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***PREVIEW  
RESTATEMENT OF THE LAW THIRD, SURETYSHIP***

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**PREVIEW,**  
**RESTATEMENT OF THE LAW THIRD**

**SURETYSHIP**

**INTRODUCTION**

On June 9 and 10, 1994, the Fifth, and most likely the last, yearly meeting of the Advisers to the Reporter for the **Restatement of the Law Third, Restatement of the Law Suretyship**, was held in Philadelphia to give final comments and advice to the Reporter for his Interim Draft dated November 17, 1994. This draft will go to the annual meeting of the American Law Institute in Chicago this May. The final approved version will most likely be available by December, 1995 and, if no major changes requiring a reconvening of the Advisers is mandated, the final version should appear in print in March-April, 1996.

The first chapter of the Restatement

<sup>1</sup> which defines the scope and nature of transactions giving rise to suretyship status is derived from Restatement of Security §82 published in 1941. Anyone who works in fidelity and surety and who has done research in this area has seen early references to terms which we understood in the context of that field, used in cases involving commercial transactions, including the old saw "a surety is a favorite of equity." It is this distinction between financial transactions and what we know as fidelity and surety law which the Restatement seeks to clarify through the creation of a universal definition of surety status. Whether this goal has been accomplished is open to serious question.

Of the 16 men who served as Advisers<sup>2</sup> ten either taught commercial transactions and the Uniform Commercial Code in various law schools across the country or practiced in those fields of law.

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<sup>1</sup> As references to the Restatement herein are to Chapters, Topics and Sections as set forth in the Reporter's Draft dated November 1994, all are subject to deletion from or change in the final version.

<sup>2</sup> See Appendix "A" for the make-up of the Advisers group.

Five advisers, and the Assistant Reporter, worked mostly in fidelity and surety practices. The remaining member was the distinguished law professor, E. Allan Farnsworth, of Columbia University School of Law, Reporter for the Restatement Second, of the Law of Contracts. It took this group two entire days to advise the Reporter on how to define the subject. To accommodate the views of both "sides" a very different approach was developed to describe what one might have thought were familiar transactions.

The final product is yet to be anointed but it may result in the fidelity and surety advisers issuing a minority report at the ABA annual meeting in 1996 or the mid-winter meeting of the Fidelity and Surety Law Committee of the ABA Tort and Insurance Practice Section in 1997. The purpose of such a report would be to keep the courts from reaching wrong conclusions based on the Restatement in situations the fidelity and surety industry deals with in everyday business.

### IS IT SURETYSHIP?

The question which divided the Advisers: What is suretyship? Aside from the funny looking three cornered hat we have all heard about (or is it a *menage a trois*?) how do you know when you are in the presence of suretyship?

The first Chapter of the Restatement defines the scope of the status to which its rules apply to be suretyship if, by contract, an obligee has recourse against a secondary obligor or its property with respect to the obligations of the principal obligor to that obligee. Further, this status is said to exist regardless of the form of the qualifying transaction or the terms used to describe the secondary obligor or secondary obligation; and whether or not it is conditional, is known or not known to the principal obligor; whether or not the obligee knows the secondary obligor has suretyship status and whether or not the principal obligor's duty to satisfy the underlying obligation may be limited to a particular source.

In most cases, suretyship status is identifiable from terms in the contracts which create it such as "guaranty" or "surety bond". In the case of less obvious relationships, however, the Chapter sets

out exacting criteria for situations where the transaction involves suretyship. These criteria boil down to situations in which the secondary obligor is liable to the obligee in some way with respect to an obligation, the cost of which ought to be for the account of the principal obligor. The Reporter stresses that the substance of the transaction, rather than the form, determines if suretyship rights exist.

In addition to Chapter One entitled "Transactions Governed by the Law of Suretyship", there are additional chapters entitled:

- Chapter Two - Formation, Enforcement and Interpretation of the Secondary Obligation
- Chapter Three - Incidents of Suretyship Status
- Chapter Four - Multiple Secondary Obligors
- Chapter Four - Enforcement of Secondary Obligations<sup>3</sup>
- Chapter Five - Rules Applicable to Particular Secondary Obligations.

To date, sixty-nine Sections are included in the Chapters including sections dealing with Statutory Bonds and a section dealing with Fidelity Coverage.

### CONCLUSION

It is probably safe to say that many, if not most, of those who work in the fidelity and surety area of the law have never looked at or quoted the former Restatement of Security to a court. It is, therefore, safe to guess that publication of Restatement Third, Suretyship, will not change that pattern. Nevertheless, those of us who advised the Reporter are waiting to see the final product, and if some of the rules do not conform to suretyship as we know and understand that status in the context of the fidelity and surety practice areas, we are prepared to set out in detail, for any court that could become confused, the cases where the rules should be different than as restated. The leadership of the Fidelity and Surety Committee of the Tort and Insurance Practice Section of the ABA is committed to

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<sup>3</sup> This may be a misprint as the index shows two chapters numbered four.

disseminating this information through meetings and publications and anyone interested should keep an eye on those for further information.

**APPENDIX A**

**Restatement of the Law Third  
Suretyship**

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