is not discharged. The Indiana courts maintain the same doctrine, at the same time stating that the general proposition that a material alteration in the terms of the contract, without the consent of the surety, will relieve such surety, applies to build-

[1] 21 Tex. Civ. App. 590; 54 S. W. 303.

ing contracts.[1] In a Minnesota case the bond specifically forbade any changes in the plans of a building contract involving an increase in the cost of the building exceeding three hundred dollars. It was held, on the first appeal therein, that any changes increasing the cost to a larger sum would constitute such a departure from the original contract as would release the insurer from all liability under the bond.[2]

On a second appeal in this same case the court laid down a principle of an extremely drastic character. It held that where changes are made by the contractor (the "risk"), which are not demanded by the insured, but which are required as a duty under a proper construction of the contract, and are acquiesced in by the "risk" as his own interpretation of the meaning of the plans and specifications, then such alteration, even where exceeding in amount three hundred dollars, does not relieve the insurer from liability on such contractor's bond.[3] A somewhat different but equally as important a question as any presented in the foregoing cases is to be found in American Surety Company *v.* Board of Commissioners of Waseca County *et al.*[4] Here a municipality was given a bond by a contractor for public work, conditioned that the contractor should pay all just claims for work and labor performed and for materials furnished as they became due. It was held that such municipality had no right to withhold payments to the contractor, as such payments had been stipulated for and agreed upon in the contract, on the ground that the contractor was in default with his labor and material men. Having no such right, the municipality is not disregarding its duty to a surety upon the bond when making payments in accordance with the terms of the contract, though previously notified of the default by such surety. The Minnesota supreme court, in passing upon the question, said

[1] Am. Sur. Co. *et al.* *v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. 793. See also U. S. to the use of A. P. & F. Co. *v.* Nl. Surety Co., 92 Fed. 549; 34 C. C. A. 526; Am. Sur. Co. *v.* U. S. to the use of M. H. Co., 24 Sou. 388.

[2] Nor. Ev. Luth. Beth. Cong. *v.* U. S. Fid. & Guar. Co. *et al.*, 81 Minn. 32; 83 N. W. 487.

[3] Idem., 86 N. W. 330.

[4] 77 Minn. 92; 79 N. W. 649.

"the municipality is not a trustee for the purpose of enforcing a liability accruing to other parties through the delinquency of the contractor, for by express provision this right rests with the injured party. . . . The parties for whose benefit and protection the obligation is entered into are as independent of each other under the law as if separate bonds had been required and given. . . . While it is the law that a creditor or an obligee upon a bond must deal fairly with a surety, he cannot be held to have dealt unfairly if he has simply complied with the terms of his contract and has been powerless to do otherwise. The 'board' had no authority under the statute to enforce the contractor's duty towards the laborers and material men by withholding payments on the estimates, and consequently it neglected no duty to the surety."[1]

As a broad, general principle it may be said that the law of insurance forbids that there shall be such dealings between the "risk" and the insured of which the insurer is kept in ignorance as shall put the latter in a position of peril. It seems but reasonable that if the insured designedly acts in the manner just indicated, it should be held to have released the insurer and to have elected to look solely to the "risk."[2]

Notwithstanding the fact that it has been intimated in some quarters that neither an unauthorized change in the terms of the collateral contract of indemnity or of the work to be performed thereunder will serve to release the insurer from liability, the true rule should be stated otherwise. Upon well recognized legal principles, any substantial violation of the plain provisions of the policy whereby either the terms of such collateral contract, or the nature of the work to be performed thereunder are materially changed without the consent of the insurer, should have the effect in law of relieving the latter from further liability under the policy.[3]

[1] See also Fewell *v.* Am. Sur. Co. *et al.*, 28 Sou. 755; Am. Sur. Co. *v.* Woods, 105 Fed. 741; 106 Fed. Rep. 263; 45 C. C. A. 282; Am. Sur. Co. *et al. v.* Lauber *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[2] See U. S. to the use of H. B. & Co. *v.* Am. Bond & Trust Co., 89 Fed. 921.

[3] See House *v.* Am. Sur. Co., 21 Tex. Civ. Appl. 590; 54 S. W. Rep. 303; U. S. to the use, etc. *v.* M'Intyre & Fid. & Dep. Co., 111 Fed. 590.

§ 146. **Discharge of Liability by Payment of Loss.** — The insurer cannot be called to meet his obligations until the fact that the " risk " has failed to meet his engagement becomes apparent to the court.[1] The insurer, however, cannot require the insured to first exhaust the property of the " risk " before enforcing the policy or await the collection of indemnity by the insurer from the " risk."[2] With respect to the insured, the insurer is to be regarded as the principal, even when it signs the indemnity agreement in terms as a surety.[3]

Where separate suits are pending on one policy it would seem just that the insurer be permitted to maintain a suit in equity through which the funds in its hands can be equitably distributed.[4]

Where claims of material men are in excess of the insurer's liability named in a policy running to the United States, the equitable rule of *pro rata* distribution will be applied and no priority should be given to the United States or to any individual creditor by reason of his having first commenced suit. In such a case the United States is to be regarded as having voluntarily made itself trustee alike for its own interests and for the interests of the material and labor men, and having thus voluntarily created and accepted a trust, it is barred by equitable principles from asserting for itself any advantage over other beneficiaries.[5]

In an English case a policy was issued guaranteeing to the holder of a deposit receipt, payment of his deposit if the debtor made default for more than twenty-one days after May 15, 1893. The facts in this case were as follows: On April 4 the bank suspended payment; on April 22 the insurer accepted notice of a claim ; on April 26 a scheme for the reconstruction of the bank was provisionally approved; on

[1] Un. Trust Co. *v.* Citizens' Trust Co., 185 Pa. St. 217; 39 Atl. 886.

[2] Amer. Sur. Co. *v.* Law Cem. Co., 96 Fed. 25; 110 Fed. 717; U. S. *v.* Am. Sur. Co., 110 Fed. 913.

[3] U. S. to the use, etc. *v.* Hazzard *et al.*, 53 N. Y. App. Div. 410; 65 N. Y. Sup. 1051.

[4] See Von Dendriesch *v.* Rohrig, 45 N. Y. App. Div. 526; 61 N. Y. Sup. 341.

[5] Am. Sur. Co. *v.* Law. Cem. Co., 96 Fed. 25; 110 Fed. 717; see also U. S. *v.* Am. Sur. Co., 110 Fed. 913.

May 15 the deposit became due and was not paid. June 11 the reconstruction scheme was finally approved, and in virtue thereof became binding upon the bank and its creditors as from April 26 with the result that the bank was freed from all its obligations and its liabilities passed in a modified form to the new bank. It was held, that the policy was to be regarded as a contract of indemnity, and that the insured was entitled to recover from the insurer what the bank failed to pay when it became due, and that an assignment by the insured of such rights as he had against the bank would satisfy the policy.[1]

Where the insurer guaranteed payment to a depositor of the deposit receipt of a bank "after default" in payment by the bank, and the bank stopped payment and had failed to pay when the receipt became due, it was held, that the bank was in default, notwithstanding it was reconstructed.[2]

§ 147. **The Measure of Damages.** — The case of American Surety Company *v.* Woods[3] is to be regarded as a leading case on the subject of the measure of damages under policies of contract insurance in this country. The facts therein — so far as they are material to the question of damages — were as follows: The "risk" (a firm of contractors), being about to construct certain sewers in the city of New Orleans, furnished in connection therewith a bond issued by the American Surety Company to the New Orleans Sewerage Company, providing that the "risk" should well and truly, and in good, sufficient, and workmanlike manner, perform the work provided for in the separate contract of the "risk" with the insured, bearing even date with the bond, in accordance with the terms and conditions therein stipulated, and in each and every respect comply with the conditions and covenants therein contained. The "risk" thereupon commenced work under its said contract and continued to do so for several

[1] Laird *v.* Securities Ins. Co., 22 Rettie, Scotch Session Cases, 452.

[2] Young *v.* Trustee Assets & Invest. Ins. Co., 21 Rettie, Scotch Session Cases, 222; see generally Buck *v.* Guarantors Liability Indemnity Co., 34 S. E. 950; 97 Va. 719.

[3] 105 Fed. 741; 106 Fed. 263; 45 C. C. A. 282.

months, when it refused to proceed further with the work on the ground that a fraud had been practised upon it in obtaining it, and that even if such contract had been valid in its inception, it had been released therefrom by a violation of its terms on the part of the insured. The latter thereafter went into the hands of a receiver and made no attempt to complete the contract so repudiated by the "risk." It was in fact never completed. Later on the receiver brought suit on the bond, alleging that damages had been sustained by reason of the non-performance of the contract on the part of the "risk," beyond the amount of such bond. The specific ground of such alleged damage was said to be, that had "risk" performed its contract properly, the cost of the work to the insured would have been $739,500, while the cost of the work already done by the "risk," together with the amount which it would have cost and will cost to complete said work, was $912,099.09, and that by reason thereof the insured was damaged in the sum of $172,599.09. At the trial the court instructed the jury with reference to damages as follows: "(I.) If the 'risk' abandons the work before completion and refuses to complete the same, having no lawful cause for such action, the measure of damages which the insured is entitled to recover is the difference between the cost of completing the work at the contract price and what it would have cost him to complete the work or to procure the work completed by others. (II.) After the abandonment of the contract by the 'risk,' the insured would have had the right to have gone on and completed the work itself, or to have let out a contract for the completion of the work to other contractors upon the best terms attainable, and in that case they would have had the right to recover as damages the difference between what it would have cost if the 'risk' had complied with the contract and what it actually cost the insured to complete the work. But the insured was not bound to complete the work or to employ anybody else to complete the work, and in lieu thereof, in order to prove damages, they had the right to offer testimony as to what it would have cost them to complete the work or have it

completed, and upon such testimony to recover from the insurer the difference between the necessary cost of completion as thus established, and what it would have cost under the contract of the insured with the 'risk.'" Under these instructions the jury found a verdict of $90,000 against the American Surety Company, who at once sued out a writ of error to the United States circuit court of appeals (fifth circuit). In holding that the foregoing instructions were erroneous, the appellate court spoke as follows: "Under the common law there must be, to authorize a recovery, a breach of the contract which causes damage. If only a breach is shown, there could only be a verdict for a nominal sum. When a contract is discharged unlawfully, he can, in a suit for damages, recover his outlay and the probable certain profits he would have made if he had been permitted to proceed with the work. His profits in such case would have been a gain he would have received but for the unlawful act of his employer. . . .

"By the terms of the contract sued on, the contractors were to furnish all necessary labor to excavate and build the sewers. The sewerage company was to furnish at its own cost all materials of every kind required to construct the sewer. We must bear in mind, therefore, that the contract on the part of the contractors was one to labor or to furnish labor. . . .

"It is contended that as a contractor, in the case of a breach of the contract by the employer, can recover his lost profits, and that he would be permitted to prove what it would cost to complete the work he was prevented from doing, and where it cost him less than the contract price could recover the difference as the profit which he would have made, that in all fairness the same rule should apply when a breach of the contract is made by the contractors. There are several considerations making differences in the two cases. When the contractor is stopped from work by the owner or employer who is to furnish the materials, he cannot go on and finish the work. He cannot by completing the work himself, or by others, show just what his profit, if any, would be. When he

sues for damages, therefore, he must, to recover profits, prove, if he can, what he would have made had he not been stopped. He is prevented from finishing the work, and such evidence is necessary to show what gain or profit to him was in the contract. On the other hand, when the contractor abandons the work, the owner or employer is kept in possession. He is free to employ others to finish the work. He has it in his power by employing others to complete the work to ascertain exactly the amount of his damages. The contractor, when stopped, or unlawfully discharged by the breach of the contract by the employer, has not this power. For the breach of a contract the injured party is entitled in a suit for damages to receive compensation for his loss, and nothing more. . . . The contractor or builder stopped from his work by the breach of the contract committed by his employer has clearly lost the profit that he would have certainly made by the completion of the work. His loss would have been certain in the event he had the work done at a cost greater than the contract price. The contention that the measure of his damages is the difference between the contract price and a greater price which he has never paid must be based on the erroneous theory that the contract is necessarily worth to him the sum above the contract price it would cost the contractor to finish the work. The fact that the contractor would lose a fixed sum by completing the work does not show that the contractor would lose that sum by the failure of the contractor to finish it. If the contractor stops the work and the employer does not complete it, it cannot be said that he has been damaged what the former would have lost had he not stopped the work. When the contractor breaks his contract he is liable to his employer for the amount the employer is damaged, but it does not follow that he is liable for the amount the contractor saved by the abandonment of the contract. It is a mistake to assume that whatever the contractor saved by stopping the work was lost by the employer who does not complete it. . . .

"In the absence of legal defence, the employer can of course recover damages for a breach of the contract of employment

by the employee. Where the employee or contractor without legal cause abandons the work unfinished, the right of the employer to sue for a breach of the contract is not dependent upon his completing the abandoned work. He may sue at once and recover of the employee or contractor such damages as under legal rules he can show he has sustained. But when the employer does not name the expense of completing the work and determines not to finish it, the sum which the contractor would have lost had he complied with the agreement and finished the work, or the difference between the contract price and the cost of completing the work, cannot be taken as the measure of damages." Again in this same case where the "risk's" contract with the insured provided that in case of delay in doing the work, the latter might take charge thereof and complete it at the cost of the "risk," it was held that this not only provided the measure of the insurer's liability under the policy in case of breach of the "risk's" obligations to the insured, but also the manner in which such liability should be arrived at. "Such a provision of the contract," observed the court, "conceding a different rule to prevail in its absence, rescues the case from the uncertain and speculative control of expert witnesses and applies to it the practical test of actual cost. It secured to both the 'risk' and the insurer a valuable right of which they should not be deprived."

In a Pennsylvania case the measure of damages to the insured as grantee of certain ground rents, under a policy insuring the completion of certain buildings agreed to be erected therein within a designated period after the sale of such ground rents, for the non-completion of such buildings, was said to be the difference in the market value of the ground rents if the buildings had been completed according to agreement and their value with the buildings in the uncompleted state in which they were left, not to exceed the amount of the insurance.[1] Again in American Surety Company v.

[1] Ger. Am. Ti. & Tr. Co. v. Cit. Tr. & Sur. Co., 190 Pa. 247; 42 Atl. 682. See generally on this subject, Union Tr Co. v. Citizens' Trust & Surety Co., 185 Pa. St. 217; 39 Atl. 836; Am. Bond & Tr. Co. v. U. S., 15 App. D. C. 397.

Lucas[1] the question of the measure of damages under a policy of contract insurance was discussed at some length.

In this case the insured sought to recover damages from the insurer on account of sums expended by him in completing a contract of the "risk" (a subcontractor) amounting to $14,908. At the time the work was abandoned by the "risk," there was due from the county on account of the work (a courthouse) $22,500. Against this balance there was an order from the insured calling for the payment to the "risk" of $5,000 or so much as might be advanced by the bank (as holders of this fund for the county) out of the next estimate of the amount due on the work. The next estimate referred to was $10,000. The bank advanced money to the "risk" upon this order, and when the "risk" failed, he was indebted to the bank $13,050. Upon settlement by the county, this order was paid by the insured as for $10,000, and charged against the $22,500 balance. The insured compromised with the county on account of claims for delay in completing work by agreeing to pay the bank's deficit, $3,050, and also additional claims against the county for $1,248.47 for lumber bills. Then the county paid the insured $12,500 less the amount of such lumber bills, the insured first paying the bank $3,050. It was held that the insured, as against the insurer, was entitled to charge against the $22,500 balance only $5,000 on the order, and must account for any excess of that amount paid on such order in settlement with the insurer; but he was allowed a credit for damages for the delay due the county for not completing the building in time.

Where the "risk" agrees to complete a building for the insured on a certain date, and in default thereof to pay him ten dollars for every day thereafter that the building remained unfinished, as liquidated damages and thereafter defaults, the amount per day agreed to be paid is to be regarded as a penalty, and the insured will be limited in his

[1] 57 S. W. 969.

recovery against the insurer to the actual damage he has sustained.[1]

If the insurer stands ready and willing at all times to settle its liability after default of the "risk," but has been obliged to invoke the aid of a court of equity to marshal and adjust the claims of the various parties insured which exceed in the aggregate the total amount of the policy, it cannot be charged with interest on the amount thereof, because of the delay incident to such proceedings.[2]

General creditors of the "risk," not protected by the policy, have no right to demand that they be subrogated in equity to a security taken by an insurer to indemnify it against loss by reason of the issuance by it of a policy of contract insurance.[3]

An insurer taking a counter indemnity bond from the "risk" is not prejudiced by any undisclosed relation existing between the signers thereof not disclosed on the face of the policy nor by the indemnifying agreement. It is entitled to stand, with reference to the right of reimbursement from the indemnitor, on the position most favorable to itself, and the fact that the insurer has been reimbursed for a payment of one claim through such indemnitor does not enlarge its liability to other creditors of the "risk" as to whom, in the marshalling of claims, the claim paid must be treated as though the insurer had not been reimbursed.[4]

In marshalling claims against a "risk" as against the insurer issuing a policy conditioned upon the payment of the same, the fact that certain of the claims have been pur-

[1] Weedon *v.* Am. Bond & Trust Co., 38 S. E. 255; 128 N. C. 69; see also Boyce *v.* U. S. Fid. & Guar. Co., 111 Fed. 138.

As to method of computing damages under contract insurance bonds, see Nl. Sur. Co. *v.* T. B. T. Br. & Con. Co., 176 Ill. 156; 52 N. E. 938; U. S. to the use of Snyder *et al. v.* Hazzard *et al.*, 53 App. Div. N. Y. 410; 65 N. Y. Sup. 1051; U. S. *v.* M'Intyre & Fid. & Dep. Co., 111 Fed. 590; Chicago House Wrecking Co. *et al. v.* U. S., 106 Fed. 385; Am. Sur. Co. *v.* Woods, 105 Fed. Rep. 741; 106 Fed. 233; 45 C. C. A. 282; Boyce *v.* U. S. Fid. & Guar. Co., 111 Fed. 138; Am. Bond & Tr. Co. *v.* Takahashi *et al.*, 111 Fed. 125.

[2] American Surety Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717.

[3] *Ibid.*

[4] *Ibid.*

chased by one who has bound himself to indemnify the insurer does not increase the amount to which other claimants are entitled, and for the purpose of making distribution to them, such claims must be treated as still subsisting.[1]

[1] Am. Sur. Co. *v.* Law. Cem. Co., 110 Fed. 717. See also United States *v.* Am. Sur. Co., 110 Fed. 913.

N. B. — Special attention is invited to the following cases which were reported too late for purposes of comment thereon in the text. Each involves some particular phase of contract insurance law. St. Paul Title & Trust Company *v.* Sabin and the United States Fidelity & Guaranty Company, Wisconsin Supreme Court, 87 N. W. 1109; United States, etc., *v.* M'Intyre and Fidelity and Deposit Co., 111 Fed. 590; United States, etc., *v.* Morgan & American Surety Company, 111 Fed. 444; Mullin and Fidelity & Deposit Co. *v.* United States, 109 Fed. 817; Boyce *v.* United States Fidelity and Deposit Co., 111 Fed. 138; American Bonding and Trust Company *v.* Takahashi, 111 Fed. 125; Parrs Bank *v.* Albert Mines Syndicate, 5 Commercial Cases, 116; Am. Bond. & Tr. Co. *v.* U. S. 15 Appeals D. C. 397.

CHAPTER XVI.

CREDIT INSURANCE.

§ 148. **Definition and Nature of Credit Insurance.** — Credit insurance is a subsidiary form of commercial insurance, and may be defined as an agreement whereby, for a valuable consideration, the insurer agrees to indemnify the insured in a specified amount against losses arising through the insolvency of third parties to whom goods and merchandise have been sold on a credit basis by the insured. Credit insurance, as thus defined, constitutes a valid form of insurance.[1] The supreme court of Wisconsin, in construing a policy of credit insurance, remarked, with reference to the same: "We regard the contract before us as unquestionably a contract of insurance. An insurance contract is an agreement whereby one party agrees to wholly or partially indemnify another for loss or damage which he may suffer from a specified peril. The peril of loss by the insolvency of customers is just as definite and real a peril to a merchant or manufacturer as the peril of loss by accident, fire, lightning, or tornado, and is, in fact, much more frequent. No reason is perceived why a contract of indemnification against the ever present peril of insolvency is not just as legitimately a contract of insurance as a contract which indemnifies against the more familiar but less frequent peril of loss by fire."[2]

Again, in passing on a credit insurance policy, the New Jersey court of appeals said: "The business for which this corporation was created was the issuing of certificates of

[1] Lauer *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. Rep. 53; People *v.* M. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24; Tebbetts *v.* Mer. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281; Strouse *v.* American Cr. Ins. Co, 91 Md. 244; 46 Atl. 328.

[2] Shakman *v.* The U. S. Credit System Company, 92 Wis. 366; 66 N. W. 528.

guaranty, which may be called contracts of insurance or indemnity to traders for losses incurred by the failure of their customers who are debtors to the traders and become insolvent. . . . Indeed, so peculiar is the system of insurance engaged in by this company that its contracts of insurance appear to be protected as its exclusive property by a copyright."[1]

§ 149. **Scope of Credit Insurance.** — The New York court of appeals, in a late case, gave the following exposition of the general purpose and scope of credit insurance: "It would seem to be necessary to inquire with respect to the scope, purpose, and meaning of the policy under which the claim is made. . . . The purpose was to indemnify the claimants from loss by insolvency of such debtors as had made a general assignment for the benefit of creditors. The claimants have sustained the loss since an assignment has been made. The assignment or transfer in each case was for the benefit of creditors or a creditor, and it is general in the sense that it embraced, substantially, all the property that the debtor had. The assignee in each case went into possession, and the assignor ceased to do business. The debtor, owing the claimant, thereby lost the title, possession, and dominion over all he had, and thereby became disabled to pay any one else. It would seem to be reasonable in such a case to conclude that the claimant had sustained a loss by reason of the insolvency of a debtor who had made a general assignment within the fair meaning of the policy.

"The contract in question was prepared by the insurer and intended for use, not in any particular state or locality, but throughout the country generally. The local law in any state,

[1] Gray *v.* Reynolds, 55 N. J. Eq. 501; 37 Atl. 461. On question of validity of credit insurance, see Claflin *v.* U. S. Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293. See also on general subject of credit insurance Smith *v.* Nl. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 28; Hayne *v.* Metropolitan Trust Co., 67 Minn. 245; 69 N. W. 916; Robertson *v.* U. S. Credit System Co., 57 N. J. Law. 12; 29 Atl. 421; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328; People *v.* Mer. Cr. Co., 166 N. Y. 416; 60 N. E. 24; Im. Mnfg. Co. *v.* Am. Cr. Ins. Co., 26 Ins. Law Journal, 926; McCallum *et al.* *v.* Nl. Cr. Ins. Co. *et al.*, 86 N. W. 892; Am. Cr. Ins. Co. *v.* Ellis, 156 Ind. 212; 59 N. E. 679.

with respect to its construction, is not to govern. Each state may have laws and statutes of its own that govern general assignments for the benefit of creditors, but these terms are not used in the policy in question in any statutory or local sense. When the insurer indemnified against insolvency of debtors who had made a general assignment for the benefit of creditors, the contract is not to be interpreted technically, but the language must be held to mean what the words import in the commercial world. Hence the character of the instrument or the nature of the transaction must be determined by the effect it has upon the debtor in the business community, and not by the name which the parties see fit to give it. It may be a statutory assignment, a mortgage, a confession of judgment, or some other contrivance, the purpose and effect of which are to dispose of all the debtor's assets and disable him from paying his debts. In such cases the loss is fairly within the scope of the indemnity secured to the insured by the policy. It is the completeness of the transfer and its effect upon the debtors in business, and not the name or form of the instrument or transaction, that give it character. Any transfer by a trader or merchant of all his stock and business, when it covers substantially all his property, may be an assignment within the meaning of the policy, in spite of the form or the name given it."[1]

§ 150. **Construction of Policies.** — "Insurance against mercantile losses," observed Judge Lacombe, of the United States circuit court of appeals for the second circuit,[2] is a new branch of the business of underwriting, and but few cases dealing with policies of that character have as yet found their way into the courts. The necessarily nice adjustment of the respective proportions of loss to be borne by insurer and insured, the somewhat intricate provisions which are required in order to make such business successful, and the lack of experience in formulating the stipulations to be entered into by both the parties to such a contract, have naturally tended to make them crude and

[1] People v. Mer. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

[2] Tebbetts *et al.* v. Mercantile Credit Guarantee Co. of N. Y., 73 Fed. 95; 19 C. C. A. 281.

difficult of interpretation." Then after quoting with approval certain cases holding that all ambiguous clauses of policies of insurance are to be construed in favor of the insured, Judge Lacombe continued as follows: "In the light of well settled principles of law expressed in these authorities, the contract under consideration must be construed. The cases cited, holding that the surety is a favorite of the law and that a claim against him is *strictissimi juris*, have no application. Corporations entering into contracts like the one at bar may call themselves 'guarantee' or 'surety' companies, but their business is in all essential particulars that of insurers, who, upon careful calculation of the risks of such business and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure persons against loss, in return for premiums sufficiently high to make such business commercially profitable. These contracts are in fact policies of insurance and should be treated as such."[1]

Contracts of this character must be given a reasonable construction so as to give effect to the intention of the parties and so as to carry out, rather than defeat, the purpose for which they have been executed. They should neither, on the one hand, be so narrowly or technically interpreted as to frustrate their obvious design, nor, on the other hand, so loosely and inartificially as to relieve the insurer from liability fairly within the scope or spirit of their terms.[2]

In case of ambiguity or uncertainty concerning the meaning of conditions in contracts of this character, that meaning is to be adopted which is most favorable to the assured. That rule is justly applicable to the words used in the policy in question, where there is nothing to show that they were used in any narrow, special, or local sense.[3]

[1] See also Goodman *v.* Mercantile Credit Guaranty Co. of N. Y., 45 N. Y. Sup. 508; 17 N. Y. App. Div. 474; American Cr. Ins. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264; Mer. Cr. & Guar. Co. *v.* Littleford Bros., 18 Ohio, Cir. Ct. Rep. 889.

[2] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703. See also Rosenbaum *v.* U. S. Cr. Sys. Co., 60 N. J. Law, 294; 37 Atl. 505; 44 Atl. 966.

[3] People *v.* Mer. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

All conditions limiting liability are to be strictly construed. In the interpretation of conditions they are to be construed liberally in favor of the insured, and strictly against the insurer. The policy should be interpreted in such a way as to accomplish the general purpose had in view and at the same time give effect to all of its conditions according to their fair and reasonable meaning.[1]

§ 151. **Applications for Policies.** — As in other branches of guaranty insurance law, the issuance of a policy is preceded by a formal "proposal" for the same filled out by the prospective insured on blanks furnished for that purpose by the credit insurance company. Such applications, when so filled out and signed by the insured, are by their terms made part of the policy to be thereafter issued, and the answers therein contained are a part of the consideration which is recited in such policy as the inducement for the issuance of the same by the insurer.[2] The general purpose of the insurance companies in requiring such applications is to ascertain the nature and extent of the liability to be named, so that it may determine whether or not to issue the policy, and if so under what conditions and at what premium.

§ 152. **The Policy: its Form and Content.** — The form of the policy issued by the various credit insurance companies is not always uniform, and for that reason it is difficult to state in detail the usual content of such policies. Speaking generally it may be said that credit insurance policies are ordinarily issued in the form of a bond of indemnity, to which are attached, either in the form of "riders" or by insertion thereof in the body of the policy, certain conditions which serve to define and limit the liability of the insurer and at the same time control the conduct of the insured during the period of liability by prescribing a line of action for him to pursue with reference to such insurer. The content of such policies

[1] People *v.* Mer. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24. See also Mercantile Cr. & Guar. Co. *v.* Littleford Bros., 18 Ohio, Cir. Ct. Rep. 889.

[2] See American Cr. Indemnity Co *v.* Carrollton Furniture Mfg. Co, 95 Fed. 111; 26 C. C. A. 671.

usually embraces the following matters: parties, amount, period and scope of liability, naming of a " risk " or class of " risks " covered by the policy, warranties as to representations in applications, absolute and partial limitations upon liability, provisions for notice and proof of loss by the insured, and payment thereof by the insurer within a designated time, limitation as to bringing suit, etc.

While the general purpose of such insurance is to furnish the business world protection against loss by extension of credit, the guaranty that is in fact given by the credit insurance companies is limited and controlled by certain specified conditions which are inserted in the policies that are issued. Briefly summarized, these conditions generally relate to the following matters: 1st. To defining insolvency as that term is used in the policy.

2nd. Limitation of liability to a certain stipulated amount in the aggregate, and in the case of individual " risks " not to exceed a certain amount on any one " risk," against loss resulting from insolvency of debtors to the insured over and above an annual net initial loss to an amount stipulated in the policy; such net loss to be borne by the insured on his total gross sales and deliveries of merchandise amounting to a certain named sum or less, such sales and deliveries to be made to firms, corporations, or individuals actively engaged in commercial or mercantile pursuits in the United States between certain specified dates.

3rd. Sales and deliveries to be confined to such as are made *bona fide* to parties who have a certain designated rating in the current books of Dun or Bradstreets or other commercial agency named in the policy.

4th. No credit account to exceed the amount designated in the policy as permissible for any one debtor.

5th. No claim to be filed under the policy on account of any one insolvent debtor in excess of a certain designated percentage of the lowest amount of the capital rating given by the commercial agency named in such policy.

6th. All initial claims against insolvents after payment of

insurance to remain the property of the insured; all others to be the property of the insurer, by right of subrogation after settlement of loss.

7th. Immediate notification of insolvency of the insured's customers, and furnishing of proof of loss in the manner prescribed in the policy. The foregoing does not of course constitute a full statement of all the manifold conditions of credit insurance policies. It will, however, serve to show in a very general way the nature and scope of the business carried on by credit insurance companies in this country. The policy as now issued would seem to be based on sound business principles, requiring the insured to be his own insurer to the extent of bearing an initial loss before recourse can be had by him to his policy of credit insurance, and at the same time limiting the scope of liability to such "risks" as have a fair business rating in the commercial reports.

The basic principle of credit insurance is a division of liability between the insurer and the insured. The insured under such policies undertakes to bear a certain loss before any responsibility attaches to the insurer. The latter does not insure as to the loss assumed by the insured, but only undertakes to insure to a fixed amount after a deduction is made for loss so assumed by the insured.[1] The rate of premium charged is based upon the percentage of the insured's losses to the total business transacted by him on a credit basis during preceding years, as well as upon his value as a moral hazard.

§ 153. **Attachment and Duration of Liability.** — Liability under a contract of credit insurance attaches as of the date designated in the policy for the commencement of liability thereunder. Ordinarily there is no difficulty in ascertaining when such liability attaches, but the determination in all cases of the period of duration of liability under a policy is by no means easy. True it is that in most cases the policy states specifically the period of liability; yet so many circumstances

[1] See Brierre *v.* Am. Ind. Co., 67 Mo. App. 384. See also Lauer *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. Rep. 53; Gray *v.* Reynolds, 55 N. J. Eq. 501; 37 Atl. Rep. 461.

may arise by reason of acts of the parties in violation of the conditions of the policy or because of the use of ambiguous language in the instrument itself, as to render a determination of the period of liability a matter of no little difficulty and doubt. A brief examination of the cases wherein questions relative to the duration of liability under credit insurance policies were considered will now be presented. In Hogg *v.* Indemnity Company,[1] a policy had been issued providing indemnity against loss on total gross sales made between June 15, 1896, and June 14, 1897, inclusive, liability to cease June 14, 1897. By a rider attached, it covered losses occurring after payment of premium on sales and shipments made from April 1, 1896, to June 15, 1896. The policy also provided that claims should be barred unless notice thereof was given within ten days after the insured was informed of a debtor's insolvency during the term of the policy and a final statement of claims filed in accordance with this condition was to be made and received at the insurer's office within 30 days after the policy expired. An adjustment was to be made within 60 days after its receipt, and the amount found due was payable at once. In case the policy was renewed, losses on sales covered, resulting after its expiration on shipments made during the term of the policy, could be proven in accordance with the terms of the renewal. On this state of facts the Massachusetts supreme court held that it did not authorize a claim for indemnity under the policy for a loss resulting from an insolvency on the part of a debtor to whom the insured had previously sold goods, where such insolvency occurred after the date of expiration of the policy.

Again, in Sloman *v.* Guaranty Company,[2] a policy had been issued wherein indemnity was promised to the insured against loss by insolvency of the insured's debtors owing for merchandise sold between April 1, 1893, and March 31, 1894, the policy to expire by its terms on the date last mentioned. It was further provided that final proofs of losses should be presented within 90 days after the expiration of the policy, and

[1] 172 Mass. 127; 51 N. E. 517.

[2] 112 Mich. 258; 70 N. W. 886.

that no loss should be payable unless included in such proofs, except that should the policy be renewed on expiration, losses occurring after such expiration on sales made during its existence should come within the scope of the insurer's liability. The holding of the Michigan supreme court in this case was to the effect that losses occurring after the expiration of the policy on sales made during its existence were payable, though the policy was not renewed, provided the final proof of loss was made as required. In Talcott *v.* Insurance Company,[1] a policy was issued conditioned to indemnify the insured against losses on sales during a certain designated period by reason of the insolvency by legal process of any buyer to whom goods should have been sold and delivered during the specified period named in the policy or by reason of any judgment or decree of court obtained for goods so delivered within the said period, upon which execution should have been returned unsatisfied. It was held that the policy did not cover losses on sales made during the specified period where judgment for the price was not recovered until afterwards.

Unlike some other forms of insurance, the effect of renewal provisions in a policy, followed by the issuance of such renewal policy, is, under the peculiar conditions of credit insurance policies, practically to merge the original and renewal policies into one continuing policy for the period of time named in both policies.[2]

By way of limitation upon the period of liability, policies frequently provide that in the event of failure or discontinuance of business on the part of the insured, occurring before the date named for the expiration of the policy, the same shall become void. In a Maryland case the policy had been issued to a firm composed of two partners, and contained the clause just mentioned. After goods had been sold on credit during the term of the policy, but before the "risk" defaulted in his payment therefor, by such copartnership, one of the partners

[1] 41 N. Y. Sup. 281; 9 N. Y. App. Div. 433; 163 N. Y. 577; 57 N. E. 1125.

[2] See Amer. Credit Indemnity Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340.

died. Subsequently the partners by whom such goods had been sold became insolvent, and in an action on the policy to recover for losses covered thereby, the court held that the death of one member of the firm was not a discontinuance of the business within the terms of the policy, and that the surviving partner was entitled to recover the losses so incurred.[1]

In an English case, a policy was considered wherein was a condition closely analogous to the one given above. It provided that if any member of the insured (a trading copartnership) should die, or cease to be such trader, the policy issued to them providing against loss by insolvency of customers of such copartnership should become void upon such death or retiracy.

It was held that the policy became void upon the retirement of one of the partners from trade.[2] So again it is said that the insolvency of the insurer terminates the policy.[3]

In a late case the policy provided, in substance, that it should be enforceable by the insured where the "risk" made a general assignment or went into the hands of a receiver, or, without failing in business, offered to compromise under a compromise approved by the insurer. The "risk" while in the hands of a receiver offered a compromise to the insured, by giving notes on time, which offer was never accepted or executed. However, the insurer agreed that any ultimate loss on the notes might be readjusted until Nov. 9, 1899, the date of the maturity of the last of the notes, under a clause that provided that where a "risk's" offer of settlement had been deducted on an adjustment and the insured did not subsequently realize the amount of the offer, the loss should be readjusted, provided the estate of the "risk" was settled and the deficiency ascertained within twelve months from the expiration of the policy. The policy expired March 31, 1897, and the deficiency was not ascertainable until 1899.

[1] Amer. Credit Ind. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[2] Solvency Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17.

[3] See Smith *v.* Nl. Cr. In. Co., 65 Minn. 283; 68 N. W. 28.

