

# FAITHFUL PERFORMANCE UNDER FIDELITY, PUBLIC OFFICIAL AND STATUTORY BONDS

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## I. INTRODUCTION

This article is devoted to a discussion of the meaning of the term “faithful performance” as it is used in fidelity bonds, as well as various statutory and public official bonds. Although public official bonds are surety bonds, rather than pure fidelity bonds, they are discussed for their instructive value in light of the paucity of cases construing the term “faithful performance” in fidelity bonds.

As will be discussed, a controlling factor in the interpretation of faithful performance bonds is any applicable statutory limitations. If the bond is non-statutory, or if the statute or regulation calling for issuance of the bond offers no guidance (as in the case of credit union bonds discussed in Section B of this article), the court is free to broadly interpret the term “faithful performance.” On the other hand, in such situations the reach of the bond can be limited if the term faithful performance is carefully defined in the bond. Each of these possibilities, however, may be restricted by statute. Accordingly, the starting point in the investigation of a claim under a faithful performance bond is a review of any applicable statute.

### A. Incorporation of Statutory Provisions into Faithful Performance Bonds

Any statutory coverage requirements are read into the bond, including any statutory indication of what the term “faithful performance” should

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mean.<sup>1</sup> The statute, nevertheless, may be singularly unhelpful. For example, LA. REV. STAT. ANN. § 33:1443,<sup>2</sup> setting forth the bonding requirements of certain Louisiana sheriffs, provides in pertinent part:

Except in Orleans Parish, the sheriff shall give bond ... with the following conditions ... '[I]f the said [above bound sheriff] shall well and faithfully execute and make true returns, according to law, of all such writs, orders and process as shall come into his hands as sheriff aforesaid ... and shall faithfully do and perform all such other duties as may be required of him by law, then the above obligation to be null and void, otherwise to remain in full force and virtue.'<sup>3</sup>

In contrast, the bonding statute for South Carolina State Troopers at issue in *Rosemond v. Employers Mutual Casualty Co. of Des Moines, Iowa*<sup>4</sup> provided more guidance as to what should be covered by a trooper's faithful performance bond:

*Patrolmen to be bonded*—Every officer and patrolman commissioned pursuant to this chapter shall file a bond, or be covered by a surety bond, ... conditioned for the faithful performance of his duties, for the prompt and proper accounting of all funds coming into his hands and for the payment of any judgment recovered against him in any court of competent jurisdiction upon a cause of action arising out of breach or abuse of official duty or power and damages sustained by any member of the public from any unlawful act of such officer or patrolman; *provided*, that coverage under such bond shall not include damage to persons or property arising out of the negligent operation of a motor vehicle.<sup>5</sup>

Of course, to constitute unfaithful performance the act or omission for which recovery is sought under the bond must be an act or omission by or attributable to the bonded official. Accordingly, it has been held that a sheriff and his surety are not liable for unauthorized acts by a deputy committed during the tenure of the sheriff's predecessor.<sup>6</sup> Likewise, the sheriff's surety may not be liable for misconduct (conversion of county property) that the former sheriff committed after having left office.<sup>7</sup> Nor is the sheriff's

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1. Elmer W. Beesley, *Liability of Surety on Public Official Performance Bond Where Claim Not Based on Dishonest or Fraudulent Acts*, PROC. A.B.A. SEC. INS. NEGL. COMPEN. LAW 236 (1964). Mr. Beesley's article affords an excellent and fairly recent overview of statutory faithful performance bonds.

2. LA. REV. STAT. ANN. §33:1443 (West 1988)

3. *Id.* (emphasis added).

4. 238 F. Supp. 657 (W.D.S.C. 1965).

5. *Id.* at 658 n.4 (quoting S.C. CODE ANN. § 46-852 (Michie 1962), as amended by S.C. CODE ANN § 23-5-20 (Law Co-op. 1976) (repealed 1993)).

6. *Karr v. Dow*, 507 P.2d 455 (N.M. Ct. App. 1973).

7. *Hemphill County v. Adams*, 406 S.W.2d 267 (Tex. Civ. App. 1966), *rev 'd on other grounds*, 408 S.W.2d 926 (Tex. 1966).

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surety liable for defalcations the sheriff committed as civil defense director, a completely separate office.<sup>8</sup> These principles appear to be generally applicable to faithful performance bonds.

In any event, as discussed below, different categories of officials may be held to different standards of faithful performance, including, in the case of custodians of funds such as tax collectors, strict liability for any shortage of funds.<sup>9</sup>

## B. Credit Union Bonds

Credit union bonds are a good example of the relative freedom available to both courts and bonding companies in the absence of statutory guidance. Federal regulations require fidelity bonds for each such institution's employees, but typically offer no specific guidance as to the interpretation of the term "faithful performance" in such bonds:

(a) *Scope.* His part provides the requirements for fidelity bonds for Federal credit union employees and officials ....

