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PUBLIC OFFICIAL BLANKET BONDS AND GOVERNMENT EMPLOYEE CRIME COVERAGE FORMS

Jeffrey S. Price
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I. INTRODUCTION

This article discusses the various forms of and issues relating to public official bonds and government employee crime coverage policies. Public official bonds are generally bonds that are issued by the public official and the surety jointly in favor of the governmental entity that the public official serves. These bonds are commonly required by statute and create a three-party relationship more typically found in the context of traditional surety bonds. Public official bonds are issued for individual public officials, but can also be issued in the form of a blanket public official bond covering an entire department or class of public officials. In addition to public official bonds (and sometimes in lieu of), government employee crime coverage policies have become increasingly more popular and provide coverage for governmental entities in a slightly different context. Specifically, government employee crime coverage policies differ from public official bonds in that they typically create the traditional two-party relationship where the insurer issues an insurance policy agreeing to indemnify the insured for certain losses arising from the dishonesty or other enumerated conduct of its employees. The distinctions in terminology and coverages are important when considering and addressing the issues that arise upon the public entity's loss due to the conduct of a covered public official or employee.

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II. PUBLIC OFFICIAL BONDS—GENERALLY

A. Statutory Requirements

A public official bond refers to an instrument "by which a public officer and a secondary obligor undertake to pay up to a fixed sum of money if the officer does not faithfully discharge the duties of his or her office."[1] A statutory public official bond is thus a public official bond mandated by statute. BLACK'S LAW DICTIONARY defines "official bond" as "a bond given by a public officer, conditioned on the faithful performance of the duties of office."[2] Within the parameters of the three-party surety relationship, the public official is the principal, the bonding company is the surety (sometimes called the secondary obligor), and the government—or in many cases, the public being served by the official—is the obligee.

Each individual state has its own statutory bond requirements generally found within the state code.[3] While these statutory provisions are often interspersed throughout the state code, many states have a specified a "Public Officials" or "Public Office" chapter that contains the general bond requirements, procedures, and authority for the issuance of these bonds. In other instances, the statutory bond requirements for the various individual officials are found within the specific chapter relating to their office.[4] As seen in Appendix A, there are a multitude of public official bonds that are either required or authorized under the various state statutes.[5]

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[1] RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 71 cmt. c. (1996).

[2] BLACK'S LAW DICTIONARY 171 (7th ed. 1999).

[3] Although all fifty states have statutory bond requirements, there is a statutory prohibition against requiring or obtaining surety bonds for officers and employees of the United States Government in carrying out their official duties. *See* 31 U.S.C. § 9302 (2006).

[4] Included in Appendix A of this Article is a chart citing the statutory authority for the issuance of public official bonds. The chart is limited to the code provision stating the over-arching requirement for public officials.

[5] As this article discusses, there can be a difference in how the courts interpret bonds that "shall be issued" and bonds that "may be issued."

Generally speaking, state statutes require public official bonds[6] for all elected and most non-elected public officials. These public officials can range from the governor to members of the local school board. Statutes may require an individual Public Official Bond for each public official or may allow for a blanket bond for all public officials that fall into a certain group (*i.e.*, all members of the board of directors or all alderman of a town or city).[7] Depending on the statutory language, a Public Official Bond may be a "faithful performance bond," "fidelity bond," "public employees blanket bond," or "public employee dishonesty policy." While "faithful performance" bonds appear to be the most commonly required Public Official Bond, the others may be statutorily required. Each of these types of bonds are discussed in this article.

B. General Requirements

1. When is a Public Official Bond Required?

"Statutory bonds" by definition, Public Official Bonds are required when a statute so dictates. The Public Official Bond is often required to be effective before or upon the taking of the oath of office by the employee or official. Other times, a Public Official Bond may run indefinitely, covering successive employees or officials as they assume office. Some statutes mandate the procurement of a Public Official Bond,[8] while others will simply authorize the procurement of a bond.[9] If the controlling statutory language merely "authorizes" the issuance of a bond, the bond will only be considered a statutory Public Official Bond

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[6] Hereinafter Public Official Bond.

[7] *Compare* KAN. STAT. ANN. § 19-4207 (2005) (excluding county treasurer from officials that may be bonded with a blanket bond), *with* KAN. STAT. ANN. § 19-4203 (2005) (stating that for county officers and employees, a blanket bond may be purchased to cover both elected and appointed officers and employees).

[8] *See, e.g.*, ARK. CODE ANN. § 25-16-502 (2005) ("[T]he Auditor of State *shall execute* and deliver to the Governor a bond to the State of Arkansas . . . .") (emphasis added).

[9] *See, e.g.*, ARK. CODE ANN. § 26-52-105 (2005) ("The [Income Tax Director] *may require* such of the officers, agents, and employees as he may designate to give bond for the faithful performance of their duties . . . .") (emphasis added).

to the extent the language of the bond reflects the requirements and intent of the statute.[10] For instance, in *Price v. Arrendale*,[11] a bond was procured by the governmental entity to protect itself from loss caused by the employee's failure to perform his duties. Because the bond did not meet the criteria set forth in the authorizing statute, it was held to be a non-statutory bond, not subject to the provisions of the code affecting official bonds.[12]

The distinction between statutory and non-statutory bonds is vital in determining how a court should interpret the terms of the bond. Bonds that are considered statutory in nature may be interpreted by the court to conform to the statutory requirements rather than by the terms actually set forth therein. On the other hand, non-statutory bonds should be interpreted as written.

2. What does the Public Official Bond Protect Against?

The Public Official Bond is commonly issued to protect against a public official's conduct or omissions that constitutes a breach of the public official's duties of office. However, the extent of protection is dependent upon the type of bond required. These bonds generally guarantee against more than the public official's fraud or dishonesty and, in certain cases, may cover loss arising from simple negligence or omissions (even if made in good faith).

State statutes vary in their description of the Public Official Bonds that are required for their state employees and public officials.[13] Although the intent is, in many instances, to require a faithful performance bond, many statutes use the term "fidelity bond." While legislatures may believe it to simply be a matter of semantics, these terms are not interchangeable and result in distinct coverage.

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[10] *See* Price v. Arrendale, 168 S.E.2d 193 (Ga. Ct. App. 1969).

[11] *Id*.

[12] *Id.*

[13] *See, e.g.*, CAL. EDUC. CODE § 22259 (2019) (stating that, for the State Teacher's Retirement System, "[a]ll board members and officers and employees of the system shall execute a fidelity bond, in an amount determined by the board to be prudent, conditioned upon the faithful performance of the duties of the board member or employee.").

Fidelity bonds are typically designed to guarantee the honesty of the bonded person. These typically consist of a contract "whereby one agrees, for consideration, to indemnify another against a loss arising from the want of honesty, integrity, or fidelity of an employee or other person holding a position of trust."[14] Bonding companies may define fidelity bonds as guaranteeing the honesty of employees and any losses arising from the dishonest actions of its employees, such as theft or embezzlement.

Conversely, a faithful performance bond is designed to guarantee that a public official or employee act with honesty and/or in faithful performance of his or her official duties. As noted above, these bonds can be issued individually for a specific public official, or, if the statutes so allow, can be issued as an employee blanket bond, covering all employees of a designated office or department. The coverage provided by faithful performance bonds is broader than that provided by fidelity bonds. Faithful performance of duties necessarily includes fidelity and honesty to the public entity. Therefore, conduct that is covered by a fidelity bond is likely to also be covered by a faithful performance bond; but not all conduct covered by a faithful performance bond would be covered by a fidelity bond.

Some states have recognized this distinction. For example, the Code of Laws of South Carolina provides:

> (A) When bonding of county officials or employees is statutorily required, the governing body of a county may purchase a fidelity bond to cover all or a portion of the county officials and employees. A fidelity bond may be used instead of specific statutory bond requirements including, but not limited to, those found in Sections 12-39-10, 12-45-10, 14-17-40, 14-17-60, 14-17-350, 14-23-1050, 17-5-20, 17-5-70, 22-1-150, 22-1-160, 23-11-30, and 23-13-20. Any officials or employees not covered by a fidelity bond must be bonded as required by statute.
>
> (B) The purchase of a fidelity bond as provided in subsection (A) or the replacement of an existing bond

[14] 35A AM. JUR. 2D *Fidelity Bonds & Insurance* § 1 (2019).

> with a fidelity bond covering one or more county officials or employee must be evidence by passage of a resolution by the county's governing body. A fidelity bond must meet or exceed the minimum value of the bond required by the statute or statutes for the covered officials or employees.[15]

Most states are not as clear in defining the terms and standards of care for "dishonesty" and "faithful performance" as South Carolina. For the states that do not express the distinction, a comparison of the actual terms and conditions of a fidelity bond to the terms of a faithful performance bond illustrates the difference.

In *M.B.A.F.B. Federal Credit Union v. Cumis Insurance Society*,[16] a credit union's general manager recommended a loan to the board of directors without any evidence of the value of the proposed collateral. The general manager allegedly failed to verify the collateral and directed another employee to process the loan, knowing that it had not been approved by the credit committee. A loss resulted and the federal district court found that, based upon his acts, the general manager had been negligent.[17]

The policy covered the "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 through the failure on the part of such employee. . . to well and faithfully perform his duties."[18] The insurer argued that an employee's failure "to well and faithfully perform his duties" necessarily required a showing of intentional or willful misconduct.[19] The Fourth Circuit disagreed and held:

> The condition of an official bond, that the officer who gives it, shall "well and truly" execute the duties of his office, includes not only honesty, but reasonable skill and diligence. If the duties are performed negligently

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[15] S.C. CODE ANN. § 4-11-65 (2019).
[16] 681 F.2d 930 (4th Cir. 1982).
[17] *Id.* at 931.
[18] *Id.* at 932.
[19] *Id.* at 931.

> and unski[ll]fully; if they are violated from want of capacity or want of care; they can never be said to have been "well and truly executed."[20]

Applying this standard, the Fourth Circuit held that a lack of faithful performance included the negligent acts of employees in the carrying out of their duties.[21]

Although faithful performance bonds provided broader coverage than fidelity bonds, it is important to note that faithful performance bonds are not generally construed as "strict liability" bonds. They do not provide coverage for all acts or omissions by a public official that results in a loss. The public official may act with "reasonable skill and diligence," yet a loss nevertheless ensues.

Some courts have, however, indicated that public officials and their sureties can essentially be held strictly liable for certain public funds. In *Cordray v. International Preparatory School*,[22] the Ohio Attorney General and Department of Education brought suit against, among others, a non-profit corporation that previously operated as a community school and the treasurer of the corporation.[23] Following the close of the community school, the state auditor determined that the school had improperly sought and received $1,407,983 in overfunding from the Ohio Department of Education.[24]

The treasurer argued that she could not be held strictly liable because she was not a "public official" under the ordinary meaning of the term, but instead was the treasurer for a private entity that contracted with the state.[25] The Ohio Supreme Court stated:

> That public officials are liable for the public funds they control is firmly entrenched in Ohio law. In *Crane Twp.*

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[20] *Id.* at 932. *See also* Minor v. Mechanics' Bank of Alexandria, 26 U.S. 46, 69 (1828).
[21] *Id.* at 932.
[22] 941 N.E.2d 1170 (Ohio. 2010).
[23] *Id.* at 1171-72.
[24] *Id.* at 1172.
[25] *Id.* at 1173.

> *ex rel. Stalter v. Secoy* (1921), 103 Ohio St. 258, 259-60, 132 N.E. 851, this court stated that it is "pretty well settled under the American system of government that a public office is a public trust, and that public property and public money in the hands of or under the control of such officer or officers constitute a trust fund, for which the official as trustee should be held responsible to the same degree as the trustee of a private trust fund."
>
> In *Seward v. Natl. Surety Co*. (1929), 120 Ohio St. 47, 49, 165 N.E. 537, this 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 other public officials, to hold the public official accountable for the moneys that come into his hands * * *
>
> The liability for public officials is strict: "Over the years, this court has held public officials liable for the loss of public funds, even though illegal or otherwise blameworthy acts on their part were not the proximate cause of the loss of public funds." *State v. Herbert* (1976), 49 Ohio St.2d 88, 96, 3 O.O.3d 51, 358 N.E.2d 1090.[26]

The court ultimately concluded that because community schools fall within the definition of public office because they are entities established by the laws of Ohio for the exercise of a function of government, the treasurer was a public official and could be held strictly liable for the improper funds.[27]

3. Who does the Public Official Bond Protect?

Public Official Bonds may be issued for the benefit of the governmental unit in which the principal holds office, or it can provide

[26] *Id.* at 1173.
[27] *Id.* at 1175.

coverage to the general public.[28] The Public Official Bond is "in the nature of an Indemnity Bond rather than a Penal or Forfeiture Bond; it is, in effect, a contract between the officer and the government, binding the officer to discharge the duties of his or her office."[29] The Public Official Bond is not intended to protect the principal or the public official himself, but rather is intended to protect the entity or the citizens served by the official.