On this state of affairs it was held, that as the offer of compromise was never carried out nor made the basis of an adjustment, there could be no readjustment under the clause providing therefor, and that the loss was to be computed under the clauses of the policy which governed cases of insolvency.[1]

§ 154. **Scope of Liability.** — In view of the fact that credit insurance has reference to payment of losses arising through the "insolvency" or "failure" of parties to whom credit has been extended by the insured, it is of primary importance to ascertain the meaning of these words as employed in the policies issued. By so doing a long step will have been made towards ascertaining the scope of liability under policies of credit insurance. The question here presented was gone into at length by the Maryland court of appeals in Strouse *v.* American Credit Indemnity Company of New York.[2] In the opinion in that case — which involved the construction of a credit insurance policy — the court spoke as follows: "This scheme of indemnity includes two classes of losses, the one an initial loss which must be borne by the indemnified, the other a loss in excess of the initial loss, which must be borne by the indemnitor. Both kinds of losses are such as result from insolvency of debtors who owe the indemnified. Obviously the inquiries which first suggest themselves are these: What is meant by the term 'insolvency,' as used in the body of the bond? Which are the losses that belong to the two classes respectively? What is the period of time at which the initial loss must be ascertained? As upon the location of that time the extent of the liability of the indemnitor, in a large measure, depends. It is insisted by the company (the insurer) that the term 'insolvency' is limited and defined by conditions 'II a' and 'II b,' indorsed upon the bond. These clauses are as follows: '(II a) General assignments of or attachments against insolvent debtors, the absconding of the debtors or executions returned *nulla bona*, shall constitute insolvency

[1] People *v.* Mercantile Credit Co., 35 N. Y. Misc. 755; 72 N. Y. Supple. 373.
[2] 91 Md. 244; 46 Atl. 328.

(II b) the appointment of a receiver, a sell out, or the death of the debtor does not establish insolvency, but the indemnified may prove such claim during the term of this bond, or renewal thereof, provided legal proof shall be given, establishing the insolvency of the debtor.' These bonds of indemnity and certificates are contracts confined to the business affairs of merchants, and relate exclusively to the insolvency of merchants. Naturally, then, it must follow that the insolvency against which they afford indemnity is 'insolvency' as understood by merchants and as defined in bankrupt and insolvent laws relating to merchants and to mercantile transactions, unless a contrary or different purpose is clearly and unequivocally manifested by some term of the contract. On the face of the bond protection against loss resulting from the insolvency of debtors is afforded. The insolvency designated is the usual legally defined 'insolvency,' which is an inability of the debtor to pay his debts as they fall due in the ordinary course of business, and this is dependent neither upon a formal adjudication nor on an actual insufficiency to meet liabilities. As a defeasance clause limiting the liability of the indemnitor, it must be clearly expressed and strictly construed. Conditions II a and II b cannot be held to narrow the meaning of the term 'insolvency' as used in the body of the instrument. 'General assignments or attachments against insolvent debtors shall constitute insolvency.'

"'The absconding of debtors or executions returned *nulla bona* shall constitute insolvency.' Obviously this means that these things shall constitute evidence of insolvency. It is not every general assignment or every attachment that is declared to constitute insolvency, but such an assignment made by or an attachment issued against an insolvent debtor. But who is an 'insolvent debtor'? Unless you reason in a vicious circle, the answer must be, one who is unable to meet his obligations as they fall due in the ordinary course of business. An execution returned *nulla bona* cannot constitute a debtor's insolvency. Insolvency is a status. The return on execution may be evidence of that status, but is not the status itself.

These four things named in clause "II a" do not create the status or condition of insolvency; they are simply results which flow from the antecedent pre-existing insolvency. They are therefore evidence of the thing from which they proceed, they are not the thing itself. Section 116 makes this demonstrably clear. The appointment of a receiver, etc., does not establish, that is, does not prove, insolvency; but legal proof may be given establishing the insolvency of the debtor; that is, establishing his inability to pay his debts as they fall due in the ordinary course of business. Now, if none of the things named in 'II a' constituted insolvency, there could be no legal proof of insolvency under 'II b,' because there could be no insolvency to be proved unless there was a general assignment. an attachment, an absconding, or a return of *nulla bona.* A thing which in its very nature cannot constitute insolvency, though it may constitute evidence of insolvency, cannot, by being called insolvency, be other than it intrinsically is, namely, a means of proving the existence of insolvency. This must be so unless the thing to be proved is identical with the thing that proves it, unless insolvency as a fact and the evidence which proves that it is a fact are one and the same thing. But the two are manifestly different."[1] Another case wherein this same question was considered, but under a different wording of the policy, is that of Goodman *v.* Mercantile Credit Guarantee Company.[2] The policy there under consideration provided that the "term 'loss sustained by reason of insolvency of debtors' is agreed to mean losses upon sales made by the indemnified to debtors who have made a general assignment for the benefit of their creditors, or who have been declared insolvent in legal or judicial proceedings, or whose business has been sold by the sheriff, marshal, or other public officer, under an attachment, execution, or other process, or against whom an execution has been returned unsatisfied upon a judgment

[1] See in this same connection Am. Cr. In. Co. *v.* Carrollton Furniture Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Am. Cr. In. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; People *v.* Mer. Cr. Co., 166 N. Y. 416; 60 N. E. 24.

[2] 45 N. Y. Sup. 508; 17 App. Div. 474.

obtained by the indemnified for sales of merchandise made during the period covered by the contract." Commenting upon this provision, the court spoke as follows: "On Jan. 4, 1893, Thayer, the debtor, executed a conveyance of his entire stock of goods, wares, and merchandise to a trustee, with directions to sell and apply the proceeds, after payment of fees and expenses, to the payment of nine specified creditors, preferring them in the order in which they were named. The instrument refers in one place to the property transferred as a 'part of his property and effects,' and in another as only 'a part of his property.' On Jan. 11, 1893, Thayer executed another instrument, which recited the former and conveyed any unexpended surplus to the same trustee for the payment, *pro rata*, of eighty-three creditors. The insured rely wholly upon these instruments, which they claim constitute a general assignment for the benefit of creditors. The insured first contends that by 'general assignment' in the policy is meant any such disposition by a debtor of his property as induces insolvency in the ordinary meaning of the term, — as renders it impossible for the insured to realize its claim. This seems to us to be reasoning in a circle. The policy provides for indemnity against losses by 'insolvency,' and then undertakes to define of what insolvency shall consist. This definition is binding upon the parties, and no loss which does not comply with it can be proved against the defendant. But the execution of a 'general assignment' is employed as a test of insolvency. Consequently to say that such an assignment is meant as produces insolvency is either to say nothing at all or to abrogate the contract definition entirely and adopt one from some outside source which may or may not be like that provided for. 'Assignment' cannot be defined in terms of 'insolvency,' at the same time that 'insolvency' is defined in terms of 'assignment.' Discarding such a definition, we see no reason why the term 'general assignment' for the benefit of creditors should not be given its ordinary legal significance."

The New York court of appeals had occasion recently to consider this same question in People *v.* Mercantile Credit Guar-

antee Company.[1] It was there held that written transfers, by which debtors convey substantially all their property to pay or secure debts, the property being at once delivered and the debtors thereupon ceasing to do business, constitute general assignments for creditors within the meaning of a policy prepared for use, not in any particular state or locality, but throughout the country generally, insuring against loss or sale sustained by the insolvency of debtors who have made a general assignment for the benefit of their creditors, whether the assignment be in the form prescribed by state statutes or an assignment at common law, or for the benefit of a single creditor or all. The question before the court involved a construction of the policy or contract which the company delivered to the claimants and which the latter insisted entitled them to payments from the assets in the hands of the receiver. "It will be convenient," observed the court, "to consider the two claims separately, since the policies and the conditions governing the rights of the parties are different. The claim of the Winsted Hosiery Company amounts to $364.24, made up of three distinct items or debts due the claimant from three different customers for goods sold: namely, one Getz, $101.70; one Moses, $176.14; and Robie & Co., $86.40. The two former debtors are in Texas and the latter in Illinois. By the terms of the policy the defendant, in consideration of $90, insured the hosiery company 'to an amount not exceeding three thousand dollars against loss sustained by reason of the insolvency of debtors owing the insured for merchandise usually dealt in, sold and delivered in the regular course of business.' The policy contains numerous conditions and stipulations which qualify the general obligation of the insurer, but we are now concerned with only one of those conditions, which was as follows: 'The term "loss sustained by the insolvency of debtors" is agreed to mean losses upon sales made by the insured to debtors who have made a general assignment for the benefit of their creditors.' The question therefore is, whether, upon

[1] 166 N. Y. 416; 60 N. E. 24.

the facts found, the three debtors named to whom the insured sold goods and failed, made a general assignment for the benefit of their creditors within the fair meaning of this provision of the defendant's policy. They did make written transfers, respectively, of substantially all their property to pay or secure their debts, and the question certified is whether either of the three instruments appearing in the record constitute a general assignment within the meaning of the policy 'when, at the time of their respective execution, the property severally described therein constituted substantially all the property of the respective debtors and was at once delivered and the respective debtors thereupon at once ceased to do business.'

"The other claim was presented by Daniel Forbes Co. of Chicago, under a different policy, involving the meaning of other conditions. The general purpose expressed is the same as the policy just considered, and it expired on the 30th of April, 1897. The claim was rejected on the ground that it had not accrued within the life of the policy. It amounts to $441.97 for goods sold to an insolvent debtor, and it is claimed that the following conditions of the policy exclude it from sharing in the assets held by the receiver: (1) 'Only such amounts as are actually owing by an insolvent debtor to the insured at the date of his insolvency shall be taken in the calculation of the losses under this policy, and only when this debtor has made a general assignment for the benefit of his creditors, or has been declared insolvent in legal or judicial proceedings, or an execution has been returned unsatisfied on a judgment obtained against him by the insured, or some other creditor, for merchandise sold to said debtor during the period covered by this policy, provided said execution has not been returned after the appointment of a receiver or trustee of the property of the debtor.' (2) 'This policy shall expire on the 30th of April, 1897, and any loss by reason of the insolvency of any debtor after said time shall not be provable hereunder.' (3) 'Final verified proofs of loss must be presented to the company within sixty days after the expiration of the policy, and no loss is payable unless included in such proofs presented

within that period. Losses to be adjusted and paid within sixty days after final proofs.'

"The claimant's debt was for goods sold and judgment was recovered thereon and execution issued twelve days before the policy expired, but the execution was not returned unsatisfied until three days after, that is, on May 3, 1897, and the question certified to us is: 'Did the return of the execution unsatisfied on May 3, 1897, constitute it an insolvent debtor, for which the company was liable under the terms of the Daniel Forbes policy?' I think that this claim is fairly within the indemnity provided by the policy.

"(1) The conditions require that the judgment be obtained 'for merchandise sold to said debtor during the period covered by this policy.' That condition is satisfied by the facts of this case.

"(2) Any loss by reason of the insolvency of the debtor after the expiration of the policy is not provable. That means that the loss and the insolvency must occur within the year covered by the policy. Both facts did occur within that time in this case.

"(3) There is no express limitation in the policy with respect to the time when the execution is to be returned, except that it must not be returned 'after appointment of a receiver or trustee of the property of the debtor.' That did not happen in this case.

"(4) The only limitation in the policy concerning the return of the execution is implied in the condition that final verified proofs of loss must be presented within sixty days after the policy expires, and no loss is payable unless included in such proofs submitted within that time. It may be possible that unless the execution is returned within the sixty days limited for presenting final proofs that the insured will not be able to make proofs of his claim. But in this case the return was made within three days after the policy expired, so that the insured could and did present the claim in his proofs. To sustain the decision under review it is necessary to hold that not only must the goods be sold within the life of the policy

and the judgment rendered and the execution issued, but that it must be returned unsatisfied within that time, which is one year, and that too when there is no language in the policy or in the conditions which would warrant such a construction. It would reverse the legal rule for the interpretation of such conditions and require us to hold that they are not to be construed liberally in favor of the insured, but strictly against him, by importing into the contracts words that the parties have not used. The return of the execution does not constitute the main fact of the insolvency, but it is simply evidence of that fact, and if the insured, when presenting his proofs of loss within the time stipulated, can show that it has then been returned, that is a compliance with the terms of the policy. The contention that the goods must be sold, judgment recovered, execution issued, and returned unsatisfied, all within the year, would defeat in most cases every purpose of the insured in entering into the contract and destroy all benefits to be derived by him under it. The sheriff in this state has sixty days within which to return the process, and perhaps in other states even a longer time, and if the insurer can be held only on such judgments and executions as have been returned unsatisfied within the year when the goods are sold, the indemnity to the insured is a delusion. It is very clear that no such construction should be adopted unless the language employed admits of no other. When the conditions of this policy are carefully read it will be seen that such an extreme and destructive stipulation is not to be found. No language has been employed to limit the liability of the insurer to debts upon which an execution has been returned unsatisfied within the year, and that proposition comprehends the whole question. Such a limitation cannot be based upon conditions that are obscure or of doubtful meaning."

A most instructive case on the scope of liability under renewal policies is American Credit Indemnity Company *v.* Champion Coated Paper Company.[1] The facts in this case, so far as they relate to matters of construction, were as fol-

[1] 103 Fed. 609; 43 C. C. A. 340.

lows: Two bonds of indemnity against loss by the insolvency of debtors were issued to a mercantile company, the second being a renewal of the first. They contained identical provisions to the effect that any loss covered by the terms of such bond and resulting from sales and shipments made during its term, but which should not become provable under its conditions before its expiration, might be proved under a renewal thereof, "under and subject also to the terms and conditions of such renewal," and also in case such a bond was a renewal, losses occurring during its term on sales and shipments made during the term of the preceding bond might be proved thereunder, subject also to the terms, conditions, and limitations of such preceding bond. It was held that under such provisions one evident purpose of a renewal was to extend the protection of the preceding bond to losses on sales during its period which did not technically become provable before its expiration, and hence that such losses arising from sales and shipments made during the term of the first bond and proved during the term of the second were governed by the terms and conditions of the original bond, rather than those of the renewal, as to matters wherein the two differed.

A somewhat analogous question was before the court in Strouse *v.* American Credit Indemnity Company.[1] Here the policy had a "rider" attached to it, whereby similar losses, provable under a renewal of a prior lapsed policy, were allowed to be proved under the later policy, in accordance with its terms and conditions. The lapsed policy had guaranteed the insured against losses in excess of an initial loss of $6,250, and provided that losses occurring after its expiration on goods shipped during its continuance should be provable under a renewal of it. On this state of facts the court ruled that only such losses as were in excess of the initial loss of $6,250 were provable under the policy, the provisions of the original lapsed policy as to such initial loss being regarded as incorporated in the later policy, and the provision as to the terms and conditions of the latter relating only to the mode of proving such claims.

[1] 91 Md. 244; 46 Atl. 328.

It sometimes becomes a matter of importance, in connection with the payment of claims, to determine whether or not certain parties come within the list of "risks" covered by the policy. This is a question exclusively for the jury to determine, under proper instructions from the court.[1]

Where the policy stipulates that no loss shall be proven after its expiration, except that, in case the same is renewed and the premium on such renewal paid at or before the expiration of the policy, loss resulting after such date of expiration on shipments made during the term of such policy may be proven during the term of the renewal policy next immediately succeeding, the question as to what constitutes insolvency is governed by the terms of the first policy and not by those of the renewal, under which the insolvency occurred and loss was proved.[2]

§ 155. **Discharge of Liability.** — As in other and kindred forms of insurance, the insurer in credit insurance contracts may be discharged from liability in a variety of ways. Chief among these may be mentioned the following:

1. By rescission of the contract or by cancellation of the policy.
2. By misrepresentation on the part of the insured.
3. By concealment on the part of the insured.
4. By breach of warranty on the part of the insured.
5. By breach of conditions on the part of the insured.
6. By payment of loss by the insurer to the insured.

§ 156. **Discharge of Liability by Rescission or Cancellation.** — There can be no doubt but what the ordinary principles of fraud relative to the right of cancellation, where the same is practised in connection with the formation of the contract, are applicable to credit insurance. The policy may be cancelled at any time by mutual consent, and usually by either party where no liability has been incurred.[3] Incidentally, in this connection, it may be observed that in the case

[1] Strouse *v.* Am. Cr. Ind. Co., 91 Md. 244; 46 Atl. 328.

[2] Am. Cr. Ind. Co. *v.* Athens Woolen Mills, 92 Fed. 581: 34 C. C. A. 161.

[3] See *ante*, §§ 49, 50.

of mutual credit insurance companies formal written notice of retirement from such companies is usually required to relieve the withdrawing member from future liability of any nature.[1] Again it has been held that where the insurer fails during the life of a policy, and no liability has been incurred thereunder, the insured cannot, as against a receiver of such insolvent company, recover back the whole premium paid, but only the unearned premium for the balance of the year subsequent to the insolvency of the insurer.[2]

In one case the right to rescind a policy for a fraudulent concealment of the insolvency of a customer was held barred by laches, through delay of the insurer in seeking to rescind the same after notice of such insolvency.[3]

§ 157. **Discharge of Liability by Misrepresentation.** — The custom prevalent in credit insurance companies of requiring all parties seeking this form of insurance to fill out blank applications for policies, wherein are contained a large number of inquiries relative to the past business history of the insured, as well as searching queries as to the extent and condition of his business at the time such application is forwarded to the insured, renders the subject of misrepresentation of considerable importance in credit insurance law. However, as it is the practice to insert in both the application and the policy provisions making all the representations contained in such applications warranties, most of the legal questions thereby presented will be discussed under that head.[4] However, attention is called to one case, where the subject of misrepresentations was gone into at some length.

Here an application for a credit guaranty policy placed the applicant's gross sales during the preceding fourteen months at $622,835, and his losses at $1,323. The insurer agreed to buy from the insured an amount not exceeding $15,000 of

[1] See *In re* Insolvency Mut. Guar. Soc., 10 W. R. 572; Solvency Mut. Guar. Co. *v.* York, 3 H. & N. 588; Solvency Mut. Guar. Co. *v.* Froane, 7 H. & N. 5; Solvency Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17.

[2] Smith *v.* Nl. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 283.

[3] Am. Cr. Ins. Co. *v.* Wimpfheimer, 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498.

[4] See *post*, § 159.

uncollectable debts arising during the period of liability covered by the policy owing for goods sold and delivered in excess of one half of one per cent on the total gross sales and deliveries made during that time, subject to the terms and conditions attached to the policy. One of these stated that the policy was issued on the basis that yearly sales and deliveries of the insured were between $1,800,000 and $2,500,000. This last clause was not treated as a warranty, and for that reason did not have the effect of exempting the insurer from liability if the insured's total sales on which the half of one per cent was to be computed failed to reach $1,800,000; therefore the insured was allowed to recover his losses not exceeding $15,000 in excess of that *ratio* on his actual total sales during the period of liability.[1]

§ 158. **Discharge of Liability by Concealment.** — In view of the character of credit insurance, wherein the personalities of the "risks" insured against are necessarily unknown as well as numerous, there is but small opportunity for an extended application of the doctrine of concealment to this branch of guaranty insurance law. For a presentation of such doctrine the case of American Credit Insurance Company *v.* Wimpfheimer *et al.*[2] may be referred to. Here the failure of the insured under a credit indemnity policy to inform the insurer at the time of obtaining a renewal that a customer to whom sales had been made by the insured during the life of the original policy was insolvent, and that an application for a receiver was pending, was held not to be such a fraudulent concealment as served to avoid the policy, if the renewal was taken at the insurer's instance.

The renewal bond was drawn according to the same terms and conditions as the original, save as to the amount of initial loss. The court, in passing upon the questions thus presented, spoke as follows: "The plaintiff is engaged in the business of insuring merchants against loss by insolvency of debtors.

[1] Tebbetts *v.* Mercantile Credit Guarantee Co., 73 Fed. Rep. 95; 19 C. C. A. 281.

[2] 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498.

This particular class of insurance is of recent origin, but the principles which must govern the construction of the bond are not new." "Fraud in the suppression of a material fact arises only where one party to the contract fraudulently and intentionally conceals from the adverse party something which he knows, and the other party does not know, and which the first party was bound to state, the suppression of which has induced the adverse party to enter into the contract. Suppression *veri* or concealment will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arms' length, on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation, and either may remain silent and be safe."

§ 159. **Discharge of Liability by Breach of a Warranty.** — In discussing the doctrine of warranty in this immediate connection, the first question that naturally presents itself is this: Has the doctrine of warranty, as developed in the law of fire, life, and marine insurances, been adopted into the law of credit insurance, either in whole or in part? In answer to the question, attention is called to a decision of the United States circuit court of appeals for the second circuit, — that of American Credit Indemnity Company *v.* Carrollton Furniture Manufacturing Company,[1] — where the court spoke as follows: "In the application for insurance the plaintiff (the insured) warranted the answers to the questions asked by the defendant (the insurer) to be true, and offered these answers as a consideration for the policy to be issued. The policy subsequently executed declared that it was issued in consideration of the application, which was made part of the contract of indemnity. The answer to the question in regard to gross sales and gross losses was that for each of three

[1] 95 Fed. 111; 36 C. C. A. 671.

years ending in July, 1891, 1892, and 1893 the gross sales were about $100,000. The actual sales for these years were $87,441.61, $99,990.65, and $97,831.06. The gross losses stated in the answer for the same years were $498.90, $1,040.26, and $818.22. The losses as claimed by the defendant (the insurer) for those years were $3,080.74, $2,275.17, and $1,334.59. The important question upon this point was in regard to the amount of losses for the year ending in July, 1891, which the defendant claimed had been reduced to about $1,680, and there was vague testimony about an additional reduction of small amount. The defendant asked the court to charge that the written answers to the questions in the application were express warranties upon the faith of which the policy was given, and if untrue the materiality of the same was unimportant, and if not strictly performed that the plaintiff could not recover. The court charged that if there was a substantial misrepresentation as to the facts at the time the application was made, the plaintiff was not entitled to recover; but if the differences were unsubstantial and immaterial, such differences would not stand in the way of its recovery, and if the difference was between $498.90 and $3,080.74, that would be a material and substantial variation from the amount stated in the application, and would defeat the plaintiff's right to recover. The request in regard to the necessity of strictness in performance of a warranty was not complied with, and probably from the fact that as the policy also made misrepresentation and concealment matters in avoidance, the difference between a warranty and representation was not sharply pointed out. The application contains an unequivocal warranty, and by the express terms of the policy became a part of the contract. Courts have been reluctant to import terms of warranty which were contained in the application or proposal for insurance into the completed agreement, unless the policy clearly manifested the agreement of the parties to the union of the two papers in one contract; but where there is a distinct agreement that the application is a part of the contract, and the statements in the applica-

tion upon which the contract is based are expressly declared to be warranties, the intent of the insured to bind himself to exactness of truth in his answers, although the facts which are called for may seem not material, is clearly and adequately manifested, and the contract must be enforced according to its terms. Where the assertions or representations upon which the contract is declared to be based are warranties, they must be strictly true, or the policy will not take effect; and this is so whether the thing warranted be material to the risk or not. It would perhaps be more proper to say that the parties have agreed on the materiality of the thing warranted, and that the agreement precludes all inquiry into the subject. The answer in regard to the amount of gross sales was expressed to be approximate, but in regard to the amount of gross losses, which were the result of the business for the year ending in July, 1891, the answer professed to be exact; and the question of a breach of warranty, if any question really existed rather than that of misrepresentation, should have been submitted to the jury. If no question could exist in regard to the fact of a breach, as would be the case if the actual loss was $1,680, instead of $498, there was no liability under the policy."[1]

Undoubtedly where the policy recites that it was issued in consideration of the application and the statements therein contained and warrants these to be true, then under such circumstances these statements constitute warranties. A warranty in credit insurance as well as in other branches of insurance law is in the nature of a condition precedent, and devolves upon the insured the burden of averring performance thereof in his pleading, and of proving the same strictly at the trial.[2]

§ 160. **Discharge of Liability by Breach of Conditions.** — To all forms of credit insurance policies a large number of con-

[1] To the same effect see American Cred. Ind. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264. See however Tebbetts *v.* Mer. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281.

[2] Am. Cr. Ind. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

ditions will be found attached, either in the body of such policies or in the form of "riders" annexed thereto. The rulings of the courts as to the principal conditions here referred to will now be presented. First, attention should be called to the rule that all such conditions should be strictly construed against the insurer.[1]

Where a policy against loss in a certain ratio had been issued, containing a stipulation that only losses incurred by sales to persons whose capital, as well as credit, was rated in "Bradstreet's," should come within the scope of the insurer's liability under the policy, it was held that a loss of the kind mentioned arising from the failure of one of the insured's customers was not within the policy, as the capital of such customer was not rated in "Bradstreet's."[2]

Again, in another case, a credit indemnity policy provided that the insurer should not be liable unless the insured's debtor had a certain rating in a mercantile rating book. In this book one of insured's customers was given a satisfactory rating under the name of the city in which he had a business house, and under the names of other cities in which he had branch houses the names of such houses were given with "See B," referring to the first mentioned city. It was held that there was evidence sufficient to go to the jury on the question of the rating of such debtor.[3] One of the valid implied conditions of credit insurance policies is that the insurer shall only be liable for losses accruing directly to the insured, through credit sales made by the latter during the period of liability. In other words, there must be a legal identity between the insured and the party making the sales upon which the claim for loss under the policy is based.[4] Under such circumstances, the question of identity is one of fact for the jury to determine.[5] A condition requiring the payment

[1] Am. Cr. Ind. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[2] Robertson *v.* U. S. Cr. System Co., 57 N. J. L. 12; 29 Atl. 421.

[3] Strouse *v.* Am. Cred. Ind. Co., 91 Md. 244; 46 Atl. Rep. 328.

[4] American Cr. Ind. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264; Strouse *v.* Am. Cr. Ind. Co., 91 Md. 244; 46 Atl. 328.

[5] Strouse *v.* Am. Cr. Ind. Co., 91 Md. 244; 46 Atl. 328.

of the premium as a condition precedent to the insurer's liability under the policy is reasonable and valid.[1] But the insurer may by its conduct estop itself from setting up the failure to pay the premium.[2] Where a credit insurance policy contains a provision that where the insured shall hold other security or indemnity, the amounts realized therefrom shall be deducted before the loss under such policy shall be adjusted, the same does not entitle the insurer to deduct the proceeds of a policy in another company, which provides in terms that it shall not cover losses insured by the first company, but shall only attach when that company's policy is exhausted.[3]

Where a "rider" attached to a policy provided that in case a customer was not rated "within the system" of the insurer by the mercantile agency designated therein, but was rated by another specified mercantile agency, that then losses suffered on his account should be covered by the policy, the latter will, even though the insurer's "system" requires a rating as to both capital and credit, cover a customer who is rated by the agency designated by the policy only as to credit, but by the other agency as to both capital and credit.[4]

Where a policy contained definitions of insolvency, and at the same time required the insured to give notice within a designated time of the insolvency of a debtor on blanks furnished for that purpose, but which contained no reference to insolvency, and required the insured to answer questions as to the "failure" of the debtor, it was held that the word "failure" was used in a commercial sense.[5]

In a federal case[6] the policy provided that the insured should make proof of loss within twenty days after obtaining knowledge of the insolvency of any one "risk." The insured, within three days after a receiver had been appointed for a

[1] See *ante*, § 88.

[2] See Am. Cr. Ind. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340.

[3] Am. Cr. Ind. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264.

[4] Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528.

[5] Am. Cr. Ind. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671.

[6] Am. Cr. Ind. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264.

certain "risk," notified the insurer upon one of the blanks furnished for this purpose that the "risk" had made an assignment. Five days later an amended proof of loss was made, notifying the insurer that a receiver had been appointed and giving details as to the "risk's" account with the insured. A final proof of loss covering all losses sustained by the insured through failure of all the several "risks" covered by the policy was furnished six months later. It was claimed that the insured had failed to make proper proof of loss within the twenty days. In passing adversely on this contention, the federal court of appeals observed that "no better evidence of the supposed insolvency of the debtor could have been supplied than was furnished by the first proof of loss. The provision (in respect to furnishing proof of loss within twenty days) is intended, not to require formal proof of insolvency, but to afford the insurer prompt notice that a loss has happened, for the purpose of investigation and measure of protection. Occupying as it does the position of a surety, the insurer is entitled to subrogation, and upon paying a loss is entitled to a transfer of the claim against the debtor. The meaning of this condition is that the insurer shall have prompt notification of a probable loss, and in that behalf shall have proof within twenty days after the indemnified has reason to suppose a debtor to be insolvent. What was done by the insured was in compliance with both conditions with respect to proof of loss. The earlier proof informed the insurer of the failure of the debtor. Their final proof was in all respects sufficient." [1]

Another credit indemnity policy provided that "proofs of loss must be made within twenty days after knowledge of the insolvency of any debtor shall have been received by the indemnified, otherwise such claims shall be barred." Another condition was to the effect that the first losses up to a certain sum should be borne by the indemnified before any claim should be made upon the insurer. It was held, that the

[1] As to probative effect of proof of loss, see Sloman *v.* Mer. Cr. Guar. Co., 112 Mich. 258; 70 N. W. 886.

failure to give notice of a loss, although the loss came within the second condition, relieved the insurer from liability for it.[1]

It was said in a late case that failure to return an execution until three days after the expiration of a credit insurance policy will not relieve the insurer from liability on the claim upon which it is based, under a condition in the policy limiting liability to cases "where an execution has been returned unsatisfied on a judgment obtained . . . for merchandise sold to said debtor during the period covered by the policy," where the other requirements are complied with, and the only applicable requirement as to returning the execution is the implied one that it shall be before the expiration of the time fixed for presenting final verified proofs of loss, which is done.[2]

In another case the policy provided that final proofs of loss should be furnished within ninety days after the expiration of the policy, and that no loss should be payable unless included in such proofs, except that should the policy be renewed on expiration, losses occurring after such expiration on sales made during its existence were payable. On this state of facts the Michigan supreme court held that losses occurring after the expiration of the policy on sales made during its existence were payable, though the policy was not renewed, if final proof of loss was made as required.[3] In Talcott *v.* Credit Insurance Company,[4] the court was called upon to construe a policy providing indemnity to the insured against losses on sales by reason of the insolvency, by legal process, of any buyer to whom goods should have been sold and delivered during the period of the policy, or by reason of any judgment or decree of court obtained for goods so delivered, within the said period of the policy upon which execution should have been returned unsatisfied. It was held, that the

[1] Jaeckel *v.* Am. Cred. Ind. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505.

[2] People *v.* Mer. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

[3] Slowman *v.* Mer. Cr. Guar. Co. of N. Y., 112 Mich. 258; 70 N. W. 886.

[4] 41 N. Y. Sup. 281; 9 N. Y. App. Div. 433.

policy did not cover losses on sales made during the specified period, where judgment for the purchase price thereof was not recovered until afterwards.

Where a policy provided that final proof of loss should be forwarded to the insurer, and the amount due from the latter under final proof of loss should be adjusted and paid within sixty days after receipt by the insurer of such final proof of loss, the latter is not entitled to deduct from the amount to be paid by it, payments made by the debtors within the sixty days on account of indebtedness included in such final proof of loss, especially where the policy contains a provision that no loss can be proven after the expiration thereof.[1]

Where the original policy insured against credit losses for one year, and provided that there should be deducted from such losses, as an initial loss to be borne by insured, a certain percentage of the total gross sales during the year, and attached to such policy was a "rider" which did not provide for any such deduction, but expressed that it should cover all losses for the year preceding that named in the policy except those of which insured had had notice, or those sustained prior to a specified time, or cases where an extension had been granted to the debtors for goods sold during such time, it was held, that the deduction first stated could not be imported into the "rider."[2]

A policy against loss through the insolvency of debtors to the extent of $20,000 over and above a net loss of $7,500 to be first borne by the insured on total gross sales and deliveries amounting to $1,600,000, provided that such sum of gross loss should be the limit to be borne by the insured, and that all claims making up such sums of gross loss should remain his property. It also required that insured should make two proofs of loss, — one within twenty days after knowledge of any debtor's insolvency, the other within twenty days after the expiration of the policy. It was

[1] Jaeckel *v.* Am. Cr. Ind. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505.

[2] Goodman *v.* Mercantile Credit Guarantee Co., 17 N. Y. App. Div. 474; 45 N. Y. Sup. 508.

stipulated in the clause requiring the last proof that the amount due thereunder should be adjusted and paid within sixty days after receipt of such final proof of loss. Under this state of facts it was held, that the insurer's liability was lessened by a payment made by an insolvent debtor before the expiration of the policy, and that such debt was not to be regarded as a part of the initial loss.[1]

While it is true that any and all conditions may be waived by the insurer if it sees fit to do so, nevertheless mere silence by not replying to a letter concerning a loss is not a waiver of a specific requirement where the contract provides that silence shall not waive any defect in the notice, and that changes in the conditions of the policy must be written and signed by designated officers.[2] It has been held, by at least one court of high authority, that where the policy does not forbid a compromise of debts covered by the policy, and it is not shown that the insurer was in any way injured by such compromise, nor that more money could have been secured from the debtor than was obtained by compromising, the insurer cannot insist that he is relieved of responsibility because some of the debts were compromised.[3] Still again where the policy provides that loss on claims made under the policy, which were under extension at the time of the payment of the premiums therefor, should not be included in the calculation of losses, the mere taking of notes as evidence of antecedent debts is not to be treated as an extension within the meaning of such policy, though such notes matured at a later date than the open accounts for which they were substituted.[4]

§ 161. **Discharge of Liability by Payment of Loss.** — The fact of there being a liability of some amount admitted by the insurer, the question then arises as to the exact extent of such liability. This, under the peculiar and somewhat am-

[1] Strouse v. American Credit Ind. Co., 91 Md. 244; 46 Atl. Rep. 328.

[2] Am. Credit Ind. Co. v. Carrollton Furniture Manuf. Co., 95 Fed. Rep. 111; 36 C. C. A. 671.

[3] Strouse v. Am. Cred. Ind. Co., 91 Md. 244; 46 Atl. 528.

[4] *Ibid.* See also Am. Ind. Co. v. Wood, 73 Fed. 81; 19 C. C. A. 264.

biguous language of the earlier credit insurance companies, has so far been a task of no small difficulty. There are many cases bearing upon the question of the discharge of liability by payment of loss, and these will now be referred to. It will be observed from a reading of these cases that the principal difficulty experienced in arriving at a decision therein has arisen out of the ambiguous and obscure wording of the policy with reference to the method of ascertaining the amount of loss to be paid and the means to be employed in adjusting the proportions of the loss to be borne respectively by the insurer and the insured.

It seems entirely clear that where the insured has settled a claim against a "risk," whose account has been insured, directly with such "risk," that such settlement is a bar to any claim thereafter on account thereof on the part of the insured against the insurer.[1]

Where the policy expressly provides that, in adjusting losses and before determining the percentage thereof to be borne by insurer, there shall be deducted all sums paid, offered and accepted, settled or secured, and the value of any security or collateral held by insured, etc., and that when only a part of the loss is secured by it, the proportionate amount of everything realized or secured by insured shall be credited to so much of it as the policy covers, it is said that the word "loss" does not mean the amount of indebtedness due from the insolvent at the time of his suspension or failure, but the balance of his indebtedness after deducting from the entire indebtedness the payments made by the "risks" prior to adjustment under the policy.[2]

With respect to the meaning of the term "loss" in credit insurance policies the federal and state courts in New York do not seem to be agreed. In Mercantile Credit Guaranty Company of New York *v.* Wood *et al.*[3] the policy issued

[1] See Schattman *v.* Am. Cr. Ind. Co., 34 N. Y. App. Div. 392; 54 N. Y. Sup. 225.

[2] Mercantile Credit Guarantee Co. *v.* Wood, 68 Fed. Rep. 529; 15 C. C. A. 563.

[3] 68 Fed. 529; 15 C. C. A. 563.

insured to the holder an amount not exceeding $10,000 against loss sustained by reason of the insolvency of debtors owing the insured for merchandise. It also contained, besides provisions as to loss to be first borne by the insured, etc., a provision that in adjusting losses, before determining the percentage of loss to be borne by the insurer, that there should first be deducted all sums paid, offered and accepted, settled or secured, and the value of any security or collateral. It was held that the "loss" insured against meant, not the whole amount due from an insolvent debtor at the time of his suspension, but the amount remaining due after deducting from such indebtedness any payments made by the debtor, and that a clause in the policy providing that when only a part of a loss was covered by it the proportionate part of everything realized should be credited to so much of the loss as the policy covered, did not change such meaning; but if said clause did not refer to the case of the insured's holding other insurance and introduced an ambiguity, the doubt should be resolved against the insurance company which prepared the policy. The appellate division of the New York state supreme court in the case of Goodman *et al. v.* Mercantile Credit Guaranty Company of New York [1] arrived at a conclusion — however, with expressed regret — totally opposed to that of the federal court given above.

In the case of American Credit Indemnity Company *v.* Champion Coated Paper Company [2] a policy had been issued which guaranteed the insured against loss not exceeding $20,000 resulting from the insolvency of debtors "over and above" a loss of $2,000 first agreed to be borne by the said insured. It further provided that the claims provable under the policy should include only the amount to be first borne by the insured and the amount of the bond, and that no amount against any one insolvent debtor should be covered for more than $10,000. Under such provisions, it was said the initial loss to be borne by the insured must be

[1] 45 N. Y. Sup. 508; 17 N. Y. App. Div. 474.
[2] 103 Fed. 609; 43 C. C. A. 310.

deducted from the amount of "covered" or "provable" loss which would require the aggregate amount of such covered loss to be $22,000 to authorize a recovery of the full amount of the policy. It was also held, under a clause of this same policy, providing that when the amount of a claim against any debtor at the time of insolvency exceeds the amount covered thereby that all amounts realized or secured therefrom should be deducted *pro rata*, the insurer is entitled to have credited an amount paid the insured by a third person in settlement of a suit brought to charge him with liability for the debt as a partner for the amount realized upon the claim.