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(c) *Minimum coverage; approved forms.* Every Federal credit union will maintain bond and insurance coverage with a company holding a certificate of authority from the Secretary of the Treasury. Credit Union Blanket Bond Standard Form No. 23 of the Surety Association of America (revised to May, 1950) is considered the minimum coverage required and is approved. Credit Union Blanket Bond Forms 581 and 582 are also approved. Any other basic bond forms, and all riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of the NCUA Board. Fidelity bonds must provide coverage for the fraud or dishonesty of all employees, directors, officers, and supervisory and credit committee members.<sup>10</sup>

Although the regulation affords no guidance for interpretation of the term "faithful performance," it does not preclude a credit union bond from defining that term, so long as the bond form is approved by the NCUA. The term "faithful performance," as used without definition in the first version of the federal credit union bond was construed for the first, and apparently

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8. *Id.* at 926 (the Texas supreme court reversed the appellate court's companion holding that the county's claim was time barred as to both the sheriff and surety and remanded the case without further comment for consideration of other, unspecified, points of trial court error).

9. *Cecil v. Gila County*, 227 P.2d 217 (Ariz. 1951).

10. 12 C.F.R. § 701.20 (1997).

only, time in *M. B. A. F. B. Federal Credit Union v. Cumis Insurance Society, Inc.*<sup>11</sup> Insuring Clause A of the bond provided coverage for:

For direct loss of, or damage to, any property, as defined herein, caused by the fraud or dishonesty of any of the Insured's employees, as herein defined, ... or though the failure on the part of such employee ... to well and faithfully perform his duties.<sup>12</sup>

The manager of the Myrtle Beach Credit Union had made a \$200,000 loan, in purported reliance on an appraisal valuing the proposed collateral at \$285,000, even though he knew that the borrower was about to purchase that property for \$72,000. Further, the manager disbursed the loan proceeds before submitting the loan to the loan committee. There was no indication of deliberate wrongdoing, and the court deemed this conduct to be ordinary negligence.<sup>13</sup>

Finding the credit union's loss to be covered, the Fourth Circuit stated:

We agree with the district court's holding that the quoted coverage insures against negligence. As it reasoned, Insuring Clause A covers two types of conduct — 'fraud or dishonesty' and that an employee 'well and faithfully perform' — if the latter clause is to have any independent significance it must mean something other than fraud or dishonesty.<sup>14</sup>

Although not involving credit union bonds, two earlier cases are of interest because they construe the undefined term "faithful performance" in a bond for a financial institution's officer. In *American Bank v. Adams*<sup>15</sup> a bank teller's faithful performance bond was held to cover loss due to his lack of "due and ordinary diligence."<sup>16</sup> In contrast, in the somewhat atypical case of *Sparta State Bank v. Myers*,<sup>17</sup> a bank cashier's faithful performance bond was held not to apply to loss occasioned through his incompetence because, before being hired, the cashier had protested that he knew nothing about banking and was incompetent to be a cashier. The bank officials nevertheless had persuaded him to take the job.

Following the *Myrtle Beach Credit Union* decision, the Cumis Insurance Society, by endorsement, revised insuring Clause A of its bond to read:

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11. 681 F.2d 930 (4th Cir. 1982).

12. *Id.* at 932.

13. *Id.*

14. *Id.*

15. 29 Mass. (12 Pick.) 303 (1832).

16. *Id.* at 306.

17. 177 N.E. 258 (Ind. 1931).

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A. For direct loss of, or damage to, any property, as defined herein, caused by the fraud or dishonesty of any of the Insured's employees, as herein defined, and directors, committed anywhere, whether acting alone or in collusion with others, or through the failure on the part of such employee, excluding directors acting as directors except for fraud or dishonesty, to faithfully perform his trust.

The 1988 endorsement in numbered Paragraph 4 further defined "faithful performance" as:

FAITHFULLY PERFORM HIS TRUST. As used in Insuring Clause A, an employee shall be deemed to have faithfully performed his trust if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Insured unless such conduct constitutes gross negligence. Faithful performance of trust coverage does not include (1) losses caused by simple negligence, mistakes, errors, oversights, inadequate training, or ignorance or unintentional violation of credit union rules or regulations, or (2) losses resulting from acts known to, acquiesced in or ratified by the board of directors.

In 1996, the Cumis Insurance Society began issuing its Bond No. 400 which, in Paragraph 12, further defines "[failure to faithfully perform his/her trust]" as:

'Failure to perform his/her trust' means acting in conscious disregard of your established and enforced share, deposit or lending policies.

'Failure to faithfully perform his/her trust' does not mean:

- a. Negligence, mistakes or oversights; or
- b. Acts or omissions resulting from inadequate training; or
- c. Unintentional violation of laws or regulations; or
- d. Unintentional violation of your policies or procedures; or
- e. Acts or omissions known to, acquiesced in, or ratified by your Board Of Directors; or
- f. Acts of an 'employee' for which you could have made claim under Employee or Director Dishonesty Coverage.