The Public Official Bond indemnifies those who have suffered a loss as a result of the official's misconduct. In many instances, that would be the governmental entity that the public official is serving. However, certain statutes include a provision specifically allowing a member of the public to bring suit against the bond, if that individual has suffered a loss resulting from the official's misconduct.[30] To that end, while there is varying degree of specificity in the statutory requirements, almost all satisfy the general purpose requiring an official to issue a bond for the faithful performance of his or her duties.[31] A Public Official Bond is taken "as assurance of compliance with the law."[32] It is designed to ensure that the official or employee will faithfully perform his or her duties while in office.

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[28] *See* Hugh E. Reynolds, Jr. & James Dimos, *Fidelity Bonds and the Restatement*, 34 WM. & MARY L. REV. 1249 (Summer 1993); 63C AM. JUR. 2D *Public Officers & Employees* § 130 (2019).

[29] 63C AM. JUR. 2D *Public Officers & Employees* § 130 (2019).

[30] *See, e.g.*, IDAHO CODE ANN. § 59-815 (2019) ("Every official bond executed by an officer pursuant to law is in force and obligatory upon the principal and sureties herein to and for the state of Idaho, and to and for the use and benefit of all persons who may be injured or aggrieved by the wrongful act or default of such officer in his official capacity, and any person so injured or aggrieved may bring suit on such bond, in his own name, without an assignment thereof.")

[31] Some states require bonds conditioned upon the fidelity or honesty of the public official. The distinction between a faithful performance bond and a fidelity or honesty bond is discussed in more detail herein.

[32] 12 AM. JUR. 2D *Bonds* § 6 (2019).

III.
BACKGROUND OF PUBLIC EMPLOYEE COVERAGE

Public Official Bonds have been a requirement in the United States for essentially its entire existence. The Pennsylvania Supreme Court stated in 1802:

> Take a view of all the offices created by the legislature of Pennsylvania, as well as before since the revolution, and we must lay it down as a general rule, that where the officer. . . is necessarily entrusted with the money of individuals, or to perform a duty which he alone can perform. . . the wisdom and justice of the legislature have been manifested in prescribing that the officer shall give bond with sufficient sureties for the faithful payment of those monies, for the faithful performance of those duties. . .[33]

While Public Official Bonds have remained a constant, other forms of public official coverage have been created and evolved. These forms included public employee blanket bonds,[34] which were purchased by governmental entities to protect the entity itself rather than the public or any other third party from the acts of public officials or employees.[35] The Blanket Bonds were structured similarly to commercial blanket bonds and blanket position bonds using the terms "insured" and "insurer" rather than "principal," "obligee," and "surety" as used in the Public Official Bonds. The Blanket Bonds often combined both "per loss" and "per employee" employee dishonesty insuring agreements into one form which allowed for a faithful performance of duty option available when required to comply with statutory requirements.[36]

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[33] Yard v. Lea, 3 Yeates 335, 345 (Pa. 1802)

[34] Hereinafter Blanket Bonds.

[35] Robert Duke, Carol A. Pisano, & Richard S. Mills, *History and Development of Mercantile Crime Policies—Their Interpretation and Construction*, *in* COMMERCIAL CRIME INSURANCE COVERAGE (Randall I. Marmor & Susan Koehler Sullivan eds., 2015).

[36] *Id.*

In 1986, the Surety and Fidelity Association of America[37] and the Insurance Services Office, Inc.[38] worked together to simplify the policies for commercial entities and replace the Blanket Bonds.[39] The SFAA and ISO had joint responsibility for the various crime coverage forms. For instance, the SFAA was solely responsible for the forms and rating rules for Coverage Forms A (Employee Dishonesty) and B (Forgery or Alteration) while the ISO was responsible for the remaining coverage forms.[40]

In 1988, SFAA introduced the simplified coverage forms O (per loss) and P (per employee) for government entities. Both Form O and Form P[41] are identical to Form A, but include additional exclusions, conditions, and definitions that relate specifically to public office.[42]

In 2000, the SFAA and ISO ultimately elected to create their own individual crime programs for commercial and government entities.[43]

IV. ISSUES RELATED TO MODERN GOVERNMENT CRIME INSURANCE

With the creation and increased use of both the SFAA Policy and the ISO Policy, a number of preliminary issues have arisen—and will likely continue to arise—when determining whether coverage is implicated.

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37 Hereinafter SFAA.

38 Hereinafter ISO.

39 *Id.* A full history of the development of the commercial crime policy is outside the scope of this article. However, an informative history can be found in Duke et al., *supra note* 35, at 7-11.

40 *Id.* at 8.

41 Collectively hereinafter Form O/P.

42 Duke et al., *supra note* 35, at 9.

43 *Id.* at 9. The SFAA introduced the Crime Protection Policy effective March 1, 2000 and the ISO Commercial Crime Policy and Government Crime Policy were also introduced, effective March 1, 2000.

A. Is Government Crime Insurance Statutory?

Public Official Bonds have traditionally been considered statutory in nature, which means that the Public Official Bond is required to conform to the requirements set forth in the mandating or authorizing statute. Courts have previously stated, "public officials do not have the power to contract away the rights of the public for whose benefit the official bond is required. . . Therefore, provisions in official bonds which tend to limit or restrict the surety's liability are void."[44] The question remains, however, whether government crime policies fall into this same general category. This distinction is important for the underwriting surety/insurance company to understand to prevent courts from striking or otherwise altering the terms of government crime insurance to conform to statutory requirements. Statutory requirements for public officials have recently been a moving target as many states have altered their statutes to (1) remove certain bond requirements; and/or (2) allow for government crime policies to replace traditional Public Official Bonds.[45]

For example, the Tennessee state legislature recently enacted a statute stating:

> (e) County governments shall either:
>
> (1) Obtain and maintain blanket surety bond coverage for all county employees not covered by individual bonds referenced elsewhere in statute. The minimum amount of such blanket bonds shall be one hundred fifty thousand dollars ($150,000.00); or
>
> (2)(A) Obtain and pay the premiums or other costs with respect to a policy of insurance issued by an insurance company duly authorized to do

[44] State v. Lidster, 467 N.E.2d 47 (Ind. Ct. App. 1984); Nat'l Sur. Co. v. Morgan Cty., 440 S.W.2d 791 (Ky. Ct. App. 1969) (refusing to enforce clause terminating sheriff's bond on discovery of dishonesty; sheriff was also serving as tax collector).

[45] For example, *see* TENN. CODE ANN. § 8-19-101, *et seq.* (2019).

> business in this state or an agreement with a pool established pursuant to § 29-20-401 or any entity established pursuant to § 29-20-401(b)(2) for administration of such agreement, that provides government crime coverage, employee dishonesty insurance coverage, or equivalent coverage that insures the lawful performance by officials and their employee of their fiduciary duties and responsibilities. Any such policy or agreement maintained shall have limits of not less than four hundred thousand dollars ($400,000) per occurrence; . . .[46]

These changes have been met with some pushback. For instance, during the legislative process in Tennessee, the Tennessee Advisory Commission on Intergovernmental Relations issued a report titled "Insurance as an Alternative to Surety Bonds for Public Officials" stating, *inter alia*:

> It is unclear whether an insurance policy can be written that provides the same coverage as Tennessee's public official surety bonds. However, even if such a policy could be written and found in the market place, it is widely believed that it would be prohibitively expensive. While other states allow insurance instead of surety bonds, no state requires the insurance to be the equivalent of Tennessee's surety bonds. If it did everything a surety bond did and was available at the same cost, it would essentially be a surety bond. In that case, there seems to be little advantage in providing insurance as an alternative.
>
> The consensus of the Commission is that Senate Bill 624 is not needed, at least not in its current form. It is not clear that it would provide the same safeguards as Tennessee's individual surety bond requirements, particularly as they relate to holding individual office-holders accountable. The Commission would, however,

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[46] TENN. CODE ANN. § 8-19-101 (2019).

> endorse a provision allowing blanket coverage that is equivalent of the individual surety bonds currently required, which could be less expensive and easier to administer.[47]

Some other states have altered their statutory schemes with respect to Public Official Bonds to allow Blanket Bonds to replace the traditional Public Official Bonds, but do not allow for government crime insurance to satisfy the bonding requirements. In light of these changes to the statutory requirements, whether government crime insurance can be considered a "statutory bond" may become important.

While there is little to no case law currently interpreting whether government crime insurance would be considered statutory in nature, guidance can be found from courts interpretation of bonds in other contexts. As discussed briefly above, Public Official Bonds are generally considered to be statutory in nature. Mississippi, for example, has discussed the statutory nature of Public Official Bonds numerous times. First, in *Adams v. Williams*, the Mississippi Supreme Court stated:

> The Revised Code of 1880 materially changed the law regarding liability on official bonds. Section 403 of the Revised Code of 1880 provided the condition of official bonds, and then added that this provision was

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[47] Report of the Tennessee Advisory Commission on Intergovernmental Relations: "Insurance as an Alternative to Surety Bonds for Public Officials" (Jan. 2014); *available at* https://www.tn.gov/content/dam/tn/tacir/documents/ 2014_SuretyBonds.pdf_(last accessed June 6, 2016). Notably, this report discusses the difference in accountability for the public official under a Public Official Bond in comparison to government crime insurance. Public officials seeking to secure a Public Official Bond typically are required to execute a bond application inclusive of an indemnity agreement. Thus, in the event the surety on the Public Official Bond is required to make payment under the Public Official Bond, the surety has the ability to seek indemnification from the principal public official. On the other hand, government crime insurance operates as insurance. Thus, the insurer does not have a right to seek indemnification against the public official. Instead, any recovery the insurer may obtain would be by way of subrogation and/or assignment of the insured's claim against the public official and subject to any defenses the public official may have to the claim of the insured.

declaratory only, and that a failure to observe the form therein prescribed should not vitiate any official, but all official bonds should be valid and binding in whatever form they might be taken, whether in the proper penalty or without any penalty, whether correct or incorrect in their recitals of any kind, whether properly payable or not, and whether approved by the proper officer, or not approved at all, and whether irregular in any other respect whatever, if only such bonds should be delivered as the official bond of the officer and serve as such. This section expressly provided that such bonds should be obligatory on every one who should subscribe them as such. This provision was not in the Code of 1871. Section 403 of the Code of 1880 is section 3463 of the Code of 1906, and was section 3055 of the Code of 1892. The obvious purpose of the legislature, in the passage of this section of the three Codes of 1880, 1892, and 1906, was to make an official bond binding on all who subscribed it without regard to any irregularity whatever, and whether the instrument should be signed by the principal or not.

* * *

Under our statutes, the plain purpose of section 3463 in the Code of 1906, was to hold both the principal and the sureties on the official bonds liable without any regard to irregularities whatsoever, if only the bond served as the official bond during the term for which it was given. The purpose of the law was to declare, emphatically, that no official, and no surety on any official bond, should be relieved of liability thereon, provided only that such bond was accepted, and that such bond served as the official bond intended by law. The statute is grounded in the highest possible considerations of justice and right.