Under a policy agreeing to indemnify the insured against losses by sales and deliveries in his business in excess of one-fourth of one per cent of his annual sales and deliveries to an amount not exceeding $10,000, "save such sum or sums as shall be deducted therefrom as hereinafter provided," it was stipulated that "in the computation of losses, when final adjustment hereinunder is made, no loss on any one claim shall be included in excess of thirty-three and one-third per cent of the lowest capital rating" in a certain reference book, "and in no event shall claims of loss exceed $7,500 on any one individual or firm;" also, "that in the computation of indemnity under this bond for which the insurer is liable, first, twelve per cent shall be deducted from the total gross losses as calculated under the provisions of this bond; second, the said one-fourth per cent loss of said insured shall also be deducted from said total losses, and the remainder shall be and constitute the amount of indemnity to be paid by the insurer not to exceed $10,000." The insured suffered a loss of over $23,000 on sales to one person. It was held, that the twelve per cent and the one-fourth of one per cent were to be deducted from $7,500, and the balance measured the insured's recovery.[1] In another case the policy stated that $3,750 was the initial loss to be borne by plaintiff, and that "when claims should be allowed by the

[1] Rice *v.* Nl. Cr. Ins. Co., 164 Mass. 285; 41 N. E. Rep. 276.

insurer beyond the amount to be borne by it, such claims should be at once transferred to the insurer and the latter should become the owner thereof to the extent of the amount paid thereon and that the amount realized therefrom, less cost of collection, should be divided *pro rata* as the interests of each might appear." Another clause was as follows: "To simplify adjustment and to avoid disputes it is agreed that such sum of gross loss shall be the limit to be borne by the indemnified, as less twenty-five per cent will equal the agreed amount of net annual loss, all claims making up such sum of gross loss to remain the property of the indemnified, the company relinquishing its claims as hereinbefore provided." This last clause was regarded as obscure, and the court refused to consider it as an agreement that the claims should be retained by the insured, the latter relinquishing the right thereto on condition that a larger limit of loss than that stated should be borne by the insurer.[1]

A policy provided against loss from the insolvency of those to whom the insured should sell goods in excess of five-eighths of one per cent of the amount of his total sales. Advances made on goods were protected and covered thereby. All claims for debts due the insured from any one individual were limited to $10,000. The tenth condition of the policy was: "All settlements accepted, amounts paid, secured, or guaranteed, or in process of collection on any claim at the time of final proof of loss, shall first be deducted and pro-rated on shipments made under it before condition number eight shall apply." That condition provided for additional deductions of fifteen per cent of the amount of the claim, and five-eighths of one per cent of the amount of the annual sales. It was held, that sums realized after a debtor's insolvency should be deducted in full, and not apportioned between the insured and uninsured part of a debt contracted wholly during the life of the policy, and that insured was entitled to deduct from the price

[1] Jaeckel *v.* Am. Cr. Ind. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505; see also Am. Cr. Ind. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

realized on the sale of goods consigned to him his commissions before crediting the amount received on the sale on the indebtedness.[1]

Again, under a clause of the policy declaring that, in estimating the loss of the insured upon a debt due him from an insolvent, "the securities of such debtor held by any one at the time of the appointment of such receiver, taken at their actual value, and the other assets of such debtor taken at the value as shown by his books . . . less twenty-five per cent, should be deemed a payment to the extent of such value on account of the amount owing to the insured," it was held that neither the lands of the debtor nor mortgages upon them were "securities of such debtor."[2]

A most important question to be considered in this connection is that with reference to the amount to be deducted from all claims presented by the insured, on account of the "initial loss," which under the provisions of the policy must first be borne by such insured. Policies of credit insurance as now written usually provide indemnity against loss in a designated amount, over and above an initial gross loss of a stipulated amount, to be first borne by the insured. Some of the policies also provide that all claims making up the initial loss shall remain the property of the insured, and that a first proof of loss shall be made within a certain time after knowledge of the insolvency of the debtor, and another and final proof be filed later within a certain period of time after the expiration of the policy, and that the amount due from the insurer under first proof shall be adjusted and paid within sixty days after receipt of such final proof. Under such provisions as have just been set forth, it would seem that as the insurer's liability under the policy is referable to the first proof of loss, the initial loss to be borne by the insured is to be ascertained as of the same period, and hence that a debt from an insolvent debtor within the terms of the policy, but

[1] Talcott *v.* Nl. Cred. Ins. Co., 28 N. Y. App. Div. 75; 51 N. Y. Sup. 84.

[2] People *v.* Mercantile Credit Guar. Co., 35 N. Y. Misc. 755; 72 N. Y. Sup. 373.

paid before the same expired, is not to be treated as a part of such initial loss.[1]

Where a corporation has insured creditors against loss of the debts of their commercial debtors and becomes insolvent during the life of a policy, providing that the loss of the insured is to be adjusted by it only so far as it exceeds a stated percentage of his gross sales, the minimum thereof being fixed at an arbitrary sum for the purposes of computation, this minimum must be adopted as to the amount of the gross sales at the time the insurer became insolvent. It is upon this as a basis that in proceedings to dissolve the corporation, the insured may be allowed to recover such proportion of the total liability as the term of the policy bears to the time which has elapsed after its issue and before the insurer became insolvent.[2]

Where the policy provides that, in calculating losses, no credit that may have been given shall be included therein exceeding a credit of thirty per cent on the lowest capital rating of the debtor in the mercantile agency's book or reports, if the insured gives a larger credit than this, the excess only, and not the entire credit, should be excluded.[3]

[1] In this connection attention is called to the cases of Talcott *v.* Gray as receiver of the United States Credit System Company, 59 N. J. Eq. 595; 42 Atl. 603; Smith *v.* Nl. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 28; 72 Minn. 364; 75 N. W. 596; 78 Minn. 214; 80 N. W. 966; Talcott *v.* Nl. Cr. Ins. Co., 51 N. Y. Sup. 84; 28 N. Y. App. Div. 75; Am. Cr. In. Co. *v.* Wood *et al.*, 73 Fed. 81; 19 C. C. A. 264; Shakman *v.* Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; Am. Cr. In. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340; Am. Cr. In. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Am. Cr. Ins. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; Strouse *v.* Am. Cr. In. Co., 91 Md. 244; 46 Atl. 328; 47 Atl. 1063; Sloman *v.* Guar. Co., 112 Mich. 258; 70 N. W. 886; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. Law, 12; 29 Atl. 421; Jaeckel *v.* Am. Cr. In. Co., 34 N. Y. App. Div. 565; Hayne *v.* Metropolitan Tr. Co., 67 Minn. 245; 69 N. W. 916; Brewing Co. *v.* Starrs, 5 Ont. 189; Pemberton *v.* Oakes, 4 Russ. 154; Ellicott *v.* Ins. Co., 8 Gill & J. 166; McCallum *et al.* *v.* Nl. Cr. Ins. Co. *et al.*, 86 N. W. 892; U. S. System Co. *v.* Rosenbaum, 64 N. J. L. 34; 37 Atl. 595; 44 Atl. 966; Claflin *v.* Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; Lauer *v.* Gray, 55 N. J. Eq. 544.

[2] People *v.* Mer. Cr. Guar. Co., 35 N. Y. Misc. 755; 72 N. Y. Sup. 373.

[3] Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 366.

In another case the policy covered "excess losses" caused by the failure or insolvency of customers of the insured to whom the latter had made sales on credit, such excess losses to be ascertained by deducting from the actual losses fifteen per cent thereof, and also one per cent of the total year's sales, to be not less than a stipulated amount. The policy also stipulated that the year's sales on which the one per cent was to be computed should not be less than $90,000. During the life of the policy the insured became insolvent. It was held that such insolvency terminated the policy. During the period elapsing before the insolvency of the insurer, the insured's sales aggregated only $75,000. It was said that for the purpose of determining the excess loss, the one per cent was to be computed on this amount and not on the aforesaid $90,000.[1]

In this same case it was held that the insolvency of the insurer dispenses with the necessity of making formal proof of loss in order to recover. Under such circumstances, it was said, the insured can recover on a *quantum meruit*.

With respect to the method of proving claims against credit insurance companies which have passed into the hands of a receiver, the late case of People *v.* Mercantile Credit Guarantee Company[2] is in point. It was held in that case that where a corporation organized under the laws of the state of New York is dissolved by a final judgment of the supreme court of that state during the pendency of an action brought against it in a court of general common-law jurisdiction in the state of Illinois, in which action the corporation had appeared, a judgment rendered in the Illinois action against the corporation after its dissolution and after the attorneys who had appeared for it therein had withdrawn their appearance, and without either service of process upon or appearance by the receiver appointed in the dissolution action, is not binding upon the receiver in the state of New York, and is not

[1] Smith *v.* Nl. Cr. Ind. Co., 63 Minn. 283; 68 N. W. 28.

[2] 65 N. Y. App. Div. 306.

evidence as against the receiver of the existence of a debt on the part of the corporation. A statute of the state of Illinois authorizing the entry of a judgment against a corporation under such circumstances has no extraterritorial effect. As incidental to the subject now under consideration it may be said that an action against the insurer to recover back premiums paid upon the policy, which had been, subsequent to the issuance thereof, cancelled and rendered ineffective by the acts of the insurer, is not an action upon the policy and the special limitation for bringing suit thereon does not apply.[1]

[1] McCallum *v.* Nl. Cr. Ins. Co. *et al.*, Minn. ; 86 N. W. 892.

CHAPTER XVII.

TITLE INSURANCE.

§ 162. **Title Insurance defined and discussed.** — Title insurance is an agreement whereby the insurer, for a valuable consideration, agrees to indemnify the insured in a specified amount against loss through defects of title to real estate wherein the latter has an interest either as purchaser or otherwise. A contract of the nature just defined has been judicially declared to be one of insurance.[1] To create liability on the part of the insurer there must be privity of contract between it and the party who seeks to compel the latter to make indemnity on account of defects in the title of property whereupon a policy has been issued. This is accomplished so as to give a right of action to purchasers from the insured, by inserting the words "and his assigns" after the name of the insured in the policy.

§ 163. **Nature of the Liability of the Insurer under the Policy.** — It was contended in Trenton Potteries Co. *v.* Title Guaranty and Trust Company[2] that the obligation of a title insurance company in examining and certifying as to the condition of a title is the same as that of any lawyer who is required to bring to the performance of such duty only the exercise of ordinary reasonable skill and knowledge of his profession. In other words, that liability could be predicated only upon negligence and misconduct in the examination.[3] This con-

[1] Trenton Potteries Co. *v.* Title Guarantee & Trust Co., 64 N. Y. Sup. 116; 50 App. Div. 490; M. T. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Gauler *v.* Trust Co., 9 Pa. Co. Ct. Rep. 634; Wheeler *v.* Real Es. Tit. Ins. & Trust Co., 160 Pa. St. 408; 28 Atl. 849; *Ex parte* Calhoun, 87 Ga. 359; Graham *v.* Lawyers' Title Ins. Co., 20 N. Y. App. Div. 440; 46 N. Y. Sup. 1055.

[2] 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490.

[3] See Ehmer *v.* Title Guarantee & Trust Co., 156 N. Y. 10; 50 N. E. 420.

tention, made in behalf of the insurer, was denied by the court in the following language: "The contract of insurance is an entirely different contract, wherein the doctrine of skill or negligence has no application. The contract issued by this defendant is one of insurance pure and simple, issued by a corporation for which provision is made in the insurance law of the state. Therein these corporations are placed upon substantially the same footing and are made subject to the same rules as apply to other insurance companies, excepting so far only as the character of the business transacted by the corporation is different from that transacted by other insurance companies recognized and provided for in the same law. . . . That such is the character of these contracts is recognized by decisions in other states."[1] The United States circuit court of appeals for the eighth circuit remarked with reference to the character of the insurer's liability in title insurance as follows:[2] "The insurer is not a surety. It agreed for an adequate consideration to 'indemnify, keep harmless, and insure' the insured from all loss or damage not exceeding $55,000, the amount of the mortgage debt, which he or his assigns might sustain by reason of defects in the title to the mortgaged premises or by reason of liens or incumbrances thereon existing at the date of the policy. The contract is plain and explicit on this point. In a word it is a guaranty that the mortgagee (the insured) should not suffer any loss or damage by reason of defects in the title to the property, or liens or incumbrances thereon existing at the date of the policy." Where a title insurance company merely assumes to act as an abstractor, its duty in such a case is simply to exercise due care.[3] So far as its employment involves a search of the title to the premises and an examination of the same, its duty would not be other or

[1] See Wheeler *v.* Trust Co., 160 Pa. St. 408; 28 Atl. 849.

[2] Minn. Title Ins. & Trust Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56.

[3] Economy Building & Loan Ass. *v.* West Jersey Title & Guarantee Co., 64 N. J. L. 27; 44 Atl. 854; see also Elmer *v.* Title Guar. & Trust Co., 156 N. Y. 10; 50 N. E. 420; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 61 N. Y. Sup. 118; 50 N. Y. App. Div. 490.

different than that of a lawyer engaged to perform the same service, the obligations in such case being the exercise of ordinary reasonable skill and knowledge of the profession, and liability could only be predicated of negligence and misconduct in the examination.[1]

§ 164. **Construction of Policies.** — Contracts of title insurance are subject to the same rules as are applicable to other insurance policies, and all doubts and ambiguities, if any, contained in the policy are to be resolved in favor of the insured.[2]

§ 165. **The Application.** — It is customary to require parties applying for title insurance to fill out printed applications for the same, wherein are to be found a number of questions relative to the proposed insurance. It is usually the practice to refer to this application by number in the policy and to therein provide that the facts stated in the application shall constitute warranties.[3]

§ 166. **Scope of Liability.** — The determination of the scope of liability in title insurance is ordinarily of no great difficulty. The terms used in defining such scope are nearly always well understood and have been frequently construed by the courts.[4] The liability usually extends to defects in the chain of title, incumbrances, judgments, mechanics' liens, assessments, etc.[5] Within the ordinary scope of liability are defects in the title to the premises at the time the policy is issued; liens or incumbrances affecting the same at said time; and finally, any defect apparent of record in the execution or filing for record of the instrument of conveyance in connec-

[1] Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[2] Trenton Potteries Co. *v.* Title Guar. & Tr. Co., 64 N. Y. Sup. 116; 58 N. Y. App. Div. 490; Trust Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Place *v.* St. P. T. I. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[3] See Stensgard *v.* St. P. R. E. T. I. Co., 50 Minn. 429; 52 N. W. 910.

[4] See Quigley *et al.* *v.* St. P. T. I. & Tr. Co., 60 Minn. 275; 62 N. W. 287; 64 Minn. 149; 66 N. W. 364; Ger. Am. Title & Tr. Co. *v.* Citizens Tr. Surety Co., 190 Penn. St. 247; 42 Atl. 682; Wheeler *v.* Real Es. Ti. & Tr. Co., 160 Penn. St. 408; 28 Atl. Rep 849; Trenton Potteries Co. *v.* Title Guar. & Tr. Co., 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490.

[5] Minn. Tit. Ins. & Tr. Co *v.* Drexel *et al.*, 70 Fed. 194; 17 C. C. A. 56.

tion with which the policy is issued.[1] The general intent and effect of policies of title insurance is to insure a valid security both as to title and against incumbrances. There is no implied agreement to go beyond the conditions existing at the time the policy is issued and to assume a general liability to indemnify against future incumbrances, municipal or otherwise.[2] The liability under the policy has been extended to the case where an adjoining wall is used by a party owning the land next adjacent to the property, the title of which was insured, who refuses to pay for such use.[3] In Trenton Potteries Company *v.* Title Guaranty and Trust Company,[4] it was held that where a policy of title insurance is procured by the grantee of real property after he has taken possession thereof under his deed, whereby the grantee is insured against defects of title arising by reason of liens or incumbrances on the property at the date of the policy, and contains a provision that the liens and incumbrances arising after the date of the policy or created or suffered by the insured, and assessments not confirmed at the date of this policy, are not to be deemed covered by it, liability thereunder extends to a confirmed assessment existing at the date of the policy, although the confirmation took place after the grantee had taken possession under his deed. This ruling was expressly based upon the principle that the policy was to be construed as covering incumbrances existing at its date, and not as a covenant of warranty broken before its date, when the insured took his deed and entered into possession of the property. In an action upon a policy of title insurance, grounded on the eviction of the insured from the land, it is necessary that the declaration show either an eviction under a paramount title by due process of law, or a disturbance of title or possession under a paramount title equivalent to an eviction.[5] Where the in-

[1] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287.

[2] Barton *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 24; 44 Atl. 871.

[3] Thomas *v.* Tradesmen's Trust & Savings Fund Co., 7 Pa. Dist. Ct. Rep. 375.

[4] 50 N. Y. App. Div. 490; 61 N. Y. Sup. 118.

[5] Barton *v.* West Jersey Title & Guaranty Co., 64 N. J. L. 24; 44 Atl. 871.

surer undertakes to defend the insured, it is bound to protect him through all stages of the proceeding, or else notify him that it will not, in time to enable him to protect himself. It is also bound at all times to furnish him all reasonable information as to the status of adverse claims, so as to enable him to take all proper precautions for his protection.[1]

So too it has been held that a title insurance policy covers a loss resulting from a misdescription of the premises in the insured conveyance, although the error was not the fault of the insurer.[2]

A policy was issued insuring against all loss by reason of defects or unmarketableness of the title to the estate or mortgage interest insured or because of liens or incumbrances charging the same at the date of the policy, saving defects or objections to title by reason of liens, charges, and incumbrances thereon, which do or may now exist, including unmarketability by reason of the possibility of mechanics' and municipal liens, but not actual losses by reason of such liens. It was held that the insurer was not liable for municipal claims filed against the property three years after the policy issued. The insurance only applies against liens the rights to which are already inchoate at the date of the policy.[3]

A leading case on the scope of liability in title insurance is that of Minnesota Title Insurance and Trust Company *v.* Drexel.[4] The policy here issued by the insurer was conditioned against loss sustained through defects in the title to real estate insured, or liens or incumbrances thereon existing at the date of the policy. It was further provided that no right of action upon the policy should accrue until the insured had conveyed or agreed to convey to the insurer his interest in the property at a price which in the case of a title acquired through a foreclosure should be the amount bid at the foreclosure sale; that payment, discharge, or satisfaction of the

[1] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 64 Minn. 149; 66 N. W. 364.

[2] Gauler *v.* Solicitors Loan & Trust Co., 9 Pa. Co. Ct. 634.

[3] Wheeler *v.* R. E. Ti. & Tr. Co., 160 Pa. St. 408; 28 Atl. Rep. 849.

[4] 70 Fed. 194; 17 C. C. A. 56.

mortgage indebtedness, except by foreclosure of the mortgage, should annul the policy; and that the insurer should have an opportunity to defend any suits affecting the title. After the issue of the policy, suits were brought to establish mechanics' liens on the property claimed to have existed when the policy was issued. The insurer defended them, but the liens were established and the property sold to satisfy them. The insured foreclosed his mortgage and bought it in for the amount due on said mortgage with interest and costs. Later, the insured offered to convey title to the insurer for the amount bid at the foreclosure sale, and demanded, in default of a purchaser for that amount, that the insurer redeem the property from the sale had under the mechanics' lien judgments. The insurer declined to do either, and the insured redeemed the property, and thereupon sued the insurer for the amount so paid. In passing upon the legal questions therein involved, the federal court of appeals for the eighth circuit spoke as follows:

"Under the policy if the mortgaged property, with a clear title and free from incumbrances, was worth the amount of the mortgage debt, the mortgagee could confidently rely upon the sufficiency of his security. The mechanics' liens upon which the mortgaged property was sold were the liens upon the property at the date of the policy. The insurer nevertheless refused either to pay these prior liens or to pay the insured the amount bid for the property at the foreclosure sale, which was the amount of his mortgage debt, thus forcing the insured, in order to protect his security and his title, to redeem the property from the sale on the mechanics' liens. The policy provides that where by foreclosure the insured has acquired title to the property, the price to be paid by the insurer shall be the amount bid at said foreclosure sale. The insurer was obligated by the terms of the policy either to pay this amount or to relieve the property from all liens existing thereon at the date of the policy. It refuses to do either, and seeks to escape all liability by putting the burden of freeing the property from the liens existing thereon at the

date of the policy upon the mortgagee, on the ground that, at the sale of the property under the mortgage debt, the mortgagee bid the full amount of his mortgage debt, and thereby himself assumed the burden of paying off the mechanics' liens. Under the terms of the policy, the mortgagee had the right to look to the insurer for the extinguishment of all liens upon the property which existed at the date of the policy and to gauge his bid on the assumption that the insurer would discharge its obligation in this regard. The contention of the insurer is in the teeth of a very plain provision of the policy, which declares that payment, discharge, or satisfaction of said mortgage indebtedness shall fully terminate, annul, and avoid the policy and all liability of the insurer thereunder. The case at bar falls directly within this exception. We need not consider what effect this provision would have where the property was purchased by a stranger at the foreclosure sale. Beyond controversy it includes and binds the parties to the contract, and is applicable to every case where the mortgagee insured becomes the purchaser of the property at the foreclosure sale for the amount of his mortgage debt."

§ 167. **Representations, Warranties, and Conditions in Title Insurance.** — The doctrines of general insurance law with reference to misrepresentation, breach of warranty, and breach of conditions appear to have full application to title insurance.

In Stensgard *v.* St. Paul Real Estate Title Insurance Company,[1] it was held that where a policy of insurance provides that any untrue answers to questions contained in the application should avoid the policy, the answers amount in legal effect to a warranty, and the matter of their materiality is not open. "The effect of falsity in the statement on the validity of the contract is not made to depend on the intent with which the statement is made, as that the intent shall be fraudulent, but on whether true or false to the best of the applicant's knowledge and belief. Where the contract itself does not stipulate the effect that a particular false statement or representation shall have on the contract, or where it stipu-

[1] 50 Minn. 429; 52 N. W. 910.

lates merely that the misrepresentation or suppression of a material fact shall avoid it, the fact misrepresented or suppressed must have been material, as an inducement to enter into the contract; and as the materiality must be shown by matters outside the terms of the contract, it is a question of fact. But the parties may by their contract determine the materiality for themselves, as where they stipulate that if a statement of fact made by one of them and set forth in the contract be false, it shall avoid the contract. In such a case the statement is in effect a warranty. Whether they have made the statement material and in effect a warranty is a question for the court, to be determined by an interpretation of the contract."[1] In the case from which the foregoing quotation was made, the insured, in answer to a question contained in the application, stated that the last price paid for the property, the title to which was to be insured, was $11,000. This statement the insurer claimed was false and that its legal effect was to avoid the policy. In sustaining this contention the court held that the question called for the actual, not merely the nominal price, and inasmuch as it appeared that although the consideration stated in the deed was $11,000, the transaction was really a trade of mining stock of little value and $3,000 in cash, and that an instruction to the jury that if $3,000 and the market value of the stock amounted to $11,000, or that the insured honestly believed he was paying $11,000 cash value and the grantor accepted it as that amount in money, they should find the answer true, was sufficiently favorable to the insured under the circumstances. Again in another case a policy had been issued insuring the mortgagor's title for the mortgagee's benefit, providing that no right of action should accrue under it unless the insured was actually evicted under an adverse title, or unless there had been a final judgment upon a lien or incumbrance under which the title of the insured should be divested by sale under judgment or foreclosure, or unless the

[1] Stensgard *v.* St. P. Real Es. Tit. Ins. Co., 50 Minn. 433; 52 N. W. 910.

insured had contracted to sell the estate or interest insured and the title had been declared by a court of last resort of competent jurisdiction defective or incumbered by reason of a defect or incumbrance for which insurer would be liable. Notwithstanding these conditions of the policy, they were held not to apply where the land was held under actual adverse possession, and plaintiff had lost it absolutely by reason of a defect in the title insured.[1]

In a Minnesota case it was agreed in an application that the statements therein contained were correct and true to the best of the applicant's knowledge and belief, and that any false statements or any suppression of material information should avoid the policy applied for. In answer to a question therein contained, the insured stated that there were no liens or incumbrances on the insured's property, except a certain mortgage. To the further question, "Are any of said incumbrances to remain?" the applicant answered, "Only the $2,200 mortgage now insured." At the time the application was made, no part of the labor or material for which certain mechanics' liens were afterwards filed had been furnished, but other labor and material had been furnished in doing other parts of the work, and of the amount to be paid for the same, $1,700 was unpaid. It was contended that the amount due on these unpaid claims constituted mechanics' liens on the title; that the application warranted the truth of the statements above referred to, and that they were false and consequently avoided the policy, even though no loss or prejudice resulted by reason thereof. The court refused to sustain this contention, and in doing so based its action upon the principle that where a policy contains a condition which renders it void at its inception, and this is known to the insurer when it issues the policy, the latter thereby waives the condition.[2]

"Tenancy of the present occupants," stated in a title insurance policy as a defect to the title against which the in-

[1] Place *v.* St. Paul Title Ins. & Trust Co., 67 Minn. 126; 69 N. W. 706.

[2] Quigley *v.* St. P. T. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287.

surer does not insure, means tenancy which arises through the occupation or temporary possession of the premises by those who are tenants in the popular sense. It does not include those who are asserting ownership in fee as against the title insured, and who are in adverse possession at the time the policy is issued. The complaint did not allege compliance with the conditions as to a contract to sell or that the title had been declared defective by a court of last resort. It was held that, under the circumstances, these conditions were ineffective and void. They apply only to guard against actions for nominal damages instituted by persons who had ascertained that defects existed in their titles, but whose possession remained undisturbed and who had suffered no loss.[1]

Such conditions do not apply to a case where not only does another party hold possession of the land adversely to the insured, but the latter has lost it absolutely by reason of a defect in the insured's title.[2]

§ 168. **The Measure of the Insured's Damage.** — In title insurance actual loss must precede actual compensation.[3] Where the policy runs direct to the purchaser of the property and the title turns out to be wholly defective, the measure of damages is the price paid for such property.[4]

In another case where a mortgagee's policy had been issued and the property sold under foreclosure of mechanics' liens covered by the policy, — the insured meanwhile having foreclosed his mortgage and bid the property in at the sale, — it was held that the purchase of the property by the insured at the foreclosure sale did not extinguish the insurable interest of the insured under the conditions of the policy and thus annul the latter, but that the insurer was bound either to buy the property for the amount bid at the mortgage foreclosure sale, or else redeem it from the sale had under the mechanics'

[1] Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[2] *Ibid.*

[3] *Ibid.*

[4] Ehmer *v.* Title Guar. & Trust Co., 156 N. Y. 10; 50 N. E. 420. See also Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr & Sur. Co., 190 Pa. St. 247; Quigley *v.* St. P. T. Ins. & Tr. Co., 64 Minn. 149; St. Paul Tit. Ins. & Tr. Co. *v.* Johnson, 64 Minn. 492; 67 N. W. 543.

liens, and that the insured was entitled to recover the amount paid by it for this last purpose.[1]

Where by reference to a contract in the policy, it becomes a part of it, and the insurer limits its liability under the policy to $2,200 by reason of defects in the insured's title, but further agrees by said contract to defend the same or pay the claim on which suit is brought, or pay the insured the amount of the liability under the policy, and in undertaking a defence is guilty of negligence therein, even if under no legal liability to defend a claim not covered by the policy, the amount of the recovery is not limited to the $2,200 named as the limit of liability under the policy.[2]

[1] Minn. Title Ins. & Trust Co. *v.* Drexel *et al.*, 70 Fed. 194; 17 C. C. A. 56; Ger. Am. Tit. & Tr. Co. *v.* Cit. Trust & Surety Co., 190 Penn. St. 247; 42 Atl. 682. See generally on the subject of title insurance, St. Paul Title Ins. & Tr. Co. *v.* Johnson *et al.*, 64 Minn. 492; 67 N. W. 543; Title Guar. & Tr. Co. *v.* Wrenn, 36 Oregon, 62; 56 Pac. 271; Russ *v.* Lawyers' Title Insurance Co. *et al.*, 8 N. Y. Misc. Rep. 6; 28 N. Y. Sup. 392; F. Ins. Tr. & Safe Dep. Co. *v.* Earle *et al.*, 23 Penn. County Ct. Rep. 449; Barton *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 24; 44 Atl. 871.

[2] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287; see also same case, 64 Minn. 149; 66 N. W. 364.

PART V. — JUDICIAL INSURANCE.

CHAPTER XVIII.

JUDICIAL INSURANCE.

§ 169. **Judicial Insurance defined and classified.** — Judicial insurance is an agreement whereby for an agreed premium one party (termed the insurer) agrees to indemnify another (termed the insured) in a designated amount against loss arising either through the official misconduct of a third party known as the "risk" in his capacity as an appointee of a court or else through the failure of such "risk" to faithfully perform the conditions of his formal undertaking entered into while a litigant before the courts. There are two classes of bonds which properly come within the category of judicial insurance contracts. The first embraces what may be termed "administration bonds," such, for example, as are furnished by executors, administrators, guardians, conservators, committees of lunatics, curators, trustees, assignees, receivers, masters, etc. In the second class are found that large class of bonds required by statute to be given either in the course of litigation or such as are subject to control by the courts. These bonds may be termed "statutory," and as examples thereof may be mentioned appeal, arrest, attachment, capias, sheriff's indemnity, maritime libel, replevin, injunction, ne exeat, arbitration, bail, detinue, partition, supersedeas, certiorari, bastardy, peace, support, stay, and removal bonds.

Partly for purposes of convenience and partly owing to their quasi-judicial nature, the subject matter of "excise bonds" will be considered herein under the head of "statutory bonds."

§ 170. **The Nature of Judicial Insurance Bonds.** — At the very threshold of the present discussion, one is confronted with the question as to whether judicial bonds of the kind executed by the so-called "surety companies" for compensation can be properly termed contracts of insurance. As in fidelity and commercial insurances, where similar questions were considered, the answer must be unhesitatingly in the affirmative. This matter came indirectly before the court for determination in Industrial and General Trust *v.* Tod,[1] where a statute of the state of New York limiting the amount of any one risk which may be assumed by "insurance companies" to ten per cent of its capital and surplus, was held applicable to "surety companies" guaranteeing the performance of contracts and executing bonds and undertakings required in or permitted in all actions or proceedings or by law allowed.[2]

These insurance bonds, given in the course of legal proceedings, are to be considered as something more than mere contracts between the parties. They are part and parcel of the judicial proceedings themselves.[3]

Both administration and statutory insurance bonds are contracts, not only between the parties interested in the proceedings wherein they are given, but they constitute as well a contract with the state touching the due administration of justice, to the effect that all the requirements of law and of the court shall be observed and that the privileges afforded thereby in consideration of the acceptance thereof by the courts shall not be abused.[4]

§ 171. **Construction of Judicial Insurance Bonds.** — Judicial insurance — in respect to matters of construction — presents

[1] 56 N. Y. App. Div. 39; 67 N. Y. Sup. 362.

[2] See, in this connection, People *ex rel.* National Surety Company *v.* Feitner *et al.*, 31 N. Y. Misc. Rep. 433; 54 N. Y. App. Div. 633; 166 N. Y. 129; 59 N. E. 731; Epstein *v.* U. S. Fid. & Guar. Co., 29 N. Y. Misc. 295; 60 N. Y. Sup. 527; Joy *v.* Elton, 83 N. W. 875; Matter of Thurber, 43 N. Y. App. Div. 528; 162 N. Y. 244; 56 N. E. 631.

[3] People *ex rel.* Ritzenthaler *v.* Higgins, 151 N. Y. 570; 45 N. E. 1033.

[4] See Lyman *v.* Schermerhorn & Fid. & Dep. Co., 53 N. Y. App. Div. 32; 167 N. Y. 113; 60 N. E. 324; People *ex rel.* Ritzenthaler *v.* Higgins, 151 N. Y. 570; 45 N. E. 1033.

some strong points of differentiation from its sister branches, fidelity and commercial insurances. Particularly is this noticeable in the absence of any substantial recognition in judicial insurance of that principle of fidelity insurance law which requires — in case of uncertainty as to the meaning of the language of the policy — that it shall in all cases be construed most strongly against the insurer.

Indeed, no one who gives a careful reading of the decisions relating to judicial insurance bonds can fail to recognize the fact that, with some few exceptions, they have been treated by the courts as if in all respects identical in legal effect with the undertaking of the private surety, so familiar in the domain of suretyship. Why this should be is perhaps attributable to the fact that the statutes under which such bonds are given provide that they shall be executed by "sureties," which term is usually, by special statute, made applicable to incorporated companies engaged in the business of furnishing such bonds for compensation. Perhaps it results from a combination of causes, among which are the following: The form of the contract itself, being almost invariably prescribed by statute, or sanctioned by long judicial usage, is essentially the same, whether the instrument be the undertaking of the private surety or the more formal bond of the "corporate surety company." Again, the contracts themselves, while as a matter of practice drawn by the insurer, admit of little choice, either in language or terms, because these are almost invariably prescribed by statute or immemorial usage. Therefore the reason for the rule that governs in fidelity insurance relative to matters of construction does not exist to the fullest extent in judicial insurance.

Finally, there is an almost entire absence of the usual concomitants of insurance contracts, such as proposals, applications, representations, warranties, and multiform conditions, which in themselves suggest, if they do not almost compel the courts to treat such agreements as contracts of insurance rather than those of suretyship. However here, as in other forms of guaranty insurance, the contract being entered

into for a consideration and not gratuitous, this marked disposition of the courts to apply to judicial insurance bonds the rules of private suretyship rather than the principles of insurance law cannot well be reconciled on grounds of judicial consistency. The present prevailing doctrine of the courts with respect to the status of "surety companies" issuing such bonds is well set forth by the Maryland court of appeals in March *v.* Fidelity and Deposit Company of Maryland.[1] In that case the court said: "When the statute enabled this corporation to become a surety, it described a relation perfectly well known and understood in law. Certain rights, duties, responsibilities, and functions belong to the condition of suretyship, and they are all necessarily and conclusively implied when one lawfully becomes a surety. These incidents must attach to the suretyship in this case (administrator's bond) unless the statute which authorized it establishes and defines a difference between it and the contracts of ordinary suretyship."[2]

Another statement of the rule is this: "The contract of the surety is to be construed like other contracts, so as to give effect to the intention of the parties. In ascertaining that intention we are to read the language used by the parties in the light of the circumstances surrounding the execution of the instrument, and when we have thus ascertained their meaning we are to give it effect. But when the meaning of the language used has been thus ascertained, the responsibility of the surety is not to be extended or enlarged by implication or construction, and is *strictissimi juris*."[3]

In Lyman *v.* City Trust, Safe Deposit and Surety Company of Philadelphia *et al.*,[4] the question as to what rule of construction should apply to judicial insurance bonds was before the New York court of appeals for determination. It was contended strenuously in that case by counsel for the

1 79 Md. 309; 29 At. 521.

2 See also Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Con. Tr. Co. *v.* Columbia Finance & Trust Co., Ky. ; 60 S. W. 1.

3 Thompson *v.* American Sur. Co., 56 N. Y. App. Div. 113; 67 N. Y. Sup. 564.

4 166 N. Y. 274; 59 N. E. 903.

"surety company" that its liability was not to be extended beyond the strictest terms of the bond. In disposing of this contention adversely, the court used these words: "The rule of law invoked by the 'surety company' depends for its application upon the ascertainment of the intention of the parties to the instrument, which is to be reached upon a consideration of the whole thereof, in the light of the circumstances under which it was made."