The new definition appears to have satisfied the bonding company's apparent objective of restricting coverage, including its desire to preclude coverage for various forms of negligence, and maintaining the bond as a fidelity bond, rather than a surety bond. However, it does not appear that the definition of faithful performance from either the endorsement or Bond No. 400 has yet been construed in a written opinion. Given the absence of

any definition of faithful performance in federal regulations, and the regulations requirement that bond forms be officially approved, it is submitted that the more restrictive definitions of faithful performance instituted since the *Myrtle Beach Credit Union* case, being unambiguous, should be upheld as a matter of contract.<sup>18</sup>

### C. Law Enforcement Officers Bonds

Generally an official's faithful performance bond applies only to the performance of the official's duties. Sometimes, however, courts are faced with claims against law enforcement officers founded on bad acts that, though not committed in the course of performing or attempting to perform official duties, purport to have been. Accordingly, until fairly recently, many courts drew a meaningful, although difficult, distinction between an official's acts performed by virtue of office, and acts performed under color of office. Some courts found that faithful performance bonds covered wrongful acts performed under either rubric, while others restricted coverage to acts performed in the course of performing or attempting to perform a true official duty, that is, by virtue of office. Under this distinction a bond would cover, for example, damages caused by a sheriff in attempting to execute a writ, but seizing the wrong property. However, it would not cover damages caused by the same sheriff in effecting a clearly unlawful arrest, supported by neither warrant nor probable cause. The court would deem the seizure of the wrong property to have been made by virtue of the sheriff's office, but the blatantly false arrest to have been only under color of office.<sup>19</sup>

The distinction between acts by virtue of and under color of one's office generally has little significance today. By 1962, most courts already held that faithful performance bonds applied to any acts performed under color of office, although not to the official's purely private acts.<sup>20</sup> As the Mississippi Supreme Court stated in that year:

In the books there are to be found much refinement and quibbling in behalf of sureties on official bonds, as to whether the act of the officer was done colore officii, or virtue officii .... The intricacies of this discussion are satisfactorily avoided by those courts which in accordance with the weight of authority

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18. See *Valentine v. Bonneville Ins. Co.*, 691 So.2d 665,668 (1997) ("An insurance policy is a contract and should be construed using general rules of interpretation of contracts set forth in the civil code."); *Bank of the West v. Sup. Ct. of Contra County*, 833 P.2d 545, 551-552 (Ca. 1992) ("While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.").

19. See Charles A. Noone, *Liability of Surety on Sheriffs' Official Bonds*, 18 INS. COUNS. J. 22 (1951).

20. *King v. Kelly*, 137 So. 2d 808 (Miss. 1962) (sheriff's bond does not apply to damages resulting from sheriff murdering deputy).

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hold that sureties are liable for the acts of an official performed under color of his office as well as for those done by virtue of his office.<sup>21</sup>

Although this article's scope is restricted to interpretations of the term "faithful performance," it is appropriate to note with respect to law enforcement officers' bonds in particular that the terms of the bond, and the terms of the statute calling for the bond's being posted, determine whose faithful performance is at issue.<sup>22</sup> For example, a bond may cover all personnel of a law enforcement agency, or may cover only the head of the law enforcement agency, such as the sheriff, or the chief of police. In the latter event, the question arises as to whether the agency head and its bond are liable for the unfaithful performance of a deputy or employee. It is beyond the scope of this article to tabulate the legislative and judicial positions of the fifty states on this issue. However, the broadly applicable case of *Coon v. Ledbetter*<sup>23</sup> is of interest. Noting a fifty year series of isolated Mississippi Supreme Court cases holding that a member of the public injured by a deputy sheriff's tort could recover from the sheriff's surety, the Fifth Circuit held that neither the sheriff nor the surety was liable on a respondeat superior theory for civil rights violations under 42 U.S.C. § 1983.<sup>24</sup>

Once a law enforcement officer has taken a person or property into custody, it is clear that his duty of faithful performance includes the duty to keep that person or property safe. In *Dedeaux v. Lawler*<sup>25</sup>, for example, the court affirmed a default judgment holding the sheriff liable for damages to a boat that vandals destroyed while it was in the sheriff's custody pursuant to a writ of replevin. Likewise, a host of cases hold that law enforcement officers have a duty to protect individuals in their custody and afford them appropriate care, such as medical care.<sup>26</sup> Clearly failure to provide such care would be a failure of the official to faithfully perform his duties and, consequently, should be covered by his official bond.<sup>27</sup> Depending on state law, ordinary negligence may be sufficient to constitute a breach of the official's duty to care for prisoners, and hence, a breach of his faithful performance bond.<sup>28</sup>

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21. *Id.* at 811. Further guidance as to the scope of the "under color of law" rubric may be found in general liability and civil rights cases not involving faithful performance bonds, which are beyond the scope of this article. *See, e.g.*, *Baker v. McCollan*, 443 U.S. 137 (1979); *Slavin v. Curry*, 574 F.2d 1256 (5th Cir. 1978).