* * *

And in addition to all this, the express language of the section 3463 of the Code of 1906, ends all controversy

> along this line. **So as the conditions in the bond do not provide for the performance of an act in violation of the law, the form of the conditions is immaterial, provided only the bond served its office as his bond.**[48]

The Mississippi Supreme Court expanded on this language in *State v. Moody*.[49] In *Moody*, the State of Mississippi initiated an action against Willie Estus Moody, a former member of the board of supervisors for the Fourth District of Pearl River County, Mississippi, and his two (2) sureties. Tri-State Insurance Company issued a bond with penal sum of $12,000 on behalf of Moody in conjunction with his first term as a board member. During Moody's first term, he converted approximately $6,931 from the county.[50] Employers Mutual Casualty Company issued a bond with a penal sum of $12,000 on behalf of Moody in conjunction with his second term as a board member. During Moody's second term he converted approximately $33,457.50 from the county.[51]

The trial court entered a judgment against Moody and Tri-State in the amount of $6,931, plus interest resulting in a total judgment that did not exceed the $12,000 penal sum. The trial court also entered a judgment against Moody in the amount of $33,457.50, plus interest with respect to the conversion committed during his second term. However, the trial court limited Employers Mutual's liability to the $12,000 penal sum of the bond.[52] The State of Mississippi appealed the trial court's judgment with respect to interest amounts, but more importantly Employers Mutual's liability. The State of Mississippi asserted that under the applicable Mississippi code provisions, the Employer Mutual's bond was required to have a penal sum of five percent of the sum of all state and county taxes and thus, Employers Mutual should be liable up to that amount.[53]

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[48] Adams v. Williams, 52 So. 865, 867-69 (Miss. 1910) (emphasis added).

[49] 198 So. 2d 586 (Miss. 1967).

[50] *Id.* at 587.

[51] *Id.*

[52] *Id.*

[53] *Id.* at 588.

The Mississippi Supreme Court agreed with the State of Mississippi and entered judgment against Employers Mutual in the full amount of Moody's misappropriated funds during his second term.[54] In making its determination, the court considered the application and construction of two relevant Mississippi code provisions. The first statute stated:

> Each member of the board of supervisors, before entering upon the duties of his office, shall execute a bond with sufficient sureties, . . . conditioned, and approved as bonds of county officers are required to be, in a penalty equal to five percentum of the sum of all the state and county taxes shown by the assessment rolls and the levies to have been collectible in the county for the year immediately preceding the commencement of the term of office of said member, . . .[55]

Pursuant to this statute, Moody was required, as a member of the board of supervisors, to obtain a bond in the amount of $33,985.[56] The second relevant statute stated:

> The bonds of all officers required to give bond shall be conditioned in the following form, to wit:
>
> "Whereas, the above bound A B was duly elected (or appointed) to the office of . . . , on the . . .day of. . . for the term of . . . years from the . . . day of . . .; therefore, if he shall faithfully perform all the duties of said office during his continuance therein, then the above obligation to be void."
>
> But a failure to observe the form herein prescribed shall not vitiate any official bond; and all official bonds shall be valid and binding in whatever form they may be

[54] *Id.* at 592.

[55] MISS. CODE ANN. § 2872 (1956); *see also* MISS. CODE ANN. § 25-33-1 (2019) (current statute for appointment, oath, and bond of public officers and employees).

[56] *Moody*, 198 So. 2d at 588.

> taken, except so far as they may be conditioned for the performance of acts in violation of the laws or policy of the state; and whether in the proper penalty or without any penalty, or whether correct or incorrect in its recitals as to the term of the office or otherwise, or whether properly payable, or whether approved by the proper office or not approved by any, or if irregular in any other respect, such bond, if delivered as the official bond of the officer, and serving as such, shall be obligatory on every one who subscribed it for the purpose of making the official bond of such officer to the full penalty, or, if it has no penalty, to the full penalty of the bond which might have been required.[57]

Thus, the State of Mississippi asserted that Employers Mutual was liable under this statute for the full amount of the bond that was required by the statute rather than the one it actually issued.[58] The court agreed with the State of Mississippi stating:

> The penalty of Moody's bond should have been $33,985, and the penalty of $12,000 provided in the bond was not a proper penalty. In this situation, section 4033 writes into the bond the proper penalty required by law and binds the principal and surety for such amount. We hold that Employers Mutual upon executing the bond as surety became liable for the proper penalty, which in this case was $33,985, which results in its being liable for the amount which Moody misappropriated during his 1960-1964 term of office.[59]

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[57] MISS. CODE ANN. § 4033 (1956).

[58] *Moody*, 198 So.2d at 588.

[59] *Id.* at 591. The court also quoted State v. Smith, 40 So. 22, 24 (Miss. 1905) stating:

> When one signs what purports and is intended to be an official bond, whether as principal[,] obligor[,] or surety, the law writes in all necessary recitals, including proper penalty. No other interpretation of the statute can subsist without

Accordingly, at least under Mississippi law, Public Official Bonds are considered statutory and may be altered by the court to comply with the statutory requirements. In the instance, such as in the State of Tennessee, where the state legislature has statutorily allowed for government entities to purchase a government crime insurance policy in lieu of Public Official Bonds, the question arises whether the policies are subject to revision by the court to comply with the statutory requirements?

A meaningful comparison can be made on this particular issue to courts' interpretation of the statutory (or non-statutory) nature of fidelity bonds in other contexts, such as Financial Institution Bonds.[60] In *Bankinsure, Inc. v. Peoples Bank of the South*,[61] the bank sought coverage under a FIB issued by BancInsure for losses allegedly suffered by the Bank as a result of the conduct of a bank employee.[62] The FIB at issue limited coverage to losses resulting from fraudulent or dishonest acts of employees to losses caused by the employee with the manifest intent to cause the Bank to sustain loss or to obtain improper financial benefit for the employee or another person or entity.[63] Further, for "loan" losses, the FIB did not provide coverage unless there was proof of collusion between the employee and one or more parties to the transaction and the employee received an improper benefit in connection with the transaction.

The bank argued that, despite the plain language of the FIB, these limitations for coverage were unenforceable as a matter of law because the FIB was a statutory bond and the coverage limitations conflicted with the coverage requirements of the statute. The relevant statute stated:

> disturbing the whole governmental system and ignoring the plain intendment of the legislative department.

[60] Hereinafter FIB. Most states have enacted statutes that require banks to obtain bonds that protect the bank against the dishonesty of its employees. In response to this requirement, FIBs have evolved into a product that is obtained by vast majority of banks. While the FIB provides coverage for a number of different risks, the employee dishonesty coverage is the most prominently sought feature by banks.

[61] 866 F. Supp.2d 577 (S.D. Miss. 2012).

[62] *Id.* at 579.

[63] *Id.* at 581.

> Every active officer and employee of any bank or trust company in this state shall furnish a fidelity bond to the bank by which he is employed for the faithful performance of this duties, executed by some surety company authorized to do business in the State of Mississippi, as surety. The conditions of such bond, whether the instrument so describes the conditions or not, shall be that the principal shall protect the obligee against any loss or liability that the obligee may suffer or incur by reason of the acts of dishonesty of the principal or by reason of the violation of any of the provisions of the banking laws of Mississippi. The amount of such bond shall be fixed by the board of directors, subject, however, to approval of the state comptroller and the same shall be inspected upon the examination of the bank or trust company.[64]

The bank asserted that because this statute required a fidelity bond to be issued for officers and employees of banks, the fidelity bond issued for such coverage should be considered a statutory bond.[65] BancInsure, on the other hand, asserted that the bond was not a statutory bond as defined by the statute and thus, should be enforced as written.[66]

While the United States District Court for the Southern District of Mississippi did not ultimately determine whether the FIB at issue was a statutory bond, the court did ultimately side with BancInsure stating:

> It is ultimately unnecessary to determine whether the subject Bond is a statutory bond required by § 81-5-15, since in the court's opinion, even assuming that is the case, the terms of the Bond may be enforced as written, as they are not inconsistent with the underlying purpose of § 81-5-15.[67]

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[64] MISS. CODE ANN. § 81-5-15 (2012).
[65] *BankInsure*, 866 F.Supp.2d at 581.
[66] *Id.* at 581-83.
[67] *Id.* at 582.

The court continued to conclude that because the FIB could be applied *as written*, the bank was required to show the claimed losses were caused by the employees' manifest intent to cause the bank to sustain such loss, or to obtain an improper financial benefit for himself or for another; and in the case of any loss resulting directly or indirectly from "loans," that the employee was in collusion with one or more parties to the transactions and received an improper financial benefit in connection with the transactions.[68]

Another case in the FIB context to consider is in *Kansas Bankers Surety Co. v. Farmers State Bank, Yale, IA*.[69] In *Kansas Bankers*, the bank sought coverage under a FIB issued by Kansas Bankers for losses caused by a bank employee's issuance of bad loans and guaranties.[70] The FIB imposed limitations on coverage to prevent coverage for bad business decisions resulting in loan losses similar to the one in *BankInsure*. The bank asserted that the FIB was a statutory bond while Kansas Bankers asserted that it was not.[71]

The relevant Iowa statute stated:

> The officers and employees of a state bank having the care, custody, or control of any funds or securities for any state bank shall give a good and sufficient bond in a company authorized to do business in this state indemnifying the state bank against losses, which may be incurred by reason of any act or acts of fraud, dishonesty, forgery, theft, larceny, embezzlement, wrongful abstraction, misapplication, misappropriation, or other unlawful act committed by such officer or employee directly or through connivance with others, until all of the officer's or employee's accounts with the state bank are fully settled and satisfied.[72]

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[68] *Id.* at 583.
[69] 408 F. Supp.2d 751 (S.D. Iowa 2005).
[70] *Id.* at 753.
[71] *Id.* at 754-55.
[72] IOWA CODE § 524.705 (2005).

The United States District Court for the Southern District of Iowa determined that the bond was a "statutory bond governed by the statute."[73] While the court observed that the FIB contained a note on the first page stating that it was not a statutory bond, the court determined that this disclaimer, standing alone, did not conclusively rebut the following presumption:

> [I]f a bond is of a type required by statute the general rule is that "[i]t is presumed that the intention of the parties was to execute such a bond as the law required."[74]

Although the court determined that the FIB was statutory and should be "liberally construed in light of the purpose for which it was required, coverage required by the statute is read into the bond, and conditions not described by the statute are considered surplusage" the court ultimately determined that the FIB's coverage limitations were still applicable.[75] In doing so, the court determined (1) the direct loss requirement was consistent with the statutory mandate and (2) the manifest intent requirement was consistent with the statute's inherent incorporation of an element of intent.[76]

Similarly in *First National Bank and St. Paul Fire & Marine Insurance Co.*,[77] the bank sought coverage under two (2) FIB's issued by St. Paul relative to an allegedly fraudulent scheme by a number of bank officials.[78] The FIB's contained a limitation on coverage to only instances where dishonest or fraudulent acts were committed by an employee with the manifest intent (1) to cause the bank a loss and (2) to obtain a financial benefit for some other person or entity.[79] Further, if the loss results from a loan, the employee must have been in collusion with one or more of the parties to the loan and must have received in connection therewith a financial benefit of at least $2,500.

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[73] *Kansas Bankers*, 408 F. Supp.2d at 755.
[74] *Id.* at 755 (internal citations omitted).
[75] *Id.* at 755-57.
[76] *Id.* at 756.
[77] 2 F.3d 801 (8th Cir. 1993).
[78] *Id.* at 804.
[79] *Id.* at 808.

The bank argued that the manifest intent requirement was contrary to South Dakota law and thus, the bank should not have to prove that the employees committed fraudulent or dishonest acts with the manifest intent to cause the bank a loss and to obtain at least a $2,500 benefit.[80] The United States Court of Appeals for the Eighth Circuit held in favor of St. Paul stating:

> We conclude that the fidelity bond's additional requirements of manifest intent and of the $2,500 benefit are legally enforceable under South Dakota law. First, the South Dakota Director of Banking and Finance approve St. Paul's fidelity bond as written. Second, these two additional requirements under the fidelity bond are not inconsistent with the underlying purpose of § 51-17-36.[81]

As seen above in the FIB context, there is some disagreement among courts whether FIB's are considered statutory bonds subject to the terms of the statute. However, even when the court determines that the FIB is a statutory bond, the FIB can be applied with its limitations as written.