Indeed, evidence is not wanting of a tendency on the part of the courts to apply to the contract of the compensated surety different rules of construction from those applied in the case of private sureties. Thus in the Matter of Thurber,[1] the appellate division of the New York supreme court had occasion to consider an application on the part of a "surety company" to be released from its liability under an administration bond, based on certain provisions of the New York Code, which it was claimed were only applicable to private sureties. In passing upon the application the court said:

"It is fair to assume that when acts were first passed authorizing the release of sureties upon their application, it was in view of the fact that such sureties were, for the most part, so engaged without consideration, and acted gratuitously. Under such circumstances there was a strong equity existing in their behalf, which made the provision for their relief entirely proper. . . . By statute, persons required to give bonds under the provisions of any law are authorized to give the bond or undertaking of any fidelity or insurance company authorized by the laws of the state to transact business. . . . By the provisions of such statutes, the 'surety or sureties, or the representatives of any surety or sureties upon the bond' may be discharged, upon complying with its provisions. The only mention of a fidelity or surety company in terms in the statute is found in the beginning thereof, and relates to the form of the bond of surety when so given. If the right is reserved to it to be discharged from liability, it must be found in the general term 'surety or sureties.' These words are apt in

[1] 43 N. Y. App. Div. 528; see same case, 162 N. Y. 244; 56 N. E. 631.

embracing the former class of persons who were sureties without consideration. Of course they are broad enough in their terms to embrace a surety company; but wherever the statute refers to such company, it is named in terms, and we think that before it can invoke an authority so extraordinary as to relieve it from a contract founded upon a valuable consideration, and of which there has been no breach or claim of breach, it should be required to point to specific words showing that it was the intent of the legislature to embrace such case. The construction of this statute will be satisfied, giving full force to all its words, by holding that the surety company, not having been named in specific terms therein, was not intended to be embraced. . . .

"We think that where the surety company engages for a consideration to become a surety, it ought not to be relieved from such contract except there be a breach of the same by the person with whom it contracts."

When this same case was heard later by the New York court of appeals, the latter, while refusing to adopt the general line of reasoning of the lower court, nevertheless observed that no rule of law required that the agreement should receive a narrow or strict construction. Its meaning must be ascertained from the language therein contained, and having arrived at that from a consideration of the whole instrument, effect must be given to the intention of the parties as thus ascertained.[1]

§ 172. **Validity of Judicial Insurance Bonds.** — The acceptance of the bond, and the turning over of property to the "risk" or the extension of certain judicial privileges on the strength of its execution and approval, are a sufficient consideration to sustain the validity of the bond in that regard. When as frequently happens, because of some irregularity in the form with respect to the statutory requirements, the bond must be regarded as invalid when considered as a statutory bond, nevertheless it can be enforced in very many cases as a common law bond. This principle is unquestionably appli-

[1] 162 N. Y. 244; 56 N. E. 631.

cable alike to judicial insurance bonds as well as to private bonds.

There can be no question raised at this late day as to the general validity of judicial bonds issued by the so-called surety companies. Whenever such companies possess the corporate power to issue such bonds, and have obtained the necessary permit to transact business in the locality where the bond is issued, all such bonds, if authorized by local statutes or ordinances, are unquestionably valid.[1]

§ 173. **Parties to Judicial Insurance Bonds.** — The parties to judicial insurance bonds are, in the strict sense of the term, two in number, the insurer, or "surety company," as it is commonly termed, which for a consideration executes the bond, and the insured for whose direct benefit it is issued. Though the "risk" join with the insurer in the execution of the bond, he is not a necessary party to the contract of insurance, though upon proper application he may be made a party defendant with the insurer in an action brought by the insured to enforce the former's liability under a statutory bond. Thus in Feinberg *v.* American Surety Company,[2] it was said that if the defendant in an action wherein an attachment has been issued, sues upon the bond given to procure it, the "risk" named in such bond is entitled to be made a co-defendant therein, as he has such interest in the subject of the action as should entitle him to be joined as a party defendant therein. The court, in its opinion in this case, observed that "from a reading of the condition of the undertaking set forth, it is apparent that the appellant (the 'risk') is the principal, while the surety company (the insurer) is merely a surety for his obligation to pay the damages occasioned by the former's act in levying the attachment; but since the appellant's rights may be fixed and determined in the present action, and as he will be liable to the surety company for any judgment that may be rendered

[1] See Mayne *v.* Fid. & Dep. Co. of Md., 198 Pa. 490; 48 Atl. 469; Flynn *v.* U. S. Sur. & Guar. Co., 61 N. Y. App. Div. 170; Borden *v.* Am. Sur. Co., 159 Pa. St. 465; 28 At. 301.

[2] 33 N. Y. Misc. Rep. 458.

against it, he has a direct interest in the present action, and he therefore may be permitted to intervene." This same question was also considered in a contract insurance case,[1] where the facts were as follows: One Nevins made an agreement to sell to one Mason certain real property on instalment, payments of said instalments to be secured by a contract insurance bond which was subsequently furnished by the Fidelity and Casualty Company at the request of Mason. Nevins subsequently brought an action against the "surety company," whereupon Mason made an application to the court to be made a party to the said action against the Fidelity and Casualty Company, on the ground that this was necessary to protect his interests as affected by the action brought on the part of Nevins. He further alleged that he was named in the contract insurance bond as the "risk" and had a good defence to the action brought by Mason, which would be lost to him unless he was made a party to the action, as the surety company could not avail itself of this defence in an action on the bond. In granting the application of Mason to be made a party to the action, the court spoke as follows:

"If judgment goes against the surety (the insurer), the petitioner as principal (the 'risk') will be liable over to the latter, and he can relieve himself from such liability if permitted to defend the action and establish his defence therein. He has therefore a direct interest in the subject of the action, to wit, the enforcement of the bond. The surety company cannot set up as defence the fraud which the petitioner charges. As the latter has not rescinded the contract of the sale of the premises, he has only a claim for damages which is not available as a defence to the surety; but if the principal and surety are sued together a successful recoupment by the former will inure to the benefit of the latter, though the surety could not if sued alone avail himself of the defence. Great liberality is always shown in

[1] 12 N. Y. Misc. 77.

admitting parties who may be injuriously affected by the action and judgment."

In all classes of judicial insurance bonds, no matter whether they run in name to the "people," "court," or "estate," they are executed for the sole benefit of those to whom the right of action thereon is given by statute.[1] In general, the right of action on judicial insurance bonds is not limited to the parties therein named, but may, it seems, be maintained by their assignees.[2]

It has been held that where a surety company issues an administration bond upon an administratrix, that it has power to accept from her the transfer of her right of action under a modifying surrogate's decree, by which, upon the discovery of the existence of other parties in interest, the amounts directed by a former decree to be paid by her to the next of kin were reduced; and that the insurer may thereafter maintain an action at law against the assignee of the shares of certain of the next of kin as established by the first decree, and who is also a party to both decrees, to recover erroneous overpayments made to him, as such moneys are to be deemed assets of the estate of the deceased which will belong to the persons entitled thereto.[3]

In Rhode Island the rule seems to prevail that by reason of the absence of any privity of contract between the administrator *de bonis non* and the insurer issuing an administration bond to the former's predecessor, such an administrator has not the right to sue upon his predecessor's bond. The doctrine of this case is directly opposed by the New York decisions, which, however, seem to rest largely upon the provisions of local statutes.[4]

[1] See Dunne *v.* Am. Sur. Co., 43 N. Y. App. Div. 91; 34 N. Y. Misc. 584; Flanagan *v.* Fid. & Dep. Co., 32 N. Y. Misc. Rep. 424; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

[2] Epstein *v.* Fid. & Guar. Co., 29 N. Y. Misc. 295; 60 N. Y. Sup. 527; see also Dunne *v.* Am. Sur. Co., 43 App. Div. N. Y. 97; 34 N. Y. Misc. Rep. 584.

[3] Lawyers' Surety Co. *v.* Reinach, 25 Misc. N. Y. 150.

[4] App. Div. of Sup. Court *v.* Lawyers' Sur. Co., 21 R. I. 454; 44 Atl. Rep. 594; Dunne *v.* Amer. Sur. Co., 43 App. Div. N. Y. 91; 34 N. Y. Misc. 481; Flanagan *v.* Fid. & Dep. Co., 32 N. Y. Misc. 424; 66 N. Y. Sup. 544.

In Flanagan *v.* Fidelity and Deposit Company,[1] it was said that a substituted receiver may maintain an action on his predecessor's administration bond, whenever that right is expressly given by statute. In such a case it seems that the statute is written into the administration bond at the time that it is executed. The question at issue therein was whether the right of action did not have to be maintained by the parties to whom the original administrator had been directed to make payment out of the administration funds that had been dissipated.

[1] 32 N. Y. Misc. Rep. 424.

CHAPTER XIX.

ADMINISTRATION INSURANCE BONDS.

§ 174. **Administration Insurance Bonds — General Remarks.** — To secure the due administration of justice and to protect the property interests of all who look to the court for such protection, what may be termed administration insurance bonds are required by statute almost universally in this country, Canada, and England. The more important of these bonds are those required of executors, administrators, guardians, trustees, committees, assignees, and receivers. All are in a sense trustees to protect definite interests and are governed to a very large extent by the same general principles and rules. The nature of these administration bonds is that of a contract of indemnity to those who may suffer loss by reason of either the misfeasance or non-feasance of the party whose faithful performance of official duty, in the course of the judicial administration of estates, is sought to be secured through the medium of such bonds. It has always been the policy of the courts to protect to the fullest possible extent those who by force of the law or without their consent are represented by others in the care of their property. It is to the existence of this policy that the universal requirement of administration bonds may be ascribed.

§ 175. **Attachment and Duration of Liability under Administration Insurance Bonds.** — With respect to the attachment of liability under administration insurance bonds it may be said that the insurer is not liable in any event for acts or defaults of the "risk" committed prior to the execution of such insurance bonds.

In general the period of duration of liability under such bonds, on the part of the insurer to the insured, is coextensive with that of the "risk" to the insured.

The insurer who issues administration bonds is bound by the recitals of the same with reference to the "risk's" appointment to the office to secure the faithful performance of the duties for which the bond is given. This is on the plainest principles of estoppel, for by its act in offering the bond, the "risk" has obtained possession of the property of the insured. Therefore it is safe to assert in this connection that the insurer is estopped from claiming that there has been no attachment of liability under a judicial administration bond by reason of irregularity in the appointment of the "risk" to the position designated therein.

§ 176. **Scope of Liability under Administration Insurance Bonds.** — By executing an administration insurance bond the insurer does not make itself privy to any order which may be made by the court directing the "risk" as to his official duties, nor is such bond violated by failure to obey such order, where the bond does not stipulate that the risk shall obey all orders of the court. However, if it does so stipulate, it would seem that such order is conclusive on the insurer, and when the failure to obey the order is judicially established, the liability of the insurer is fixed. A case in point in this connection is that of Lesster *v.* Lawyers' Surety Company.[1] This was an action brought against the Lawyers' Surety Company to enfore its liability on an administration insurance bond issued upon one Ingraham as receiver appointed in mortgage foreclosure proceedings, wherein one Mary Harris was plaintiff and one Lesster was defendant. The court, in its opinion, spoke as follows:

"The condition of the defendant's bond as surety was that, if the receiver should faithfully discharge his duties as such receiver, then the bond should be void. It is claimed by the plaintiff that the surety, by executing the bond, made himself privy to any order which should be made by the court directed to the receiver in respect to his duties; and that whenever it was made to appear that the receiver had failed to obey an order of the court, the condition of the bond was

[1] 50 N. Y. App. Div. 181; 63 N. Y. Sup. 804.

violated and the defendant became liable on it. This would be technically the case if the condition of the surety's bond provided in terms that the receiver should obey all orders of the court and should pay as directed by the court, or if there were any other express condition in the bond from which it might be inferred that the surety originally covenanted that the receiver should do the particular thing the court ordered him to do. Whenever such a bond has been made, as where one has given security for an administrator or an executor, by the terms of which he has bound himself that the administrator will obey the orders of the surrogate, it has been held such an order properly made is conclusive upon the surety, and when the failure to obey the order is established the liability of the surety is absolutely fixed. But those cases turn upon the express agreement of the surety that the administrator will obey the orders of the surrogate, and when such a contract has been made the courts say that by his contract the surety puts himself in privity with the administrator with respect to the decrees of the surrogate. But, unless the contract contains some provision from which it can be clearly inferred that the surety has come in privity with the principal so that he had bound himself to abide by the judgment against the principal, such an order is not conclusive against him, and he may question it when a liability is sought to be established against him on account of it. While the order of the court was evidence against this surety, the defendant was nevertheless at liberty to show, not that the order of the court was improper, but that the apparent disobedience to it was not in fact a disobedience at all, for the reason that the receiver had before that time faithfully discharged his duties as such by paying over all the money in his hands in pursuance to another valid order of the court."

Practically it is immaterial, so far as the insurer's liability is concerned, whether incomplete administration, resulting from a failure to place estate funds in the hands of the insured to whom they finally belong, is caused by their simple retention in the "risk's" hands, or by the latter's per-

sonal use or conversion thereof.[1] Where by reason of special circumstances the insured is unable to point to a literal breach of the conditions of a bond, but a breach has occurred in such conditions when interpreted according to the spirit of the bond, then equity will treat the same as a substantial and essential breach in every particular.[2]

In general the scope of administration insurance bonds should not be extended by construction. Where the appointment of the "risk" in an administration bond is regular and is made in a matter over which the court has assumed jurisdiction, and the "risk" has taken possession of the property and embezzled the proceeds, the insurer is liable on the bond, though the bill under which the "risk" was appointed was afterwards dismissed for want of jurisdiction.[3] The general rule in the case of administration insurance bonds is that the burden is upon the insurer, if he wish to absolve itself from liability on the bond, to see that his "risk" performs fully his obligations thereunder. The purpose of the bond is not only to protect the insured from fraud and dishonesty on the part of the "risk," but likewise to save the insured harmless in case of the latter's insolvency.

With reference to the insurer's liability, the "risk's" position is a personal trust and the performance of its duties cannot be delegated to others. The insurer's liability continues during the life of the bond, or until it has been formally discharged therefrom or the "risk" has accounted and shown a faithful administration of his trust.

The insurer, in the case of all administration insurance bonds, is liable for acts of both omission and commission on the part of the "risk."

It is often stated as a general rule that no action can be maintained upon the bond until proceedings for an accounting have been had against the "risk" or his default established in some formal proceeding.

[1] Dunne *v.* Am. Surety Co., 43 App. Div. 91; 34 N. Y. Misc. 584.

[2] Dunne *v.* Am. Surety Co., *ante.*

[3] See Bal. Bldng. & Loan Ass. *et al.* *v.* Alderson *et al.*, 90 Fed. 498; 39 C. C. A. 609.

But the rule does not obtain in several jurisdictions, notably in Illinois and Missouri.[1] In any event where it appears that an accounting is impossible or impracticable, an action in equity to establish the extent of liability and to charge the insurer is proper.[2]

It is well settled that the unauthorized acts of the "risk" with relation to the assets of an estate are treated as his individual acts and do not estop him either from maintaining an action in his representative capacity for the possession of the estate intrusted to him or from suing for damages for injury to it.[3]

It is a rule of universal application in matters relating to administration insurance bonds that they only cover acts of the "risk" while acting strictly within the official capacity designated in such bonds.[4]

The scope of such bonds can never be extended by reason of the "risk" assuming to act in any other capacity than that designated therein.

The insurer cannot be held liable for any acts or defaults committed by the "risk" out of the line of his official duties. The insurer in issuing such bond merely binds itself for such acts of the "risk" as relate to some default in transactions where the latter acts by virtue of his appointment by the court or for the omission of some act which as an appointee of the court it was his duty to perform. Hence if the "risk" commit a wrong not connected with the discharge of his official duty he is personally and not officially liable, and therefore his official bondsman cannot be held responsible therefor.[5]

In Hill *v.* American Surety Company *et al.*[6] it was held that an assignee who neglects to use ordinary diligence to procure

[1] See Bonham *v.* People, 102 Ill. 434; State *v.* Slevin, 93 Mo. 253.

[2] Otto *v.* Van Riper *et al.*, 164 N. Y. 536; 58 N. E. 643.

[3] Lawyers' Sur. Co. *v.* Reinach, 25 Misc. 150.

[4] Farmers and Traders Bank *v.* Fid. & Dep. Co., Ky. ; 56 S. W. 671.

[5] See Am. Surety Co. *v.* McDermott, 5 N. Y. Misc. 298; Lawyers' Surety Co. *v.* Reinach, 25 N. Y. Misc. 150.

[6] 81 N. W. 1024; 82 N. W. 691; 19 Wis. 107.

insurance on the estate in his hands is liable on his official bond for negligence. The court, it was said, will take judicial notice of the fact that an ordinarily prudent man, having in his possession a large manufacturing establishment, keeps the same insured against loss by fire to an amount well approaching its real value. In its opinion the Wisconsin court used these words: "It has always been the policy to protect those who by force of the law or without their consent are represented by others in the care of their property. Hence the duty of the courts to hold the assignee to strict performance, first, of all orders which the court may make as to his conduct; and, secondly, where the court is silent, to the full measure of diligence and fidelity above suggested."

In McCollister *v.* Bishop *et al.*[1] it was held, with reference to trust funds, that any agreement on the part of the "risk" whereby he surrenders or limits his control over them, renders both the "risk" and the insurer liable for any loss that may occur, for the reason that both are in contemplation of law guarantors of such funds, irrespective of motives, or whether the "risk's" surrender of control was the cause of the loss. A duly appointed successor to the "risk" may sue on the administration bond of his predecessor as being the insured, in contemplation of the insurer when the policy was issued.[2] It is a general rule that the insurer issuing a bond on an executor, administrator, or trustee does not become liable thereunder until the default of the "risk" has become fixed, and then only under the express terms of the bond itself.

A ruling on the scope of liability, somewhat novel in its character, is found in Dunne *v.* American Surety Company,[3] where it was held that an administrator *de bonis non* of an estate, appointed in the state of New York in place of a deceased administrator, may, without leave of court, and although the intestate left no debts, sue the surety on the bond of such administrator for moneys of the estate received by him, but

[1] 78 Minn. 228; 80 N. W. 1118.

[2] Flanagan *v.* Fidelity & Deposit Co., 32 N. Y. Misc. 424.

[3] 34 N. Y. Misc. 584; 43 N. Y. App. Div. N. Y. 91.

for which neither he nor his executor has accounted or will account, and this although the deceased administrator removed from the state of New York to a foreign state, died there, and did not leave in that state either personalty or personal representatives.

A most instructive case with reference to the liability of an insurer on the bond of a trustee is that of Thomson *v.* American Surety Company.[1] In this case a bond was furnished by the American Surety Company for one Cruikshank, named as trustee in a will. The conditions of this bond were to the effect that if said Cruikshank should faithfully execute the trust reposed in him as such trustee, and should faithfully pay over, distribute, and divide and account for all the property and money which should come into his hands as such trustee in accordance with the provisions of the will under which he was appointed, then the bond was to become void. The latter was executed ten years after Cruikshank was appointed trustee and three years after the entry of a judgment in an action brought by one of the *cestuis que trusts* adjudging that the sum of $83,653.33 was held by Cruikshank as trustee. An action was brought against the "surety company" on its bond to recover damages for alleged unfaithfulness on the part of Cruikshank as the "risk" named therein in the performance of his duties as trustee. On the questions of law raised in the trial of said action, the court spoke as follows: "There was nothing in this bond which made this surety responsible for any failure to execute the trust prior to the execution of the bond, or by which the surety becomes liable for money which had come to the hands of the trustee prior to its execution. It was not conditioned upon the trustee's accounting for all property which had come into his hands prior to its execution, but was conditioned upon his paying over, distributing, and dividing and accounting for all the property and money which should come to his hands as such trustee. It would undoubtedly include all property that was actually in his hands undistributed at the time of the execu-

[1] 56 N. Y. App. Div. 113; 67 N. Y. Sup. 561.

tion of the bond; but to entitle the plaintiff to recover in this action it is apparent that there must be proof that Cruikshank, after the execution of the bond, had failed to faithfully execute the trust reposed in him as such trustee or had failed to faithfully pay over, distribute, and divide and account for all the property and money which was in his hands at the time of the execution of the bond or which after its execution had come to his hands. . . .

"In the present action there was no evidence as to the failure of the defendant to faithfully perform the duties of his trust, or failure to account for and pay over to the beneficiaries of the estate the moneys in his hands, except so far as this judgment was evidence against the defendant. If this bond had been given upon the appointment of the trustee so that the defendant should become the surety for the accounting by the trustee for all the moneys that should at any time during the trusteeship come into his hands, I should have no doubt that the judgment would be conclusive upon the surety as to the amount of money which had come into his hands as such trustee, and as to the amount of money for which he had failed to account. The bond recited the appointment of the principal as trustee by an order of the supreme court. The surety would be chargeable with notice of the order appointing the trustee, and the duties and responsibilities imposed upon the trustee by virtue of his appointment. He was appointed as a substituted trustee by the supreme court. Upon such an appointment the trustee is required to account to the court that appointed him, and the accounting specified in the bond is necessarily an accounting to the court; and when a surety undertakes that a trustee appointed by the court will faithfully account for all the money that comes into his hands, it would seem to follow that it was an accounting to the court in a proper judicial proceeding that was contemplated by the parties. It could add nothing to the effect of this provision of the bond to have provided that such an accounting must be before the court having cognizance thereof, as by the very terms of the appointment and the

duties assumed by the trustee thereof it was an accounting to the court that appointed him, or some other court having jurisdiction of the trustee, which would have been necessary to relieve him from liability, and it must be assumed, I think, that it was such an accounting that was contemplated by the parties when the bond in suit was executed. The bond was conditioned upon the faithful accounting by the trustee, and such an accounting must necessarily be to the authority that conferred the appointment upon him. I think that if this judgment had contained any adjudication that the trustee had failed to account for any money in his hands at the time of the execution of the bond by the defendant, or which came into his hands subsequently, the judgment would have been conclusive upon the defendant, and the defendant would have been bound by its adjudication. . . . The trustee claims certain payments as credits which were disallowed, but all of these payments were made long before the bond in suit was executed. There was no evidence, therefore, that the trustee had failed to account for any moneys which were in his hands at the time of the execution of this bond by the defendant, or that thereafter came into his hands. As before stated, the obligation of this surety is for the future. If the trustee shall faithfully execute the trust reposed in him as such trustee, and shall faithfully pay over and distribute and render an account for all the moneys and property which should come into his hands as such trustee in accordance with the provisions of the said will, the obligation is to be void. . . . The rule is well settled that where the engagement of the surety is for the future, he cannot be held liable for the past as to which he has not covenanted.

"In this case the trust covered a considerable period before the bond sought to be enforced was executed. Under this bond the defendant was liable for any failure of the principal to account for all property and money which should come into his hands as such trustee; and the proof offered upon the trial was a judgment in an action brought against the trustee's executrix for an accounting, from which it appeared

that the trustee had failed to account for certain sums of money which had come into his hands prior to the time that the bond in suit was executed; and although I think this judgment would have been conclusive if it had adjudicated that the trustee had failed to account for moneys which had come into his hands after the execution of the bond, as there was no such adjudication, and as the whole record shows that the action was brought to compel an accounting by the trustee for money which he had received long before the execution of the bond, the judgment was not, I think, evidence against this defendant of a breach of the condition of the bond which would entitle the plaintiff to recover. It follows that the judgment should be affirmed, with costs."

It is well settled that the unauthorized acts of an administrator or executor with relation to the assets of an estate are treated as his individual acts, and do not estop him in his representative capacity or the sureties on his bond from maintaining an action for the recovery of the property wrongfully disposed of by him. Furthermore, when third persons sustain any damage by reason of the tortious or negligent acts of the personal representatives in the course of administration proceedings, the administrator is personally responsible, and a like responsibility attaches to him where no direct pecuniary advantage has resulted to the estate.[1]

§ 177. **Discharge of Liability under Administration Insurance Bonds.** — The insurer in administration insurance bonds may be discharged from liability thereunder in any one of the following ways:

First. By rescission of the contract, or by cancellation of the bond.

Second. By misrepresentation, concealment, breach of war-

[1] Lawyers' Sur. Co. *v.* Reinach, 25 Misc. N. Y. 150. See generally, on scope of liability under administration insurance bonds, Anderson *v.* Fid. & Dep. Co. of Baltimore *et al.*, 100 Ga. 739; 28 S. E. 463; Lesster *v.* Lawyers' Surety Company, 30 N. Y. Misc. 771; Morgan *et al.* *v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 857; Matter of Hazard, Petition of Am. Sur. Co., 73 Hun, 22.

ranty, or breach of the conditions of the bond, on the part of the insured.

Third. By settlement of liability under the bond with the insured, either when such settlement is made by the insurer directly, or by the "risk."

§ 178. **Discharge of Liability by Rescission of the Contract or by Cancellation of the Bond.** — Any insurer has a right to rescind a contract of judicial insurance, when he has been induced to sign the same by the fraud of the insured, on proper application to the court.

Usually the grounds upon which the surety may ask to be relieved from liability on an administration bond are pointed out by statute. Notwithstanding this fact such surety may ask for his discharge on grounds other than those named in the statute. In National Surety Company *v.* Morris,[1] the Georgia supreme court said that, in addition to the statutory grounds, "want of personal integrity, lack of business capacity, extravagant or reckless living, indulgence in vicious or immoral habits, criminality, and scores of other things might be suggested, which would certainly afford good reason for a desire to be relieved as surety. An insurer, under circumstances tending to show reasonable grounds for fear, is not obliged to wait until he becomes liable for actual waste and mismanagement before applying for relief."

It has been said that where the ultimate object of proceedings taken in court is to procure the release of the insurer from responsibility on account of some future breach of the condition of an administration bond, and no breach of the condition of such bond having occurred, and it appearing that none can possibly occur in the future, and that the duties, to secure the faithful performance of which the bond was given are now impossible of performance, the court will make no direct order for the filing of a new bond with a view to discharging the insurer from liability on the original administrator's bond.[2]

[1] 36 S. E. 690; 111 Ga. 307.
[2] Matter of McCormick, 25 N. Y. Misc. 136.

But the foregoing doctrine is modified somewhat by a late decision of the New York court of appeals, in American Surety Company of New York *v.* Thurber.[1] Here the "risk" named in an administration bond (a committee of a lunatic) made an agreement with the "surety company" furnishing the same that the latter's acceptance of a premium from the former should not abridge any right or remedy which it might otherwise have. In view thereof it was held that it was entitled to apply to be relieved from its suretyship under a provision of the New York Code providing that sureties on the bond of a lunatic's committee may be relieved on petition for acts done by such committee after an order discharging them as sureties, though the committee has not been guilty of misfeasance or a breach of the contract, to secure the faithful performance of which the bond was issued.

It was held that a statute allowing a discharge on account of such acts must be held to apply to compensated as well as private sureties, and in making this holding the court spoke as follows:

"Surety companies are a convenience to the community, and it is important that they should continue sound and able to respond to their obligations. The legislature doubtless intended to promote their stability by extending the same protection to them that it extends to other sureties. The contracts of such companies are usually based upon an annual premium for a continuing bond. If the premium were not paid after the first year, and the company could not avail itself of the privilege of the statute (providing for the release of sureties for acts of commission or omission of the "risk") its responsibility would continue with no compensation, for the bond would still be in force. No company can do business on such a basis. Moreover, if the annual premiums are paid, but the principal is squandering the estate, how can a surety company protect itself? Through its officers it may inform those interested, and request action on their part, but if they reply, "you are good, and we are safe," what

[1] 56 N. E. 631; 162 N. Y. 244.

relief is there unless it is under this section? If it cannot induce those ultimately entitled to the money or property to act, its condition is hopeless, and bankruptcy may be the result. These considerations and others of like character may well have influenced the action of the legislature when it amended the section under consideration. The provisions of the statutes authorizing the company to become a surety are part of the contract of suretyship, and were not waived by accepting the contract of indemnity which expressly provides that acceptance of security or consideration should not "limit or abridge any right or remedy which the surety might otherwise have." [1]

It has been held, under the statutes of Minnesota, that the failure on the part of an assignee to pay the agreed premium on his bond is sufficient ground for an application on the part of his surety for the former's removal from his position.[2] Where, however, the discharge of the insurer is procured on the ground of the principal's discharge, and this last is procured through fraud, this should not operate to relieve either the principal or the insurer from liability.

§ 179. **Discharge of Liability under Administration Bonds through Misrepresentation, Concealment, Breach of Warranty, or Breach of Conditions.** — The opportunities for the insurer escaping liability under administration insurance bonds, on the ground of misrepresentation, concealment, breach of warranty, or breach of conditions, are unquestionably very limited. The duties of the "risk" in such cases are usually defined by law, and must be performed under the guidance and direction of the court. The beneficiaries under such bonds do not themselves have any part in procuring the same, as this is almost invariably attended to by the "risk," who provides the bond in compliance with the express provisions of the statutes that govern and control the entire subject-matter of administration bonds. This fact alone takes away in a large measure from the insured the opportunity for mis-

[1] Matter of Thurber, 162 N. Y. 244.

[2] Am. Surety Co. *et al.* *v.* Nelson, 77 Minn. 402; 80 N. W. 300.

representation or concealment in the procuring of the bond. As a matter of fact, bonds of the character under consideration contain no express warranties, and usually but one condition, namely, the general one to the effect that if the "risk" faithfully performs all the duties of his position, then the insurer's obligation is to become null and void. In view of these facts, the question of releasing the insurer's liability under administration bonds through breach of warranties or conditions becomes of little practical importance in this immediate connection.[1]

§ 180. — **Discharge of Liability by Settlement with the Insured.**— As in other forms of guaranty insurance, recovery can only be had on an administration bond up to the amount named therein as the maximum of the insurer's liability. Whenever this amount has been once paid, all further liability under the bond ends, and the insurer is discharged. With respect to the settlement of the insurer's liability, the most practical question in administration bonds is that which relates to the effect of judgments obtained by the insured against the "risk" upon the question of the insurer's liability to the insured. In this connection, it should be first noted that the liability of the insurer is generally coextensive with that of the "risk" to the insured. In other words, if the obligation of the "risk" to the insured is destroyed, the incident — the obligation of the insurer — is destroyed. The general rule is that a default of the "risk" must be established in proper proceedings against him before any liability can be enforced by action upon the administration bond. This for the reason that it is presumed in such cases that the "risk" performed his official duties until the contrary is affirmatively proven.

It has been said that "it may well be considered as an established principle, that whenever a surety has contracted, with reference to the conduct of one of the parties in some suit or proceedings in court, he is, in the absence of fraud and collusion,

[1] See Lawyers' Surety Co. *v.* Reinach, 25 Misc. Rep. N. Y. 150.

concluded by the judgment."[1] But it seems that the foregoing is not a correct statement of the law, except as it applies to what are termed "administration bonds." In order that sureties may be conclusively bound by judgments against their principals, they must agree to be so bound in their bond.

It has been said that it is a fundamental principle in jurisprudence that every man shall have his day in court, and shall be heard in his own defence, and of this right he may not be deprived under the constitution and laws of the state. But there is a very large and eminently respectable current of authority opposed to the foregoing doctrine.

As a general rule, the insurer who issues what is known as an official bond is not, in the absence of express provisions in the policy to that effect, concluded by a decree or judgment obtained by the insurer against the "risk," unless the insurer has had its day in court, or consented thereto in advance. But administration bonds seem to form an exception to this rule, and the insurer issuing the same, in respect to its liability for the default of the "risk" therein named, seems to be classed with such insurers as issue bonds, providing that the "risk" therein named shall do a particular act.[2]

Whenever the insurer expressly provides in an administration bond that the "risk" shall do a particular act, then, in the absence of fraud or collusion, the insurer is bound by the judgment obtained against the "risk" in an action brought by the insured to recover damages by reason of the failure of the "risk" to do this particular act.[3]

It has been held that a judgment in favor of the "risk" in an action against the "risk" by such insured, for the same cause of action wherein a liability is sought to be enforced against the insurer, is a bar to any action for the same cause by the insured against the insurer. This for the reason that if

[1] State *ex rel.* *v.* Surety Co., 76 Mo. App. 227; People *ex rel.* Am. Surety Co. *v.* Anthony, 7 N. Y. App. Div. 132.

[2] State *ex rel.* *v.* Surety Co., 76 Mo. App. 227.

[3] *Ibid.*

the question of the "risk's" liability to the insured had not been previously adjudicated, the insurer could have requested the "risk" to defend the suit of the insured against it, and then if the judgment had gone against it, this would have been conclusive as against the "risk." As has already been said, administration bonds seem to form an exception to the general rule, that sureties on official bonds are not concluded by decrees, final orders, or judgments against their principals, unless the sureties have had their day in court, or an opportunity to be heard in their own defence.

However, in some states the judgments in such cases, while held to be conclusive against the principal, are only *prima facie* evidence of the sureties' liability.

It has been said that an insurer can successfully defend itself as against an alleged liability, under an administration bond issued by it, on the ground that the court appointing the "risk" to the position named in such bond, as that wherein the "risk" should faithfully perform all the duties of such position, had no jurisdiction to render the judgment.

Wherever it appears that an order of court has been made, adjudging that the "risk" in administration bonds has certain money in his hands, which he fails to pay over on proper demand, it establishes actual loss and injury to the insured, which will entitle the latter to compel the insurer to make good, under its bond, the amount of such loss and injury.[1]

It was held in a recent case that payment by the assignee of an amount found due upon a settlement is within the obligation of the policy, conditioned for the faithful discharge of his duties as assignee. It was said that a judgment against an assignee, in a suit to settle his accounts, is conclusive against the surety, as to the amount due, though he had no notice of the proceedings. In this connection, it was intimated that the insurer is not entitled to notice of the "risk's" failure to perform his duties, where they consist of a failure to pay over the amount ascertained to be due in a settlement suit.

[1] People *ex rel.* Am. Sur. Co. *v.* Anthony, 7 N. Y. App. Div. 132.

"It would seem," observed the court, "that the obligation assumed by the surety upon the bond of an assignee for the benefit of creditors is strictly analogous to that assumed by a surety of a personal representative. The duties imposed by law upon these two classes of fiduciaries are almost exactly similar. Each administers the estate committed to his charge, pays the debts, and pays over to those entitled the surplus found to be due upon his settlement. That the surety of a personal representative undertakes that his principal shall pay over the amount so found to be due on settlement has been uniformly recognized."[1] As a general rule under administration bonds, the insured may recover, in addition to the direct loss occasioned through fraudulent acts of the "risk," his own costs and expenses.[2]

[1] Nl. Sur. Co. *v.* Arterburn, 62 S. W. 862; Ky. .

[2] People *ex rel.* Surety Co. *v.* Anthony, 7 N. Y. App. Div. 132; Anderson *et al.* *v.* Fid. & Cas. C., La. 28 S. E. 463; Morgan *et al.* *v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 851.

CHAPTER XX.

STATUTORY INSURANCE BONDS.

§ 181. **Statutory Insurance Bonds — General Remarks thereon.** — The second great class of judicial insurance contracts may be termed "statutory insurance bonds." The basis for such a classification, under the general head of judicial insurance, lies in the fact that as a general rule all bonds given in the course of litigation in the courts are usually required by statute. Insurance bonds of this character have by popular usage acquired certain more specific names, such as "appeal," "cost," "removal," "attachment," "injunction," "replevin," "indemnity" bonds, etc. Besides these there are other bonds, such as, for example, "excise bonds," which are quasi-judicial in their nature. The right of the courts to accept such bonds is clearly established both by statutory enactment and the decisions relating thereto.[1] That the issuing of such bonds for compensation constitutes the transaction of the business of insurance is equally well established.[2]

§ 182. **Nature and Purpose of Statutory Bonds.** — It is not the office of statutory insurance bonds to show in detail the nature of the liability thereby assumèd by the insurer issuing the same. The only object of setting forth the scope of liability thereunder is to limit and define in a general way the extent of the obligations assumed by the obligors therein named. The policy itself is purely statutory and relates exclusively to the action or proceeding wherein it is given. It is issued solely by way of furnishing indemnity in that particular action, and any claim of any other or different

[1] See Industrial and General Trust Co., 56 App. Div. N. Y. 39; Haines *v.* Am. Surety Co. *et al.*, 73 N. Y. Sup. 293.

[2] See Indust. & Gen. Tr. Co. *v.* Tod *et al.*, 56 App. Div. N. Y. 39; People *ex rel.* Nl. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 459; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

liability would be wholly without foundation. For this reason the liability of the insurer is extinguished whenever that of the "risk" to the insured in such action is satisfied.[1]

§ 183. **Validity of Statutory Bonds.** — The general subject of the invalidity of that form of statutory bonds known as "excise" was considered at some length in Lyman *v.* Brucker *et al.*[2] It was there held that an excise bond which provided in terms of the statute that an applicant for liquor tax certificate should not violate any conditions of the provisions of the liquor tax law, and in addition, "or any act amendatory thereof or supplemental thereto," is to be deemed to refer only to such amendments as were in force when the bond was executed, and in this view a "surety company" which signs it without knowledge of its contents cannot, after it has been accepted as a valid security, attack its validity upon the ground that it is more burdensome to them than the statute requires. The court, in its opinion in this case, observed that "a strict and technical conformity to the statute is not essential to the validity of such bonds. If they conform substantially to the form prescribed, it is sufficient; neither is it any objection to them that they are broader in their terms than is required by the statute, as long as it does not entirely amount to a breach of the rights of the surety company issuing the same. Assuming then that the bond does conform in all respects to the requirements of the statute, the 'surety company' after having presented the bond to the excise commissioner as a lawful and valid security, who accepted it and who upon the strength of the security granted the required liquor tax certificate to the 'risk,' who has received the rights and benefits therefrom, then neither he nor the 'surety company' ought to be permitted to escape liability because the bond does not conform to the exact language of the statute; neither should the court, upon technical grounds, aid them in escaping the consequences of a plain violation of its conditions. The parties who execute

[1] See Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458.
[2] 26 N. Y. Misc. Rep. 594.

such bonds know or should have known the contents thereof when they have executed it, and if the language thereof was in the least prejudicial to them, they should have refused to sign it or have applied to the court to have it amended. . . . The parties to the bond, however, may waive any statutory rights with respect to applying to the court to have the same amended, and if they do so, and neglect to institute such proceedings to have the bond amended until an action is brought upon it, knowing that the 'risk' has obtained rights and privileges upon the faith and strength of it, they are estopped from questioning its validity. It would be unjust under the circumstances to permit them to repudiate their obligation."

