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THE SCOPE AND EXTENT OF A SURETY'S LIABILITY UNDER A FIDUCIARY BOND FOR THE PRINCIPAL'S WRONGFUL CONDUCT COMMITTED PRIOR TO THE ISSUANCE OF THE BOND

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INTRODUCTION

Mr. Snidely Whiplash ("Snidely") is appointed General Conservator for Dudley County and is responsible for administering the funds of minors and incompetents in hundreds of individual Probate Estates. At Snidely's request, DoRight Surety Company issues Conservator's Bonds in each of the Probate Estates in which Snidely acts as Conservator.

Over a period of years, Snidely pilfers hundreds of thousands of dollars from the Estates of the minors and incompetents. Upon discovery of the defalcations, Dudley County Probate Court removes Snidely and orders DoRight Surety Company to render accountings and reimburse the Estates for Snidely's conversion of assets.

During the course of the accounting process, it is determined that a portion of the losses took place before the issuance of DoRight Surety Company's Bonds. In some of the Estates, Snidely managed to obtain and steal funds of the wards even *before* he was appointed Conservator. Is DoRight Surety Company liable for such losses which occurred before the issuance of its Bonds? Is there liability for funds taken by Snidely before his actual appointment as Conservator in the Estates?

This paper will examine the various cases which have explored these issues. As will be seen, the surety's liability, if any, often turns upon the precise wording of the bond used by the surety. In some instances, however, courts have seemingly disregarded the language of the bond and found the surety liable for the fiduciary's breach of a "continuing duty" to account for estate assets.

I. PRE-BOND DEFAULTS AND DEFALCATIONS

A. Majority approach: Non-liability for pre-bond losses.

The majority rule appears to be that a surety on a bond of a guardian, conservator or administrator is not liable for the wrongful acts of its principal which took place before the date of the bond, unless the terms of the bond indicate a contrary intent. See, e.g., Martin v. Hanshu, 241 Kan. 521, 738 P.2d 96 (1987); National Sur. Corp. v. Williams, 110 F.2d 873 (8th Cir. 1940), cert. denied, 311 U.S. 674 (1940). See also American Bonding Co. v. Fountain, 196 S.W. 675 (Tex. Civ. App. 1917); American Bonding Co. v. People, 46 Colo. 394, 104 P. 81 (1909)(bonds are never held to be retrospective in operation, unless so intended and expressed); Thomson v. American Sur. Co., 62 N.E. 1073 (N.Y. 1902); State ex rel. Dorsey v. Banks, 76 Md. 136, 24 A. 415 (1892); Knepper v. Glenn, 73 Iowa 730, 36 N.W. 763 (1887); State ex rel. Towler v. Shackleford, 63 Miss. 648 (1879); Sebastian v. Bryan, 21 Ark. 447 (1860)(guardian's bonds construed as conditioned only for the *future* faithful performance of the guardian's duty); Fuselier v. Babineau, 14 La. Ann. 764 (1859). The approach taken by these courts is consistent with the age old maxim that the surety's liability is to be strictly construed and should not be extended by construction or implication beyond the terms of its undertaking. See Martin v. Hanshu, 738 P.2d at 97; Maryland Cas. Co. v. Cunningham, 234 Ala. 80, 73 So. 506 (1937); Bright v. Mack, 197 Ala. 214 72 So. 433 (1916).

Thus, under the majority approach, bonds containing language that the principal "*will* faithfully and impartially discharge duties *now or hereafter* required by law" or other similar terms generally will be held to apply only to future acts and conduct. A more expansive reading of the bonds arguably would enlarge the surety's obligations beyond that ever intended.

B. Minority Approach: Liability for Pre-Bond Losses

1. Retrospective Application of Bond

In a few jurisdictions, absent clear language to the contrary, the terms of the bond are deemed to relate back to the date of appointment of the fiduciary. See In re Estate of Camarda, 103 Misc. 2d 362, 425 N.Y.S.2d 1012 (N.Y. Sur. Ct. 1980); Owens v. McMahon, 122 Wash. 191, 210 P. 200 (1922). Courts following this approach emphasize that a fiduciary bond is a special class of bonds intended for the protection of minors, incompetents or estates. Id. See also 11 J.Appleman, Insurance Law and Practice § 6713 (1981). Where the bond is generally worded, or is imprecise, or leaves some question as to the scope of coverage, public policy, according to some courts, requires an interpretation that covers prior acts. See Camarda, 425 N.Y.S. 2d at 1015. The rationale underlying this line of cases is that the surety can act to protect itself simply by using language in its bond to limit exposure. Id.

"Continuing Duty" Approach

In finding the surety liable for pre-bond losses or defalcations, a number of courts have employed a "continuing duty" analysis. According to this theory, guardians, conservators, administrators and other fiduciaries have a *continuing* duty and obligation to take possession of *all* assets belonging to the ward, *including* funds that the fiduciary may have wrongfully obtained prior to the issuance of the bond. See, e.g., In re Munsell's Guardianship, 239 Iowa 307, 31 N.W. 2d 360 (1948); Century Indem. Co. v. Maryland Cas. Co., 89 N.H. 121, 193 A. 221 (1937); Fidelity & Deposit Co. v. Norwood, 38 Ga. App. 534, 144 S.E. 387 (1928). