

## **LIABILITY OF A SURETY UNDER NEBRASKA LAW**

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Surety is a unique arrangement as far as insurance is concerned. The typical insurance contract has two parties: the insurer and the policyholder. The surety contract is a three-party relationship among a principal, an obligee and an insurer. Surety is a secondary as opposed to a primary obligation. The surety agrees with the obligee that if the principal does not pay or perform as per its contract with or for the benefit of the obligee, the surety will pay or perform. Performance, release or settlement between the principal and the obligee typically releases the surety, and the surety typically retains indemnity rights against the principal or separate indemnitors. Surety has been described as a credit relationship as opposed to an insurance arrangement, and there are other mechanisms, such as bank letters of credit, which often substitute for surety. Because of the differences between surety and other types of property and casualty insurance, the question often arises whether and to what extent the legal doctrines applicable to other types of insurance apply to surety. The Nebraska Supreme Court recently answered some of these questions.

Amwest Surety Insurance Company, and its subsidiary, Far West Insurance Company, two Nebraska-domiciled insurance companies whose principal business was surety, were both declared insolvent in 2001 and ordered into liquidation under the Nebraska Insurers Supervision, Rehabilitation and Liquidation Act, Neb. Rev. Stat. §44-4801 *et seq.*

Prior to their insolvency, Amwest and Far West combined were about the tenth largest writer of surety bonds in the United States, specializing in substandard surety and bail. They wrote bonds in nearly every state. As with most insurance company liquidations, a major part of the proceedings have involved the adjudication of policyholder claims. Because only eight state property and casualty guaranty funds cover surety, the domiciliary Liquidator has adjudicated the great majority of claims without guaranty fund participation.

As with virtually all insurance company liquidation acts<sup>1</sup>, Nebraska's Liquidation Act provides that the court overseeing the liquidation proceedings has exclusive jurisdiction to hear all matters brought thereunder. Neb. Rev. Stat. §44-4804. That provision is generally accepted by courts in states with model act provisions, which generally require that the courts of other states give full faith and credit to the insurance liquidation laws of the domiciliary state, and this has been interpreted to provide for the domiciliary liquidation state as the only forum in which claims against the insolvent insurer may be brought. Neb. Rev. Stat. §44-4824(1). While the federal courts are not per se bound by those provisions, the great body of federal cases abstain in favor of the domiciliary liquidation court's jurisdiction over claims against the insolvent insurer. *See Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). In addition, the McCarran-Ferguson Act, 15 U.S.C. §1012(b), reverse pre-empts non-insurance federal law in favor of state law enacted for the purpose of regulating the business of insurance. *United States Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993). In the absence of ancillary receiverships, guaranty fund participation, or other special circumstances (such as a valid pre-existing arbitration agreement in some states), attempts to adjudicate claims against an insolvent insurer in a forum other than the domiciliary liquidation court are the exception rather than the rule.

The Nebraska Liquidation Act provides for the disposition of disputed claims. Neb. Rev. Stat. §44-4839. The Liquidation Act contemplates that an administrative adjudication procedure will resolve the great majority of claims one way or the other, with Liquidation Court participation largely limited to ultimate approval of claims, Neb. Rev. Stat. §44-4843, and distributions thereon. Neb. Rev. Stat. §44-4844. Whenever a claim is denied in whole or in part, the claimant initially has sixty days to file objections with the Liquidator. If no

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objection is filed within that period, the claimant may not object further. Neb. Rev. Stat. §44-4839. If the claimant objects and the Liquidator does not change his or her position on the claim objection, the Liquidator must refer the disputed claim to the Liquidation Court, which may either hear the matter or refer it to a court-appointed referee. *Id.* After the Liquidation Court decides the disputed claim, the losing party has appeal rights.

As a result of this process, Nebraska's appellate courts have decided a number of surety cases. One of the most significant cases, *State ex rel. Wagner v. Amwest Surety Ins. Co.*, 274 Neb. 110 (2007), commonly known as *Strategic Capital Resources*, was decided in 2007 by the Nebraska Supreme Court. Saxton, Inc., the bond principal, entered into four lease agreements with Strategic Capital Resources (Strategic). Saxton contracted with Amwest to issue four corresponding lease bonds under which Amwest agreed to provide payment to Strategic if Saxton defaulted. Subsequent to the issuance of the bonds, on June 7, 2001, Amwest became subject to an order of liquidation, pursuant to which, on July 6, 2001, all of its surety bonds, including the lease bonds, were cancelled by operation of law under the Liquidation Act. Neb. Rev. Stat. §44-4819.

Following termination of the lease bonds, on July 9, 2001, Strategic provided Amwest with written notice of Saxton's default. Each of the Amwest bonds specified that in order to recover against the surety, 30 days' written notice of the principal's default was required. In finding that the Liquidation Court properly disallowed Strategic's claims against Amwest because it had not given written notice while the lease bonds were in effect, the Nebraska Supreme Court found as follows:

Strategic's claims were correctly denied because Strategic failed to comply with the express conditions set forth in each of the lease bonds before the lease bonds were canceled.

Nebraska adheres to the rule of strict construction of guaranty contracts. A guaranty is interpreted using the same general rules as are used for other contracts. When the meaning of the contract is ascertained, or its terms are clearly defined, the liability of the guarantor is controlled absolutely by such meaning and limited to the precise terms. We have further explained that

[A] surety cannot be held beyond the precise terms of his contract. Any intention on the part of the surety to assume a further and continued liability must be found in the words of the contract made. It is not a matter of inference but of express statement. The liability of a surety, therefore, is measured by, and will not be extended beyond, the strict terms of his contract.

274 Neb. at 116 (footnotes omitted). The Court observed that "[c]ourts in other jurisdictions have similarly concluded that when a guaranty contract contains express conditions, those conditions must be strictly complied with before the guarantor is liable," specifically mentioning Arkansas, Colorado and Wisconsin. *Id.* at 118.

In response to the claimant's arguments that the bond defaults in question took place prior to the cancellation of Amwest's bonds, the Nebraska Supreme Court made another important observation concerning the nature of a surety contract:

Strategic claims that notwithstanding the fact that the lease bonds have now been terminated, the alleged defaults took place before the lease bonds were canceled and that therefore, Amwest remains liable to pay. In support of this argument, Strategic relies on cases dealing with occurrence-based insurance policies. Strategic contends that under occurrence policies, if the event insured against -- i.e., the occurrence -- takes place within the policy period,

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regardless of when a claim is made, the policy provides coverage.

However, Strategic's reliance on cases relating to occurrence policies is misplaced. The contracts at issue in this case are guaranty contracts, not insurance liability policies. As a guaranty contract, the liability of the guarantor is limited to the precise terms used in the contract. Before Amwest's liability under the bonds arose, certain conditions had to be satisfied. Strategic did not comply with those provisions while the lease bonds were in force.

274 Neb. at 119 (footnotes omitted).

The Nebraska Supreme Court in *Strategic Capital Resources* made important findings that are applicable to solvent, operating sureties. The surety contract -- the bond -- forms the legal relationship between the parties and sets forth the conditions and extent under which the surety will be called upon to perform the principal's contract.

Courts in other states have also considered how to construe surety contracts. The decisions fall into three major categories: states like Nebraska which strictly construe surety contracts in favor of the guarantor, states which construe surety contracts against the guarantor, and other states. A majority of states, such as Arkansas<sup>2</sup>, Colorado<sup>3</sup>, Illinois<sup>4</sup>, and California<sup>5</sup>, follow the same rule as Nebraska, applying strict construction to the interpretation of guaranty contracts in favor of the guarantor. Other states, such as Alabama<sup>6</sup>, Florida<sup>7</sup>, Oklahoma<sup>8</sup>, and Tennessee<sup>9</sup>, take the opposite approach, employing a strict rule of construction against the guarantor. Other states have either not considered these issues or apply more general doctrines of contract interpretation.<sup>10</sup>

Commercial banks, in their form guaranties, tend to throw in the kitchen sink in drafting their form guaranties to best assure that any suretyship defense is waived. Sureties do not generally have the same luxury. Oftentimes the form and substance of a surety bond is dictated by statute, by the owner, or by course of dealing. So it is in both the surety's and the obligee's interest to pay more attention to the specific wordings of the bond as well as controlling law to avoid unwanted or unanticipated consequences.

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### Endnotes

1. See National Association of Insurance Commissioners, Insurers Rehabilitation and Liquidation Model Act (NAIC 555-103).
2. See, e.g., *National Bank of Eastern Ark. v. Collins*, 236 Ark. 822, 370 S.W.2d 91 (1963) (Guarantor is entitled to strict construction of his undertaking and cannot be held liable beyond strict terms of the contract).
3. *Walter E. Heller & Co., Inc. v. Wilkerson*, 627 P.2d 773 (Colo. App. 1980) (Guarantee agreements are to be strictly construed in favor of the guarantor).
4. *McClean County Bank v. Brokaw*, 119 Ill.2d 405, 519 N.E.2d 453 (1988) (A guarantor is to be accorded benefit of any doubt which may arise from language of contract, and its liability is not to be varied or extended by construction or implication beyond its precise terms).
5. *Bank of America Nat. Trust & Savings Ass'n v. Kelsey*, 6 Cal.App.2d 346, 44 P.2d 617 (1935) (Contracts of guaranty are to be construed under the same rules employed in construing other contracts and should receive a fair and liberal interpretation according to the true import of their language, and the guarantor's

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liability should not be extended by implication beyond the express terms of the instrument in which the guaranty is contained).

6. *Dill v. Blakeney*, 568 So.2d 774 (Ala. 1990) (Generally, the rules governing the construction and interpretation of contracts are applicable in interpreting or construing a guaranty contract. Where language in a guaranty contract is ambiguous and susceptible of more than one meaning, the contract should be construed more strongly against the guarantor).
7. *LEA Industries, Inc. v. Raelyn Intern., Inc.*, 363 So.2d 49 (Fla. App. 3 Dist. 1978) (A contract of guaranty is generally construed against a guarantor, particularly where it has been prepared by him).
8. *Rucker v. Republic Supply Co.*, 415 P.2d 951 (Okla. 1966) (In construing a guaranty to determine the intent of the parties, it should be taken most strongly against the guarantor and in favor of the creditor).
9. *Farmers-Peoples Bank v. Clemmer*, 519 S.W.2d 801 (Tenn. 1975) (Guarantor in a commercial transaction will be held to the full extent of his engagements; in construing the guaranty instrument, the words of guaranty are taken as strongly against the guarantor as the sense will admit).
10. *Ferrell v. South Central Bell Tel. Co.*, 403 So.2d 698 (La. 1981) (Contracts of guaranty or suretyship are subject to the same rules of interpretation as contracts in general).