There has been in times past an inclination on the part of some courts to declare the giving of counter-indemnity to the insurer issuing bail bonds to be contrary to public policy. Such a holding as is here referred to is not generally supported by the more recent authorities.[1] But where the prosecutor of an accused person has become bail for the latter and has given an indemnifying bond, he cannot, it is said, recover thereon upon the forfeiture of his recognizance by the accused. This for the reason that such a recovery would be contrary to public policy.[2]

§ 184. **Construction of Statutory Litigation Bonds.** — So far as the reported cases show, there has so far been no very marked tendency on the part of the courts to treat in matters of construction the bonds furnished by the "surety companies" in any wise different from those of the private sureties. The character of the instrument furnished by these companies as contracts of insurance seems to have been completely lost sight of in all matters of construction, and the bonds of private sureties and corporate insurers have been treated as instruments of essentially the same character and nature.[3]

[1] Flynn *v.* Union Sur. & Guar. Co., 61 N. Y. App. Div. 170; 70 N. Y. Sup. 403; Mayne *v.* Fid. & Dep. Co. of Md., 198 Pa. St. 490; 48 Atl. Rep. 469.

[2] Mayne *v.* Fid. & Dep. Co., 8 Penn. Dis. Court, 711; see generally Bubb *et al. v.* Am. Bond & Tr. Co., 30 Pitts. Legal Journal, 361.

[3] See Lyman *v.* Kurtz *et al.*, 166 N. Y. 274; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

To justify any extension of liability on such bonds, the language defining such liability must be so clear and explicit as to admit of no other construction than the scope of liability contended for by the insured.[1]

§ 185. **Parties to Statutory Bonds — General Remarks concerning.** — The obligation of the insurer under a statutory insurance bond is, with respect to the right of enforcement thereof, personal to the insured.[2] Inasmuch as the "risk" named in a statutory insurance bond usually executes the same in company with the insurer, he has the right to be made a party defendant with the latter in any action brought thereon by the insured or his assigns.[3] There is particular reason for extending to the "risk" this right where he has been notified by the insurer to defend the action, and will be concluded by the result.[4]

§ 186. **Attachment and Duration of Liability.** — As a general rule, all statutory bonds, as their name implies, are creatures of statute, and their continued existence as well as operation is largely controlled thereby.[5] In general, the period of the insurer's liability under such bonds is coextensive with that of the "risk" to the insured name therein.[6]

In support of the general proposition just stated, attention is called to the case of Lyman *v.* Cheever and United States Guarantee Company,[7] where in construing an excise bond conditioned, among other things, upon the "risk's" not violating any of the provisions of the liquor tax law, while the business, for the transaction of which he had been given a permit by the state, should be carried on, it was observed that "the permit was surrendered twenty days prior to the alleged violation complained of. From the date of its sur-

[1] Sooy Smith & Co. *v.* Am. Sur. Co., 28 App. Div. N. Y. 346.

[2] Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

[3] Feinberg *v.* Am. Surety Co., 33 N. Y. Misc. 458; Matter of Mason, 12 N. Y. Misc. Rep. 77; Lyman *v.* Fid. & Cas. Co., 65 N. Y. App. Div. 327.

[4] See generally on parties Lyman *v.* Roch. Tit. & Sur. Co. *et al.*, 37 N. Y. App. Div. 234.

[5] Markoe *v.* Am. Sur. Co., 44 App. Div. N. Y. 285; 60 N. Y. Sup. 674; 167 N. Y. 602; 60 N. E. 1115.

[6] Markoe *v.* Am. Sur. Co., 44 App. Div. N. Y. 285; 167 N. Y. 602.

[7] 168 N. Y. 43; 60 N. E. 1047.

render it was no longer held by Cheever (the 'risk') as a permit under which he could continue to traffic in liquor. All fines and penalties theretofore accruing during the time the permit was held by Cheever, the surety was bound to pay. . . . Liability under the bond continued under the provision of the statute for one year, the time for which the permit was issued, or in case of its surrender previous to that time during the time for which it is held. Fines and penalties theretofore accruing may be recovered under the bond, but not for offences thereafter committed."[1]

§ 187. **Scope of Liability.** — While all statutory bonds are creatures of statute, and their existence as well as operation is controlled thereby, nevertheless substantial requirement with such statutes is all that is required in such cases. Not infrequently, if there is a lack of conformity to statutory requirements, they will be upheld as common law obligations. The present tendency of the courts is towards adopting an intermediate position, neither strict nor liberal in the construction of a "surety company's" liability under statutory insurance bonds.[2] The limitation of liability in the policy by the insurer fixes its extent. If there is no authority in law for the proceedings had wherein the bond is given, there can be none for taking such bond, and therefore the same is void.

In general the rule may be safely laid down that where parties enter into any obligation in pursuance of a statute and for the purpose of procuring some benefit conditioned upon the assumption of such obligation, they will necessarily be presumed to have intended to have come under all the conditions expressed in their contract which were required by statute.[3]

Attention is first called to a case bearing upon the scope of liability under appeal bonds issued by surety companies. Ref-

[1] See also Lyman *v.* Siebert *et al.*, 31 N. Y. Misc. 285; People *v.* Lyman, 156 N. Y. 407, 50 N. E. 1112.

[2] See Am. Surety Co. *v.* Haynes, 91 Fed. 90; Markoe *v.* Am. Sur. Co., 53 N. Y. App. Div. 285; 60 N. Y. Sup. 674; 168 N. Y. 539; 60 N. E. 1115; Lesster *v.* Lawyers' Surety Co., 50 N. Y. App. Div. 181; State *ex rel.* Owens *v.* Fraser, 65 S. W. 569.

[3] Lyman *v.* City Tr. S. D. & Sur. Co. *et al.*, 48 N. Y. App. Div. 633; 166 N. Y. 274; 59 N. E. 903.

erence is had to that of Markoe *v.* American Surety Company.[1] This was an action where the insured named in an appeal bond had obtained a judgment of divorce and for alimony against her husband. To enforce this alimony judgment, the plaintiff subsequently brought an equitable action to compel the application of certain trust funds to the payment thereof. In this she was successful, and her husband (the "risk" named in the appeal bond subsequently issued by a "surety company") appealed to the court of appeals, in which action the bond in controversy was given. The judgment was affirmed by the court of appeals, and an action upon the appeal bond was thereafter commenced. It appeared that notwithstanding the giving of the appeal bond, the "surety company," pending the appeal, collected all the income which was earned by the trust. It appeared also that prior to the commencement of the action the "risk" named in the bond paid to the insured therein named all the costs in the action. Thus the entire obligation of the "risk" on the appeal bond was fulfilled. Commenting upon the claims of the insured as to the "surety company's" liability on the appeal bond, the court spoke as follows: "It may well be asked, under these circumstances, what her complaint is in the present action. Avowedly it is to compel the surety to pay the alimony awarded to her in the original divorce judgment, less the sums received from the trust fund under the decree in the equity action. But the surety made no such contract. Its undertaking was not upon any appeal taken in the divorce case. It had nothing whatever to do with that case. Its undertaking was statutory, and related solely to the equity action which was brought in aid of the original alimony decree. There was no judgment in this equity action requiring either the husband or the trustee personally to pay the sums awarded to the plaintiff as alimony in the divorce action. The judgment in the equity action simply decreed a lien in the plaintiff's favor upon the trust fund to the extent of her alimony judgment, and directed the payment to her of

[1] 44 N. Y. App. Div. 285.

all the trust income which should be required to satisfy that alimony judgment. Not a dollar was required to be paid by this equity decree save the trust income. That that trust income should be paid to the plaintiff was, therefore, the defendant's sole undertaking. The claim of any other or different liability is wholly without foundation. It was to indemnify itself against that particular liability, and against no other, that this 'surety company' took security from the applicants in the equity action. That liability having been extinguished by the satisfaction of the equity judgment, this security was properly returned to the appellants here."

It is not the purpose of a statutory bond, given for the purpose of procuring an appeal, to show the nature and scope of such appeal, and the only object of referring to the judgment therein is to enable it to be identified as the subject of the instrument. When this is accomplished its office is performed.[1]

Turning now to the question of the scope of liability under excise bonds, attention is called to the case of Lyman *v.* Kurtz *et al.*[2] Here the "surety company" issuing an excise bond containing a condition to the effect that the "risk" would not permit gambling upon the premises where the liquor was to be sold, was held not to be relieved from liability for a breach of that condition because of a subsequent provision in the bond that it was to cover every violation of the liquor tax law, which at the time the bond was executed did not prohibit gambling, inasmuch as the parties must have intended that the bond should cover the case of gambling upon the premises as well as any violation of the provisions of the law itself. In this case it was argued by counsel for the "surety company" that the general terms of the insurer's obligation under the bond were qualified by the language which concluded the clause containing the conditions of the obligation, and that thereby the bond was so restricted as only "to cover every violation of the liquor tax law and all fines and penalties incurred or imposed thereunder." It was argued that if the

[1] Markoe *v.* Am. Sur. Co., 25 N. Y. Misc. 127; 53 App. Div. 285; 167 N. Y. 602.

[2] 166 N. Y. 274; 59 N. E. 903.

insurer's liability under the bond is not to be extended beyond the strict terms of the contract, then that is confined to violations of the liquor tax law simply, and does not comprehend the condition, for breach of which suit was brought on the bond by the insured. The court, in passing upon the question, spoke as follows: "The rule of law invoked by the 'surety company' depends for its obligation upon the ascertainment of the intention of the parties to the instrument, which is to be reached upon the consideration of the whole thereof and that in the light of the circumstances under which it was made. If it is manifest that it must have been their intention that their obligations should cover the case of gambling upon the premises as well as a violation of the liquor tax law provisions, then the subsequent language which is depended upon to qualify the more general terms of the contract will be inoperative to effect such a result and may be regarded as surplusage, or perhaps as an unnecessary repetition of the principal feature of the obligation and for the sake of emphasis. While the liquor tax law did not at that time prohibit gambling, nevertheless the legislature required, as a condition preceding the issuing of the certificate, that a bond should be issued to the people that the applicant would not permit any gambling to be done on the place designated by the tax certificate in which the traffic in liquor was to be carried on, in addition to agreeing not to violate any of the provisions of the law itself. The object of the legislature undoubtedly was that the place where the liquor business was to be carried on should not be characterized by unlawful or disorderly conduct, and to secure this end inserted the requirements in question. The parties obligating themselves to the state in pursuance of the statutory provisions and for the purpose of procuring the issuing of the certificates are necessarily to be presumed to have intended to have come under all the conditions expressed in their contract which were required by the statute.[1]

[1] See generally as to the scope of statutory insurance bonds the following cases: Markoe v. Am. Surety Co., 60 N. Y. Sup. 674; 53 N. Y. App. Div.

§ 188. **Incidental Liability of the Insurer arising out of the Execution of Statutory Insurance Bonds.** — It was at one time thought that parties by merely joining in the execution of statutory insurance bonds might be held as joint trespassers with the "risk" in case the proceedings under which the alleged trespass occurred were vacated or annulled. But the later and more modern rule in such cases undoubtedly is that in every case the insurer issuing such bonds must actually participate in the trespass in order to be held liable as a joint trespasser with the "risk." [1]

Insurers should upon principle in the case of attachment bonds only be held to make good such direct and proximate damages as the insured may have sustained by being deprived of his property, or the use thereof, or by its loss or injury, together with the taxable costs and expenses incurred in relation to the attachment. It should not, in reason or in equity, be held liable under the policy for such collateral or consequential damages as could only be recovered against the "risk" by proof of malice, and want of probable cause; such, for example, as loss of profits incident to the levy of the attachment, or injury to defendant's credit.[2]

Again, where a "surety company" was sued for wrongfully abetting a United States marshal in levying an attachment against third parties on the plaintiff's property, and it pleaded that its liability, if any, was that of a surety on the attachment bond, and that the marshal and attaching creditor had been acquitted of liability for such attachment in the United States circuit court, it was held that the plaintiff's demurrer

285; 167 N. Y. 602; 60 N. E. 1115; Vent *et al. v.* Duluth Trust Co., 80 N. W. 640; Fid. & Dep. Co. *v.* Beck, 12 App. Cas. Dis. of Columbia, 237; Kansas City *v* Am. Surety Company, 71 Mo. App. 315; Wood & Company *v.* Am. Sur. Co., 25 Misc. N. Y. 198; Borden *v.* Am. Sur. Co, 159 Pa. St. 465; 28 At 301; Kleiner *v.* Fid. & Dep. Co., 67 N. Y. Sup. 216; Numbers *v.* Rocky Mountain Bell Tel. Co. (Idaho), 63 Pac. 381; Lyman *v.* Fid. & Dep. Co. *et al.*, 49 N. Y. App. Div. 630; 166 N. Y. 410; Lyman *v.* R. T. Ins. Co., 37 N. Y. App. Div. 234; Lyman *v.* Shenandoah Social Club, 39 N .Y. App. Div. 459.

[1] See Sonnentheil *v.* Tex. Guar. & Tr. Co., 30 S. W. 945 and 56 S. W. Rep. 143; Eldridge *v.* Fid. & Dep. Co., Tex. App., 63 S. W. Rep. 955.

[2] See L. Bucki & Son Lumber Co. *v.* Fid. & Dep. Co. of Md., 109 Fed. 393, per opinion Shelby, J., dissenting.

thereto was properly overruled, since such judgment deprived the "surety company" of its contingent right as a surety to hold the attaching creditor liable on the bond, and was a bar to the action.[1]

§ 189. **Discharge of Liability by Misrepresentations.** — The case of Lyman *v.* Schermerhorn, and the Fidelity and Deposit Company of Maryland[2] is a case of much value as bearing upon the question as to when the insurer upon a liquor tax bond, given upon application therefor by the "risk," is liable for false statements contained in such application. The facts therein were as follows: One Schermerhorn applied for a permit to sell liquors. In this application Schermerhorn falsely said that he had never been convicted of felony. Pursuant to the statutes of the state of New York, Schermerhorn had furnished to the state an excise bond executed by the Fidelity and Deposit Company of Maryland in the usual form. This bond recited that Schermerhorn was about to apply for a liquor tax certificate, and the condition of the bond was that if the liquor tax certificate applied for should be given unto Schermerhorn, that the latter would not, while the business for which such liquor tax certificate was given should be carried on, violate any provisions of the liquor tax law. Inasmuch as Schermerhorn had been previously convicted of felony, no valid liquor tax certificate could be issued to him to traffic in liquors. He sold liquors, and a recovery was had against him to the full amount of the liquor traffic bond by reason of the fact that, as a person who had been previously convicted of felony, he had no legal right to traffic in liquors, or to be granted a liquor tax certificate. The New York court of appeals, in holding that the judgment so rendered against the "surety company" was void, spoke as follows:

"If the surety had known when it executed the bond that Schermerhorn had been convicted of felony, then complicity

[1] Sonnentheil *v.* Tex. Guar. & Tr. Co., 23 Tex. App. 436; 56 S. W. 143; see also Sonnentheil *v.* Tex. Guar. & Tr. Co., 10 Tex. App. 274; 30 S. W. 945.

[2] 167 N. Y. 113; 60 N. E. 324.

with him in intending to violate the law, and in his subsequent violation of it by trafficing in liquors, would be a natural inference, and equal liability with him upon the bond would follow. But the surety did not know that Schermerhorn had been convicted of felony. It did not guarantee the truth of Schermerhorn's statement. The suretyship results, not from the surety's participation in the principal's wrong, but from the state's acceptance of it as right. The county treasurer had jurisdiction to pass upon the application, accept the bond, and issue the liquor tax certificate. As between the state and the surety, both acting in good faith, the bond had its inception and validity because the county treasurer acted within his jurisdiction in issuing the certificate. It is obvious that the state might never obtain knowledge that Schermerhorn's statement was false, or, obtaining it, might never act upon it, and thus as between the state and the surety both bond and certificate would both continue to be valid. So long as the state insists upon the validity of the bond, it acts upon the truth of the application and the validity of the certificate. Schermerhorn's traffic in liquor, here proved, was before the state asserted the falsity of the application and the invalidity of the certificate, and therefore as to the surety the liquor tax certificate still protected such traffic.

"Until either the state or the surety takes some action with notice to the other that it elects to withdraw from the relation each has in good faith assumed to the other, that relation continues in the sense and meaning in which it was originally assumed. When the state changes its position with regard to the certificate, and to the qualification of the certificate holder to traffic in liquors, while it may punish the latter because of his false statement and his sales while disqualified, it cannot punish its surety without convicting it of complicity with him. Such liability of the surety was not within the meaning or intent of the surety's obligation. The surety had no intent to give a bond for a convicted felon, and the estate had no intent to ask or receive such a bond.

The bond was given and received as for a person not disqualified. The position of the surety is no worse than that of the state. The surety did not pass upon the application, the county treasurer did, and the bond would have had no life nor validity but for that officer's approval of the application; hence, when the state withdraws that approval and asserts that the certificate affords no protection to its holder, the bond which was given in consideration of such protection ceases to be supported by it. The application, certificate, and bond fall together. Until the state changed its position, the bond was good, and the certificate was good as to the surety. Thus this sale of liquor in question was protected and caused no breach of the surety's obligation."

Another case on the question of misrepresentation is that of Lyman *v.* Kane and the United States Guarantee Company.[1] This action was of essentially the same nature as the one just referred to, and was brought by the excise commissioner upon a bond given for Kane, by the United States Guarantee Company, to recover the penalty of this bond. The complaint in the action alleged false statements in Kane's application for a liquor certificate. The court, in its opinion, spoke as follows:

"The claim is that the sureties are liable because the traffic was illegal, and a violation of the provision of the liquor tax law. The traffic was under a certificate in form authorizing it. The application was in form such as to authorize and require the treasurer to issue the certificate. Still the certificate was void, because in fact the traffic was illegal under the law, the application was false as to the facts, and the certificate afforded no protection to the traffic in view of such facts.

"That the traffic was in fact illegal, and a violation of the provisions of the law cannot be doubted. Under these circumstances, no certificate could be legally issued. . . .

"The only question is whether the sureties were liable on

[1] 57 N. Y. App. Div. 549.

the bond for such illegal traffic. The condition of the bond was, 'if the said liquor tax certificate applied for is given unto the said principal, and the said principal will not, while the business for which such certificate is given shall be carried on, . . . violate any of the provisions of the liquor tax law, . . . then the obligation,' etc., shall be void.

"The claim made is that the tax certificate to be given to the principal, as a condition of making the sureties liable, must be a valid certificate, legally issued and given to the principal."

"We think this is clearly correct. The bond is to protect the state with reference to the conduct of the business by the principal, under a certificate legally issued to him. It is not intended to protect the state against the fraud of the principal in securing a certificate which is void, and in effect no certificate at all."

§ 190. **Discharge of Liability by Breach of Conditions.** — One of the implied conditions of appeal and bonds of like nature thereto is that no agreements shall be entered into between the "risk" (therein named as principal) and the insured, subsequent to the execution thereof, that shall work any material change in the situation of the parties as it existed at the time such bond was given. In a New York case[1] it was claimed that an order made in the action subsequent to the granting of an appeal bond by the American Surety Company — the same having been made without the consent of the surety company — affected such a change in the status of the parties to the appeal as to relieve it from liability. The court overruled this claim, holding that the order complained of was expressly made without prejudice to the appeal, which it was in no wise to impair, and that it did not work any such change in the situation of the parties as to relieve the "surety company" from liability on the appeal bond. In construing an excise bond, it was said that in the event of the violation of the liquor tax law by the holder of a liquor

[1] Markoe *v.* Am. Surety Co., 25 N. Y. Misc. 127; 44 App. Div. 285; 167 N. Y. 602; see also Walker *v.* Archer *et al.*, 87 N. W. 754.

tax certificate who had given the bond required by law, an action may be maintained against the "surety company" — which has executed the statutory bond required — to recover the penalty thereof, before any criminal proceedings have been instituted against the "risk" named in such bond. This, too, even where the law did not specify, at the time the breach of the conditions of the bond took place, as to who might bring action thereon for the enforcement of the bond; nevertheless, an action may be brought thereon by the state commissioner of excise, under authority conferred by the legislature passed subsequent to the breach of the conditions of the bond. This for the reason that such amendment in no way impaired the obligation of the bond, or changed the right of the parties, but related only to the form and mode of procedure. A general principle was enunciated in this case to the effect that where a bond is given in pursuance of a statute, the provisions of the statute are in effect part of the bond and of the contract of the "risk" and the insurer therein named.[1] Again, in Lyman *v.* Shenandoah Social Club *et al.*,[2] it was held that the liability of a "surety company" upon an excise bond is not limited to the civil or criminal penalties described in the statute requiring the giving of such a bond as a condition precedent to the right to sell liquors. It was held upon proof that the premises where the liquor was sold were disorderly, and that it was sold thereon at times forbidden by law, that for any violation of the conditions of the bond the surety company issuing the same becomes obligated to pay damages in the penal sum mentioned in the bond, independently of the fact that a judgment for a like amount may have been obtained against the "risk" named in such bond, in an action against him for the civil penalties.[3] It has been stated, though only by way of dictum, that material misstatements on the part of the "risk" contained in an application for a liquor tax certificate create no liability on the part of a

[1] Lyman *v.* Rochester Title & Surety Co. *et al.*, 37 N. Y. App. Div. 234.

[2] 39 N. Y. App. Div. 459.

[3] See also Lyman *v.* Gramercy Club *et al.*, 39 N. Y. App. Div. 661.

"surety company" which issues a bond given for the purpose of securing such certificate.[1]

§ 191. **Discharge of Liability by Settlement of Loss.** — The measure of the sureties' liability is fixed by the terms of the instrument they sign, and such undertaking cannot be enlarged or varied by judicial construction. The bond will be construed as the words are ordinarily understood. The liability of the "surety companies" on either a bond for costs on appeal, or on a supersedeas bond, or on an indemnity appeal bond is contingent, and anything legally satisfying the judgment appealed from or removing the liability of the principal will discharge the surety.[2] On reversal of such a judgment the "surety company" is ordinarily discharged. In general, the liability of a surety on all classes of statutory bonds is that of his principal. The extent of the recovery on supersedeas bonds is generally the amount of the judgment covered by the bond, with interest and costs in both upper and lower courts, unless the bond otherwise provides. On cost bonds upon appeal, the extent of the "surety companies'" liability usually embraces statutory costs on the appeal and disbursements, as specified in the statute governing the subject.[3] In Epstein *v.* United States Fidelity and Guaranty Company,[4] where the assignee of a claim for damages by one whose property had been attached brought an action to recover damages therefor after the attachment had been vacated, and subsequent to the bringing of such action, the order vacating the attachment was vacated, — which last order was by a subsequent order likewise vacated, — it was held that an action on the attachment bond was not prematurely brought.[5]

In an action by the assignee in insolvency on a replevin

[1] Lyman *v.* Mead *et al.*, 67 N. Y. Sup. 254. See generally Lyman *v.* Oussani *et al.*, 33 N. Y. Misc. 409; Lyman *v.* Brucker *et al.*, 26 N. Y. Misc. 594; Lyman *v.* Kurtz, 166 N. Y. 274; Lyman *v.* Schermerhorn, 167 N. Y. 113; Lyman *v.* B. G. H. Co., 33 N. Y. App. Div. 130.

[2] See Vent *v.* Duluth Trust Co., 80 N. W. 640.

[3] See Kleiner *v.* Fid. & Dep. Co., 33 N. Y. Misc. Rep. 188.

[4] 61 N. Y. App. Div. 527; 29 N. Y. Misc. 295.

[5] See generally Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

bond against the assignees for property sold to insolvent by plaintiffs in the replevin suit, it was said that the note given by insolvent for the goods replevied cannot be pleaded as a set-off.[1] An action on a bond given in the course of litigation cannot in general be maintained until the determination of the litigation in which it is issued.[2] In an action upon an excise bond given for a liquor dealer by a "surety company" to a county treasurer, the right of the state commissioner of excise to maintain an action upon such a bond, either for the recovery of the entire penalty for any breach of any condition of the bond, or for the amount of any penalty or penalties incurred or imposed for a violation of the law, was sustained. In that case it was said that "in a case between the government and the private surety, in which the purpose of the bond is to secure the observance of the law in pursuance of which the bond is given, and punishment or satisfaction for its non-observance, the penalty named in the bond is the measure of the damages for its breach, unless the statute under which the bond is given or the bond itself as read in the light of the statute, indicates a less or different measure. In such cases in which the statute fixes the measure of the damages, the courts cannot relieve against it unless authorized by statute to do so. The limits of the forfeiture of appeal in criminal cases may be cited as one instance of the power to afford relief. There may be other instances, but few, and the exceptions seem to prove the rule. Where the breach of the condition is an offence against public law or policy, pecuniary damages which have followed are usually a minor incident. The affront is to the state and its sovereign will; but some sort of satisfaction should be exacted, and when the statute has fixed its measure in money, the courts must award it. That the excise commissioner might have sued upon the bond as collateral security for the single offence need not be questioned; the question is, does the statute give him the right to recover the entire penalty because of the single offence?

[1] F. & D. Co. *v.* Haines *et al.*, 78 Md. 454; 28 Atl. Rep. 393.

[2] Boughton *v.* Omaha Loan & Trust Co., 73 Mo. App. 597.

"The action is not to recover any fine imposed upon conviction or penalty previously recovered in a civil action, and the bond is not limited to its collateral quality in either respect. It seems to be the intent of the section, as amended in 1897, to give to the bond a broader scope, namely, to subject the offender to the larger penalty in case the state commissioner of excise, the special administrator of the law, should think fit to bring the action for that purpose. It is common knowledge that the temptation to violate this and previous excise laws has developed a fertility and variety of abuses, evasions, and violations that, in default of rigorous treatment, weaken the efficiency of the law, both as a revenue measure and as a regulator of the liquor traffic. Recourse to the penalty named in the bond, instead of the fine or penalty named in any section of the act for a specific violation, was no doubt thought to be necessary in order to secure observance of the provisions of the act. If the surety thereby suffers and the offender sometimes escapes, the public may benefit by inducing the surety to become more watchful of the character of the vendor for whose fidelity he engages, and thus violations will be lessened by making it more difficult for lawless men to obtain their bonds, and when they obtain them to make them more circumspect in regard to the obligations they have assumed. Such, we think, is one of the purposes of the section providing for his bond, and the recovery is within its letter and spirit. It would be unjust under these circumstances to permit them to repudiate their obligation."[1]

In Epstein *v.* United States Fidelity and Guaranty Company[2] it was held that where assignees of an undertaking issued by a "surety company" to their assignors, to procure an attachment which was subsequently vacated, bring an action against such "surety company" for the purpose of recovering damages sustained by the attachment, the reinstatement of the attachment and the subsequent vacation of the order reinstating it,

[1] Lyman *v.* Perlmutter, 166 N. Y. 410; 60 N. E. 21.

[2] 29 N. Y. Misc. 295.

by orders made pending the action, have no effect upon the right of the assignees to sue and recover on the "surety company's" undertaking.

It was further held that a demand is unnecessary as a condition precedent to the maintenance of an action against the "surety company," as its obligation is absolute. The bringing of the action itself was held to constitute such a demand.

In Sooysmith and Company *v.* American Surety Company[1] the bond sued on was worded so as to provide "that a surety company, issuing an undertaking to discharge an attachment should, on demand, pay to the plaintiff the amount of any judgment that might be recovered in the action against the defendant, not exceeding the sum of $5,000, with interest." It was held, first, that the interest, under a proper construction of the undertaking ran from the date of the recovery of the judgment in the action, and not from the date of such undertaking; and, secondly, that under such an instrument the right of action thereon accrued only upon demand. The sum specified therein it was said becomes due upon the recovery of the judgment in the main action, and upon demand becomes payable with interest from that date.

Where the "surety company" issues an undertaking for the purpose of admitting a judgment debtor to the jail liberties, it is liable thereon to the insured for the total amount of the debt for which said judgment debtor was committed, even though the latter be solvent. Where the "risk" subsequently escapes from such liberties, the voluntary return of such judgment debtor to the jail liberties does not relieve the surety company from liability on its undertaking, especially where it appears that the action was commenced upon such an undertaking by the service of a summons upon the judgment debtor when he was actually outside of the jail liberties.[2]

Attachment being a statutory remedy, the measure of

[1] 28 N. Y. App. Div. 346.

[2] Flynn *v.* United States Surety & Guaranty Co., 61 App. Div. 170; see in this connection Mayne *v.* Fid. & Dep. Co., 8 Penn. Dist. Court, 711.

damages reasonable for breach of an attachment bond is one generally governed by the law of the state as expressed in its constitution and statutes, and as declared by its highest court. In the case of attachment bonds, reasonable attorney's fees in procuring a dissolution of an attachment, and aside from those incurred in the main case, are recoverable as an element of damage in an action thereon.[1]

[1] Bucki & Son Lumber Company *v.* Fid. & Dep. Co., 109 Fed. 393. See generally on attachment bonds Epstein *v.* U. S. Fid. & Guar. Co., 61 N. Y. Sup. 527; Tyng *v.* Am. Sur. Co., 48 App. Div. N. Y. 240; Anderson *et al. v.* Fid. & Dep. Co., 100 Ga. 739; 28 S. E. 463; Morgan *et al. v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 857; Eldridge *v.* Fid. &. Dep. Co., Tex. App. ; 63 S. W. 955; Schwartz *v.* Fid. & Dep. Co., 105 La. 161; 24 Sou. Rep. 479; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Kleiner *v.* Fid. & Dep. Co., 33 N. Y. Misc. Rep. 188; see also McCormick *v.* Nl. Sur. Co., 66 Pac. 741; Sheldon *v.* Fid. Tr. & Guar. Co., 71 N. Y. Sup. 65; 72 N. Y. Sup. 1128; St. Paul Tit. & Tr. Co. *v.* U. S. Fid. & Guar. Co. *et al.*, 87 N. W. 1109; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518; on removal bonds, Hollister *v.* U. S. Fid. & Guar. Co., Minn. ; 87 N. W. 776.

PART VI.—MUTUAL RIGHTS AND OBLIGATIONS AS BETWEEN THE INSURER AND THE "RISK."

CHAPTER XXI.

MUTUAL RIGHTS AND OBLIGATIONS AS BETWEEN THE INSURER AND THE "RISK."

§ 192. **General Remarks on the Mutual Rights and Obligations of the Insurer and the "Risk."** — The respective rights of the insurer, insured, and the "risk" in guaranty insurance, in relation to each other, are governed by diverse rules and constitute different legal relationships. The relationship of the insurer to the insured is governed in nearly all departments of guaranty insurance by the general principles of insurance law. The relationship of the "risk" to the insured is defined and controlled by the law of master and servant, principal and agent, trustee and *cestui que trust*, or guardian and ward, etc., as the case may be.

When one comes to consider the nature of the relationship that exists between the insurer and the "risk," some doubt may arise as to the exact nature of such relationship.[1]

Not infrequently the contention has been made that where the "risk" has signed the policy of insurance, this in itself makes him a party to the contract of insurance.[2] Such contention, however, is by no means sound. The purpose in having the "risk" join with the insurer in executing the

[1] See matter of Thurber, 43 App. Div. N. Y. 528; Guar. Co. of N. A. *v.* First Nl. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909.

[2] See Guar. Co. of N. A. *v.* Mec. Sav. Bank & Trust Co., 80 Fed. 766; 26 C. C. A. 146.

policy of insurance is that he may in this formal manner enter into certain definite obligations with the insurer looking to the latter's indemnification in case of payment of loss to the insured. In other words, the act of the "risk," in subscribing his name to the policy, is to be construed, not as making him a party to the contract of insurance, but merely as evidencing his consent to the terms, and his agreement to indemnify the insurer in case of loss.[1] The real nature of the "risk's" relation to the insurer is pointed out in Rice *v.* Fidelity and Deposit Company,[2] where the court, in construing a guaranty insurance policy, made use of these words: "The complaint alleges, and the fact was, that the plaintiff (the insured) made an agreement of employment with Perry (the 'risk'), at the time this policy was made, under which he was liable to them for the losses which they claim to have sustained under his dishonest and fraudulent acts. The policy in suit recited this employment, and gave to the plaintiffs further indemnity to the amount of $10,000 against these losses. The legal effect of this contract was to create the relation of principal and surety between Perry and the fidelity company."[3]

The legal relationship existing between the "risk" and the insurer being thus ascertained, it then becomes pertinent to inquire just what are the mutual rights and obligations of the two, growing out of the concurrent obligations of the insurer to the insured under the contract of insurance entered into by the former with the latter at the request of the "risk."[4]

§ 193. **Rights of the "Risk" as against the Insurer.** — It is not essential to the validity of the contract as between the insurer and the insured, that the policy should have been issued

[1] Am. Bond & Tr. Co. *v.* Milwaukee Har. Co., 91 Md., 733; 48 Atl. Rep. 72.

[2] 103 Fed. 427; 43 C. C. A. 270.

[3] See to the same effect Guar. Co. of N. A. *v.* Geddes, 22 Fed. 639; Feinberg *v.* Am. Sur. Co. *et al.*, 33 N. Y. Misc. 458.

[4] See generally on rights between the risk and the insurer, City Tr. Co. *v.* Fid. & Cas. Co., 58 N. Y. App. Div. 18; Am. Sur. Co. *v.* McDermott, 5 N. Y. Misc. 298; 9 N. Y. Misc. 132; Am. Bond & Tr. Co. *v.* U. S., 15 App. D. C. 397.

either at the express or implied request of the "risk." It is however, a matter of almost universal practice to have the request for the issuance of the indemnity policy proceed from the "risk" as a necessary preliminary to the issuance of the policy of insurance. In view of the necessity of the existence of a contract relationship between the insured and the "risk" as a basis for the issuance of a valid policy of guaranty insurance, such relationship must always exist in order to furnish the requisite insurable interest. Now in view of the fact that the issuance of such a policy is almost universally preceded by a request for the same made by the "risk" to the insurer, thereby creating a legal obligation on the part of such "risk" to reimburse the insurer in case of loss, it would seem to be a necessary result of this that the former should have some rights arising out of his relationship as principal to the latter which must be recognized, if the insurer is to retain its right to demand reimbursement from the "risk" under the latter's indemnity agreement with the former. This on the theory that inasmuch as he has assumed the obligation of reimbursing the insurer for all losses arising on the policy through his conduct, he should know the full extent of such obligation and have the reasonable opportunity to make good any loss to his employer covered by the policy, in the first instance, before recourse is had to enforcing the insurer's liability thereunder. Let us now examine and see to what extent, if at all, such rights exist. We will consider these rights as arising out of the "risk's" express or implied promise to indemnify the insurer in case of liability being incurred on his account under the policy. These may be summarized as follows.

1. The right to a full knowledge of the terms and conditions of the policy issued upon him by the insurer to the insured.

2. Prompt and accurate information as to the nature of all claims made by the insured under the policy, so far as they may affect him, and his ultimate liability to the insurer.

3. Opportunity to investigate such claims, and to either explain or make settlement therefor.

4. The privilege of personal and continuous control over property intrusted to his care as contemplated when the policy was applied for, free from unconscionable interference therewith by the insured. In short, the right to say that so long as his responsibility exists, just so long must the "risk" be permitted to retain the same personal control over the insured's property that was contemplated when the policy was applied for.

5. The right to demand from the insurer the return of all counter-security held by the latter and belonging to the "risk" as soon as all claims under the policy shall either have been settled in full and the policy itself shall have been cancelled or terminated.