22. This issue also may arise, though less dramatically, with respect to other officials such as tax collectors, discussed *infra*, Section D.

23. 780 F.2d 1158 (5th Cir. 1986) (construing Mississippi sheriff's statutory bond).

24. 42 U.S.C. § 1983 (1997).

25. 179 So. 2d 779 (Miss. 1965).

26. *See, e.g.*, *Elsberry v. Haynes*, 256 F. Supp. 738 (W.D. Okla. 1966).

27. *Id.*

28. *Glover v. Hazelwood*, 387 S.W.2d 600 (Ky. 1964).

A general discussion of the degree of care owed by law enforcement officers to their prisoners would involve an examination of the statutory and common law of all fifty states, as well as federal jurisprudence under the Sixth and Fourteenth Amendments to the Constitution and numerous civil rights enactments. Two recent decisions by the United States Fifth Circuit Court of Appeal, *en banc*, however, are of sufficient importance to require mention.<sup>29</sup> In *Hare v. City of Corinth*<sup>30</sup> a pretrial detainee's survivors sought to recover damages for her suicide while in police custody. In *Scott v. Moore*<sup>31</sup> a pretrial detainee sought to recover damages because, while in police custody, she was raped by a previously well behaved guard. In both cases the *en banc* court held that a pretrial detainee, invoking the due process safeguards of the Fourteenth Amendment to the United States Constitution, must bear the same burden as would a convict invoking the Sixth Amendment's prohibition of cruel or unusual punishment. In order to recover damages for episodic acts or omissions, the confined person, whether or not a convict, must show that the department head or governing authority had actual knowledge of the risk that the prisoner would suffer the injury complained of and reacted to that risk with deliberate indifference.<sup>32</sup> Thus, in the Fifth Circuit at least, the surety for a sheriff or chief of police would only rarely face liability under federal constitutional law for at least an isolated episode of prisoner abuse. There still would remain questions of whether the bonded official had breached a state law duty to protect the prisoner and thereby breached a bonded duty of faithful performance.

The general rule that acts performed under color of office are covered by the law enforcement officer's bond leads to the coverage of most false arrests and similar torts.<sup>33</sup> Two exceptions are the bonded officer's purely personal and private activities, and, perhaps, acts completely outside the bonded officer's jurisdiction.

In *Kapson v. Kubath*<sup>34</sup> Michigan deputy sheriffs, assisting Indiana authorities, crossed into Indiana to raid an unlawful gambling establishment. The Michigan deputies wrongfully damaged some property in Indiana and took some of it with them back to Michigan. The sheriff's surety was found not liable because the deputies, at the time of the wrongful act, were outside

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29. *Scott v. Moore*, 114 F.3d 51 (5th Cir. 1997); *Hare v. City of Corinth*, 74 F.3d 633 (5th Cir. 1996).

30. *Id.*

31. 114 F.3d 51.

32. *Scott*, 114 F.3d *id.* at 53-54; *Hare*, 74 F.3d at 647-50.

33. See Charles A. Noone, *supra note* 19, at 26. See also *King v. Kelly*, 130 So.2d at 810-11; 16 at 810-11.

34. 165 F. Supp. 542 (W.D. Mich. 1958).

their jurisdiction and thus could not have been acting in the performance of a duty imposing liability on the sheriff by virtue of his office. The court did not consider whether law enforcement officers completely outside their territorial jurisdiction nevertheless could act under color of their office and so render their sureties liable.

The question of whether a law enforcement officer's acts are purely personal and private, and therefore outside any official bond coverage, is very fact intensive. Thus, in *King v. Kelly*<sup>35</sup> the Mississippi sheriff who murdered his deputy clearly was not acting, or purporting to act, in an official capacity.<sup>36</sup> However, in *Britt v. Merritt*<sup>37</sup> the facts were so ambiguous that the Louisiana Court of Appeals and the State Supreme Court reached opposite conclusions while applying the same rule of law. In *Britt* a deputy sheriff claimed that he was attempting to halt a bootlegger to search his jeep for contraband alcohol and, in self defense, shot the bootlegger, allegedly because the bootlegger attempted to run him over with a jeep. The corner's report, however, indicated that the bootlegger had been shot in the back. The court of appeals and the supreme court applied the same legal standard: "[N]either the sheriff nor the surety on his official bond is responsible for a wrongful act of a deputy sheriff unless it was done in violation or in an unfaithful or improper performance of an official duty."<sup>38</sup> The court of appeals, purporting to believe the deputy's version of events, characterized his acts as a misguided and wrongful attempt to perform his duty, for which the bond afforded coverage.<sup>39</sup> The Louisiana Supreme Court, however, held that the plaintiff had failed to prove by a preponderance of the evidence that the deputy was attempting to effect a search for contraband liquor rather than murdering the bootlegger. Accordingly, neither the sheriff nor the surety were liable.<sup>40</sup>

The liability of law enforcement officers for deliberate and negligent misconduct affords material for a full treatise. Assuming the officer's liability, however, it may be said that, barring an authorized exception in the bond, or a statutory exception, the faithful performance surety also will be liable for any negligent or intentional misconduct committed in attempted or pretended performance of official duty, even if the act itself proves to be

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35. 130 So.2d 808.