Another context which may provide guidance relative to whether government crime insurance can be considered statutory and can be modified by the courts to conform to the statute is through the case of *Joseph Rosenbaum, M.D., Inc. v. Hartford Fire Insurance Co.*[82] In *Rosenbaum*, Dr. Rosenbaum obtained an employee dishonesty bond from Hartford which defined employee to include "[a] trustee, an officer, employee, administrator or a manager, except an administrator or a manager who is an independent contractor, or any Employee Welfare or Pension Benefit Plan (hereinafter called Plan) insured under this insurance. . . ."[83]

Dr. Rosenbaum established a pension plan for his professional corporation and caused hundreds of thousands of dollars of the plan money to be invested in second mortgages through a property company

[80] *Id.*
[81] *Id.* (internal citations omitted).
[82] 104 F.3d 258 (9th Cir. 1996).
[83] *Id.* at 262.

managed by a man named Mr. Glickman.[84] Mr. Glickman allegedly used Dr. Rosenbaum's money to pay off old investors, and commingled investors' money with company money, using it freely rather than reinvesting it as promised. Dr. Rosenbaum then sought coverage under the employee dishonesty bond asserting that Mr. Glickman was a covered employee.[85]

Dr. Rosenbaum asserted that Hartford sold him a bond "covering anyone who had to be bonded under ERISA" and that because Mr. Glickman fell within that class, the employee dishonesty bond covered him.[86] Dr. Rosenbaum further asserted that Mr. Glickman was a "trustee" under the terms of the employee dishonesty bond to bring him under the language of the bond. The court dismissed this argument indicating that Mr. Glickman, while potentially a fiduciary, was not a trustee under the employee dishonesty bond.[87]

In the alternative, Dr. Rosenbaum argued that "because Mr. Glickman was required to be bonded, and the Hartford bond was designed to cover anyone who was required to be bonded, it covered Mr. Glickman."[88] The relevant statute stated:

> (a) **Requisite bonding of plan officials**. Every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan (hereafter in this section referred to as a "plan official") shall be bonded as provided in this section; . . .
>
> Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official, directly or through connivance with others.[89]

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[84] *Id.* at 206.
[85] *Id.*
[86] *Id.* at 261.
[87] *Rosenbaum*, 104 F.3d at 262.
[88] *Id.*
[89] 29 U.S.C. § 1112(a) (1996).

The United States Court of Appeals for the Ninth Circuit ultimately determined that Dr. Rosenbaum's assertion was meritless.[90] In its determination, the Ninth Circuit noted that the Hartford employee dishonesty bond did not say that it provides all bonding required by ERISA, but rather that the additional coverage of employees is "in compliance with certain provisions of" ERISA. The Ninth Circuit further stated:

> The statute does not require that any bond be construed to cover all persons required to be bonded. It requires plan officials who receive, handle, disperse or exercise custody of plan money to be bonded. The statute also prohibits plan officials from permitting any official who has not met the bonding requirements to receive, handle, disperse or control plan funds. **If Mr. Glickman had to be bonded, then perhaps the Rosenbaums as trustees should not have invested the ERISA plan's money with Property Mortgage Company without ascertaining whether he was. They perhaps could have insured the plan against the risk that he might not be bonded as required by buying an "agents rider" or coverage including persons in his position. The Rosenbaums could have invested their ERISA plan's money in a manner not requiring bonding, as by buying securities through a stockbroker. That they invested instead with Property Mortgage Company does not imply that their bond on Dr. Rosenbaum's employees, trustees et al. covered Property Mortgage Company's employees**.[91]

Thus, *Rosenbaum* stands for the proposition that it is the insureds' job to ensure that the required coverage is met under the dishonesty policy.[92]

In applying these cases to government crime insurance, a court should uphold the additional requirements and limitations in the policy

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[90] *Rosenbaum*, 104 F.3d at 262-63.

[91] *Id.* at 263 (emphasis added).

[92] *See* Renasant Bank v. St. Paul Mercury Ins. Co., 882 F.3d 203 (5th Cir. 2018) (holding the insured to the terms of the coverage policy).

regardless of whether government crime insurance is held to be considered statutory. Public insureds should not be alleviated of the express terms of their policies.

Another issue relative to statutory requirements is the indemnification provision. For example, the ISO Policy contains the following condition:

> **a. Indemnification**
>
> We will indemnify any of your officials who are required by law to give individual bonds for the faithful performance of their duties against loss through "theft" committed by "employees" who serve under them, subject to the applicable Limit of Insurance.

This assumption of liability that is not covered under the primary obligation of government crime insurance raises the question of whether government crime insurance is intended to be a statutory bond. This provision covers indemnification for those who serve under the covered "employee." For example, in the event that the respective policy covers a public official such as a court clerk, the indemnification provision will apply to loss through "theft" committed by an employee in the clerk's office such as a financial officer or bookkeeper. The indemnification provision does *not*, however, indemnify the covered "employee" for his or her own dishonest acts. This coverage is an additional protection for the public official and not necessarily for the public entity or the public in general.

B. General Coverage

1. Who Can Bring a Claim Against Government Crime Insurance Policies?

One significant difference between the Public Official Bond and government crime insurance is the relationship between the parties. In contrast to the three-party relationship created by the Public Official Bonds, government crime insurance creates a two-party contractual relationship and is construed as a contract of insurance. The only party with rights against the insurer is the insured. The SFAA Policy explicitly

states "we will pay for loss covered by an Insuring Agreement of this Policy *that you sustain*."[93] Similarly, the ISO Policy states "and applies to *loss that you sustain*."[94]

Courts have correctly interpreted this language to exclude claims by persons other than the entity purchasing the insurance policy.[95] In *Sommers Oil Co. v. Great American Insurance Co.*, the plaintiff filed suit against the insurer of a state oil inspector alleging that the state oil inspector had accepted bribes from certain gas stations, which ultimately resulted in the plaintiff's loss. The insurer filed a motion to dismiss on the grounds that the policy did not provide coverage for the plaintiff's alleged losses. The United States District Court of the Southern District of Georgia granted the insurer's motion stating, "[t]he language of the policy clearly shows that the losses incurred by Plaintiff in this case are not covered by the policy. The policy covers only those losses incurred by the State of Georgia, as the policyholder, that resulted from employee dishonesty."[96]

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[93] Commercial Crime Policy for Government Entities, Form No. 00 01 04 12 (2005 ed.), *reprinted in* STANDARD FORMS OF THE SURETY ASS'N OF AMERICA, "Consideration Clause" (emphasis added).

[94] Government Crime Policy, Form No. 00 23 08 13, Section A "Insuring Agreements" (ISO 2005 ed.) *reprinted in* ANNOTATED COMMERCIAL CRIME INSURANCE POLICY 877 (Toni Scott Reed and Carleton R. Burch eds., 3d ed. 2015) (emphasis added).

[95] In practice, other entities (such as a state attorney general's office) may attempt to bring claims on behalf of the public entity and the insurer must evaluate the policy language and the law of the jurisdiction to determine (1) whether the third party has legal rights to assert the claims of the insured and (2) whether the bases of the third party's claim overcomes the policy language limiting claims to those of the insured. In addition, the covered property provision must be considered and if the loss is to a third party and the third party is not asserting the claim seeking to recover the insured's funds or compensation for the insured's direct damages, coverage would likely not be implicated.

[96] *Id.* at *3. *See also* Lynch Props., Inc. v. Potomac Ins. Co., 140 F.3d 622, 629 (5th Cir. 1998) ("Although employee dishonesty policies may cover the loss of third-party property in the possession of the insured. . . these policies do not serve as liability insurance to protect employers against tortious acts committed against third-parties by their employees.").

2. What does Government Crime Insurance Cover?

Government crime insurance contains several enumerated insuring agreements, and subject to all terms, conditions, exclusions, and limitations, generally covers loss caused by employee dishonesty, forgery or alteration, loss inside the premises, loss outside the premises, computer fraud, and money order and counterfeit paper currency. The SFAA Policy defines "employee" as:

> 5. **Employee** means:
>
> a. Any natural person:
>
> (1) While in your service or for 30 days after termination of service; and
>
> (2) Whom you compensate directly by salary, wages or commission; and
>
> (3) Whom you have the right to direct and control while performing services for you.
>
> b. Any natural person who is furnished temporarily to you to:
>
> (1) Substitute for a permanent employee as defined in (a) above who is on leave; or
>
> (2) Meet seasonal or short-term workload conditions;
>
> while that person is subject to your discretion and control and performing services for you excluding, however, any such person while having care and custody of property outside the premises.

c. **Employee** does not mean any:

(1) Agent, broker, person leased to you be a labor leasing firm (except when furnished on a temporary basis under the circumstances set forth in Definition 5.b), factor, commission merchant, consignee, independent contractor or representative of the same general character; or

(2) Member of any legislative board or council or any advisory commission, except while performing acts within the scope of the usual duties of an employee.

This definition of employee covers not only elected public officials, but also the public official's subordinates if they are employees of the insured entity.

Notably, government crime insurance also excludes "[l]oss caused by any 'employee' required by law to be individually bonded." In *City of Concordia v. American States Insurance Co.*,[97] the court addressed this exclusion. Specifically, Kansas does not have a statute requiring the city manager to be bonded with an individual bond versus a blanket bond, so the question was whether the language of the policy could be reconciled with the language of the statutes.[98]

The City of Concordia applied for a government crime policy to cover all city employees. The applications for the policy required the city to list all officers, officials, and employees to which the insurance would apply. Notably, the application included the following statement: "Note, Persons required by law to be individually bonded and treasurers or tax collectors by whatever title known are automatically excluded from

[97] No. 89,200, 2003 WL 21948009 (Kan. Ct. App. 2003).
[98] *Id.* at *2.

coverage under Coverage Forms O and P."[99] This warning referred to exclusion 1(c) of Form O/P, which states:

> 1. Additional Exclusions:
>
> We will not pay for loss or damages as specified below:
>
> * * *
>
> c. Bonded Employee: loss caused by an "employee" required by law to be individually bonded.[100]

Under the Kansas statute, "The [city] manager shall receive a salary to be fixed by the commission and shall give bond for faithful performance of his or her duties in such amount as may be provided by ordinance."[101] The corresponding city ordinance requiring the city manager's bond states:

> The city manager shall, before entering upon the duties of his office, give a good and sufficient bond to the city, duly approved, conditioned upon the faithful performance and discharge of his duties, and to properly account for all public monies coming into his hands. Such bond shall be in the amount of five thousand dollars ($5,000.00).[102]

Neither the state statute nor the city ordinance required that the city manager's bond be an individual bond, nor did either prohibit the city manager's bond from being included as part of a blanket bond. The city argued, therefore, that the policy exclusion did not apply because the city listed the city manager as one of the covered employees under the policy. The insurer, however, argued that the Kansas statutes, taken as a whole, demonstrate that "when a city official is required to give bond, it

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[99] *Id.* at *1.
[100] *Id.*
[101] *Id.* at *4 (quoting KAN. STAT. ANN. § 12-1013).
[102] *City of Concordia*, 2003 WL 21948009 at *4-5 (quoting CONCORDIA, KAN., ORDINANCE 2-54).

is implied that it should be an individual or separate bond unless a blanket bond is expressly permitted."[103]

The court reviewed the construction of similar Kansas statutes and ultimately determined that the Kansas legislature could have included a restriction against blanket bonding for a city manager, if it had so desired. Therefore, the court ruled that (1) the city manager was required to give bond; (2) the city disclosed that the manager was to be included in the crime policy issued by the insurer; (3) the insurer did not object or raise the exclusion when it issued the policy; (4) the policy language regarding the term "individually bonded" was ambiguous; (5) the definition relied upon by the city (i.e., that the city manager's bond could be part of a blanket bond) was reasonable; and (6) "[t]he insurer has the obligation to protect itself from possible misinterpretation by careful drafting of its own policy exclusion language."[104] The court analyzed the language of the policy and compared it to the legislative intent surrounding official bonds.

Another requirement under government crime insurance is the requisite level of intent. As discussed above, there is difference between the intent required for fidelity bond coverage (dishonesty) and faithful performance coverage. Generally speaking, government crime insurance implicates a "fidelity bond" level of intent requiring the employee to act with some level of dishonesty. However, one substantial difference between the SFAA Policy as compared to the ISO Policy (as well as the Blanket Bonds and Public Official Bonds) is the level of intent required to implicate coverage under the respective policies.[105] The SFAA Policy states, in pertinent part:

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[103] *Id.* at *5 (citing several Kansas statutes with provisions that expressly authorize a blanket bond to cover a specific individual officer or employee).