6. The right to be made either a party defendant with the insurer in an action brought against it by the insured to enforce the former's liability under the policy, or in lieu thereof to exercise the right at all stages of the proceeding to conduct, in conjunction with the insurer and with equal rights, the defence of such actions.[1]

7. The right to demand an accounting with the insured whenever the "risk" is required to keep accounts by express direction of the insured.[2]

In addition to the foregoing specifically enumerated rights, there are, of course, others of which mention has not been made. As bearing upon the subject now under consideration, attention is called to the case of American Bonding and Trust Company *v.* Takahashi *et al.*[3] In this case the insurer had furnished a contract insurance bond to the insured, (a railway company) conditioned upon the latter's being protected from claims for labor performed for the "risk," who was a contractor engaged in furnishing laborers to the insured

[1] Nevins *v.* Fid. & Cas. Co., 66 N. Y. St. Rep. 674; American Sur. Co. *v.* Ballman *et al.*, 104 Fed. 634; Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Lyman *v.* Fid. & Cas. Co., 65 N. Y. App. Div. 327.

[2] See Warren *v.* Holbrook, 95 Mich. 185; 54 N. W. 712.

[3] 111 Fed. 125.

in connection with some tunnel work undertaken by the latter. The agent of the insurer, at the time the "risk" applied for the bond, required that all moneys to become due from the insured to the "risk" under the executory contract then existing between them should be paid to such agent *as trustee* to be disbursed by him to the laborers. Pursuant to such requirement a clause was inserted in both the contract of the insured with the "risk," and in the bond furnished by the insurer to the insured, so providing. The agent failed to properly account for a part of the moneys paid over to him by the insured pursuant to said agreement, and thereupon the "risk" brought suit to recover the amount thereof from the insurer, on the theory that the agent, though named as trustee in the agreement and bond, was in fact the representative of the insurer alone. In this contention the "risk" was sustained both by the trial court and by the federal court of appeals for the ninth circuit.

In this same connection the case of Boyce *v.* United States Fidelity and Guaranty Company [1] is not without its bearing upon the question of the rights of the "risk" and the insurer *inter sese.* Here the "risk" had entered into a contract with the city of Cincinnati for public work, which not only fixed a time by which the work should be completed, but further provided that, if the "risk" should fail to commence or proceed with the work to the satisfaction of the insured, the latter should have the right, on notice, to declare the contract forfeited. As between the "risk" and the insurer — which furnished a contract insurance bond to the insured, insuring the faithful performance of the "risk's" contract with the insured — it was agreed that the former should indemnify the latter against any loss by reason of the "risk's" default, and that in case such default did occur, the insurer should be subrogated to his rights in the premises and might use the "risk's" property and equipment for the purpose of completing his work under the contract with the insured.

The insured declared that the progress of the work was not

[1] 111 Fed. 138.

satisfactory and after due notice declared the contract ferfeited and annulled. Afterwards the insured permitted the insurer to complete the work, in doing which the latter incurred a considerable expense above the price stipulated to be paid by the insured to the "risk" therefor.

Under the foregoing state of facts the federal court of appeals for the sixth circuit held as follows: That under the power given the insured by its contract with the "risk," its decision that the work was not proceeding satisfactorily was conclusive on the "risk," and authorized the insurer to assume charge of the work, and that the insurer thereby became a creditor of the "risk" for the amount of loss it sustained in completing the latter's contract with the insured, and entitled as such to maintain a petition against him in involuntary bankruptcy.

In this same case it was said that where a contract entered into with the insured by the "risk" for public work gives the former the power to terminate the same if not satisfied with the progress of such work in case of delay continued after ten days' notice to the "risk," such notice is not required to contain a positive statement that a forfeiture would be declared, nor could the "risk" object that a forfeiture was declared within ten days after the notice was given, where, in the mean time, he had entirely abandoned the work.[1]

§ 194. **The Doctrine of Subrogation in its Relation to Guaranty Insurance.** — In no branch of insurance law does the principle of subrogation play such an important part as in that of guaranty insurance. The existence of such a right in favor of the insurer, as an incident to the existence of the relationship of insurer to insured, in a sense characterizes the contract of guaranty insurance in its relation to other branches of insurance law. There is no subsidiary branch of guaranty insurance in which the right of subrogation may not be said to exist. This statement applies to the fullest extent to the subject matter of fidelity, commercial, and judicial insurances.

[1] See generally U. S. Car Co. *v.* Bagley, 87 N. W. 1044.

Generally speaking the right of subrogation does not arise primarily from any terms of the policy of guaranty insurance. While it frequently happens that provision is made for it in the policy, yet the right exists irrespective thereof. Guaranty insurance being a contract of indemnity pure and simple, it naturally follows that after the insured has been fully indemnified by the insurer, all opportunity for further indemnification should be taken away from him. This is done by the adoption of the "doctrine of subrogation" into insurance law. The reason for such adoption is the one just given above, rather than, as has been frequently supposed, the striking analogy existing between the contract of guaranty insurance and that of private suretyship.

It has been well said that subrogation is not a doctrine applied to insurance law on the ground that underwriters are sureties. They have rights which are somewhat similar to the rights of sureties, but that, again, is in order to prevent the assured from recovering more than a full indemnity.[1]

As a matter of fact all the benefits of subrogation, and even more, may be obtained by the insurer after payment of a loss under a policy of guaranty insurance, through the enforcement of the "risk's" express or implied agreement to indemnify the insurer against any loss that may come to it through the issuance of the policy in question.

The difference in legal effect that exists between that right of subrogation which is extended to the insurer under the principles of insurance law, and that concurrent right just referred to as arising out of the "risk's" express or implied agreement to indemnify, may be here referred to. Just wherein the difference lies may be explained as follows: As an insurer the "surety company's" right of subrogation does not rest upon any relation of contract or of privity between such insurer and the "risk." Therefore a request from the "risk" to the insurer to issue such a policy is not necessary to the existence of the right. It arises out of the nature of the contract of insurance as one of indemnity, and is derived

[1] Castallain *v.* Preston, L. R. 11 Q. B. D. 380.

from the insured alone and can be enforced in his right only. In any event the insurer can take nothing by such subrogation but the right of the insured, and if the latter has no right of action against the "risk" none passes to the insured.[1]

From what has been said it is clear that where the right of subrogation is claimed by the "surety company" in the capacity of an insurer and not as a surety or guarantor for the "risk," it may be subject in its operation to substantial equities existing in favor of the "risk" as against the insured.[2]

On the other hand, the right to reimbursement which belongs to the insurer by reason of having furnished the policy at the request of the "risk," is in reality a right based on an express or implied agreement on the part of the "risk" to indemnify the insurer against any loss incurred by reason of the issuance of such policy. It arises in such a case, not out of the contract of insurance, but out of the express or implied contract of indemnity existing between the "risk" and the insurer. This right can be enforced without being in any manner limited or controlled by agreements entered into by the insured with the "risk" or by equities subsisting between them.[3]

Reserving for subsequent sections of this work a consideration of the rights of the insurer under the "risk's" express or implied contract of indemnity, our attention will be directed solely in this immediate connection to the insurer's right of subrogation growing out of the contract of insurance entered into between it and the insured.

Speaking in general terms, upon payment of a loss under the policy to the insured, the insurer thereupon becomes subrogated to the rights of the insured as against the "risk," and can in its own name or in the name of the insured or in their joint names maintain an action against the "risk" for indemnity, provided the latter is legally responsible to the

[1] St. Louis I. M. & S. R. Co. *v.* Com. Union Ins. Co., 139 U. S. 223; 35 Lawyers' Edition, 157.

[2] See Mercantile Mutual Ins. Co. *v.* Calebs *et al.*, 20 N. Y. 175.

[3] See Chi. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79; Fid. & Dep. Co. *v.* Haines & Stokes, 78 Md. 454; 28 Atl. 393.

insured for the loss paid by the insurer under the policy. Under such circumstances the acceptance of a given amount from the insurer by the insured, in full discharge of the former's liability to the latter under the policy, does not in any manner affect the right of the insured to recover from the "risk" the whole amount of the loss for which the latter was responsible under his contract with the insured. The insured under such circumstances can recover only one satisfaction for the loss, and if the amount recovered from the "risk," increased by the sum paid by the insurer to the insured, be more than sufficient for the latter's just indemnity, the excess must be held by it in trust for the former. The inquiry in all such cases, undertaken for the benefit of the insurer, is as to the amount for which the "risk" is bound under its contract with the insured, and the latter's recovery thereon is not affected or limited by the amount it has been able to collect from the insurer under the policy of insurance. In all cases where the insurer seeks to enforce the right of subrogation as against the "risk," although it be the sole party beneficially interested, yet its rights are to be worked out through the cause of action which the insured has against the "risk." In such an action the "risk" is bound to respond for all damages sustained through the identical breach of his contract with the insured, which was itself made the basis of the insured's claim under the policy against the insurer. If only part of the loss has been paid by the insurer, the insured is entitled to the residue. This last for the reason that the liability of the "risk" is in legal effect first and principal and that of the insurer secondary, not in order of time but in order of ultimate recovery. The insurance is to be treated for what it is in law, a mere indemnity, and the insured and the insurer are to be regarded for the purpose of enforcing the former's rights against the "risk" for the benefit of the latter as one person. Therefore payment by the insurer before such suit is brought cannot affect the right of action possessed by the insured as against the "risk."

The general rule of law is that where there is a contract of guaranty insurance, and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the insurer is bound to pay; and if the insurer has already paid it, then if anything which diminishes the loss comes into the hands of the person who has already been paid the full indemnity, it then becomes the property of the party who had furnished such indemnity.[1]

It is now well settled that the acceptance of payment of loss by the insured from the insurer subrogates the latter to all the rights of the insured against third parties instrumental in causing the loss so paid. The payment of such loss puts the insurer in all respects into the place which the insured occupied in relation to the latter's claim against such third parties. The acceptance of payment from the insured under such circumstances operates as a virtual assignment of the cause of action to the insurer and any part payment operates as an assignment *pro tanto*. The consent of the "risk," either to the issuance of the policy or the payment of loss thereunder, is not necessary in order to entitle the insurer to exercise the right of subrogation. In all cases, the insurer must actually settle an existing liability under the policy in order to entitle it to the right of subrogation.[2]

§ 195. **The Right of Subrogation in Fidelity Insurance.** — The nature of the insurer's right of subrogation in fidelity insurance is clearly pointed out by the court in London Guaranty and Accident Company *v.* Geddes.[3] It was there observed that there would in any event be no liability on the part of the insurer to the insured under a fidelity insurance policy but for the embezzlement of the "risk." "If," said the court,

[1] Ch. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79; 35 Lawyers' Ed. p. 97; Ins. Co. of N. A. *v.* Fid. etc. Co., 123 Pa. St. 223; 16 Atl. Rep. 791; Fid. & Tr. Co. *v.* People's Natural Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339.

[2] See Ins. Co. of N. A. *v.* Fid. etc. Co., 123 Pa. St. 223; 16 Atl. Rep. 791; Fid. Title & Tr. Co. *v.* People's Natural Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339; Am. Bond & Tr. Co. *v.* L. & W. Va. Guar. Co., 95 Fed. 49; Central Trust Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530.

[3] 22 Fed. 639.

"the 'risk' had faithfully and honestly performed his duties to the insured, the latter would have no cause of action against him. For this reason there could be no legal difference in the relation which the insurer sustains to the 'risk,' and the relation which a private person signing as surety on his bond would have sustained to him.

"In such a case the insurer would have the same remedy that the insured would have after the payment to it of the loss by the former. The insurer, under the circumstances, stands in the shoes of the insured, and has a right to be subrogated to all the rights of such insured in the prosecution of the 'risk.'" Continuing, the court observed, "that there was a principle of public interest involved in this question that should entitle the insurer to all the remedies that the insured would have. We all know," observed the court, "that in the case of large corporations whose sole business it is to make, handle, and disburse money for the benefit of stockholders or parties interested in their earnings, if they get their money from the sureties of their dishonest employees they will not prosecute the employee, either civilly or criminally. They will simply stand on the bond, and if they get their money from the surety they leave the punishment of the dishonest servant to the man who has suffered rather than spend their money in prosecution which either directly or indirectly may punish the wrongdoer. It seems to me that the common dictates of public policy should give to the surety of such employer the same remedy that the defrauded employer should have."

As soon as the insurer pays the debt of the "risk" there arises in his favor an equity to have the securities held by the insured for his debt turned over to him and to avail himself as fully of them as the insured might have done. For the purpose of indemnity, the insurer is entitled to be subrogated to all rights, remedies, and securities of the insured arising out of the claim that is made the basis of the insurer's liability under the policy, and entitled to enforce his liens, priorities, and means of payment as against the "risk." As

a general rule to give effect to the manifest intention of parties to extend to the insurer the right of subrogation, it must be held to be coextensive with the right of the insured to proceed against the "risk" for the purpose of enforcing the identical claim which it has sought to enforce against the insurer under the policy. On account of the necessity of an insurable interest in the insured and by reason of the fact that insurance is a contract of indemnity, the insurance agreement itself is treated as accessory to the original contract of employment entered into between the insured and the "risk" and adheres to it, and the power to enforce the right of subrogation on the part of the insurer against the "risk" must be determined by the correlative right of the insured to demand enforcement of the corresponding obligation of the "risk" under the contract of employment existing between such "risk" and the insured.

The right of subrogation exists in all cases in fidelity insurance, whether the policy is issued upon persons in public or private employ. Where only partial settlement is made by the insurer with the insured of a claim under the policy, it would seem that the right of subrogation can nevertheless be enforced for the full amount in favor of the insured against the "risk," subject, however, to the obligation on the part of the former to account for any excess to the insured.[1]

§ 196. **The Right of Subrogation in Commercial Insurance.** — The right of subrogation belongs to the insurer on payment by it to the insured of a loss coming within the scope of liability under a policy of commercial insurance.[2]

In a late Pennsylvania case it appeared that a "surety company" had issued a policy to a mortgagee insuring his title

[1] Ch. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79. See generally, as to the right of subrogation of the insurer under policies of fidelity insurance, the following cases: Guar. Co. of N. A. *v.* East Rome Town. Co., 96 Ga. 511; 23 S. E. Rep. 503.

[2] St. P. T. Ins. & Tr. Co. *v.* Johnson *et al.*, 64 Minn. 492; 67 N. W. 543; Guar. Co. of N. A. *v.* East Rome Town. Co., 96 Ga. 511; 23 S. E. 503; Fid Title & Tr. Co. *v.* People's Natural Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339; Dane *v.* Mortgage Ins. Corp., 1 Q. B. 54 (1894); Am. Sur. Co. *v.* Law. Cem. Co. *et al.*, 96 Fed. 25, 30; 110 Fed. 717; Citizens' Trust & Surety Co. *v.* Goodchild, 195 Pa. 80; 45 Atl. Rep. 662.

to the mortgaged premises and indemnifying him against loss by reason of the non-completion of certain buildings agreed to be built upon the mortgaged premises at the time the mortgage loan was made. The policy also guaranteed the mortgagee against loss by reason of claims of mechanics' liens or material men and undertook to see that the amount of the mortgage loan should go to paying laborers and material men. The "risk" made an assignment before the completion of the work, and the "surety company" at this time still had $10,000 out of the total mortgage loan of $56,000 under its control. The insured called on the insurer to complete the buildings under the contract of indemnity, and it did so, and in the course thereof expended more than $10,000. For this reason it refused possession of the premises to the assignee of the "risk" and rented them. It was held that it had no right to retain the rents to reimburse itself for its expenditures, but must seek repayment on the same basis as other creditors.

The right to enforce subrogation against the "risk" may be lost by acts of the insurer. An excellent example of such a case is to be found in American Surety Company *v.* Ballman *et al.*[1]

Here a "surety company" issued a contractor's bond in behalf of Trumanhauser Bros. to the Burlington Elevator Company. The former at the same time gave the "surety company" an indemnifying bond signed by themselves, Ballman and Durfee. The elevator company sued the "surety company," and the latter notified the parties to the indemnifying bond to come in and defend. They did, and in the name of the "surety company" conducted a vigorous defence. A judgment was rendered against the "surety company." At the request of the indemnitors a writ of error was sued out and an appeal perfected and the case set for hearing in the United States circuit court of appeals. Before that time the "surety company" paid the judgment in full and dismissed the appeal. On this state of facts the court spoke as follows:

[1] 104 Fed. 634.

"The object and purpose of this notice undoubtedly was to make the judgment which might be rendered in the original case conclusive of the liability of the indemnitors under their bond. It is well settled that to accomplish that purpose the indemnitors must not only have the notice, but must be afforded a full opportunity to defend the action." It was further said, that the right to appeal was a valuable right that belonged to the indemnitors under the circumstances, and that the effect of the "surety company's" action in paying the judgment and dismissing the appeal was to discharge the indemnitors from their obligations as such to the "surety company."

§ 197. **The Right of Subrogation in Judicial Insurance.** — There is no possible room for questioning the privilege of the insurer issuing a judicial insurance bond to enforce the right of subrogation to the fullest extent as against the "risk" named therein, upon settlement with the insured of a legal liability incurred thereunder.[1]

In Fidelity and Deposit Company of Maryland *v.* Haines *et al.*,[2] the court, expressly recognizing the fact that statutory insurance bonds are contracts of indemnity, held that the insurer which issues such bond is entitled, in case it is sued thereon, to be subrogated to the rights of the "risk" to the extent of availing itself of the defences which would be open to the latter in an action brought by the insured against such "risk."[3]

The right of subrogation exists to the fullest extent in

[1] See Far. & Trad. Bank *v.* Fid & Dep. Co., 56 S. W. 677; Ky.; Myers *v.* Miller, 45 W. Va. 595; Am. Sur. Co. *v.* McDermott, 25 N. Y. Sup. 467; 5 N. Y. Misc. 298; Am. Sur. Co. *v.* Crow *et al.*, 49 N. Y. Sup. 946; 22 N. Y. Misc. 573; 17 N. Y. App. Div. 634; Milbank *v.* Am. Sur. Co., 43 N. Y. Sup. 474; People *ex rel.* Surety Co. *v.* Anthony, 7 N. Y. App. Div. 132; Lesster *v.* Lawyers' Surety Co., 63 N. Y. Sup. 804; 50 N. Y. App. Div. 181; Am. Sur. Co. *v.* Thurber, 30 N. Y. St. Rep. 489; Smith *v.* Nl. Sur. Co., 28 N. Y. Misc. 628; Lawyers' Sur. Co. *v.* Reinach, 25 N. Y. Misc. 150; Dunne *v.* Am. Sur. Co., 43 N. Y. App. Div. 91; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458.

[2] 78 Md. 454; 28 Atl. Rep. 393.

[3] See Milbank *v.* Am. Sur. Co., 14 N. Y. App. Div. 250; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 489; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

favor of the insurer who has been compelled to meet an obligation on the bond given in the course of judicial administration affecting trust estates. The case here presented is even stronger than is represented in fidelity bonds, in that it relates to estates under the care of the courts.

In Farmers and Traders Bank *v.* Fidelity and Deposit Company of Maryland [1] it was held that an insurer on an administration bond who has been compelled to account for a trustee's defalcation is entitled to be subrogated to the rights of the *cestui que trust* against one who has wrongfully appropriated part of the trust estate.

It is a general doctrine in equity that a surety who has discharged the debt is entitled to stand in the shoes of the creditor as to all liens securing the debt. This doctrine of subrogation, however, being an equitable one, is only enforced to accomplish the ends of substantial justice.[2]

A most instructive case on such right of subrogation is that of People *ex rel.* Lawyers' Surety Co. *v.* Anthony.[3] In this case the Lawyers' Surety Company had issued an administration bond upon one Anthony as receiver of an insolvent corporation. Anthony was discharged by order of the court, and at the time of his discharge was directed to pay over to his successor certain amounts of cash which had come into his possession as receiver. This he failed to do, and the Lawyers' Surety Company was called upon to pay the amount by reason of its issuance of the administration bond on Anthony as receiver. This payment was made by the Lawyers' Surety Company pursuant to an order of the court authorizing the substituted receiver to receive payments of the amount of the deficiency of Anthony from the "surety company," and upon receipt thereof to assign, transfer, and set over to the latter all his rights against the said receiver, so that the "surety company" should be subrogated to the rights of the substituted receiver. After satisfying the liability of Anthony,

[1] 56 S. W. 671; Ky.
[2] Continental Trust Co. *v.* Am. Sur. Co., 80 Fed. 480; 25 C. C. A. 364.
[3] 7 N. Y. App. Div. 132.

the "surety company" signed a demand for the payment of the sum so paid, and this was served upon Anthony, together with certified copies of the orders and papers upon which the demand was based. Anthony failed to comply with this demand, and an application was made by the "surety company" directing the issuance of a warrant of attachment as for contempt, which order was duly granted and the warrant of attachment was issued thereon. Anthony was arrested, and subsequent to his arrest filed an affidavit, in no way denying the facts herein set forth, but alleged that he had taken an appeal from the order fixing the amount of his liability, and that upon such appeal he verily believed that said order would be reversed entirely or so modified as to reduce his liability many thousands of dollars. The receiver assigned to the "surety company" all his claims under said order, with the intention, as was stated, of subrogating the surety in his place and stead in respect to said order. It was argued that because of the use of these words there was no subrogation, and that the substituted receiver did not actually subrogate the "surety company" in its place and stead, but only said that he intended by the assignment so to do. This contention was overruled, the court holding that the "surety company" having, under the circumstances disclosed, paid the amount required to be paid by the "risk," and the decree being assigned to it under the authority of the court by its officer, succeeded necessarily to all the rights which the receiver had, and was entitled to pursue the same remedies as the receiver had for the enforcement of the decree.

It was held in Smith *v.* Surety Company [1] that where the insurer on a statutory insurance bond given by a "risk," who was one of two joint debtors for the payment of a debt, is compelled to pay such debt in full, he is entitled upon equitable principles to be subrogated to all rights of the creditor against all the joint debtors. It is a "well settled rule," observed the court in this case, "that where the relation of principal and surety exists, the creditor must preserve unimpaired

[1] 28 N. Y. Misc. 628.

all his rights against the debtor where he intends to look to the surety for payment. This obligation springs from the right of subrogation established by law in favor of the surety who pays the debt of his principal, and if the creditor fail to comply with this obligation, or destroy or impair the right of subrogation to the judgment and securities, the surety will be released. It is a familiar principle of law that a surety who pays a debt for his principal is entitled to be put in the place of the creditor, and to avail himself of every means that the creditor had to enforce payment against the principal debtor. The doctrine of subrogation is frequently applied in cases where the person advancing money to pay the debt of a third party stands in the situation of a surety, or is only secondarily liable for the debt. It is also applicable to cases where the debtor is compelled to pay the debt of a third person to protect his own rights or to save his own property. Subrogation is not founded upon contract, but upon principles of equity, and may be enforced where no contract or privity of any kind exists between the parties. It has been repeatedly held that whenever one not a mere volunteer pays and discharges the debt of another, he is entitled to all the remedies which the creditor possessed against the debtor. . . . The rule seems to be well settled that a surety after paying off a debt shall stand in the place of the creditor and have all the rights which he has for the purpose of obtaining his reimbursement. He will be entitled to every remedy which the creditor has against the principal debtor to enforce every security and all means of payment, to stand in the place of the creditor not only through the medium of a contract, but even by means of securities or contracts entered into without the knowledge of the surety, having a right to have those securities transferred to him, though there was no stipulation for that, to avail himself of all those securities against the debtor, and it is immaterial by what means the security is created."

Again, the insured has no legal authority to question the right of the insurer to the securities in the former's hands applicable to the payment of the obligations which the insured

has compelled the insurer to pay. It is immaterial, so far as such insured is concerned, what the legal rights are between the "risk" and the "insurer." The insured is not called upon to set up a defence for the benefit of the "risk" as against the insurer, nor to litigate their rights. It is sufficient, so far as the insured's rights are concerned, if he receives from the insurer payment in full of his claim against the "risk." When the "risk" has had an opportunity to be heard he may feel that he is legally and morally obligated to reimburse the insurer, who has paid money in the belief that there was a legal obligation on its part so to do, and he may not object for this reason to the enforcement of the securities in the hands of the insured by the insurer. Before the insurer can demand and enforce an assignment of securities or enforce the rights of subrogation it must first have settled the "risk's" obligations in full.[1]

§ 198. **The Right of Indemnification — General Remarks thereon.** — In discussing the question as to the insurer's right to demand indemnification from the "risk" after payment of loss by it to the insured, reference is had, not to the exercise of the right of subrogation, but to the enforcement of a promise on the part of such "risk" to make good to the insurer any loss it might sustain by reason of issuing the policy of guaranty insurance to the insured. The "promise" here referred to may be either an express agreement to indemnity, or it may be implied by law by reason of the circumstances under which the policy was issued. Attention will be first called to the subject of the "risk's" express contract of indemnity. This is evidenced usually either by fit words to that effect inserted in the policy itself (which is then signed by the "risk" as well as the insurer) or else by the execution of a separate written contract of indemnity, signed only by the "risk." As has already been observed, the policy some-

[1] Smith *v.* Nl. Sur. Co., 28 N. Y. Misc. 628. See also Am. Surety Company *v.* McDermott, 25 N. Y. Sup. 467; 5 N. Y. Misc. 298; Am. Sur. Co. *v.* Crow *et al.*, 49 N. Y. Sup. 946; 22 N. Y. Misc. 573; Milbank *v.* Am. Sur. Co., 43 N. Y. Sup. 474.

times contains certain stipulations as to proof of loss between the insurer and the insured, to the effect that "a written statement of loss, certified to by the duly authorized officer of the insured, and based upon the accounts of the insured, shall be *prima facie* evidence of such loss."

Where such provisions are found in the policy, it is evident that if they are to be held binding upon the "risk" in an action brought against him by the insurer, for the purpose of compelling indemnification, this would necessarily have an important bearing upon the manner and amount of proof necessary to establish such a right. Are such provisions then binding upon the "risk"? This question was answered by the supreme court of Minnesota [1] in substance as follows: Where the policy has been executed at the request of the "risk" and in the form requested by him, it follows that his obligation to the insurer is coextensive with that of the insurer to reimburse the insured; also that any provisions in the policy as to the proof of liability binding upon the insurer in favor of the insured are equally binding on the "risk" in an action brought by the insurer against him to recover indemnity for what it had paid in his behalf.

To entitle the insurer to recover on an express promise of indemnity given it by the "risk," it is not necessary in the first instance to show that the indemnitor had the legal right to issue a counter-indemnity bond to the former. But if issue is made on this point, then it must be shown that the "risk" (if a corporation) had the right to issue such counter-indemnity.[2]

The general subject of indemnity, when preserved by the express contract, is discussed at length in American Surety Company *v.* Crow.[3] This was an action where the American Surety Company had furnished an appeal bond in consideration of the granting to it of a counter-indemnity bond, promising and agreeing to keep it indemnified from all loss,

[1] Fidelity & Casualty Co. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351.

[2] City Trust Safe Deposit and Surety Co. *v.* Wilson Mfg. Co., 58 N. Y. App. Div. 271.

[3] 22 N. Y. Misc. Rep. 573.

damages, etc., sustained by reason of the latter's execution of the said appeal bond. The American Surety Company was obliged to pay the full amount of the appeal bond, and brought an action against the signers of the counter-indemnity bond to recover the amount paid by it on the appeal bond. Crow, one of the signers of this counter-indemnity bond, defended in the action on the ground that it was agreed, as between the American Surety Company and himself, that the former would look for indemnity exclusively to Thurber, one of the signers of the counter-indemnity bond. On the merits of this defence, the court spoke as follows: "While an instrument not under seal may be delivered upon condition, the observance of which is, as between the parties, essential to its validity, it is not permissible to show a contemporaneous parol agreement, inconsistent with that which is written and tending to nullify it. The indemnity bond was given to induce the surety company to become surety on the undertaking, and it was, therefore, induced to incur a liability indemnified against, so that the obligation is founded on valuable consideration. This obligation was not an ordinary court bond. If it had been, Crow (as attorney for the 'risk') might have been rejected by the court because of his relationship to the 'risk,' but where no such objection is made by the creditor, even the attorney may become liable." It was further contended by Crow that the American Surety Company settled all liability on the bond with Thurber, the co-surety, by accepting from him notes, stocks, and securities, whereby Crow was discharged. Commenting on this defence, the court said: "Thurber gave a six months' note for the demand secured by the stock of the Hazard Company, which note, after the payment of six months' interest, was renewed by another at three months. But these promises to pay were not given or accepted in satisfaction, and were not, so to speak, unless followed by payment. They were unperformed, and nothing was realized from the stock. The broken promises to pay did not discharge the obligation sued upon.

"Where time is given to the principal debtor without the

consent of the sureties, they may be discharged; but the mere giving of time to a co-surety whose obligation is equal will not discharge the others, if not prejudiced thereby. The acts of Thurber in further securing the American Surety Company in no manner prejudiced his co-surety, Crow, and did not discharge the liability of either on the bond."[1]

§ 199. **The Right of Indemnification — How affected by Stipulations in the Contract of Indemnity.** — Frequent and ingenious are the clauses inserted by insurers in both policies and contracts of indemnity whereby it has been sought to render easy and sure the road towards prompt indemnity from the "risk" for losses paid by the insurer to the insured under the policy. Before stating in terms what these are, it may be remarked that it does at times seem like a hardship on the insurer to compel him, after a stubborn contest with the insured over the payment of a loss, to establish at great expense the "risk's" liability to itself, after payment of the claim. Occasionally the courts have judicially recognized this fact. The case of King *v.* Victoria Insurance Company[2] affords an excellent example of this kind. The facts in that case were as follows: Plaintiff had insured a cargo of wool in transit to Australia. It was injured through negligence on the part of officers of the Queensland government. The insurance company paid the loss, and took an assignment of the claim for damages from the insured against the Queensland government. Defendants relied mainly on the defence that the loss paid was not covered by the policy, and was paid without any legal liability so to pay. The court, in its opinion in the case, spoke as follows:

"To us it seems a very startling proposition to say that when the insurers and insured have settled a claim of loss

[1] See also Amer. Sur. Co. *v.* Crow *et al.*, 17 N. Y. App. Div. 634. See generally on the right to demand indemnity, March *v.* Fid. & Dep. Co., 79 Md. 309; 29 Atl. 521; Bubb *v.* Am. Bond. & Tr. Co., 30 Pittsburg Law Journal, 361; Am. Sur. Co. *v.* Lawrenceville Cem. Co., 96 Fed. 25; 110 Fed. 717; U. S. *v.* Am. Surety Co., 110 Fed. 913; Parrs Bank *v.* Albert Mines Syndicate, 5 Com'l Cases, 116; Guarantor's Liability Ind. Co. *v.* Bank, 34 S. E. 950.

[2] 74 Law Times, 206.

between themselves, a third party who caused the loss may insist upon ripping up the settlement and on putting in a plea for the insurer which they did not think it right to put in for themselves, and all for the purpose of availing himself of a highly technical rule of law, which has no bearing on his own wrongful act. It is not alleged that there is anything but perfect good faith in the claim made by the insured and satisfied by the insurance company. It is not alleged that the question of negligence has not been fully and fairly tried in that action as it could have been in an action by the government. But it was argued, as a matter of positive law, that in order to sue for damage done to injured goods, insurers must show that if they had disputed their liability, the claim of the insured must have been made good against them. If that be good law, the consequences would be that insurers could never admit a claim, on which dispute might be raised, except at the risk of finding themselves involved in the very dispute that they had tried to avoid with persons who had no interest in that dispute, but were sued as being the authors of that loss. The proposition is as novel as it is startling. As with regard to the question whether the loss is or is not within the terms of the policy, whatever might have been the result of a dispute between the parties to it, there is nothing to suggest that the claim is not one which the insured might not honestly and reasonably make, or one to which the insurer might not honestly and reasonably accede. We will assume, as the court below has assumed, that the insured could not, by the terms of the policy, have compelled the insurer to indemnify them. Still if, on a claim being made, the insurers treat it as within the contract, by what right can a stranger say that it was not so? The payment would not be made if no policy existed, and it seems to us an extravagant theory to say that a payment made in such circumstances is a voluntary payment on the policy carrying with it the legal incidents of such payment. Such settlement of claim between the parties ought not to be opened for a by-purpose at the instance of parties not concerned. To hold otherwise would convert rules of law

framed for the purpose of checking speculations in lawsuits into instruments for promoting lawsuits, which the parties interested were wise enough to avoid by agreement."[1]

Returning now to the subject of the language employed in express contracts of indemnity to secure to the fullest extent the rights sought therein to be preserved, the following may be given as a common example of those contract provisions above referred to, to wit:

"That he (the 'risk'), for himself, his heirs, and administrators, hereby agrees to indemnify (the insurer) against any loss or damage it may sustain or become liable for in consequence of this policy or any renewal thereof, and forthwith after the insurer shall have paid the insured or any person or persons entitled to the same any money under or by reason of such bond, to reimburse the insurer for all amounts so paid, and all other losses, damages, costs, charges, and expenses, if any, that the insurer shall in any way incur or become liable for in consequence of such policy, and also that any proper evidence of payment by the said insurer of any such loss, damage, or expense shall be *conclusive evidence* against him and his estate, of the fact and extent of his liability to said insurer under this agreement."

The question now comes up as to what is the legal force and effect of such provisions as the above, making certain evidence conclusive upon the "risk." Such clauses as the foregoing have been upheld by the courts of England, where the matter has often been presented. The leading case there is London Tramways Company *v.* Bailey.[2] In this case Bailey had been a conductor of the tramway company under an agreement by which he was to pay them £25, to be retained, together with his wages for the current week, as security for the proper discharge of his duties. It was further stipulated, in case of any breach by him, that the company might retain this £25 and his wages for the current week as damages for such breach, and it was provided that the manager of the

[1] See also Guarantee Co. of N. A. *v.* Pitts, 30 Sou. 758.

[2] L. R. 3 Queen's Bench Div. 217.

company should be the sole judge between the company and the conductor as to whether there had been a breach, and that his certificate should be binding and conclusive evidence of the fact in all courts of justice.

It was held that the agreement was not illegal and that the proceeding being a civil one, the manager's certificate that the deposit and wages had been forfeited was conclusive of the fact, precluding the magistrate from making any further inquiry.[1]

The above decisions have seldom been followed in the United States, where all such provisions, in so far as they attempt to make such proof *conclusive* upon the risk, are declared to be against public policy and *to that extent* void. A leading case on this subject is that of the Fidelity and Casualty Company of New York *v.* Eickhoff,[2] where the court spoke as follows:

"The right of a party to waive the protection of the law is subject to the control of public policy, which cannot be set aside or contravened by any arrangement or agreement of the parties, however expressed. Thus an agreement to waive the defence of usury is void. So, also according to the weight of authority, is an agreement made at the time of contracting a debt to waive the prospective right of exemption. The agreement under consideration is more than a mere enlargement of contractual rights or the establishment of a rule of evidence. It provides that the plaintiff may by his own *ex parte* acts conclusively determine and establish the existence of his own cause of action. In short, he is made the supreme judge of his own case. The case is not at all analogous to the common provisions in building and construction contracts by which the determination of some third person, such as the architect or engineer, as to the amount or character of the work is made conclusive between the parties, in the absence of fraud or mistake. Nor is it at all analogous to a provision in an executory con-

[1] See also Wilson *v.* Glasgow Tramways & Omnibus Co., 5 Sc. Sess. Cases (4th Ser.), 981, and Glasgow Tramway & Omnibus Co. *v.* Dempsey, 3 Cowp. Just. 440; Scott *v.* Avery, 5 H. L. Cases, 811; Brown *v.* Overbury, 11 Ex. Rep. 715.

[2] 63 Minn. 170; 65 N. W. 351.

tract for the sale or manufacture of an article to the satisfaction of the buyer where, if the article is declined, the parties are, in contemplation of law, left *in statu quo.* In the present case the attempt is to provide that after the alleged cause has occurred, the plaintiff shall be the sole and conclusive judge of both its existence and extent. Such an agreement is clearly against public policy. Had the provision been that the voucher or other evidence of payment should be merely *prima facie* evidence of the fact and extent of defendant's liability, — thus merely shifting the burden of proof, but leaving the defendant at liberty to rebut this *prima facie* evidence, — although even then a somewhat drastic provision, we do not think it could be held to contravene public policy. To that extent we think the provision is valid, but in so far as it assumes to make the voucher of payment by plaintiff conclusive of defendant's liability, it is void." In a later case this same court went into the subject again briefly, as follows: "In this case as in the Eickhoff case the guaranteed agent in his application for the guaranty bond stipulated that the voucher or other evidence of payment by the plaintiff to the elevator company should be conclusive evidence against him of the fact and extent of his liability to the plaintiff. In the Eickhoff case we held that this stipulation was void as being against public policy in so far as it made such voucher or other evidence of payment conclusive. Counsel suggests that this was *obiter*, the case having been considered simply with reference to the future trial, but we see no good reason for changing our views, and therefore adhere to what was said in that case. And assuming that the voucher or evidence of payment introduced in this case was *prima facie* evidence of the fact and extent of defendant's liability to plaintiff, shifting the burden of proof upon defendant, we are of the opinion that the trial court was justified in concluding that this *prima facie* case was sufficiently rebutted."[1]

[1] Fid. & Cas. Co. *v.* Crays, 76 Minn. 450; 79 N. W. Rep. 531; see also F. & C. *v.* Lawler *et al.*, 61 Minn. 144; 66 N. W. Rep. 143; Eickhoff *v.* F. & C. Co., 74 Minn. 139; 76 N. W. Rep. 1030.