36. *Id.* at 811.

37. 53 So. 2d 121 (La. 1951).

38. *Id.* at 122-23 (quoting *Britt v. Merritt*, 45 So. 2d 902, 907 (La. Ct. App. 1950) (This legal standard does not address the under color of office/by virtue of office distinction. The language may, however, be broad enough to allow coverage for acts performed under color of office).

39. *Britt*, 45 So. 2d at 906-907.

40. *Britt*, 53 So. 2d at 123.

unlawful, such as a false arrest. Even a personal tort could be covered if artfully masked by the officer as a performance of duty, as the Court of Appeal opinion in *Britt v. Merritt* illustrates.<sup>41</sup>

#### D. Bonds For The Faithful Performance of Treasurers, Tax Collectors and Related Officials

It almost goes without saying that the surety for a tax collector's or treasurer's faithful performance of official duties will be liable if the official steals public money.<sup>42</sup> Not surprisingly, the surety for a tax collector or treasurer also has been held liable for the official's negligent loss of funds, including funds lost through failure to detect the misdeeds of subordinates. In *City of Lake Worth v. First National Bank in Palm Beach*<sup>43</sup> a city treasurer's surety was held liable for the loss of funds advanced by the City for the purchase of certain bonds, which instead were misappropriated, even though the treasurer was guilty of no wrongdoing. The treasurer did act as custodian of such bonds as were purchased, although not officially required to do so. The court reasoned that had the treasurer performed adequately all of his duties as treasurer, he could not have avoided discovering the fraud. The court stated:

Even though he was not specifically charged with the duty of acting as custodian of the bonds purchased by the city, Stimson [the treasurer] did act as custodian of the bonds actually received by the city. This circumstance alone may not be sufficient to charge him with knowledge of what was going on. We are unable, however, to see how, if he had properly discharged the duties imposed upon him by the city charter, Stimson could have failed to know that the city's funds were being improperly diverted. ... Having such knowledge, it would have been his duty to report it to the city manager and commissioners; and if this had been done, the loss of the City's funds could have been avoided. We find that Stimson failed to perform fully the duties of his office and that his failure caused loss to the City.<sup>44</sup>

In *Independent School Dist. 93 v. Western Surety Co.*<sup>45</sup> the school district's treasurer did not cause any money to be lost in the ordinary sense of the word. He simply kept such poor records that the school district thought it had more money than it actually had. In consequence, the treasurer paid warrants that could have been rejected. The court of appeals found that the

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41. 45 S.2d 902.

42. See, e.g., *Wittmann v. Harrod*, 152 So. 2d 717 (Miss. 1963).

43. 93 So. 2d 49 (Fla. 1957).

44. *Id.* at 56-57.

45. 419 F.2d 78 (10th Cir. 1969).

treasurer's inadequate recordkeeping constituted a breach of his bonded duty to faithfully perform his office.<sup>46</sup> The court did not resolve the more difficult question of whether the school board had sustained a loss covered by the bond when it had, in fact, received value for all of the monies paid out, its contention being that to incur an unlawful deficit was a loss *per se*. Instead, the court found that the school board had failed to present adequate evidence of which warrants, if any, would not have been paid had the treasurer exercised due diligence, and so had not established the amount of any alleged loss.<sup>47</sup> Accordingly, the court of appeals affirmed the trial court's take nothing verdict.<sup>48</sup>

*Platte County v. New Amsterdam Casualty Co.*<sup>49</sup> arose because, during the Great Depression, the county treasurer did not send out notices of delinquent personal property taxes. As the sending out of delinquency notices was positively required by statute, the court deemed failure to do so within a reasonable time to be a failure by the treasurer faithfully to perform his duty, without regard to whether his failure was negligent or deliberate.<sup>50</sup> The court noted that the duty to send out delinquency notices did not make the treasurer an insurer of the tax's collection.<sup>51</sup> The court, however, also took note of the circumstance that for such funds as actually were collected, except with respect to a loss excused by statute, or caused by God or a public enemy, the treasurer would be the county's insurer.<sup>52</sup>

In *Cecil v. Gila County*<sup>53</sup> the county treasurer and her surety were held strictly liable for the loss of funds that she asserted (and the court assumed for purposes of its ruling) were stolen by an unknown party from the office safe.<sup>54</sup> The court relied on the specific statutory duty of a county treasurer to safeguard funds:

Our basic law ... does not detail the duties of county officers, among whom is the county treasurer. It left such task to the legislature. [The statute] pronounces the duties imposed upon a county treasurer. It provides, in part:

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46. *Id.* at 80.