[104] *Id.*

[105] This discussion is specific to the general coverage granted under a government crime policy. However, most insurers, including under the ISO Policy and the SFAA Policy, offer a "faithful performance endorsement" which extends coverage similar to the Public Official Bond. The faithful performance endorsement option is discussed in detail in Section IV(D) of this article.

> We will pay for loss resulting directly from dishonest acts committed by an employee, whether identified or not, acting alone or in collusion with other persons, with the ***manifest intent*** to:
>
> a. Cause you sustain loss; and also
>
> b. Obtain improper financial benefit for:
>
> (1) the employee; or
>
> (2) any person or organization intended by the employee to receive that benefit.[106]

On the other hand, the ISO Policy does not require a public official to act with "manifest intent" to implicate coverage.[107] However, it limits coverage to loss that arises directly from theft (as that term is defined). The ISO Policy states, in pertinent part:

> The Company will pay the Insured for loss of or damage to Money, Securities and Other Property resulting directly from Theft committed by an Employee, whether identified or not, acting alone or in collusion with other persons. For purposes of coverage Theft shall also include forgery.
>
> Theft is defined to mean the unlawful taking of property to the deprivation of the Insured.[108]

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[106] Commercial Crime Policy for Government Entities, Form No. 00 02 04 12 (2005 ed.), reprinted in STANDARD FORMS OF THE SURETY ASS'N OF AMERICA. (emphasis added).

[107] Many proprietary forms issued by insurance companies likewise do not require manifest intent and thus, use a different standard. A discussion of all potential standards is outside the scope of this article, but insureds and insurers alike should be careful to examine the standard is their respective policies.

[108] Government Crime Policy, Form No. 00 26 03 00 (ISO 2005 ed.) *reprinted in* ANNOTATED COMMERCIAL CRIME INSURANCE POLICY 877 (Toni Scott Reed and Carleton R. Burch eds., 3d ed. 2015).

These varying levels of intent create a significant distinction in the coverage provided to a governmental entity under government crime insurance.

C. The Intent Required under Government Crime Insurance

1. The SFAA Policy

Under the SFAA Policy, the public official must have acted with "manifest intent" to cause the governmental entity a loss and for the public official or a person intended by the public official to obtain an improper financial benefit. What constitutes manifest intent may be impacted by state law and deserves its own complete discussion.[109] However, for the purpose of this article, it is necessary to provide a brief overview of manifest intent.

The Third Circuit thoroughly discussed the differing standards with respect to manifest intent in *Resolution Trust Corp. v. Fidelity & Deposit Co. of Maryland*.[110] The Third Circuit noted that courts tend to agree on the meaning of the term "manifest" as meaning that the intent of the employee must be "apparent or obvious."[111] The Third Circuit stated:

> To date, the Court of Appeals for the Sixth, Seventh and Tenth Circuits have adopted the following standard of culpability: "Although the concept of manifest intent does not necessarily require that the employee actively wish for or desire a particular result, it does require more than a mere probability . . . manifest intent exists when a particular result is substantially certain to follow from conduct."

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[109] *See* THE "MANIFEST INTENT" HANDBOOK (Samuel J. Arena, Jr. et al. eds., 2002); Michael Keeley, *Employee Dishonesty Claims: Discerning the Employee's Manifest Intent*, 30 TORT & INS. L. J. 915 (Summer 1995).

[110] 205 F.3d 615 (3d. Cir. 2000).

[111] *Id*. at 637. *See, e.g.*, FDIC v. St. Paul Fire & Marine Ins. Co., 942 F.2d 1032, 1035 (6th Cir. 1991); North Jersey Savs. & Loan Ass'n v. Fid. & Deposit Co., 660 A.2d 1287, 1291 (N.J. Super. Ct. Law Div. 1993). There is some discussion among courts whether this creates a subjective or objective standard.

> * * *
>
> In contrast to the construction of "manifest intent" adopted by the Courts of Appeals for the Sixth, Seventh and Tenth Circuits, the Court of Appeals for the Second, Fourth and Fifth Circuits have applied the term "manifest intent" differently, and we read those cases as requiring that the insured establish that the employee acted with a specific purpose or desire to both injure the insured and obtain a benefit.
>
> * * *
>
> We agree with the approach espoused by the Courts of Appeals for the Second, Fourth and Fifth Circuits, and hold that the term "manifest intent" as it is used in the fidelity provision requires the insured to prove that the employee engaged in dishonest or fraudulent acts with the specific purpose, object or desire both to cause a loss and obtain a financial benefit.[112]

As seen above, the meaning of the term "manifest intent" has been the subject of some controversy and has been interpreted under two distinct tests: (1) the substantial certainty test and (2) the specific intent test. In the context of Insuring Agreement (A) of the Financial Institution Bond, courts have generally limited coverage to losses involving "embezzlement or embezzlement-like acts."[113] At the very least, courts

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[112] 205 F.3d at 633-34.

[113] First Defiance Fin. Corp. v. Progressive Cas. Ins. Co., 688 F.3d 265 (6th Cir. 2012); Fed. Deposit Ins. Corp. v. St. Paul Fire & Marine Ins. Co., 942 F. 2d 1032, 1035-37 (6th Cir. 1991); Glusband v. Fittin Cunningham & Lauzon, Inc., 892 F.2d 208, 212 (2d Cir. 1989); Verex Assurance, Inc. v. Gates City Mortg., Inc., Civ. No. C-83-0506W, 1984 WL 2918, at *2 (D. Utah 1984). *See also* FINANCIAL INSTITUTION BONDS 48 (Duncan L. Clore ed., 2d ed. 1998) ("Insuring Agreement (A) was revised to clarify the Surety Association's long standing intent, . . . to limit loan losses to claims in which the culpable employee acted with the intent or purpose to gain a benefit at the expense of his employer—in other words, when the employee intended to defraud the insured bank of money."); Robin v. Weldy, *A Survey of Recent Changes in Financial Institution Bonds*, 12 FORUM 895, 897 (1977) ("The surety industry is trying to

uniformly consider negligent or sloppy conduct to fall far short of the manifest intent requirements.[114]

In *First Defiance Financial Corp. v. Progressive Casualty Insurance Co.*,[115] the Sixth Circuit faced a situation where the bank employee had transferred funds from a client's brokerage account into his own account. The Sixth Circuit concluded that the employee had "assuredly" met the manifest intent standard under the substantially certainty test and explained:

> In view of the fiduciary relationship between [the bank] and its clients, a theft from client accounts by a [bank] employee would be substantially certain to cause losses to the bank. Nor was there any way [the employee's] fraud could benefit the employer. "Embezzlement is a zero-sum game. For the employee to win, the employer must lose." Just as there are no free lunches from the economist's perspective, there are no free thefts from a bank's perspective.[116]

While embezzlement-type acts are likely covered under any "manifest intent" test, acts that constitute bad business judgment and/or negligence likely are not covered. In *FDIC v. St. Paul Fire & Marine Insurance Co.*,[117] the Sixth Circuit held that there was no coverage under a bankers blanket bond for the losses caused by a former bank president who made bad loans to his friends and business associates. The court indicated that the bond covered fraud but not bad business judgment and that the

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stress the obvious—this coverage insures against loss caused by a thief who happens to be an employee of the insured.").

[114] *See generally*, Fed. Deposit Ins. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 146 F. Supp.2d 541 (D.N.J. 2001), aff'd, 57 F. App'x 965 (3d Cir. 2003) (negligence and bad business practices do not meet manifest intent requirements); Progressive Cas. Ins. Co. v. First Bank, 820 F. Supp. 473 (S.D. Tex. 1993); Oritani Sav. & Loan Ass'n v. Fid. & Deposit Co. of Md., 821 F. Supp. 286 (D.N.J. 1991); Glusband v. Fittin Cunningham & Lauzon, 892 F.2d 208 (2d Cir. 1989) (reckless or imprudent conduct not enough for manifest intent).

[115] 688 F.3d 265.

[116] *Id.* at 271 (internal citations omitted).

[117] 942 F.2d 1032 (6th Cir. 1991).

former bank president's actions fell somewhere between embezzlement, the classic scenario for coverage whereby the employee gains at the employer's expense, and a scenario in which the employee causes a loss while intending to benefit the employer.[118]

While the meaning of the term "manifest intent" has been interpreted by courts with respect to Insuring Agreement A, few courts have had the opportunity to interpret this provision in light of government crime insurance. Accordingly, it is likely that courts faced with this decision in the future will look the interpretations in its jurisdiction (and accompanying tests) used under other policy forms. Regardless, "manifest intent" is clearly a substantially more stringent standard than faithful performance.

2. The ISO Policy

As noted above, the ISO Policy does not use the manifest intent standard to define coverage. Instead, coverage under the ISO Policy hinges on whether the employee has committed a "theft." The ISO Policy defines "theft" as:

> "Theft" means the unlawful taking of "money", "securities" or "other property" to the deprivation of the Insured.[119]

Courts have taken different approaches to interpreting what constitutes theft in relation to crime policies. Some courts have taken a strict approach to interpreting "theft." For example, in *Coopersville Motors, Inc. v. Federated Mutual Insurance Co.*,[120] the insured asserted a claim under the policy for damages in excess of $650,000 allegedly resulting

[118] *Id.* at 1037. For more cases substantively discussing the "manifest intent" requirement, *see* Michael Keeley & Carla Crapster, *The Insuring Agreements—Employee Dishonesty Coverage, in* ANNOTATED COMMERCIAL CRIME INSURANCE POLICY 73, 78 (Toni Scott Reed and Carleton R. Burch, eds., 3d ed. 2015).

[119] Government Crime Policy, Form No. 00 26 03 00 (ISO 2005 ed.) *reprinted in* ANNOTATED COMMERCIAL CRIME INSURANCE POLICY 877 (Toni Scott Reed and Carleton R. Burch eds., 3d ed. 2015).

[120] 771 F. Supp. 2d 796 (W.D. Mich. 2011).

from the conversion of assets by two car dealership employees. The employees were accused of using funds that were paid on vehicle sales to cover expenses of the insured rather than properly forwarding the funds to the floor plan financing companies, using funds received after the sale of the dealership to cover expenses that were incurred prior to the sale, and providing inaccurate financial statements to the buyer of the dealership prior to the sale.[121]

The United States District Court for the Western District of Michigan determined that none of the claimed "thefts" implicated coverage under the policy, but were simply evidence of a bad business deal.[122] The court reasoned that theft under the terms of the policy required an unlawful taking of property to the detriment to the insured and in this instance, there was no evidence that the allegedly diverted money was used for any purpose other than paying legitimate dealership expenses.[123] Other courts have similarly interpreted "theft" in this manner.[124]

In *Morris Kirschman & Co. v. Hartford Fire Insurance Co.*,[125] the insured's employee was accused of manipulating the company's accounts receivable to make them appear current and collectible so that her department's performance would appear better. Allegedly, the employee and her department received in excess of $200,000 in merit pay raises and bonuses as a result of the employee's manipulation of the accounts.[126] Additionally, the insured claimed that some $5 million in accounts receivable became uncollectible due to the employee's manipulation.

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[121] *Id.* at 800.

[122] *Id.* at 801.

[123] *Id.*

[124] *See* Hartford Fire Ins. Co. v. Mitchell Co., No. 08-00623-KD-N, 2010 U.S. Dist. LEXIS 132887 (S.D. Ala. Dec. 15, 2010) (declining to expand "theft" to encompass generally dishonest acts); Pine Belt Auto. v. Royal Indem. Co., No. 06-5995 (JAP), 2008 U.S. Dist. LEXIS 84393 (D.N.J. Oct. 21, 2008).

[125] No. 03-1743, 2004 U.S. Dist. LEXIS 17427 (E.D. La. Aug. 27, 2004).

[126] *Id.* at *2.