In White *v.* Middlesex Railroad Company [1] it was held that an agreement between a railroad company and a conductor to the effect that the railroad company's president should be the sole judge between the company and the conductor as to whether the company is entitled to retain and hold a certain sum deposited by the conductor as security for the proper discharge of his duties, and for the accounting and paying over to the railroad company of all fares received, together with the provision that the president's certificate stating that said sum was to be retained as forfeited to the company, and as to the cause of such retention, should be a final adjudication thereof, and binding and conclusive evidence between the parties in all courts of justice, was void as against public policy.[2]

§ 200. **The Necessary Requisites to establish a complete Right of Indemnification in Favor of the Insurer as against the "Risk."** — These may be briefly stated as follows:

1. A request, either express or implied, from the "risk" to the insurer, that a policy be issued in his behalf to the insured.
2. The execution of, delivery to, and acceptance by the insured of the policy requested by the "risk."
3. Notice and proof of loss by the insured to the insurer.
4. Allowance and payment of claim duly presented after investigation thereof, by the insurer to the insured.
5. Evidence that the claim so paid was a legal and enforceable one under the policy.
6. A promise, either express or implied, on the part of the "risk," to indemnify the insurer.

The foregoing matters will now be considered and taken up for separate consideration.

§ 201. **A Request for the Policy by the "Risk" — How shown.** — The general principle that no one can make himself a creditor of another without his consent or against his will has an undoubted application to guaranty insurance. It therefore follows that to give the insurer any rights, other

[1] 135 Mass. 216.

[2] See, *contra*, Guarantee Co. of N. A. *v.* Pitts, 30 Sou. 758.

than those arising by way of subrogation, as against the "risk" after payment of loss, it must appear that the policy was issued in the first instance at the request of the "risk."

Such request may be either express or implied. But unless there has been such a request, the insurer cannot recover from the "risk" after the payment of loss, save as such right is given under the doctrine of subrogation heretofore referred to.[1] A mere stranger or volunteer who pays the debt cannot thus be subrogated to the insured's rights.[2]

§ 202. **The Execution, Delivery to, and Acceptance by the Insured of the Policy requested by the "Risk."** — After having been requested by the "risk" to furnish the policy, it of course follows that this request must be complied with in terms of the request. That is, the policy so furnished must be of the kind, nature, and content called for by such request. For where the policy does not conform in terms to the application, there is no corresponding obligation on the part of the "risk" under his contract of indemnity, to reimburse the insurer for claims paid thereunder to the insured. But difficulties often arise through professed ignorance on the part of the "risk" as to the provisions of the policy furnished, claiming, after a loss has been incurred, that the policy was not of the kind and nature requested by him. Of course where the "risk" — as is sometimes the case — signs the policy with the insurer, no question of this nature can possibly arise. But where reference must be had solely to the "application," to determine the nature of the policy sought for by the "risk," a more difficult question is presented.

With respect to guaranty insurance contracts it may be stated generally, that in the absence of fraud on the part of the insurer or its agent, and in the absence of illiteracy or bodily imfirmity on the part of the "risk" such as to render him incapable of contracting, the latter is bound to know the contents of his application. The same rule applies here

[1] See *ante*, §§ 195–197.
[2] Queen *v.* O'Bryan, 37 Canada Law Journal, 303.

as is held applicable to "proposals" for a policy on the part of employers. The rule here referred to is well stated in Ryan *v.* World Life Insurance Company, as follows:[1] "If the insured signed the application without reading it, and without its being read, that of itself was inexcusable negligence. The application containing her agreement and representation is an important contract. When she signed it she was bound to know what she signed. The law requires that the insured shall not only in good faith answer all the interrogatories correctly, but shall use reasonable diligence to see that the answers are correctly written. It is for his interest to do so, and the insurer has a right to presume that he will do it. He has it in his power to prevent this species of fraud, and the insurer has not." Again the United States supreme court,[2] through Justice Field, has laid down a similar rule as follows: "It was the insured's duty to read the application he signed. He knew that upon it the policy would be issued, if at all. It would introduce great uncertainty in all business transactions if the party making written proposals for a contract, with representations to induce its execution, should be allowed to show, after it had been obtained, that he did not know the contents of his proposals, and to enforce it notwithstanding their falsity as to matters essential to its obligations and validity. Contracts could not be made or business fairly conducted if such a rule should prevail, and there is no reason why it should be applied merely to contracts of insurance. There is nothing in their nature which distinguishes them in particular from others. But here the right is asserted to prove, not only that the assured did not make the statements contained in his answers, but that he never read the application, and to recover upon a contract obtained by representations admitted to be false just as though they were true. If he had read even the printed lines of the application, he would have seen that it stipulated that the rights of the company should in no respect be

[1] 41 Conn. 172.

[2] N. Y. Life Ins. Co. *v.* Fletcher, 117 U. S. 529.

affected by his verbal statements or by those of his agents, unless the same was in writing and forwarded with his application to the home office. The company, like any other principal, could limit the authority of its agents and thus bind all parties dealing with them with knowledge of the limitation. It must be presumed that he read the application, and was cognizant of the limitations therein expressed."

In the absence of fraud, a person who is competent to contract is conclusively presumed to have made the contract which he signs and to be bound by its terms, though he is in fact ignorant of its contents.[1]

The "risk," under such circumstances as we are now considering, must be presumed to know the contents of the application he signs. If the language thereof was ambiguous or prejudicial to his rights, he should have refused to sign it or have applied to the insurer to have its language or terms amended.[2]

The rule is this connection may be stated as follows: That persons having capacity to make a contract must, in the absence of fraud, misrepresentation, or concealment, be held to have known what the words used in a contract made by them were, and to have known their meaning; and they must also be held to have known and fully comprehended the legal effect of the contract which the words used made. Contracts for insurance do not furnish an exception to this rule. But there is a most important element of estoppel present in all such cases, arising from the fact that the "risk," having accepted the benefits to be derived from the issuing of a policy in his behalf, cannot escape the burdens connected therewith. Where a party by mistake chooses to sign a contract which gives full effect to the parties' intentions and one of them acts on it, the other cannot say, after liability has occurred, "I meant what I have not stated; and though you have relied upon my statement, I will only be liable for what

[1] See De Jernette *v.* F. & C. Co. of N. Y., 98 Ky. 558; 33 S. W. 828.

[2] See Lyman *v.* Bruker *et al.*, 26 N. Y. Misc. Rep. 594.

I meant." Finally, in this connection it seems entirely safe to assert, that no matter what the rights of the "risk" may have been in the beginning and prior to his securing employment through the issuing of a policy by the insurer to the insured in his behalf, after this has been done and he has secured employment on the strength of it, he then becomes estopped with respect to his obligations to the insurer, from claiming that the policy furnished by the latter was not of the kind and nature requested by him in his application for the same. On the question as to what constitutes legal proof of the execution of the policy by the insurer the case of Fidelity and Casualty Company of New York *v.* Yoder is in point.[1] Here the insurer sued the "risk" to compel the latter to indemnify it on account of a loss paid under a blanket policy to the Missouri Pacific Railway Company. The petition set out the policy issued by the insurer to the insured, insuring the honesty of certain employees of the latter, including the particular "risk" sued in that action. The execution of the policy was denied by verified answer in positive terms. No proof of its execution was made. The written application for the policy itself was made by the railway company, and the proof showed that the "risk" never saw it. An officer of the railway company testified that the original policy was in his possession and that he had attached a copy thereof to his deposition. This was held insufficient to prove the execution of the instrument.

It often becomes an important question to determine the kind of indemnity policy applied for by the "risk" as set forth in his written application. This question may be answered, not only by a reference to the wording of the application itself, but also by reference to the proposal of the insured if any there be, and also by taking cognizance of the situation of all the parties, insured, insurer, and the "risk," at the time that the application for the guaranty policy was made. First of all the situation of the parties should be looked at as it existed at the time the application for the policy was sent

[1] 64 Pac. Rep. 1027.

in. With regard to the "risk," it should be observed that he is seeking to secure some position of trust, the door to which is only open to him through the medium of a guaranty insurance bond. On the part of the insured there exists the necessity of filling such a position of trust in a manner conducive to the safety of the handling of funds in connection with the duties of such trust position, and a further necessity of obtaining some assurance that the duties of the same will be faithfully performed. This again is sought for on the part of the insured through the medium of a guaranty insurance bond. Finally, on the part of the insurer is the desire to secure a premium, through assuming a liability which shall be proportionate to the amount of the premium received therefor. From the foregoing it is clear that in order to secure a position of trust, the "risk" must first furnish a satisfactory indemnity policy to the insured. The word "satisfactory" is used as addressing itself, not to the mind of the "risk," but rather to that of the insured. It is the latter rather than the former whose approval of the policy offered is to be sought and secured. By what has just been said it is not to be inferred that the "risk" has no rights whatever in the premises. That is very far from true. The legal rules governing this question may be stated as follows:

1. If the application itself contains words indicative of the fact that the "risk" is cognizant of the nature and content of the policy proposed to be granted by the insurer to the insured, in such case the "risk" is estopped to deny that the policy furnished by the insurer to the insured was not of the kind and nature requested by him. Thus, for example, the "risk" not infrequently agrees in terms to reimburse the insurer for any loss or damage or expense that it may sustain or become liable for in consequence of guaranteeing the insured against loss through his acts, defaults, and neglects, "*as provided in such guarantee.*" It is upon the words "as provided in such guarantee," that the insurer must base the principle of estoppel to the effect that the "risk" is precluded by his own words from attempting to show that the policy

furnished by the insurer to the insured was not of the kind requested by him in his application.

2. In view of the fact that it is the insured rather than the "risk" who is the party whose requirements, with reference to the nature and content of the policy applied for, are to be consulted by the insurer, the acceptance of the policy by the insured concludes the "risk" from afterwards asserting that such policy was not of the kind and nature requested by him, especially when it appears that he has accepted its benefits.

The obtaining of the position of trust by the "risk" with the insured on the strength of the procurement of the policy of guaranty insurance from the insurer and its subsequent acceptance by the insured, estops the "risk" from afterwards claiming that the policy so furnished was not of the kind and nature requested by him.

§ 203. **Necessity of showing Notice and Proof of Loss by Insured to the Insurer.** — The theory on which the insurer seeks to recover from the "risk" is that it has been compelled to pay the insured a certain sum of money, in response to a legal obligation evidenced by the policy issued by the insurer to the insured at the request of the "risk." Now it is unquestionably true that any and all conditions of a policy (and this includes, of course, the usual ones with respect to notice and proof of loss) may be waived by the insurer if it sees fit so to do, they being inserted therein for the latter's benefit. But a somewhat different question is presented when the insurer seeks to recover from the "risk" moneys paid by it on account of losses incurred by the insured, which, though covered by the policy, have never been made the basis of a formal claim supported by the customary proof. It has been claimed that such a case would come under the application of the principle, that the law does not allow a person to make another his debtor by volunteering to pay his debt, and that therefor the insurer should be held to strict proof as to substantial compliance by the insured with all provisions of the policy as to notice and proof of loss, in order to enable it to

exact indemnity from the "risk." This proposition, it would seem, is not without some authority to support it. It was said by the court in Fidelity and Casualty Company *v.* Eickhoff [1] that where a policy is executed at the request of the "risk," it follows that his obligation to indemnify the insurer is coextensive with that of such insurer to reimburse the insured. Now this being true, the question presents itself whether, under such circumstances, there exists any legal liability on the part of the insurer to the insured to settle losses whereof no notice or proof of claim was filed. The answer is, no. Does it not therefore follow that the "risk's" obligations being coextensive with that of the insurer's, its duty to indemnify the insurer after payment of loss cannot be said to exist where there is no notice or proof of such loss filed by the insured with the insurer? There is no well defined principle of agency, either express or implied, which authorizes the insurer in behalf of the "risk" to waive these matters and thereby affect the rights of the latter in that connection. There is, however, still another and different view which might be taken of this question. It is this: Assuming that the insurer was liable under the terms of the policy for a loss, would not the bare existence of such legal liability be a sufficient justification in the eyes of the law for a payment of such loss to the insured, notwithstanding that the latter had filed no written notice or proof of loss, as provided for in the policy? In other words, it would seem reasonable to assert that the mere act of the insurer in waiving formal proofs of loss should not so operate as to deprive it of the right to demand indemnity from the "risk" on account of a loss paid under such circumstances. The true view of the matter would seem to be this: The insurer cannot of its own initiative (if such a course of proceeding can be conceived of) volunteer to pay a claim not previously presented by the insured, and then call upon the "risk" to indemnify it on account of such payment. But when the insured has himself taken the initiative and in some manner — no matter how

[1] 63 Minn. 170; 65 N. W. 351.

informally — preferred a claim under the policy against the insurer, then it would seem that the latter should have the right to waive formal provisions of the policy with respect to notice and proof of loss, and still have the right to claim indemnity from the "risk."

§ 204. **Allowance and Payment of Claims after Investigation thereof by the Insurer.** — No action at law can be maintained by the insurer against the "risk" to compel the indemnity before the former has paid the loss for which a claim has been filed by the insured.[1]

In this connection it would seem proper, as a matter of evidence, that the insurer should offer testimony tending to prove that he made a thorough and careful investigation of the claim; this on the ground that such evidence tends to establish the insurer's good faith in paying the claim in all cases where the existence of a legal liability on the part of the insurer to pay such claim or the existence of collusion between the insurer and the insured, are matters at issue before a court or jury. This would undoubtedly be admissible where fraud or collusion with the insured in the payment of a claim was charged by the "risk" against the insurer.[2]

§ 205. **The Claim paid by the Insurer to the Insured must have been a valid and enforceable one under the Policy.** — The broad general proposition may be laid down that where the insurer is under no legal liability to pay a claim to the insured under the policy, it cannot recover therefor from the "risk," by way of enforcement of any express or implied agreement to indemnify.[3]

It has even been said[4] "that a surety cannot accelerate the liability of the principal by paying the liability before it is due." But the principle certainly could not be so extended as to forbid an insurer paying a claim before the

[1] See *post*, Am. Bond & Tr. Co. *v.* L. & W. Va. Gas Co., 95 Fed. 49.

[2] See State *ex rel. v.* Surety Co., 76 Mo. App. 227.

[3] Wilkes *v.* Harper, 1 N. Y. 586; Mer. Mut. Ins. Co. *v.* Calebs *et al.*, 20 N. Y. 173.

[4] Addison on Contracts, p. 1013.

expiration of the time customarily allowed in all policies for paying claims.[1]

In this immediate connection a most important and practical question presents itself as to what evidence it is necessary for the insurer to introduce in order to establish its right to demand indemnity from the "risk" on account of losses incurred by it under the policy through acts of such "risk."

The subject here referred to was considered at some length in the case of the Fidelity and Casualty Company of New York *v.* Eickhoff.[2] This was an action brought by the insurer to compel one Eickhoff (the "risk") to make good and reimburse to it certain moneys which it had been compelled to pay to the insured, by reason of certain alleged acts of fraud or dishonesty on the part of said Eickhoff. In its opinion in this case the supreme court of Minnesota (Mitchell, Judge) spoke as follows: "Our construction is that the plaintiff was only bound to make good and reimburse the elevator company for loss sustained by reason of a shortage of grain caused by the actual fraud or dishonesty of the defendant. But the bond also provides how the existence and amount of a shortage shall be ascertained; it shall be accepted as evidence that it was caused by the fraud or dishonesty of the defendant and not by any of the various other causes, enumerated as exceptions, for which the plaintiff was not to be liable; in other words, that a shortage ascertained in the manner prescribed should be *prima facie* evidence of its existence and that it was caused by defendant's fraud or dishonesty, thus casting the burden upon the plaintiff to rebut this *prima facie* case of proof. It is not bound to do this by affirmative evidence showing the particular one of the causes enumerated as exceptions which produced the shortage, but may do it by negative evidence showing that it was not caused by the fraud or dishonesty of the defendant, and hence must have been produced by one or more of the excepted causes. This it may do by a fair preponderance of evidence as to any of the

[1] See City Tr. & Sur. Co. *v.* Fid. & Cas. Co. of N. Y., 58 N. Y. App. Div. 18.
[2] 63 Minn. 170; 65 N. W. 351.

excepted causes, except errors and carelessness in weighing and thefts by persons other than those covered by the bond, in which cases the proof must be conclusive. The word 'conclusive' in this connection must be construed as meaning so strong as to require a finding or verdict that the shortage resulted from the cause alleged. This may also be done by negative or circumstantial evidence." Another instructive case along this same line is that of the Fidelity and Casualty Company of New York *v.* Crays.[1]

Here the Fidelity and Casualty Company of New York issued a policy on one Crays as the "risk" in charge of a grain elevator in the employ of the Peavey Elevator Company, the insured. The policy under which Crays had been bonded provided that the Fidelity and Casualty Company should only be liable for acts of fraud and dishonesty on the part of Crays personally, and not for his errors, mistakes, or mere negligence. A claim was put in by the Peavey Elevator Company for loss claimed to have arisen by reason of Crays' failure and refusal to deliver or turn over to the Peavey Elevator Company all the grain which he had bought and received for it. This claim was paid by the Fidelity and Casualty Company to the elevator company, and an action was thereafter brought by the Fidelity and Casualty Company against Crays to compel him to reimburse it for the amount so paid to the elevator company. This action was brought on Crays' written agreement to reimburse the Fidelity and Casualty Company for any moneys that it should pay on his account by reason of the issuance of the policy above referred to. The court, in refusing to allow the insurer to recover thereon, said: "We shall assume, without deciding, that the evidence was conclusive that the bond of indemnity declared on was in the form and of the kind requested by the defendant, and direct our attention to the evidence of the shortage for which plaintiff (the Fidelty and Casualty Company) was liable to the elevator company. It will be seen from an examination of the bond that the plaintiff was only liable for

[1] 76 Minn. 450; 79 N. W. 531.

acts of fraud and dishonesty on the part of the defendant personally, and not for his errors, mistakes, or mere negligence. The mode of ascertaining a shortage in the grain accounts of receiving agents at elevators was as follows: There shall be deducted from the total amount of grain and dockage received by the receiving agents at said grain elevators the amount of grain on hand, screenings and dirt from such grain as has been cleaned at such elevator or elevators, together with the amount of shipments based upon weights of grain and dockage at terminals, and if the result shows a deficit and the shortage is not caused by the various exceptions agreed to, this proof of loss will be accepted as binding on the company. We shall also assume, without deciding, that this mode of ascertaining a shortage is binding on the agent guaranteed as well as upon the plaintiff, and that the shortage ascertained in the mode prescribed is evidence, not only of the fact of the amount of the shortage, but also that it was caused by the fraud and dishonesty of the agent, although to so hold would practically render the agents guarantors not only of the absolute accuracy of their own weights, but also of the weights at terminals, with which they have nothing to do and over which they have no control, and this, too, under the penalty of being branded with fraud and dishonesty if there is any discrepancy between the two weights. But if it is to be held that the agents have assumed any such drastic liabilities, certainly the plaintiff should be held very strictly to the mode of proof prescribed in the bond. The method of proving the defendant's shortage adopted on the trial and the way the elevator company's account with him was kept was to charge him with the amount of grain which he reported from day to day that he had taken into the elevator and to credit him with the alleged weights at terminals to which the wheat had been shipped by order of the elevator company. The defendant, as a witness in his own behalf, testified positively that he shipped out at the direction of the elevator company all the wheat that he took in or received for it, and never sold or disposed of any of the grain in any

other way and never had converted to his own use a particle of the wheat, and that he never admitted that there was a shortage. There was no evidence in the case tending in the least to impeach or cast suspicion on his honesty or integrity, except the bare fact of his shortage of three hundred and thirty bushels out of all the wheat he handled from September to May. Upon this state of the evidence the trial court was amply justified in finding that there was no shortage proven, at least none for which the plaintiff was liable to the elevator company."

The construction of express contracts of indemnity running from the "risk" to the insurer is touched upon in American Surety Company *v.* Thurber *et al.*,[1] where it was said that the extent of the "risk's" liability under such contracts depends upon the wording thereof, and the agreement is to be construed so as to give effect to each and every part thereof, according to the intentions of the parties at the time. Where there is no ambiguity, the operative words of the contract cannot be controlled by erroneous recitals.

The "risk," even when confined in the penitentiary, may be sued at law by the insurer on his agreement to indemnify the latter after payment of loss to the insured.[2]

After payment of loss by the insurer to the insured, if a demand is necessary in order to recover from the "risk" (and the necessity for such a demand is very doubtful), it is the former, and not the latter, who should make the demand upon the "risk" where suit is brought upon the contract of indemnity.[3]

It is unnecessary, in order to sustain the insurer's right to exact indemnity from the "risk," to show that payment to the insured was made with notice thereof, to such "risk."[4]

§ 206. **A Promise to indemnify by the "Risk" — How shown.** —This is ordinarily shown by the introduction of evidence of

[1] 21 N. Y. St. Rep. 459.

[2] Guar. Co. of N. A. *v.* First Nl. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909.

[3] See People *ex rel.* Surety Co. *v.* Anthony, 7 N. Y. App. Div. 132; Malone *v.* F. & C. Co, 71 Mo. App. 1.

[4] City Tr. Co. *v.* Fid. & Cas. Co. of N. Y., 58 N. Y. App. Div. 18.

the written contract to indemnify. In the absence of such written agreement, the following appears to be the rule: Where the policy is issued upon the request of the "risk," the law implies that the latter requested the payment of losses thereunder to be made, and also implies a promise on the part of the "risk" to indemnify the insurer to the extent of all payments so made. It is immaterial whether this payment was made, in fact, at the request of the "risk," so long as the insurer was under a legal liability to the insured to make the same.[1]

The right of action on the part of the insurer against the "risk" for indemnification after payment of loss does not depend upon the fact that demand for reimbursement was made and refused before the action was commenced. At most, the absence of a demand might prevent the recovery of interest on claims paid.[2]

However, if the contract between the "risk" and the insurer provides for indemnity by the former to the latter "upon demand" therefor, then of course, such demand is a condition precedent to the maintenance of any action to enforce the right of indemnity.[3]

In this immediate connection, certain general rules may be given with a view to suggesting the more important, rather than with the purpose of stating all which might be given on the subject of proof of loss by the insurer as against the "risk."

1. The insurer is not required to prove his cause of action literally, but in the absence of any contract provisions (as here before referred to) shifting the burden of proof, all claims for indemnity on the part of the insurer against the "risk" must be proved with substantially as much particularity as if a prior settlement of these same claims had never taken place between the insurer and the insured.[4]

[1] See Am. Bond & Trust Co. *v.* L. & W. Va. Gas Co., 95 Fed. 49.

[2] See Epstein *v.* U. S. Fid. & Guar. Co., 29 N. Y. Misc. 295.

[3] See Sooysmith & Co. *v.* Am. Sur. Co., 28 N. Y. App. Div. 346.

[4] See Fid. & Cas. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; Fid. & Cas. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531; *contra*, Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758.

2. If evidence offered and admitted proves a cause of action in itself, and that is supported by allegations of the complaint broad enough to cover it, this is sufficient.

3. It is sufficient if the substance of the issue be established.

4. As part of the *res gestae*, all books of accounts, letters, and memoranda, kept by the "risk" and relating to the claim sued upon, are admissible in evidence.[1]

5. All admissions of the "risk" made against interest relative to the matter in issue, are admissible in evidence.

6. All statements of account which have been shown to the "risk," and which relate to the matter in issue, and which have been by him formally admitted to be correct, and in reliance upon which the claim has been paid by the insurer to the insured, are admissible in evidence against the "risk."

§ 207. **The Measure of the "Risk's" Liability to the Insurer after the Payment of a Liability under the Policy to the Insured.** — At common law a surety could call upon his principal for reimbursement, not only for what he may have been obliged to pay in discharge of the obligation for which he was bound, but also for all reasonable costs and expenses incurred in consequence of such default. The foregoing — in the absence of express stipulation — is undoubtedly the rule in contracts of guaranty insurance. The only limitations in such a case would be that the insurer could recover only the amount actually paid under a legal obligation to the insured so to do, and that the expenses must have been reasonable and incurred in good faith. The insurer is also entitled to interest on the amount paid. Occasionally there is inserted in the indemnity agreements given by the "risk" to the insurer some such clause as this: "I hereby agree that forthwith, after the company (the insurer) shall have paid the party or parties entitled to the same, any money under or by reason of such guarantee, to repay said company the amount so paid, and all other costs, damages, and expenses, if any, that it shall have incurred or become liable for, in consequence

[1] Supreme Council, etc. *v.* F. & C. Co. of N. Y., 63 Fed. 48; Hall *v.* U. S. Fid. & Guar. Co., 77 Minn. 24; 79 N. W. 590.

of such guarantees." Such agreements as the foregoing are undoubtedly valid, and the rule of law in such cases is as above stated ; that is, the measure of the "risk's" liability to the insurer, after payment of loss under a policy, is the amount so paid with interest thereon, at the legal rate, together with all reasonable and legitimate expenses incurred by the insurer in connection therewith. Occasionally, too, one finds in the "risk's" contract of indemnity an agreement to give the insured the right to take possession of any moneys or property which the latter may find belonging to the "risk," and for that purpose to enter into any house, break doors, etc. And in case the insurer should make any payment under any such policy or agreement, the latter shall apply such money, or sell or dispose of such property as it shall deem best for its reimbursement, including expenses of reimbursement and cost of keeping such property, etc. The foregoing provisions are in part, at least, of questionable validity, and amount at most to a sort of inchoate lien or pledge on the moneys and properties of the "risk" that may belong to him at the time a loss incurs. Such a provision as the foregoing, however, would probably afford a sufficient legal justification for basing thereon a demand by the insurer upon the insured, for any salary due from the latter to the "risk," in connection with the employment out of which the liability sought to be enforced arose.[1]

[1] See generally in this connection Mullin & Fid. & Dep. Co. *v.* U. S., 109 Fed. 817; U. S. *v.* M'Intyre & Fid. & Dep. Co., 111 Fed. 590; U. S. etc. *v.* Morgan & Am. Sur. Co, 111 Fed. 474; Wood *v.* Brown, 104 Fed. 203; 43 C. C. A. 474; U. S. *v.* Am. Surety Co. *et al.*, 110 Fed. 913.

CHAPTER XXII.

PRACTICE.

§ 208. **General Remarks.** — It is not our purpose in this chapter to discuss at length matters of practice likely to arise in the trial of cases arising under policies of guaranty insurance. An attempt will be made, however, to make a few suggestions of a practical nature along this line.

§ 209. **Venue of Actions.** — From the standpoint of both the insurer and the insured, as well as the "risk," it becomes important to determine just where the proper place for trial may be of controversies arising either between the insured and the insurer or between the insurer and the "risk." As a general thing this matter is to be determined wholly by reference to the local statutes of the state wherein the action is brought. The only difficulty likely to arise is where the defendant is a guaranty insurance company organized under the laws of a foreign state and has no corporate habitat or residence within the state where the action is brought. By way of suggestion, with a view to meeting the difficulties that may arise in this connection, attention is called, without comment thereon, to the cases cited in the notes.[1]

Under a statute requiring a foreign corporation, having a place of business in the state, to appoint the commissioner of corporations its attorney, upon whom process might be served in any action against it, and providing that the authority of the commissioner to accept service should continue so long as any liability remained outstanding against the corporation in the state, a non-resident of the state has the same right to sue therein as a citizen, and may maintain an action against the

[1] Eickhoff *v.* Fidelity & Casualty Company of New York, 74 Minn. 139; 76 N. W. 1030; Easley *v.* Insurance Company, 38 Pac. Rep. 405; American Surety Company *v.* Holly Springs, 77 Miss. 428; 27 Sou. Rep. 612.

corporation after it has ceased to do business there, so long as suits against it by the citizens of the state are pending, or until it is decided that at the time of the bringing of the action no liabilities against the corporation exist in the state.[1]

§ 210. **The Right of Removal from State to United States Courts.** — A marked tendency is everywhere to be observed on the part of insurance companies to remove actions brought against them for trial, wherever possible, from the state to the United States courts. In this connection it may be observed that frequent attempts have been made by the legislatures of the several states to deprive foreign insurance companies of the right to remove all such actions from the state to the federal courts. Such legislation is clearly unconstitutional, for the reason that foreign insurance companies, being citizens of the state where it is corporated, within the meaning of the "Removal Act," cannot, under the constitution of the United States, be deprived of the right to remove cases brought against them from the state to the federal courts.[2] Nevertheless, the purpose of such legislation may be indirectly accomplished by revoking the license granted to foreign insurance corporations to do business within the state, where such license is required by statute, and the motive which induces such action on the part of the state in so doing is not ordinarily a subject for judicial inquiry.[3]

§ 211. **Equitable Jurisdiction of Suits brought by the Insured against the Insurer to recover under Policies of Guaranty Insurance.** — It not infrequently happens, particularly in the case of fidelity insurance policies, that the trial of actions between the insured and the insurer, under such policies, necessarily involves the taking of a long and complicated account. In states where statutes exist allowing a compulsory reference in

[1] Youmans *v.* Minneapolis Title Ins. & Trust Co., 67 Fed. Rep. 282.

[2] Home Ins. Co. *v.* Morse, 20 Wallace, U. S. 445.

[3] Doyle *v.* Conn. Ins. Co., 94 U. S. 55; Hartford Fire Ins. Co. *v.* Raymond, 70 Mich. 485. See generally Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909; Am. Surety Co. *v.* Lawrenceville Cement Co. *et al.*, 96 Fed. 25; 110 Fed. 717; Olds *et al.* *v.* City Trust, Safe Dep. & Sur. Co., 61 N. E. 223; Hollister *v.* U. S. Fid. & Guar. Co, 87 N. W. 776.

such cases as a matter of right to either party, the advantages of a bill in equity, under the chancery practice, are thereby obtained, and the intervention of a jury rendered unnecessary.[1]

However, in the absence of statute, it is not clear by any means that equity can take jurisdiction of such actions except with the consent of both parties. The general subject of equity jurisdiction of suits between the insured and the insurer in the domain of guaranty insurance was touched upon by the United States court of appeals (fifth circuit) in the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company.[2] As what is therein said has some direct bearing on the matter now under discussion, the following excerpt from the opinion in that case is here given: "This is a bill in equity," observed the court, "to recover on a contract of fidelity insurance. Equitable jurisdiction was asserted on the ground that the examination of a complicated account not convenient to be examined in a court of law, and also on the ground that there are quite a number of credits to be allowed the defendant in the account, the proper mode of applying which required the action of a chancellor. A stipulation filed in the case above shows that both parties preferred the equity jurisdiction, and no objection is made to it in this court. It may be doubtful whether, if the point has been sharply contested by demurrer below, the equity of the bill could have been maintained. It is true that there is a concurrent jurisdiction of matters of account in law and equity. But it is laid down that where all the items of account are on one side, and no discovery is asked, there is no equity jurisdiction. It is true that there are a few large items of credits, but it is not clear that they would make the account a mutual one, in the sense in which it is understood in equity. However this may be, we think it is our duty to proceed to consider the cause on the merits." It is the constitutional right to trial by jury in such cases that is preserved

[1] Pierce *v.* Equitable Life Assur. So., 145 Mass. 56; F. & C. Co. of N. Y. *v.* St. Mathews Savings Bank, 104 Fed. 858; 44 C. C. A. 225.

[2] 80 Fed. 766; 26 C. C. A. 146.

in state courts by state constitutions, and in the United States courts by the United States constitution, that stands in the way of the determination of such actions by the court sitting in chancery.[1]

§ 212. **The Right of the Insurer to go into Equity prior to a Settlement of Claim for Loss by the Insured, for the Purpose of compelling the "Risk" to settle such Claim.** — A somewhat different question from that referred to in the preceding section arises when the aid of a court of equity is invoked by the insurer for the purpose of compelling the "risk" to satisfy a liability of the insurer to the insured already incurred under the policy through acts of such "risk."

The reason for this is the fact that a fiduciary relationship exists between the insurer and the insured. Story, in his work on Equity,[2] states that "principals and sureties stand in a fiduciary and confidential relation, and that the same principles apply to them as to the other parties sustaining fiduciary relations one to the other." In Robinson *v.* Pope[3] it was said "that the phrases 'confidential relation' and 'fiduciary relation' seem to be used by the court and law writers as convertible terms. It is a peculiar relation which undoubtedly exists between principal and agent, principal and surety, etc." The term "fiduciary" involves the idea of trust and confidence. It contemplates good faith, rather than legal obligations, as to the basis of the transaction.

This matter, in a somewhat involved form, was before the supreme court of Wisconsin in Dobie *v.* Fidelity and Casualty Company.[4] Before the ruling of that court can be understood, a brief statement of the material facts of the case will be necessary.

It appears that one Anderson obtained a judgment against the firm of Burke Brothers in an action for personal injuries. The Fidelity and Casualty Company was an insurer for the Burkes under an employers' liability policy, and defended the action brought against the latter by Anderson. Thereafter it

[1] Uhlman *v.* N. Y., etc., Ins. Co., 109 N. Y. 421. See Central Tr. Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530.

[2] Vol. I., p. 323.

[3] 57 Cal. 496.

[4] 95 Wis. 540; 70 N. W. 482.

induced Dobie to become the surety on an appeal bond given therein, and in connection therewith gave him an indemnifying bond conditioned to answer for all damages, interests, and costs, if any, that might be adjudged against it on the appeal, and to save him harmless from all damages and costs on account of his obligation as surety. Judgment went against the Fidelity and Casualty Company on the appeal, and Dobie thereby became liable on the appeal bond. Thereupon he brought an action to compel the Fidelity and Casualty Company to pay the judgment rendered on the appeal, and so exonerate him from liability; this, too, without first paying the judgment himself. Passing upon the question of law thus presented, the Wisconsin supreme court spoke as follows: "The action is by a surety to compel his principal to pay the debt for which both are liable, for the exoneration of the surety. It is ultimately the Fidelity and Casualty Company's liability. That party is the principal debtor who is ultimately liable for the debt. The question is whether a surety can in equity compel his principal to exonerate him from liability by extinguishing the obligation, without having first paid it himself. It seems to be well settled that a surety against whom a judgment has been rendered may, without making payment himself, proceed in equity against his principal to subject the estate of the latter to the payment of the debt in exoneration of the surety." Without denying that the Wisconsin court was not without some precedents upon which to base its holding in the case just referred to, it still must be admitted that the weight of judicial authority is against it on this question. Thus in American Bonding and Trust Company *v.* Logansport and West Virginia Gas Company,[1] it was held that an insurer which had issued an injunction bond could not maintain a suit in equity against the "risk" in the nature of a bill *quia timet* to require indemnity against the liability incurred, where he has paid nothing on account of it, and the suit in which the bond was given is still pending on appeal and undetermined, until which time there is no liabil-

[1] 95 Fed. 49.

ity on the bond on the part of the "risk" or the insurer. In its opinion in the case the court said: "Wherever an insurer signs an obligation with a 'risk,' the law raises an implied agreement to indemnify the insurer against all loss and damage by reason of his suretyship. . . . As soon as the contract of suretyship is entered into, it is firmly settled that the law raised an implied promise on the part of the principal to indemnify the surety against any loss to which he may be subjected by reason of the contract, and it is equally well settled that the surety cannot recover from the principal until a loss has been actually paid by the surety. . . . Where the liability of the principal to make such payment has been finally established by the judgment of the supreme court, it will be time enough to pay or to give indemnity to pay."

The doctrine of the foregoing case is in full accord also with that of American Surety Company *v.* Haynes.[1] Here it was said that the insurer's relation to an action brought to compel a "risk" to make indemnity is fixed by contract. It contracted with a third party to insure the fidelity of the defendant, and when it paid any money on that contract, and not until then, did it have a case of action against the "risk." In other words, the embezzlement by the defendant of the money of the railway company (the insured) in and of itself creates no cause of action in favor of the insurer against the "risk." The insurer must have indemnified the insured before it could have a cause of action against the "risk," and then only because of the fact that it had paid out money for the use and benefit of the "risk." Having so paid such money, the law raises a promise on the part of the "risk" to repay the same to the insurer. It is on this implied promise only that the insurer has any standing in court to recover the money sued for.