47. *Id.* at 81-82.

48. *Id.* at 82.

49. 6 F.R.D. 475 (D. Neb. 1946).

50. *Id.* at 490.

51. *Id.* at 489.

52. *Id.* at 490.

53. 227 P.2d 217.

54. *Id.* at 218.

Duties – the county treasurer shall:

1. Receive all money of the county and all other money directed by law to be paid to him, *safely keep*, apply and pay the same and render account thereof as required by law ....<sup>55</sup>

Conceding that the rule of strict liability could lead to harsh results, the court compared the liability of a county treasurer for monies received with the liability of a post master for the safety of a registered package.<sup>56</sup>

The harsh result that the *Platte County* court alluded to appears to have been reached in *State v. Herbert*.<sup>57</sup> The treasurer of the State of Ohio was authorized to invest state funds in commercial paper up to the amount of \$50,000,000. A deputy treasurer invested a total of \$8,000,000 in promissory notes of the King Resources Company. Thereafter, the treasurer inquired of his deputy whether the \$50,000,000 limit had been exceeded. On being informed that it had, he asked for and received the deputy's resignation. It was established that the deputy treasurer knew that investments in commercial paper already exceeded the \$50,000,000 when he purchased two King Resources notes.<sup>58</sup> A dissenting opinion points out that immediately upon discovering that the \$50,000,000 limit had been exceeded, the treasurer ordered the sale of sufficient securities to bring the investments within the authorized limit.<sup>59</sup> The King Resources notes were not among those sold, but were not in default at the time and met all criteria for purchase other than the \$50,000,000 investment limit.<sup>60</sup> More than two years later, with the investments still below the statutory ceiling, King Resources did fail and the notes were disposed of at a loss to the state.<sup>61</sup>

Finding that Ohio's statutory investment scheme made the \$50,000,000 investment limit an absolute requirement, and that none of the statute's exculpatory provisions were applicable, the court deemed the loss sustained when King Resources defaulted on its notes to have been the result of the deputy treasurer's unlawful purchase of the notes for which the treasurer and his sureties were liable.<sup>62</sup> The court stated:

It has been the general policy, not only with government employees and appointees, but with state officers, county officers, township officers, and all

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55. *Id.*(*emphasis added*).

56. *Id.* at 219.

57. 358 N.E.2d 1090 (Ohio 1976).

58. *Id.* at 1091.

59. *Id.* at 1097.

60. *Id.*

61. *Id.* at 1091.

62. *Id.* at 1094-95.

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other public officials, to hold the public official accountable for the moneys that come into his hands as such official ...; that is to say, that when he comes to account for the money received, it must be accounted for paid over, unless payment by the official is permitted by an act of God or a public enemy.<sup>63</sup>

It is not practical in this article to address the specific rules of all, or even many, states. It is sufficient to say that when the loss of public funds is concerned, the surety of the official charged with the custody of those funds, in addition to having liability for the official's own misconduct, will be liable for the official's negligence (and possibly that of subordinates), and well may be held strictly liable for missing funds. Accordingly, in evaluating any case strict inquiry must be made into not only the terms of the bond and the statute requiring the bond, but also all statutes imposing duties on the official and otherwise regulating the official's conduct.

## E. Miscellaneous Public Official Bonds

### 1. *Bankruptcy Trustee Bonds*

The bankruptcy court in *In re George Schumann Tire & Battery Co.*<sup>64</sup> found, not surprisingly, that the surety on a bankruptcy trustee's faithful performance bond was liable when the trustee defied several court orders to turn over the debtor's money, which ultimately was found to be short.<sup>65</sup> In *In Re Reich*<sup>66</sup> a bankruptcy trustee was found to have breached a statutory and common law duty to care for the debtor's property in his custody when he neglected to remove from a building's roof snow that caused the building to collapse. The trustee's faithful performance surety was found liable for the resulting loss.

### 2. *Hospital Employee Bonds*

In *Hartford Accident and Indemnity Co. v. Reedy*<sup>67</sup> the surety on a faithful performance blanket bond applicable to numerous hospital employees paid a loss of over \$6,000 caused by the hospital bookkeeper's theft. The surety then sought to recover that amount from the hospital administrator, on the theory that his failure to institute bank deposit and other policies that would have precluded the theft was a failure faithfully to perform his duties, and therefore the proximate cause of its loss. Although this subrogation case does not involve the interpretation of the term "faithful performance"

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63. *Id.* at 1095 (quoting *Seward v. Nat'l Surety Co.*, 165 N.E. 537 (Ohio 1929)).

64. 145 B.R. 104 (Bankr. M.D. Fla. 1992).

65. *Id.*

66. 54 B.R. 995, 1008 (Bankr. E.D. Mich. 1985).

67. 233 So. 2d 799 (Miss. 1970).

as used in a bond (obviously the bookkeeper's stealing the money was unfaithful performance), it is of interest because of the court's analysis of the administrator's statutory duty.