One of the main questions before the court was whether the employee's actions constituted theft under the policy. The policy at issue covered theft by an employee and theft was defined as an "unlawful taking."[127] The United States District Court for the Eastern District of Louisiana ultimately determined that the "manipulation of the delinquent accounts amounted to a 'theft' as defined in the policy because it was an 'unlawful taking' which deprived [the insured] of its property."[128] The court stated:

> The policy does not require that [the employee] be criminally charged or convicted to constitute theft. And theft is theft even if [the employee] did not personally take case from [the insured's] bank accounts. The policy definition of "theft" requires "deprivation of the insured", which surely occurred in this case.[129]

The court did not, however, elaborate on how the manipulation of the accounts receivable amounted to an unlawful taking under the policy.[130] Other courts have also found coverage on general dishonest schemes by interpreting "theft" to be more expansive than intended under the relevant policies.[131] However, theft must always result in the deprivation of property from the insured and for the benefit of the employee.

D. The Faithful Performance Endorsement

Government crime insurance also provides a government crime entity endorsement for the faithful performance of duty (the "Faithful Performance Endorsement"). For example, the ISO Policy contains the following endorsement:

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[127] *Id.* at *4.

[128] *Id.*

[129] *Morris Kirschman*, 2010 U.S. Dist. LEXIS 132887, at *4.

[130] The court ultimately denied coverage under the policy because, under Louisiana law, the accounts receivable were not corporeal and thus, could not be considered tangible property or "other property" under the policy. *Id.* at *5.

[131] *See* Taylor Chrysler Dodge, Inc. v. Universal Underwriters Ins. Co., No. 08 C 4522, 2009 U.S. Dist. LEXIS 91187 (N.D. Ill. Sept. 30, 2009) (finding theft to include employee's scheme of selling false documents to customers to use to obtain loans and defraud third-party lenders with false documents).

> We will pay for loss or damage to "money", "securities" and "other property" resulting directly from the failure of any "employee" to faithfully perform his or her duties as prescribed by law, which such failure has as its direct and immediate result a loss of your covered property.[132]

1. Faithful Performance

Faithful performance is designed to assure that a public official or employee will act with honesty and/or in faithful performance of his or her official duties. Faithful performance not only covers dishonesty, but also situations including loss of funds resulting from an employee's malfeasance, willful neglect of duty, bad faith or negligence. Traditionally, states require coverage for the faithful performance of the public officials. These statutory provisions may provide:

> The bond of each public officer required by law to give bond must, unless it is otherwise provided, be made payable to the State of Alabama, with such sureties as the approving officer is satisfied have the qualifications required by law, with condition, in all cases in which a different condition is not prescribed, **faithfully to discharge the duties of such office** during the time he continues therein and discharges any of the duties thereof.[133]

In the context of Public Official Bonds, "faithful performance" is what the correlating statute defines it to be. However, a number of statutes do not further define what they intend "faithful performance" to mean. In its broadest and most common-sense interpretation, faithful performance means an officer or employee has performed his or her official duties without dishonesty, malfeasance, or negligence. While the public official's motive may be determinative with respect to coverage under the SFAA Policy requirement of "manifest intent," the motive may not

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[132] Government Crime Policy, Form No. 25 19 03 00 "Add Faithful Performance of Duty Coverage for Government Employees" (ISO 2012 ed.) *reprinted in* ANNOTATED COMMERCIAL CRIME INSURANCE POLICY 877 (Toni Scott Reed and Carleton R. Burch eds., 3d ed. 2015).

[133] ALA. CODE §36-5-5 (2019) (emphasis added).

be determinate of whether the public official faithfully performed his or her duties.[134]

In *Meeker County v. North River Insurance*,[135] the court faced a situation where the governmental entity purchased a faithful performance endorsement to meet the statutory bonding requirements. In order to satisfy statutory requirements for the bonding of public officials, Meeker County purchased a commercial crime policy that included coverage for "Public Employee Dishonesty" and also included an endorsement, labeled "Faithful Performance of Duty," that specifically amended the "Public Employee Dishonesty" coverage.[136] The endorsement specifically provided as follows:

> 1. The following is added as a Covered Cause of Loss:
>
> Failure of any "employee" to faithfully perform his or her duties as prescribed by law, when such failure has as its direct and immediate result a loss of your Covered Property, including inability to faithfully perform those duties because of a criminal act committed by a person other than an "employee."[137]

Notably, for the purposes of this case, the endorsement to the commercial crime policy also contained an exclusion that stated as follows:

> 2. The following exclusion is added:

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[134] *See* Kinzer v. Fid. & Deposit Co. of Maryland, 572 N.E.2d 1151, 1154 (Ill. App. Ct. 1991) ("[w]e fail to perceive what [the comptroller's] state of mind in so doing, i.e., his 'good faith,' had to do with whether he 'properly' accounted for funds under his control. Therefore, in so far as the language of the contract is concerned, [the comptroller's] 'good faith' is not relevant to [the surety's] liability under the bond.").

[135] No. CIV. 00-1889JRTFLN, 2001 WL 1636245 (D. Minn. 2001).

[136] *Id.* at *1.

[137] *Id.*

> Depository Failure: loss resulting from the failure of any entity acting as a depository for your property or property for which you are responsible.[138]

During the policy term, the county treasurer purchased two certificates of deposit from a single bank, the total amount of the certificates being approximately $190,000. The bank failed and was ultimately placed in receivership by the Comptroller of Currency.[139] The FDIC reimbursed to the county a total of $100,000 on the certificates, leaving a $90,000 loss. The county sought recovery under the commercial crime policy and its faithful performance endorsement for the total loss, arguing that its loss was the result of the county treasurer's failure to faithfully perform her duties as prescribed by law because the treasurer failed to ensure that all county funds were fully insured by the FDIC.[140] The insurer denied their claim based on the exclusion stated in the policy endorsement, asserting that the failed bank was the depository for the county's property and therefore any loss resulting from the bank's failure was excluded.

The court first set out the standards for the interpretation of an insurance contract and determined that no ambiguities existed in the language of the policy or the endorsement. Agreeing with the insurer, the court found that the exclusion was "clear and unambiguous and must be given effect."[141] Thus, although the court found that the actions of the treasurer "certainly [fell] within the purview of the 'Faithful Performance' endorsement,"[142] the exclusionary language was also applicable and, in this case, controlled the outcome.

In *Fournier v. Hartford Fire Insurance Co.*,[143] a plaintiff tested the enforceability of the Form O/P exclusion for civil rights violations and also the condition that the commercial crime policy be for the sole benefit of the governmental entity. The case involved alleged improper employment decisions by the county sheriff, who was covered under the

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[138] *Id.*
[139] *Id.*
[140] *Meeker Cty.*, 2001 WL 1636245, at *2.
[141] *Id.* at *3.
[142] *Id.*
[143] 862 F. Supp. 357 (N.D. Ga. 1994).

county's blanket commercial crime policy for public employee dishonesty. The commercial crime policy in question contained a "faithful performance" endorsement expanding coverage for loss caused by the following:

> Failure of any "employee" to faithfully perform his or her duties as prescribed by law, when such failure has as its direct and immediate result a loss of [the insured's] Covered Property, including the inability to faithfully perform those duties because of a criminal act committed by a person other than an "employee."[144]

The plaintiff(s) alleged that the county sheriff transferred and reassigned plaintiffs to different job duties, in violation of their civil rights. Hartford asserted that the commercial crime policy excluded coverage for civil rights violations and did not allow plaintiffs, who were not named insureds, to bring a direct action against the insurer.[145] Interestingly, Hartford also raised the issue that the sheriff was excluded as an employee "required by law to be individually bonded"—the same argument raised in the *City of Concordia* case discussed *infra*. In a footnote, the court stated as follows:

> Hartford also argues that another policy provision excludes coverage for employees who are required to have an individual bond by state law and that, pursuant to O.C.G.A. § 15-16-5, Sheriff Bell was required to have such a bond. Although it is not clear from the record, it appears that the policy at issue may have been intended to fulfill Sheriff Bell's statutory bond requirement. Thus, Hartford's argument with regard to this exclusion seems strained. The Court need not address the argument, however, as it concludes that either of the other policy provisions relied upon by Hartford bars plaintiffs from maintaining this action against Hartford directly.[146]

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[144] *Id*. at 360.
[145] *Id.* at 361.
[146] *Id.* at 361, n.2.

The crux of the plaintiffs' argument for coverage involved their interpretation that the sheriff was not an "employee" as the term is used in the policy's exclusion provision. In making their argument, plaintiffs relied upon the definition of "employee" in the policy, which provides that the County Commission must "direct and control" the activities of an individual in order for that individual to be an "employee" of the insured. The plaintiffs attempted to argue that the sheriff was an elected official, not subject to the direction and control of the County Commission and therefore not an "employee" contemplated by the civil rights exclusion.[147] Hartford responded that, if the sheriff is not an "employee," he would not be covered by the commercial crime policy in the first place. Agreeing with Hartford's response, the court aptly noted: "Essentially, plaintiffs argue that Sheriff Bell is an 'employee' for purposes of determining coverage under the policy but he is not an 'employee' for purposes of construing the exclusion for civil rights violations by employees. Plaintiffs cannot have it both ways."[148]

As for the "sole benefit" condition of the policy, the court simply reasoned as follows:

> [P]laintiffs argue that they should be able to sue [the sheriff's] insured directly for damages allegedly caused by [the sheriff]. Plaintiffs' brief is, however, void of any authority to support the proposition that an injured party has a right to maintain suit against an insurance company for the alleged misconduct of an individual covered by an insurance policy. In absence of any authority to support plaintiffs' arguments, the Court cannot conclude that the policy provision at issue contravenes the public policy of the state of Georgia.[149]

In the context of Public Official Bonds, courts have found a lack of faithful performance when an employee fails to perform statutory duties. For example, in *Centennial School District v. Kerins*,[150] the school tax collector was required to provide to his district, by the tenth of

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[147] *Id.* at 361-62.
[148] *Fournier*, 862 F. Supp. at 362.
[149] *Id.*
[150] 840 A.2d 377 (Pa. Commw. Ct. 2003).

each month, the taxes he collected in the prior month, along with a monthly accounting report detailing these collections. Although the tax collector collected taxes in each month from August 1999 through January 2000, he did not submit to the district the collected taxes for that period or the monthly accounting reports for these collections until February 2000.[151] Because the taxes were not submitted, there was substantial lost interest that the district could have earned on each monthly sum collected had each been submitted in a timely fashion. The district sought to collect the unearned interest from the tax collector and his surety under the public official bond. The surety took the position that its liability was limited to "situations in which there has been wrongdoing by the collect, such as absconding with funds."[152] The district disagreed that wrongdoing was a predicate, noting that "the purpose of obtaining a surety bond is to ensure, and provide a financial guaranty, for the faithful performance of the public official's duties.[153]

The statutory provision requiring the tax collector to obtain a bond stated that the bond shall be "conditioned upon the faithful performance of his duties as such tax collector."[154] Both the trial court and the reviewing court agreed that "[the tax collector] did not fulfill his statutory obligations. He maintained possession of funds after he was required to pay them and, by doing so, breached his fiduciary responsibility as to the proceeds" and, therefore, the surety should also be "financially accountable for the collector's breach of these duties."[155]

On the other hand, some courts have created a "good faith" exception to the concept of faithful performance. For example, in *Smith v. Dorsey*, taxpayers brought suit against school board members alleging the public expenditure of public funds.[156] The Mississippi Supreme Court discussed the good faith exception and its history and noted that under Mississippi law, personal liability should not be imposed on a public official when the public official acted in "good faith and honest

[151] *Id.* at 380.
[152] *Id.* at 385.
[153] *Id.* at 385-86.
[154] *Id.* at 386.
[155] *Id.*
[156] 599 So.2d 529 (Miss. 1992).

judgment."[157] The court ultimately found, however, that the school board members had not acted in good faith and thus could be personally liable.[158]

Courts have discussed "faithful performance" with respect to government crime insurance similarly. In *Pfeiffer v. American Alternative Insurance Corp.*,[159] the insured's tax collector made an error in calculating the property tax rates resulting in a budget shortfall. The insured's treasurer was aware of the budget shortfall, but did not investigate the matter further causing the same erroneous calculations to be used for a second consecutive year further increasing the budget shortfall to approximately $1.6 million. The insured submitted a claim under the "Faithful Performance of Duty" endorsement to the "Public Employee Dishonesty Coverage."[160] The relevant policy language stated:

> Failure of any "employee" to faithfully perform his or her duties as prescribed by law, when such failure has as its direct and immediate result a loss of your covered property.