In general it appears to be the better and more generally accepted rule that a court of equity cannot compel an indemnitor to comply with his obligation in advance of the contingency upon which by such obligation he was to become

[1] 91 Fed. 90.

liable. This principle rests upon the distinction, not always recognized by the courts, existing between the relation of surety and principal and that of indemnitor and indemnitee.[1]

§ 213. **Right of the Insurer to go into Equity subsequent to a Settlement of Claim for Loss with the Insured, for the Purpose of compelling the "Risk" to make Indemnity.** — It frequently becomes of great importance to the insurer, in an action brought by it against the "risk" to compel indemnification, to induce a court of equity to assume jurisdiction thereof. Where a long and complicated account is involved, it amounts almost to a denial of justice to be forced to submit such claims to a jury for determination. The question then comes up, on what grounds can the jurisdiction of equity be invoked? The answer to this is, if it can be invoked at all, it must be on the ground of the existence of a fiduciary relationship and the necessity for an accounting to ascertain the amount of the "risk's" liability to the insurer. But the question may be well asked, why has not this amount been fully ascertained by the sum paid by the insurer to the insured in settlement? This was evidently the view taken by the court in King *v.* Insurance Company, already cited.[2] To return now to the question of equitable jurisdiction, attention is called to the words of the court in the leading case of Marvin *v.* Brooks.[3] It was there said that "the basis of equitable jurisdiction over matters of account appears to have been seldom considered in our courts, but often discussed by the English authorities. We have been referred to many of these, but they seem to us not harmonious, and occasionally difficult to reconcile. The best considered review of the authorities puts the equitable jurisdiction upon these grounds, viz.: The complicated character of the accounts, the need of a discovery, and the existence of a fiduciary or trust relation." In those states where a compulsory reference may be had where a case involves the

[1] Central Trust Co. *v.* Louisville Trust Co., 100 Fed. 545; 40 C. C. A. 530.

[2] 74 Law Times, 206 See also Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758; *ante*, § 199.

[3] 94 N. Y. 75.

taking of a long and complicated account, most of the benefits of a resort to equity may be had by proceedings to obtain a reference to take the account and report thereon to the court.

In making such an application to the court, it should be supported not only by proper allegations in the pleadings, placed there with this particular object in view, but it should be supported by affidavits, and the motion for a reference might be based on any or all of the following six grounds, to wit:

1. That the action is equitable in its nature.

2. That a full, adequate, and complete remedy cannot be had at common law.

3. Because the trial of the issues of fact will require an examination of a long account.

4. Because a discovery is necessary.

5. On the ground that a fiduciary relationship exists between the insurer and the "risk."

6. On the ground that the trial of the issues of fact in the action involves an examination of accounts too long and too complicated for intelligent determination by a jury.[1]

[1] See generally, on questions of practice under guaranty insurance policies, the following cases: Standard Oil Co. of N. Y. *v.* Fid. & Cas. Co. of N. Y., 51 S. W. 571; U. S. Cas. & Sur. Co. *v.* Schwerin, 80 Fed. 638; 26 C. C. A. 45; Guthrie *v.* Indemnity Co., 101 Tenn. 643; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Fid. & Cas. Co. of N. Y. *v.* Phœnix Mfg. Co., 100 Fed. Rep. 604; 40 C. C. A. 614; Schwartz *v.* Fid. & Dep. Co. of Md., 24 Sou. 479; Am. Sur. Co. of N. Y. *v.* Lawrenceville Cement Co. *et al.*, 96 Fed. 25; 110 Fed. 717; Rice *v.* Fid. & Dep. Co. of Md., 103 Fed. 427; Guarantee Co. of N. A. *v.* First Nat. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909; Union Guar. & Tr. Co. *v.* Craddock, 59 Ark. 593; 28 S. W. 424; Nl. Sur. Co. *v.* Arterburn, 62 S. W. 862; Nl. Sur. Co. *v.* T. B. T. Br. & Con. Co., 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938; Sheldon *v.* Fid. Tr. & Guar. Co., 71 N. Y. Sup. 65; Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588.

CHAPTER XXIII.

PLEADING.

§ 214. **The Complaint in an Action brought by the Insured against the Insurer under a Policy of Guaranty Insurance.** — The complaint, in order to state facts sufficient to constitute a cause of action, should clearly and succinctly contain the following averments: —

First. Allegation as to the status of the plaintiff.

Second. Allegation as to the status of the defendant.[1]

Third. Allegation as to the issuance of the policy by the insurer to the insured and the payment of the consideration therefor.

Fourth. Allegation setting forth the policy in substance, or attaching a copy thereof to the complaint as an exhibit therein.[2]

Fifth. If the proposal or application for the policy is made a part thereof, these should be set forth either in substance or by copies properly referred to as exhibits therein.[3]

Sixth. Allegation setting forth the nature and extent of the liability under the policy sought to be enforced in the action.[4]

Seventh. Allegation alleging the performance of all conditions precedent. To this is sometimes added an allegation of compliance with all the warranties contained in the policy.[5]

[1] See Fid. & Cas. Co *v.* Eickoff, 63 Minn. 170; 65 N. W. 351; Guarantee Co. *v.* Nat. Bank, 95 Va. 480; 28 S. E. 909; Union Guar, etc., Co. *v.* Craddock, 59 Ark. 593; 28 S. W. 424.

[2] See Coldham *v.* Am. Cas. & Sec. Co., 8 Ohio Circuit Ct. 620.

[3] See Ulster *v.* T. & G. Co. of N. Y., 69 Mo. App. 186.

[4] See Fid. & Cas. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; A. F. S. H. Co. *v.* Knipperberg *et al.*, 65 Pac. 621; Fid. & Cas. Co. *v.* Lawler *et al.*, 64 Minn. 144; 66 N. W. 143; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 571.

[5] See Hester *v.* F. & C. Co. of N. Y., 69 Mo. App. 186; Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

It has been held, however, that it is not necessary for the insured, in an action on a policy of guaranty insurance to aver in his complaint and prove at the trial the truth of representations amounting to warranties which are contained in the application only, in order to entitle him to recover thereon. In such a case it is incumbent upon the insurer, if he wishes to rely upon a breach of such warranty, to allege it and assume the burden of proof as to such allegation.[1]

Eighth. Allegations showing the manner and time of furnishing notice and proof of loss.[2]

Ninth. Non-payment of loss, and the refusal of the insurer to pay the same.[3]

In addition to the foregoing, the following incidental matters may be here referred to.

It is not necessary to allege affirmatively that the insurer had a license to do an insurance business in the state.[4]

In California Savings Bank *v.* American Surety Company,[5] it was said that the insured, in an action on the policy, must allege facts showing that three months had elapsed after proof of loss and before the action was brought. It was also suggested that an allegation that the loss was discovered within six months from the death, dismissal, or retirement of the "risk" is essential to a correct statement of the insured's case of action.

An allegation that the insured had been fully advised and informed of the breaches of the policy has been held not to dispense with the necessity of alleging and proving the furnishing of loss.[6] So again it has been said that the insured need not allege the truth of the statements in the application, or non-performance of conditions subsequent nor negative

[1] Am. Cr. In. Co. *v.* Wood, 73 Fed. 265; 19 C. C. A. 264; Bank of Tarbow *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. Car. 320.

[2] See Coldham *v.* Am. Cas. & Security Co., 8 Ohio Circuit Ct. 620; Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

[3] See Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

[4] Fid. & Cas. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351.

[5] 82 Fed. 866.

[6] Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

prohibited acts or exceptions, or allege that his claim is not within the excepted causes of loss.[1]

A declaration which sets out the insured's cause of action with sufficient clearness and fulness to apprise the insurer of the ground of the former's claim and enable the latter to plead, is sufficient.[2] In Fidelity and Casualty Company of New York *v.* Eickhoff,[3] it was held that where a policy covers acts of fraud and dishonesty on the part of the "risk," it is not necessary to allege specifically that the loss sued for was caused by acts of fraud or dishonesty on the part of such "risk," where the complaint contains other allegations showing the manner in which the loss occurred and the nature thereof.

§ 215. **Defences to Actions brought by the Insured against the Insurer under Policies of Guaranty Insurance.** — Without attempting to do more than outline in a general way the nature of defences that may be interposed by the insurer to actions brought against it by the insured under policies of guaranty insurance, the principal defences here referred to may be enumerated as follows:

First. Denial of any loss coming within the scope of liability under the policy. In this defence the element of time when the loss occurred, and the element of cause with respect to the nature of the loss, may be offered as a separate defence or defences. This also includes the defence that the loss for which recovery is sought is covered by the "excepted causes" enumerated in the policy.

Second. Fraud in obtaining the policy.

Third. Non-payment of premium.

Fourth. Misrepresentation.[4]

Fifth. Concealment.

Sixth. Breach of warranty.[5]

Seventh. Breach of conditions.[6]

[1] Hester *v.* F. & C. Co., 69 Mo. App. 186.

[2] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[3] 63 Minn. 170; 65 N. W. 351.

[4] See Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[5] Am. Cr. Ins. Co. *v.* Wood, 73 Fed. 265; 19 C. C. A. 264.

[6] See Pickett *v.* F. & C. Co. of N.

Eighth. Alteration of the contract had between the insured and the "risk" occurring subsequent to the issuance of the policy in suit.[1]

Ninth. Release of the liability of the "risk" to the insured by the latter to the former.

Tenth. Impairment of the insurer's right of subrogation through acts of the insured.

Eleventh. Failure of the insured to furnish notice and proof of loss as required by the policy.

Twelfth. Limitation of the right of action either by statute or by special provisions of the policy.

Thirteenth. Allegation that the policy issued was against public policy or was contrary to law.[2]

Fourteenth. Estoppel or waiver of right to claim an existing liability under the policy as against the insurer.

Fifteenth. That the court has no jurisdiction of the defendant.[3]

A plea to the jurisdiction of the court in a transitory action which fails to state that the cause of action did not arise within the jurisdiction of the court or where it did arise, and which fails to show what court of the state has jurisdiction of the cause, is bad. As a general rule, such plea must show a more proper and sufficient jurisdiction in some other court of the state or country wherein the action is brought.[4] A plea in abatement which sets up two or more distinct and sufficient defences, either of which if true would necessitate a finding in favor of the defendant tendering the plea, is bad for duplicity.[5]

38 S. E. 160; Har. S. & L. Assn. *v.* U. S. F. & G. Co., 46 Atl. 910.

[1] U. S. *v.* M'Intire & U. S. Fid. & Guar. Co., 111 Fed. 590; Har. S. & L. Assn. *v.* U. S. F. & G. Co., 46 Atl. 910.

[2] Goodwillie *v.* London Guar. & Acc. Co., 108 Wis. 207; 84 N. W. 164.

[3] Fid. & Cas. Co. of N. Y. *v.* Everett, 97 Ga. 787; 25 S. E. 734.

[4] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[5] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

CHAPTER XXIV.

APPENDIX.

[In view of the fact that a number of important cases have been decided since the text of the book has been passing through the press, it has been deemed advisable to add an additional chapter to the present work, containing brief extracts from the latest decisions bearing upon the general subject of guaranty insurance.]

§ 216. **Fidelity Insurance — Fraud and Dishonesty.** — In the case of the United States Fidelity and Guaranty Company *v.* Merkley *et al.*,[1] the Kentucky court of appeals had occasion to construe a clause of a fidelity insurance policy which provided that the insurer should reimburse the insured for losses incurred by the latter through acts of fraud or dishonesty on the part of the "risk" therein named. The question at issue related solely to the meaning of the words "fraud" and "dishonesty." It was said to refer to actual and intentional fraud or dishonesty, and was held not to cover the act of the "risk" (a commission agent) in selling consigned goods on credit.

§ 217. **Fidelity Insurance — Misrepresentation — Breach of Warranty and Breach of Conditions.** — Frequent reference has been made in the text to the case of Guarantee Company of North America *v.* The Mechanics' Savings Bank & Trust Company as decided by the circuit court of appeals for the sixth circuit several years ago.[2] A writ of *certiorari* was allowed by the United States supreme court in this case, and that eminent tribunal has recently (Jan. 6, 1902) rendered a decision therein, whereby the judgment of the lower appellate court is reversed.

[1] 65 S. W. 614.

[2] 80 Fed. 766.

In passing upon the questions involved in this case, which related to the effect of alleged misrepresentations, breach of warranty, and breach of conditions on the part of the insured under a fidelity insurance policy, the federal supreme court spoke as follows:

"The teller's bond, as originally given, expired January, 1889, and was renewed from year to year. Before each renewal the bank was informed by the company that it was necessary that a certain certificate by the president or cashier should be furnished, which was done, and stated, among other things, that the accounts of the teller had been examined and verified by the finance committee of the bank. The bond provided that it was issued and renewed 'on the express understanding that the employee has not within the knowledge of the said employer at any former period either in this or other employment been guilty of any default or serious dereliction of duty;' 'that the employer shall observe, or cause to be observed, all due and customary supervision over the said employee for the prevention of default;' and that there shall be 'an inspection or audit of the accounts or books of the employee on behalf of the employer at least once in every twelve months from the date of this bond.'

"The company, not unnaturally, contends that as when the bond was renewed in January, 1892, the bank's books showed that the employee was a defaulter in the sum of $19,600 under stated liabilities, and of $3,765.44 abstracted from bills receivable, both of which could have been detected by the taking of a trial balance as is customary, or a mere comparison between the books kept by Schardt and the individual ledger, and a correct footing of the notes, the bank had not only not complied with its engagements above referred to, and falsely certified to a verification which in fact had not been had, but was guilty of such laches as in itself to defeat a recovery.

"These are matters which, while not controlling our decision, should be considered in connection with that aspect of the case which we regard as decisive.

"In addition to the provisions already mentioned, it was

agreed 'that the employer shall at once notify the company, on his becoming aware of the said employee being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.'

"The legislation of Tennessee and the decisions of its courts placed dealing in futures, when either party did not contemplate delivery, in the category of gambling, and aimed to suppress it.[1] . . .

"Whatever the common law duty on the part of the employer to notify the guarantor of the fraud or dishonesty of the employee whose fidelity is guaranteed, the parties to this contract undertook to declare the duty of the bank to the company in certain specified particulars. It required that the employee should not have been guilty of previons default or dereliction *within the knowledge* of the employer. It provided for notification of any act of the employee which might involve a loss without unreasonable delay after the occurrence of the act came *to the knowledge* of the employer. And it required immediate notification on the employer *becoming aware* of the employee being engaged in speculation or gambling. The words 'becoming aware' were manifestly used as expressive of a different meaning from having 'knowledge.'

"In Pauly's case,[2] where the bond required that the company should be notified in writing 'of any act on the part of the employee which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act may have come to the knowledge of the employer,' it was ruled that it had been properly held 'that the surety company did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not simply suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty.'

[1] Allen *v.* Dunham, 92 Tenn. 257; McGrew *v.* City Produce Exchange, 85 Tenn. 578; Palmer *v.* State, 88 Tenn. 553; Acts 1883, c. 251.

[2] Am. Sur. Co. *v.* Pauly, 170 U. S. 133.

"But the bond before us not only contained that clause, but the clause under consideration, which was a different and additional clause intended to secure the safety of prevention through timely warning.

"It seems to us that the obvious meaning of 'becoming aware,' as used in this bond, is 'to be informed of,' or 'to be apprised of,' or 'to be put on one's guard in respect to,' and that no other meaning is equally admissible under the terms of the instrument. These are the definitions of the lexicographers, distinctly deducible from the derivation of the word 'aware,' and that is the sense in which they are here employed. It is used in the same sense in the cashier's certificate on the renewals of the teller's bond.

"To be aware is not the same as to have knowledge. The bond itself distinguishes between the two phrases and uses them as not synonymous with each other. And, in view of the plain object of the clause, we cannot regard the words as equivalent to 'becoming satisfied,' though perhaps they may be to 'having reason to believe.' Even then these facts would have demanded investigation or notification, for we think the bank cannot be heard to say it did not have reason to believe that Schardt was speculating when it took his professions of repentance as sufficient assurance that he had ceased speculating, and turned its back on any independent inquiry or investigation. Our understanding of the provision is that what the company stipulated for was prompt notification of information by the bank in regard to speculation or gambling on the part of the employee. It was entitled to exercise its own judgment on that information, and had not agreed to rely on the bank's belief in that regard. It had the right to investigate for itself, whether the bank did so or not. Notification of the existence of reason for inquiry was exactly what the clause was intended to secure. The bank neither investigated nor gave the company notice of the information it had, and substituted its own judgment as to the value of that information for that of the company. In our view this conduct on its part amounted to a breach of the stipulation.

"The circuit judge in his opinion said: 'The language of the bond is that the employer shall report "on his becoming aware of the employee being engaged in speculation." Without now stopping to consider at length the meaning of the terms here used, I am of opinion that, in the absence of fraud or bad faith, the failure to disclose the result of the inquiry made in this instance did not invalidate the bond as to the surety. Certainly speculation in a reasonable and substantial sense is meant, such in length of time or magnitude as would make it serious. This, when brought to the attention of the bank officials, was a past event, and apparently in itself unimportant. The bank was under no duty by the contract, or independently of it, to actively institute or prosecute inquiries about Schardt, or to run down loose rumors or anonymous letters.' [1]

"The circuit court of appeals said: 'There is not the least evidence of any bad faith on the part of any of the officers of the bank, including Sykes, the old cashier, in not making a disclosure of what was known, but only of bad judgment in not being more considerably affected by their information.' [2]

"These quotations show that the circuit court of appeals and the circuit court concurred in the opinion that if the president and directors had such confidence in Schardt that they did not feel called upon to make any investigation in view of the information they had received, or to notify the company of that information, and were not guilty of intentional bad faith, then the bank could not be held to have violated the stipulations of the bond on its part.

"As will have been seen, we are unable to accept this conclusion. The company's defence did not rest on the duty of diligence growing out of the relation of the parties, but on the breach of one of the stipulations entered into between them. The question was not merely whether the conduct of the bank was contrary to the nature of the contract, but whether it was not contrary to its terms. Engagement in speculation or gambling was what the company sought to guard against,

[1] 68 Fed. Rep. 459, 465. [2] 47 U. S. App. 115.

because experience had admonished it of the probability that speculation or gambling would lead to acts involving loss for which it would be responsible. Bad faith, in the view of the courts below, would not exist if the bank had such confidence in Schardt's integrity that it accepted his bare statement that he was not speculating as overcoming the weight of his admission that he had been. How anything but such a denial could be expected it is not easy to see, nor how careful and prudent men could have been justified in omitting independent inquiry.

"The truth is that, in spite of strict supervision and the pursuit of the best systems of keeping accounts, there is always a risk of defalcation. The prevention of defaults or their detection at the earliest possible moment is of even more vital importance to financial institutions than to the guarantors of the fidelity of their employees. The provisions intended to protect the company in this case were not in themselves unreasonable, and so far as they operated to compel the bank to exercise due supervision and examination and due vigilance were consistent with sound public policy. We think it was the duty of this bank to have made prompt investigation, or at all events to have notified the company at once of their information that it had, and we decline to hold that the bank's misplaced confidence in Schardt affords sufficient ground for enforcing the liability of the surety company on the theory of good faith.

"Our conclusion is that the failure of the bank in the particulars adverted to defeats a recovery on the teller's bond for defalcation after information of Schardt being engaged in speculation was received.

"It also results that there can be no recovery at all on the cashier's bond. If the bank had observed the stipulation in the teller's bond to which we have referred, it is obvious that there would have been no cashier's bond, and the question would not have arisen. But this it did not do, and the bond was given. The bond provided that the company covenanted with the bank in reliance on the statement and declaration of

the president on behalf of the bank, and on the bank's strict observance of the contract; that any misstatement of a material fact in the declaration should invalidate the bond; that the bank should use 'all due and customary diligence in the supervision of said employee for the prevention of default;' 'that any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods of supervision of the said employee delivered to the company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.'

"Two of the questions and answers in this declaration were as follows:

"'Q. Have you heard or known anything unfavorable as to habits or associations, past or present? A. No.

"'Or of any matters concerning him about which you deem it advisable for the company to make inquiry? A. No.'

"In Pauly's case the president and cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the bank; and also it was held no part of the duties of the president, under the circumstances there disclosed, to certify to the integrity of the cashier as he did. In this case the dishonesty was that of the cashier alone; the statements were required to be made and were made on behalf of the bank, and the president acted for the bank in so doing; and the bonds were procured by the bank, and the bank paid the premiums. There can be no doubt that the bank was responsible for the representations of the cashier in the one instance and its president in the other in procuring these contracts of indemnity. The representations made in the declaration on which the cashier's bond was issued were clearly misrepresentations. The teller's bond required notification if the bank were informed of speculation on Schardt's part. The president had heard of such speculation, and knew that speculating was something unfavorable as to Schardt's habits; and the president of course knew that the matters

concerning him, of which he had heard, were such as it was advisable for the company to make inquiry about. True, the second question was, if he had heard of matters about which he deemed it advisable for the company to inquire, and the word 'deem' might be said to give considerable discretion, but it was not a discretion to be abused. That the company would consider it advisable to make inquiry is too plain for argument. The whole tenor of the bond renders any other conclusion impossible.

"We cannot regard the representations of the president as consistent with good faith, and he was not even called as a witness by the bank to explain his conduct, if he could have done so."

§ 218. **Fidelity Insurance — Privileged Communications.** — Before Alfred Ginsberg could secure employment with F. Hollender & Co. as a salesman and collector he was obliged to furnish them with a fidelity insurance policy. This was obtained from the Union Surety & Guaranty Company, but the latter, before issuing the same, satisfied itself as to Ginsberg's honesty by correspondence with five persons named by him. Ginsberg had been in the employ of the Hollender Company only a few days when it notified the "surety company" in writing that the new employee had failed to account for certain moneys collected by him, and had failed to call and explain, notwithstanding that he had been requested to do so. The Hollender Company stated that it looked to the "surety company" to make good the loss. An investigation was made by the latter, and when it had satisfied itself as to the truth of the charges against Ginsberg, letters were sent to those who had certified as to his character and integrity. These letters, after reciting the facts and stating that it was owing to the favorable indorsement of Ginsberg by the persons addressed, continued: "In view of these conditions, we will be greatly obliged if you will give us such information as you have, or may be able to obtain, which may aid us in locating the defaulter." Subsequently Ginsberg was found, and in time he paid the Hollender Company the money he

had collected for it. In an action for libel brought by Ginsberg against the "surety company," in which he recovered a verdict of three hundred dollars, the appellate division of the New York supreme court ordered a reversal, holding that the defendant's motion to dismiss on the ground that the letters sent by it were privileged communications, and no malice had been shown, should have been granted. Justice McLaughlin, for the court, after saying that the communications were privileged, and were sent in good faith, observed that for this reason "the plaintiff was not entitled to recovery unless he produced evidence from which a jury might find that the communication was not sent in good faith, but, on the contrary, was sent with the intent and for the purpose of injuring the plaintiff; in other words, that it was malicious. The persons to whom the communications were sent, as already indicated, were the ones whom the plaintiff informed the defendant would, and who have certified to his integrity. It was on the strength of previous communications from the same persons that the plaintiff had obtained the bond of indemnity which enabled him to secure employment with the Hollender Company, and such persons, having been instrumental in inducing the defendant to execute the bond, were properly notified of the plaintiff's failure to comply with its conditions. Under such circumstances the law does not imply malice from the fact of the publication. Something further must be proved, and that is malice, either express or implied, which must be the incentive to the publication." [1]

§ 219. **Commercial Insurance — Contract Bond.** — The Wisconsin supreme court, in St. Paul Title & Trust Company *v.* Sabin and the United States Fidelity & Guaranty Company,[2] had occasion to pass upon several questions relating to the construction of a contract insurance bond. The bond was given to secure the faithful performance by Sabin, the "risk," of all the terms of his contract with the insured relating to

[1] Ginsberg *v.* Union Surety & Guaranty Company. Decided by the appellate division of the New York supreme court, first department, Jan. 25, 1902.

[2] 87 N. W. 1109.

the reorganization of a railroad. It was claimed by the insurer, in defending an action brought against it by the insured upon the bond, that this instrument was susceptible of a strict construction favorable to the insurer, under the well known *strictissimi juris* rule. In passing upon this contention the court spoke as follows: "The bond was given more than two years after the reorganization agreement was signed. The conditions of that agreement were imported bodily into the bond by its very terms. Certainly the surety should have investigated and ascertained what these conditions were, and must be held to be bound by them. He cannot now be heard to say that he was not informed as to their character. He has agreed that they shall be performed, whatever they are. It is true that a surety is a favorite in the law, and that his liability will not be extended by construction; but when it becomes necessary to construe a contract which he has made, the same test is to be applied as in construing any other contract, namely, what was the intention of the parties as disclosed by the instrument, read in the light of surrounding circumstances."

§ 220. **Commercial Insurance — Contractors' Bond.** — An insurer issuing a contract insurance bond in behalf of a certain contractor as the "risk" therein named, is liable in favor of one supplying materials, for the price of the materials so furnished which actually enter into the work, together with the expense of transporting the same to the place where the work is being done. It is also liable for materials used in the construction of false works necessary in the performance of the contract. Where the insured supplies materials to the "risk," for a part of which he was protected by the bond, and for a part of which he was not, as between him and the insurer issuing such bond, payments made on account generally by the "risk" should be applied to the payment for materials furnished and charged prior to the dates of such payment.[1]

§ 221. **Contract Insurance — Building Contracts.** — The su-

[1] U. S. to the use of, etc. *v.* American Sur. Co. *et al.*, 111 Fed. 474.

preme court of Louisiana recently had occasion to pass upon a contract insurance bond issued by the Fidelity and Deposit Company to a contractor while engaged in constructing a building for the insured named in said bond. The latter recited the provisions of the building contract for the purpose of showing the conditions upon which the obligations of the insurer to the insured should become void. In an attempt on the part of certain laborers and material men to compel the insurer to make good to them the amount of their claims against the "risk" (the contractor) as an implied liability of such insurer under the bond, the court held that they could not recover thereon; this for the reason that the bond contained no express agreement to indemnify any one except the insured. It was not intended, the court observed, to benefit any one but the insured, and the benefit to result to him was made dependent upon the conditions named in the bond.[1]

§ 222. **Contract Insurance — Scope of Liability therein.** — In Mullin and Fidelity & Deposit Company *v.* United States to the use of Chapin-Hall Lumber Company [2] a contract insurance bond had been furnished to a contractor for the benefit of material men, conditioned for prompt payment of all claims. One of the insured contracted to furnish the contractor material on condition that eighty per cent of that put in place should be paid for the first of each month, the balance to be paid for on completion of the work. It was held that the contractor having failed to make the eighty per cent payments, and the insured having thereupon refused to proceed under the contract and treated it as rescinded, the twenty per cent became due with the rest and could be recovered of the insurer under the bond before the completion of the work.

§ 223. **Contract Insurance — Alteration of Contract as between the Insured and the "Risk" releases the Insurer.** — In the case of the United States *v.* McIntyre and United States Fidelity & Guaranty Company,[3] the court applied the following

[1] *In re* Fidelity & Deposit Company, 31 Sou. 7.
[2] 109 Fed. 817.
[3] 111 Fed. 590.

rule in construing a contract insurance bond: "It is fundamental that any change in the contract for which the surety is liable, made without his consent, will operate his discharge. The surety assures the performance of a certain contract, and his liability is conditioned inflexible upon the continuance of that particular contract. He who would charge a surety for his principal's breach of contract duty must travel without deviation the way pointed out in the contract, however iron-bound it may be, for there is for the surety, in the enforcement of his bond, no equity nor latitude beyond the strict terms." Under such circumstances the burden of proof is upon the insured to show the insurer's consent to the alterations that have been made in the contract of the insured and the "risk."

§ 224. **Contract Insurance — Nominal Damages.** — The Missouri court of appeals, in the case of Fidelity & Deposit Company *v.* Calvin & Jackson,[1] held that in a suit on a bond conditioned that the party making it should comply with and faithfully execute the terms of a certain contract to secure the performance of which the bond was given, would entitle the insured thereunder to recover at least nominal damages in case such breach occurred.

§ 225. **Contract Insurance — Marshalling of Claims in.** — In marshalling claims against a "risk" named in a contract insurance bond, where such claims exceed in amount the penalty of the bond, the fact that certain of the claims have been purchased by one who has bound himself to indemnify the insurer against its liability under the bond, does not increase the amount to which other claimants are entitled as beneficiaries of such bond. On the other hand, for the purpose of making distribution to them, such claims must be treated as still subsisting.[2]

§ 226. **Subrogation in Contract Insurance.** — A creditor of a "risk" named in a contract insurance bond, whose claim does not entitle him to the benefits thereof, has no such priority with the insurer issuing such bonds as will entitle him

[1] 83 Mo. App. 204.

[2] Am. Sur. Co. *v.* Lawrenceville Cement Co., 110 Fed. 717.

to be subrogated in equity to a security taken by such insurer to indemnify it against loss by reason of the issuance of such bond. Neither can the insurer under such circumstances be prejudiced by any undisclosed relation between the signers of such agreement. The fact that the insurer has been reimbursed for a payment of one claim through the indemnity does not enlarge its liability to other creditors of the "risk," as to whom the clalm paid must be treated as though the insurers had not been reimbursed.[1]

§ 227. — **Judicial Insurance — Insurable Interest.** — In Fidelity & Deposit Company *v.* Singer *et al.*[2] the Maryland court of appeals had occasion to touch upon the subject of insurable interest in judicial insurance while construing a replevin bond furnished by a guaranty insurance company. The bond in suit was given by the insurer to two individuals (O'Brien and Singer) as the insured, at the request of the "risk," the plaintiff in the replevin suit. On the appeal the court spoke as follows: "The uncontradicted evidence showed that neither O'Brien nor Singer in their individual capacities claimed any interest in the goods replevied, but that Singer claimed the entire property in the goods as trustee for the creditors of O'Brien, who was insolvent. And the question is: Inasmuch as O'Brien and Singer, as individuals, had no interest or right to the property seized under the writ of replevin, can a suit be maintained in their names for the use of Singer, trustee for the creditors of O'Brien, against the surety on the replevin bond? Whilst O'Brien and Singer are the obligees named in the bond, can a recovery be had on the bond in a suit brought in their names for the use of Singer, trustee, if the latter is essentially a different person from Singer individually? Singer as trustee is not named in the bond at all. The contract of a surety on a replevin bond is a contract of indemnity, and nothing more. The surety undertakes and agrees to hold the obligee named in the bond harmless; that is, to see that the goods are returned, or their value paid, to the obligee by

1 Am. Sur. Co. *v.* Lawrenceville Cement Co., 110 Fed. 717.

2 50 Atl. Rep. 518.

the principal in the bond, if the replevin suit be not prosecuted with effect, and if the obligee be entitled to the goods or their value. If the obligee has no interest in or right to the possession of the goods, a deprivation of them or of the possession of them can do him no substantial injury. A surety is never bound beyond the terms of his contract, and this means not only that he is not liable for a larger undertaking than he has assumed, but that he is not answerable to any other person than the one with whom the contract was made. A replevin bond is not, like a trustee's or executor's bond, payable to the state for the use of any one who may be or may become interested in the fund or in the estate, but is payable to the defendant in the replevin suit. Whilst a suit on it may be entered by the obligee to the use of another person, the obvious measure of the sum recoverable is the extent of the damages which the obligee might exact, and is not the amount which the equitable plaintiff, who is not a party to the bond, has sustained.

"If this were not so, a person not indemnified by the bond because not named as obligee could recover against the surety on the bond a sum in excess of that which the obligee himself could recover. The surety would then be held bound to a person with whom he did not contract, and in addition he would be made liable to the latter in a larger sum than to the person with whom he did contract. This cannot be, and hence it is clear that the extent of the right which the person to whose use the suit on the replevin bond is brought may have in the property replevied is not the measure of the surety's liability, but the extent of the right of the obligee in that property is the true measure of that liability. The assignee of the bond can have no greater right than the assignor has."

§ 228. **Judicial Insurance — Distillers' Annual Bond — Scope of Obligation.** — In a recent federal case the court had occasion to construe a distillers' "annual bond," given pursuant to statute, conditioned upon the "risk" therein named, faithfully complying with all the provisions of law relating

to the duties and business of distillers and paying all penalties incurred or fines imposed on him for a violation of any of the provisions of the statute in such case made and provided. It was held that the bond did not cover the payment of taxes on distilled spirits, which the "risk" had deposited in a bonded warehouse, nor did it require the payment of taxes for which he had given a prior "warehouse bond," which had been accepted by the government.[1]

§ 229. **Practice — Remedy at Law or in Equity.** — It has been held that where an action is brought upon a contract insurance bond issued to the United States, at the request of a government contractor, which secures claims aggregating an amount exceeding the penalty of the bond, by reason of which fact the insurer is compelled to invoke the aid of a court of equity to marshal the claims, the court may either stay the action until the United States submits its claims for adjustment to a court of equity, or it may permit the insurer to present the same facts in an action at law and enter judgment therein, in accordance with the rights and equities of all parties in interest.[2]

§ 230. **Practice — Right of Insurer to close Argument.** — In Lyman *v.* Fidelity & Casualty Company[3] the question arose as to the right of the attorney representing the insurer which had issued a judicial insurance bond, insuring the state against violations of the liquor tax law by the "risk" therein named, to close the argument at a trial of the case wherein both the "risk" and the insurer had answered separately, raising somewhat different issues. The attorney for the insurer was refused permission to close the case, and the question as to his right so to do was determined in his favor on appeal. The court, in its opinion in the case, said:

"The liability of the defendants was several, and was not necessarily the same. We think the court had no right, without appellant's consent, to require it to acquiesce in the opening and summing up by the counsel for the principal, and to

[1] United States *v.* National Surety Co., 112 Fed. 336.

[2] U. S. *v.* Am. Sur. Co., 110 Fed. 913.

[3] 65 N. Y. Appl. Div. 327.

deprive it of the right and privilege of presenting, through its counsel, its own views of the conflicting evidence and questions upon which the jury was to pass. Where such a case is being defended in good faith, an arrangement can ordinarily be made, at the suggestion of the court, by which one counsel will discuss the question of fact for all of a class of defendants that may be affected alike; and the court has it in its power, by limiting time of counsel in addressing the jury, to prevent the time of the court and the jury being unnecessarily occupied; but we cannot assent to the doctrine that the court may say arbitrarily that the attorney or counsel for a principal shall open and sum up the case, not only for his own client, but for the surety whom he does not represent."

§ 231. **Evidence — Conclusive Effect of.** — In a very recent case[1] the supreme court of Mississippi had occasion to construe a clause in a contract of indemnity given by the "risk" to the insurer, which provided that the voucher, showing payment of loss by the insurer to the insured, should be conclusive upon the "risk" as to the fact and extent of his liability to such insurer. In passing upon the question the court spoke as follows:

"One of the conditions upon which the company became guarantor for Pitts is that the voucher or receipt to it for money paid in good faith for him to the obligee of the bond should be conclusive of the fact of his liability to the obligee for the sum paid; in other words, if the guarantee company should in good faith discharge a claim by the obligee for a liability asserted against Pitts, the voucher or receipt for the payment should be proof of the liability of Pitts. There is nothing wrong or unreasonable or against public policy in this stipulation. Parties, *sui juris*, may lawfully make such stipulations and are bound by them. Under such contract the insurer was authorized to advance, as a condition of guaranteeing, to exercise discretion as to paying any demand made by the holder of the guarantee, and was bound only to act without fraud in settling a claim, and thus paying is en-

[1] Guarantee Co. of N. A. *v.* Pitts, 30 Southern, 758.

titled to hold the party guaranteed for reimbursements, and the voucher proves the claim, if not shown, to have been infected with fraud. The expense, delay, trouble, and risk of loss to the insurer is a sufficient safeguard against any unwarranted payment; and without such a stipulation as complained of here guarantee companies could not safely do business anything like as cheaply as they do, and to the evident advantage of the parties and of the general public. The stipulations of the bond are not influential in this case, which is determinable by the stipulations inducing the company to execute the bond. This suit is not on the bond."

§ 232. **Extrinsic Evidence — When admissible.** — Where a contract requires one of the parties to pay money to a person designated as "trustee," but without stating for whom or for what purpose he is trustee, the circumstances and negotiations leading up to and surrounding the transaction constitute the *res gestæ*, and may be given in evidence in an action to determine which party is responsible for a defalcation on the part of such trustee, not for the purpose of altering the writings of the parties, but to enable the court to correctly construe their agreement.[1]

[1] American Bonding & Trust Co. *v.* Takahashi *et al.*, 111 Fed. 125. See also generally Commonwealth *v.* Am. Bond & Tr. Co., 16 Pa. Superior Ct. 570; Home Savings & Tr. Co. *v.* Fid. & Dep. Co., 88 N. W. 821.

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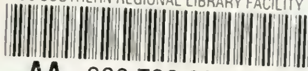

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