The court noted that no statute imposed any specific duty on the hospital administrator, and that the hospital's trustees were in charge of its control and operation. The administrator had taken over and perpetuated an on going method of operation, and neither the trustees nor the state auditor ever had criticized that method.<sup>68</sup> Nevertheless, the court assumed that the administrator had a duty to tighten up hospital procedures and require more frequent bank deposits, but held that his breach of that duty was not a proximate cause of the loss, and that his bonding company could not recover from him.<sup>69</sup>

Recently an ordinary faithful performance bond issued for hospital district trustees was deemed to cover damages (attorney's fees) caused by violation of an open meeting statute.<sup>70</sup> In reaching its decision the court relied upon the absence of any statutory specification of the damages covered by the bond, and the broad sweep of the bond "for the use and benefit of the district in the event of unfaithful performance of official duties" by the trustees.<sup>71</sup>

### 3. *Miscellaneous State Official Bonds*

Somewhat surprisingly, neither a high school principal nor his faithful performance surety were liable when the principal collected cap and gown money from the graduating seniors, but used it to buy a fan for the school. The state had afforded no statutory guidance for the principal's fund managing activities, and his good faith constituted a defense under Mississippi common law.<sup>72</sup>

In contrast, the Georgia Supreme Court found that a Department of Corrections official and his faithful performance surety were liable when the official failed to refund sums received pursuant to an unauthorized salary increase.<sup>73</sup> Denying cross motions for summary judgment, the Pennsylvania Commonwealth Court held that the director of that state's Bureau of Insurance, by taking kickbacks from insurers, failed faithfully to perform

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68. *Id.* at 801-02.

69. *Id.* at 803.

70. *Fidelity & Deposit Co. of Md. v. Concerned Taxpayers of Lee County, Inc.*, 829 S. W.2d 923 (Tex. Civ. App. 1992, no writ).

71. 829 S.W.2d *id.* 926-27.

72. *State ex rel. Cochrane v. Eakin*, 203 So. 2d 587 (Miss. 1967).

73. *Busbee v. Reserve Ins. Co.*, 256 S.E.2d 126, 127 (Ga. Ct. App. 1979).

his duties, but that the director's faithful performance surety would be liable only to the extent that the taking of kickbacks caused damage to the state, such as the higher insurance rates, a disputed factual issue.<sup>74</sup> Similarly, in Ohio the faithful performance surety of a savings and loan inspector was liable for his breach of duty when, in the course of inspecting a thrift, he stole a passbook and used it to obtain cash for himself.<sup>75</sup>

In *Pinkerton's National Detective Agency, Inc. v. Fidelity & Deposit Co. of Maryland*<sup>76</sup> the chief security examiner of the Industrial Commission of Illinois converted to his own use a treasury bond posted as self insurance collateral by Pinkerton's for its potential worker's compensation liability. The only question was one of statutory interpretation: whether the commissioner was authorized to accept the bond as collateral so that the conversion of the bond constituted a failure to perform faithfully an official duty? Concluding that the commission was authorized to accept the collateral, the court imposed liability on the surety.<sup>77</sup>

## F. Other Miscellaneous Statutory Bonds

### 1. Public Grain Warehouse Bonds

Of interest are public grain warehouse bonds, which are deemed to be bonds for the grain warehouse proprietor's faithful performance of statutorily imposed duties. Accordingly, the holder of valid grain warehouse receipts may recover for grain lost due to the proprietor's breach of duty, despite the receipt holder's own wrongdoing that was insufficient to invalidate the warehouse receipts.<sup>78</sup>

The surety is liable only for the warehouse proprietor's breach of statutory duties, and does not insure the solvency of the warehouse.<sup>79</sup> As always, however, statutory wrinkles may occur. Depending on the statute in question, the bond also may cover a warehouse proprietor's activities with respect to its own grain stored in its own warehouse.<sup>80</sup> Absent such a statutory provision, however, a warehouse proprietor's bond would cover only the

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74. *Commonwealth v. Ins. Co. of N. Am.*, 436 A.2d 1067 (Pa. Commw. Ct. 1981).

75. *Ohio Cas. Ins. Co. v. Fidelity & Deposit Co. of Md.*, 177 N.E.2d 814 (Ct. C.P. Ohio 1961).

76. 138 F.2d 469, 470-71 (7th Cir. 1944).

77. *Id.*

78. *See, e.g., St. Paul Ins. Cos v. Fireman's Fund Am. Ins. Cos.*, 245 N.W.2d 209, 216-217 (Minn. 1976).

79. *See Thomas v. Reliance Ins. Co.*, 617 F.2d 122 (5th Cir. 1980).