The policy did not expressly define "faithful performance." The court looked to the insured's charter and by-laws when determining the duties of the tax collector and treasurer. The court further stated "there is no dispute between the parties that both the [t]reasurer and [t]ax [c]ollector made some serious missteps."[161] While the court ultimately denied the insured's motion for summary judgment because it determined that the insured's lost tax revenue was a legally recoverable property interest, this case exemplifies that premise that faithful performance under

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[157] *Id.* at 546. *See also* Barnett v. Lollar, 197 Miss. 574 (Miss. 1944) ("At common law a public officer is not liable for errors or mistakes made by him in good faith when acting judicially or quasi judicially within the scope of the subject matter over which he has been given jurisdiction.").

[158] *Id*. at 549.

[159] 253 F. Supp. 3d 425 (D.R.I. 2015).

[160] Government crime insurance generally excludes coverage for tax collectors and treasurers specifically, but here the endorsement was drafted expressly to cover the tax collector and treasurer. *Id.* at 427.

[161] *Id.* at 427.

government crime insurance can and likely will be interpreted to include mere negligence.

Because of the varying degrees of intent required, government entities are far better protected against public official wrongdoing under the Faithful Performance Endorsement than the generic government crime insurance.

2. "Duty prescribed by law"

Another requirement for coverage under the Faithful Performance is that the failure of the public official's faithful performance must be with respect to the "duty prescribed by law." For example, the Faithful Performance Endorsement may state:

> The Company will pay the Insured for the Insured's direct loss of, or direct loss from damage to Money, Securities and Other Property directly caused by the failure of any Employee **to faithfully perform the Employee's duties as prescribed by law**.

This language limits the coverage of the Faithful Performance Endorsement by requiring that the faithful performance be tied to the covered employees' "duties prescribed by law." While there is limited case law discussing what constitutes "duty prescribed by law" in the context of government crime insurance, courts have discussed the meaning of duties prescribed by law in other contexts. For example, in *Pfeiffer v. American Alternative Insurance Corp.*,[162] the United States District Court for the District of Rhode Island identified the duties of the district's treasurer and tax collector by stating:

> Section 9 of the Charter states that the [t]reasurer must submit a monthly report to the Board of Directors and must, once a year, "fully report the condition of the treasury of the District, showing receipts and expenditures of the preceding year" at a public meeting. The bylaws specify further that the [t]reasurer's monthly report to the Board "show receipts and expenditures to

[162] 253 F. Supp. 3d 425 (D.R.I. 2015).

> date as compared with the annual budget, as well as a balance sheet showing cash assets, liabilities and equities to date.
>
> According to Section 10 of the Charter, the [t]ax [c]ollector is "responsible for the preparation of the tax roll," and must submit monthly reports to the [t]reasurer and report annually at a public meeting. The by-laws add the maintenance of "timely and accurate records of payments received and amounts owed for each District taxpayer" and the duty to "present to the Board of Directors for their approval all abatements."[163]

This interpretation is consistent with courts' interpretation of the duties to be faithfully performed pursuant to Public Official Bonds. For instance, in *Concord v. Peerless Insurance Co.*,[164] the city brought an action on a public official bond for the failure of the labor commissioner to faithfully perform his duties. The New Hampshire Supreme Court determined that the labor commissioner had failed to faithfully perform the duties prescribed by statute to "obtain a schedule of such minimum wage rates and to incorporate it in the advertisement for bids on public works and to make it part of the construction contract."[165] In determining the duty that the labor commissioner owed under the public official bonds, the court specifically cited the statutory language and stated that "this statute imposed a positive duty on an official."[166]

Courts have consistently interpreted "prescribed by law" to involve the legislature or laws passed by the legislature. For instance, in *State v. Larson*,[167] a criminal defendant sought to obtain a certificate of probable cause to stay execution of his sentence and to be release during his appeal of the underlying sentence. The trial court granted the criminal defendant's certificate of probable cause and released him pending

[163] *Id*. at 428. 253 F. Supp.3d 425, 428 (D.R.I. 2015).

[164] 272 A.2d 588 (N.H. 1970). Notably, the particular bond at issue in Concord v. Peerless Ins. Co. was a public officials blanket bond and not an individual public official bond.

[165] *Id.* at 589.

[166] *Id.*

[167] 850 P.2d 1264 (Utah 1993).

appeal.[168] The State of Utah appealed the certificate and release asserting that a release pending appeal was improper under the relevant statute.

The primary issue in *Larson* was whether Rule 27 of the Utah Rules of Criminal Procedure was "prescribed by law."[169] The criminal defendant asserted that the phrase "as prescribed by law" could cover a court rule as well was a statute. On the other hand, the State contended that "as prescribed by law" includes only laws established by statute.[170] In finding that the court rule at issue in this case was not "as prescribed by law," the court stated:

> In the context of this case, it is clear that the intent of the amendment to article I, section 8 was that the legislature would prescribe by statute the conditions under which a person convicted of a crime may be admitted to bail pending appeal. We come to this conclusion because section 77-20-10 was enacted at the same session of the legislature at which the constitutional amendment was proposed. It is difficult to believe that the legislature had any other intention in its use of the phrase "as prescribed by law" other than to constitutionally authorize the simultaneous passage of section 77-20-10.
>
> While it may be true as urged by defendant that a court rule might properly be determined to be "law," we do not believe that under the circumstances here, it was the intent of the constitutional amendment to have the subject of release on bail pending appeal treated otherwise than by statute.[171]

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[168] *Id.* at 1265.

[169] *Id.* at 1266.

[170] *Id.* The State of Utah cited the following cases supporting the proposition that "to be established by law" means laws passed by the law-making power of the state. State *ex rel.* Shields v. Barker, 167 P. 262, 263 (1917); State v. Cauble, 563 P.2d 775, 777 (Utah 1977); State v. Jiminez, 588 P.2d 707, 708-09 (Utah 1978).

[171] *Id.* at 1266.

In *Howard v. Cook*,[172] the Idaho Supreme Court discussed the attorney general's authority to act on behalf of the state with respect to public lands. The court looked to the relevant statutory provision which provided:

> The attorney-general shall represent or shall cause the state to be properly represented in all suits, actions, contests or controversies relating to or involving state lands or timber, before the several land offices in this state, before the general land office at Washington, D.C., and before the courts of this State and of the United States, and may employ a competent attorney or attorneys for that purpose, who shall be paid out of the fund provided for the land department of the state.[173]

The court then looked to Article 9, section 7, of the Constitution of Idaho which creates the state board of land commissioners, consisting of the governor, superintendent of public instruction, secretary of state, attorney general and state auditor, "who shall have the direction, control and disposition of the public lands of the state, under such regulations as may be **prescribed by law**."[174] The court then expressly concluded that "prescribed by law" means as prescribed by the legislature.[175]

The court also discussed Article 4, section 1, of the Constitution of Idaho which creates the office of attorney-general in the executive department, and provides his duties are "as prescribed by this constitution and as may be prescribed by law."[176] The court noted that the general powers and duties of the attorney-general are set out by statute.[177]

In *State v. Powers*,[178] the superintendent of public instruction for the state of Wyoming brought a declaratory action seeking the court's

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[172] 83 P.2d 208 (Idaho 1938).
[173] IDAHO CODE ANN. § 56-120 (1934).
[174] *Howard*, 83 P.2d at 210 (emphasis added).
[175] *Id.*
[176] *Id.* at 210.
[177] *Id. See* IDAHO CODE ANN. § 65-1301 (1934).
[178] 318 P.3d 300 (Wyo. 2014).

determination of whether a newly enacted piece of legislation should be enjoined for being unconstitutional. The Wyoming Supreme Court was asked to interpret Article 7, Section 14 of the Wyoming Constitution which provides:

> **§ 14. Supervision of schools entrusted to state superintendent of public instruction.**
>
> The general supervision of the public schools shall be entrusted to the state superintendent of public instruction, whose powers and duties shall be prescribed by law.[179]

The appellants asserted that the plain language of the provision conveyed the drafters' intent "that the Superintendent was entrusted with the responsibility and power to provide supervision of the state public school system."[180] Specifically, the appellants contended that "prescribed by law" allows the legislature to "expand or contract" the powers and duties of the superintendent, but does not give them permission to diminish the powers and duties to a level which prevents the superintendent from performing her power of general supervision. The State of Wyoming asserted that the legislature has the ultimate authority to determine the powers and duties of the superintendent and that the power to "prescribe by law" was unrestricted.[181]

The Court discussed the phrase "prescribed by law" in making its determination stating:

> Because it is potentially dispositive, we will first address the plain meaning of the phrase "prescribed by law" as it applies to the power of "general supervision" entrusted to the Superintendent in the first clause of Article 7, Section 14. **The parties agreed that the phrase "prescribed by law" refers to the legislature's ability**

[179] *Id.* at 304.
[180] *Id.*
[181] *Id.* at 305.

> **to pass laws relating to the powers and duties of the Superintendent.**[182]

After an extensive discussion of the cases involving the legislatures' ability (or lack thereof) to restrict or otherwise diminish a public official's authority granted in a state constitution, the Wyoming Supreme Court ultimately determined that the phrase "shall be prescribed by law" does not provide the legislature with unrestricted power to eliminate or transfer powers and duties of the office of superintendent.[183]

In addition to the cases discussed above, a number of other courts have similarly come to the conclusion that "prescribed by law" is intended to encompass laws prescribed by the legislature.[184] Accordingly, it in the context of government crime insurance, the insureds' faithful performance must be tied to a duty that is created by the relevant legislative intent or, at a minimum, delegated to another body by the legislature.

The requirement of the faithful performance being related to a "duty prescribed by law" creates an interesting issue for subordinates of public officials who are potentially "employees" as defined in the Faithful Performance Endorsement. For example, often times subordinates in the public official's office hold positions that are not referenced in any statute or other legislative documents and thus, have no "duties prescribed by law." In these instances, the authors of this article posit that these employees' failure to "faithfully perform" does not implicate coverage under the Faithful Performance Endorsement unless such breach is tied to a governing statute or similar law.

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[182] *Id.* (emphasis added).

[183] *Powers*, 318 P.3d at 313.

[184] *See* Tenorio-Serrano v. Driscoll, et al., 324 F. Supp.3d 1053 (D. Ariz. 2018); Litchfield Elementary Sch. Dist. No. 79 of Maricopa Cty., et al. v. Babbitt, et al., 608 P.2d 792 (Ariz. Ct. App. 1980); State of Montana *ex rel.* Dave Middlemas v. Dist. Court of Lewis and Clark Cty., 130 Mont. 73, 80 (Mont. 1956) ("The above concluding phrase, namely '*under such regulations and limitations as may be prescribed by law*' means as prescribed by the state legislature.") (emphasis in original); State ex rel. McKittrick v. Mo. Public Serv. Comm'n, et al., 175 S.W.2d 857 (Miss. 1943) (en Banc).

As a whole, what constitutes "duty prescribed by law" under government crime insurance, and more specifically, the Faithful Performance Endorsement, should be governed by the statutorily prescribed duties for the public official. Thus, each individual public official (or covered employee) should be considered on a case-by-case basis determined by their statutory jurisdiction and requirements.

3. The Interplay Between Manifest Intent/Theft and the Faithful Performance Endorsement

Another interesting issue with respect to government crime insurance is the interplay between the general coverage requirements such as the SFAA Policy's "manifest intent" requirement or the ISO Policy's theft requirement and the Faithful Performance Endorsement. In the event the covered employee's actions implicate the Faithful Performance Endorsement by failing to faithfully perform a "duty prescribed by law," the manifest intent or theft requirement will likely not affect the coverage under government crime insurance. The faithful performance standard is a lower bar for the insured to clear.

A breach of a duty prescribed by law may render the restrictive manifest intent or theft standard largely moot. However, if the insured fails to show that the Faithful Performance Endorsement is implicated whether because there is no "duty prescribed by law" or the implicated employee and/or public official did not breach a duty prescribed by law, the higher burden of manifest intent or theft must be satisfied to implicate coverage. Stated simply, the Faithful Performance Endorsement does not render the traditional fidelity component of coverage (i.e. manifest intent, theft) moot, it simply carves out a narrow scope of coverage where the insured can demonstrate that the employee's conduct, while perhaps not dishonest, did violate a duty prescribed by law.