80. *Fidelity State Bank v. Century Sur. & Ins. Corp.*, 228 F.2d 654 (10th Cir. 1955).

proprietor's actions in storing the grain of others, not its actions as a buyer of grain.<sup>81</sup>

The Texas Grain Warehouse Statute imposed on the warehouse's proprietor a duty of reasonable care, absent agreement to the contrary. When a warehouse proprietor entered into an agreement holding itself to a standard of care higher than reasonable care, its faithful performance surety was bound along with it.<sup>82</sup>

It has been held that, because the bond is to protect the holders of valid warehouse receipts (i.e., farmers storing grain), a bank that loaned money on the security of warehouse receipts that were statutorily invalid on their faces (a fact the bank was presumed to know) could not recover on the warehouse bond.<sup>83</sup>

## 2. Notary Public Bonds

Notaries public also are generally required by statute to provide bonds for their faithful performance of their duties. As always, the obvious cases are simple. When a notary forged a signature and then notarized it, she and her surety were liable.<sup>84</sup> The same result obtains when the notary falsely certifies a signature forged by another.<sup>85</sup>

However, the notary does not guarantee the truthfulness of affiants. Accordingly, it has been held that the notary's faithful performance surety is not liable for damage caused by lies in an affidavit, even if the notary knows that the affiant lies, and even if the notary would be liable personally for involvement in the fraud.<sup>86</sup> As the court explained:

It is our opinion under the foregoing authorities that relator cannot recover his loss in this action. The suit is for breach of contract against the surety on the bond, and, in such action, defendant cannot be held liable for any damages except those, if any, of which were caused by Lech's official acts as notary.

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81. United States Fidelity & Guaranty Co. v. Long, 214 F. Supp. 307 (D. Or. 1963).

82. Farmers Elevator Mut. Ins. Co. v. Stanford, 280 F. Supp. 523, 528-529 (N.D. Tex. 1967), *aff'd sub nom.* Millers Mut. Fire Ins. Co. of Tex. v. Farmers Elevator Mut. Ins. Co., 408 F.2d 776, 779 (5th Cir. 1969).

83. Central Nat'l Bank of Mattoon v. Fidelity & Deposit Co. of Md., 324 F.2d 830 (7th Cir. 1963).

84. Goodman Factors, Inc. v. Meagan's Reflections, Inc., No. 02A01-9404-CH-00092, 1995 WL 672743, \*5 (Tenn. Ct. App. Nov. 13, 1995).

85. Commonwealth ex rel. Miller v. Doak, 42 A.2d 826 (Pa. 1945); Stemmons v. Akins, 283 P.2d 797 (Okla. 1955).

86. State ex rel. Koste v. Maryland Cas. Co. of Baltimore, 355 S.W.2d 510 (Mo. Ct. App. 1960).

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Lech's official duty as notary was limited to certifying to these facts: (1) that Dorothy Myer appeared before him, (2) that she signed the application for transfer of title, and (3) that she swore that the information set out therein was true. Lech's failure to properly perform his duties in the above respects could not, under the authority cited, be the proximate cause of the relator's loss. If Dorothy Myer had actually appeared before Lech and had sworn to the truth of the facts stated in the application, Koste still would have suffered loss, for the reason that S & L Motor Company did not have title to the automobile. A notary's certificate can in no wise be deemed to certify or guarantee the facts stated in the instrument to which it is attached. To hold otherwise would make the surety of the notary's bond an insurer of all statements contained in the instrument notarized. That is not the law.<sup>87</sup>

In *Couch v. Babb*,<sup>88</sup> a notary was persuaded to sign and seal an instrument on the representation that parties whose signatures were necessary would arrive momentarily to sign, after which the documents were forcibly taken from her and falsely completed. Although "notarizing" the documents before the signing parties actually arrived was a negligent breach of the notary's duty, the court deemed it not a proximate cause of the ultimate victim's loss.

It is generally assumed that a notary's lapses, whether deliberate or negligent, such as failure to require positive identification of an affiant, are covered by the notary's bond. Accordingly, the cases generally are resolved, not by a determination of whether the notary's lapse was a breach of faithful performance, but whether the notary's lapse was the proximate or legal cause of the injury complained of.<sup>89</sup>

## II. CONCLUSION

A faithful performance bond may be deemed judicially to afford coverage ranging from strict liability for missing funds, through negligence, to no coverage for the bonded official's personal bad acts. The heart of the faithful performance problem, however, is statutory. With respect to all statutory bonds for faithful performance, the fundamental rule must be: (1) analyze the bond; (2) analyze the statute calling for the bond's issuance; (3) analyze any statutes governing the conduct of the bonded official; and (4) analyze the applicable case law.

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87. *Id.* at 515.

88. 423 S.W.2d 464 (Tex. Civ. App. 1968, writ ref'd n.r.e.).

89. The proximate cause issue is beyond the scope of this article, but is well discussed by John D. Perevich, J.D., in two Annotations. See John D. Perevich, Annotation, *Liability of Notary Public for His Bond for Willful or Deliberate Misconduct in Performance of Duties*, 44 A.L.R. 1243 (1972); John D. Perevich, Annotation *Liability of Notary Public or His Bond For Negligence and Performance of Duties*, 44 A.L.R. 555 (1972).