E. Termination of Coverage

The period of coverage under government crime insurance is set by the policy itself. Generally, there are no statutory provisions that would affect the language of the policy, although it is conceivable that a "hybrid" policy that contains a faithful performance or a policy that is approved through a statute as a replacement for the Public Official Bond

(such as in Tennessee) may be subject to statutory conditions, if that endorsement or policy is meant to stand as a public officer or employee's Public Official Bond. Additionally, some state statutes specifically require the procurement of a "fidelity bond" covering theft and dishonesty of a public official. In such cases, termination will depend on the applicable statutory provisions.

An important difference between the Public Official Bonds and government crime insurance is that while the Public Official Bond has statutorily set termination period usually tied to the term of office, government crime insurance has a much more specific termination clause. For example, the SFAA Policy states, in pertinent part:

> Coverage under this Policy is canceled as to any **employee**:
>
> a. Immediately upon discovery by:
>
> (1) You; or
>
> (2) Any of your partners, officers or directors not in collusion with the employee; or
>
> (3) As to **Employee benefit plan(s)**, any trustee, fiduciary or plan administrator not in collusion with the **employer**;
>
> of any dishonest act committee by that **employee** whether before or after becoming employed by you. Whether such discovery occurs prior to or after commencement of this Policy, there is no coverage under Insuring Agreement 1, for loss or losses resulting from acts committed by that **employee** after the date of such discovery.[185]

[185] Commercial Crime Policy for Government Entities, Form No. 00 01 04 12 (2012 ed.), *reprinted in* STANDARD FORMS OF THE SURETY ASS'N OF AMERICA, "Applicable to Specific Insuring Agreement" (SFAA 2012 ed.).

Thus, the discovery is specifically tied to the dishonest acts of the covered employee and coverage terminates automatically. Accordingly, government crime insurance has the ability to terminate coverage in instances where the Public Official Bonds do not. This protection can shield an insurer from loss arising from a known dishonest official, whereas the Public Official Bond can, theoretically, continue to cover the official's malfeasance even after known to the public entity.

V. CONCLUSION

There is no uniformity in the types of bonds that are statutorily required for public officials throughout the United States. Predominantly, most bonds required of a public official are conditioned upon his or her "faithful performance" of his or her duties. However, some statutes may also require a bond specifically ensuring the fidelity of its public officials or allow for the entity to purchase a government crime insurance instead of a bond. Regardless of the kind of bond that is statutorily required, the effect of the provision remains the same—all statutes relating to the official bond must be considered. Where a non-statutory or voluntary bond will be interpreted by its terms and conditions, a statutory bond will have the additional oversight of the provisions affecting its issuance.

Municipalities and other governmental entities are faced with many options when it comes to protecting the public and themselves from the acts of its public officials and employees. Where a statute controls, the type of bond to be procured should be obvious. However, bonding companies may offer policies that go above and beyond the statutory requirements. Whether issuing the policy or purchasing a bond, familiarity with the state code and what statutory provisions are required cannot be over-emphasized. Both the bonding companies and the governmental entities must be clear about what employees they intent to cover under the bond and what obligations, whether statutory or not, are covered.

APPENDIX A

SURVEY OF GENERAL STATE LAWS REGARDING OFFICIAL BONDS[186]

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
ALABAMA	ALA. CODE §§ 36-5-1, et seq.	Public Officers and Employees	Official Bonds
ALASKA	ALASKA STAT. § 39.05.050	Public Officers and Employees	Qualifications, Appointment and Tenure: Surety Bonds
ALASKA	ALASKA STAT. §§ 39.15.010, et seq.	Public Officers and Employees	Official Bonds
ARIZONA	ARIZ. REV. STAT. ANN. §§ 38-251, et seq.	Public Officers and Employees	Qualification and Tenure: Official Bond
ARKANSAS	ARK. CODE ANN. § 21-2-101, et seq.	Public Officers and Employees	Commission, Oath and Bond
ARKANSAS	ARK. CODE ANN. § 21-2-701, et seq.	Public Officers and Employees	Commission, Oath and Bond—Self-Insured Fidelity Bond Program

[186] This Appendix provides only the general statutes that govern official bonds for the listed state. Every state has specific statutes (in some cases voluminous in number) authorizing and setting the terms for the officers or employees that are required to give an "official" bond. These would include state-level officers and employees as well as county and municipal workers. This Appendix is only meant to direct users to the general provisions governing the broad category of official bonds.

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
CALIFORNIA	CAL. GOV. CODE §§ 1450 TO 1653	Gov't Code—General Public Officers and Employees	Official Bonds
CALIFORNIA	CAL. GOV. CODE § 24150, et seq.	Gov't Code—Gov't of Counties Officers	Officers Generally—Bonds
COLORADO	COLO. REV. STAT. § 24-13-105, et seq.	Government—State	Official Bonds
COLORADO	COLO. REV. STAT. § 30-10-110	Government—County	County Officers—Bonds of Officers
CONNECTICUT	CONN. GEN. STAT. § 4-20	Management of State Agencies	State Appointive Officers
DELAWARE[187]	DEL. CODE ANN. tit. 29, § 5107	State Government	Public Officers and Employees Cancellation of Bond on Expiration of Term
DELAWARE	DEL. CODE ANN. tit. 18, § 6543	Insurance Code	Insurance for Protection of State Self-Insured Fidelity Bond
FLORIDA	FLA. STAT. § 113.01, et seq.	Public Officers, Employees and Records	Commissions
GEORGIA	GA. CODE ANN. § 45-4-1, et seq.	Public Officers and Employees	Official Bonds

[187] DELAWARE—no general provisions regarding public official's bonds, although an official bond may be required for a given office;

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
HAWAII[188]			
IDAHO	IDAHO CODE ANN. 59-801, et seq.	Public Officers in General	Bonds of Officers and Public Employees
ILLINOIS	5 ILL. COMP. STAT. 260/0.01, et seq.	Government—General Provisions	Official Bond Act
ILLINOIS	5 ILL. COMP. STAT. 265/0.01, et seq.	Government—General Provisions	Holdover Official Bond Act
ILLINOIS	5 ILL. COMP. STAT. 270/0.01, et seq.	Government—General Provisions	Official Bond Payment Act
IOWA	IOWA CODE § 64.1, et seq.	Elections and Official Duties	Public Officers and Employees Official and Private Bonds
KANSAS	KAN. STAT. ANN. § 75-4101, et seq.	State Departments; Public Officers And Employees	Surety Bonds and Insurance
KENTUCKY	KY. REV. STAT. ANN. § 62.050, et seq.	Offices and Officers	Oaths and Bonds
LOUISIANA	LA. REV. STAT. ANN. § 42:181, et seq.	Public Officers and Employees	Qualification by Taking Oath and Giving Bond
MAINE[189]			

[188] HAWAII—no general provisions regarding public official's bonds, although an official bond may be required for a given office;

[189] MAINE—no general provisions regarding public official's bonds, although an official bond may be required for a given office;

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
MARYLAND[190]	MD. CODE ANN., STATE GOV'T § 9-1704	Miscellaneous Executive Agencies	Maryland State Employees Surety Bond Committee
MASSACHUSETTS	MASS. GEN. LAWS ch. 30 §§ 14 TO 20	Laws Relating To State Officers	General Provisions Relative To State Departments, Commissions, Officers And Employees
MICHIGAN	MICH. COMP. LAWS §§ 15.1 TO 15.6	Public Officers and Employees	Bonds of State Officers and Employees
MINNESOTA	MINN. STAT. ANN. §§ 574.01, et seq.	Compensatory and Collection Remedies	Bonds, Fines & Forfeitures
MISSISSIPPI	MISS. CODE ANN. §§ 25-1-13 TO 25-1-41	Public Officers and Employees; Public Records	Public Officers; General Provisions
MISSOURI	MO. REV. STAT. § 170.010, et seq.	Public Officers and Employees, Bonds and Records	Bonds of Officers and Contractors for Public Works
MONTANA	MONT. CODE ANN. § 2-9-501, et. seq.	Government Structure and Administration	Liability Exposure and Insurance Coverage—General Provisions Related to Official Bonds

[190] MARYLAND—no general provisions regarding public official's bonds, but the state does have a designated "State Employees Surety Bond Committee" to oversee the issuance of official bonds for given officers/employees;

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
NEBRASKA	NEB. REV. STAT. § 11-101, et seq.	Bonds and Oaths, Official	
NEVADA	NEV. REV. STAT. § 282.010, et seq.	Public Officers and Employees	Official Bonds and Oaths
NEW HAMPSHIRE	N.H. REV. STAT. ANN. § 93-B:1, et seq.	Public Officers and Employees	Officials and Employees Bonds
NEW JERSEY	N.J. STAT. ANN. § 52:14-17.16	State Government, Departments and Officers—Executive and Administrative Departments, Officers and Employees	General Provisions—Bonding of State Officers and Employees
NEW MEXICO	N.M STAT. § 10-2-1 TO 10-2-17	Public Officers and Employees	Bonds
NEW YORK	N.Y. PUB. OFF. LAW § 11, et seq.	Appointment and Qualification of Public Officers	Official Undertakings
NEW YORK	N.Y. PUB. OFF. LAW § 21, et seq.	Appointment and Qualification of Public Officers	Actions on Official Bonds or Undertakings
NORTH CAROLINA	N.C. GEN. STAT. § 58-72-1, et seq.	Insurance	Official Bonds
NORTH DAKOTA	N.D. CENT. CODE § 26.1-21-01, et seq.	Insurance	State Bonding Fund
OHIO	OHIO REV. CODE ANN. § 3.30, et seq.	General Provisions	Officer; Oaths; Bonds

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
OKLAHOMA	OKLA. STAT. tit. 74, § 591, et seq.	State Government	Official Bonds
OREGON[191]	OR. REV. STAT. ANN. § 740.352, et seq.	Insurance	Insurance Policies Generally; Property and Casualty Policies
OREGON	OR. REV. STAT. ANN. § 291.011	Public Financial Administration	State Financial Administration—Fiscal Duties of Department—Blanket fidelity bonds for state officers and personnel
PENNSYLVANIA	71 PA. CONS. STAT. § 634	State Government	Powers and Duties of the Department of General Services and Its Departmental Administrative and Advisory Boards and Commissions—Bonds and liability insurance
RHODE ISLAND	R.I. GEN. LAWS § 42-20-9	State Affairs & Government	Administration of State Departments
SOUTH CAROLINA	S.C. CODE ANN. § 8-3-10, et seq.	Public Officers and Employees	Commissions, Oaths And Bonds
SOUTH DAKOTA	S.D. CODIFIED LAWS § 3-5-1, et seq.	Public Officers and Employees	Official Bonds

[191] OREGON—general provisions regarding public official's bonds, although an official bond may be required for a given office.

STATE:	CITATION:	TITLE/ CHAPTER:	CHAPTER/ SUB-CHAPTER/ PART:
TENNESSEE	TENN. CODE ANN. § 8-19-101, et seq.	Public Officers and Employees	Bonds of Officers
TEXAS	TEX. GOV'T CODE ANN. § 604.001, et seq.	Public Officers and Employees	Official Bonds
UTAH	UTAH CODE ANN. § 52-1-1, et seq.	Public Officers	Official Oaths and Bonds
VERMONT	VT. STAT. ANN. tit. 3, §§ 251, 252	Executive	State Officers and Employees Bonded Officials
VIRGINIA	VA. CODE ANN. §§ 2.2-2809 TO 2811	Administration of Government	General Provisions Bonds of certain officers required
VIRGINIA	VA. CODE ANN. §§ 2.2-1840, 1841	Administration of Government	Department of the Treasury Blanket surety bond plan for state and local employees
WASHINGTON	WASH. REV. CODE § 42.08.005, et seq.	Public Officers and Agencies	Official Bonds
WEST VIRGINIA	W. VA. CODE § 6-2-1, et seq.	General Provisions Respecting Officers	Official and Other Bonds
WISCONSIN	WIS. STAT. § 19.01, et seq.	General Duties Of Public Officials	Oaths and Official Bonds
WYOMING	WYO. STAT. ANN. § 9-1-102	Administration of the Government	State Officers—Generally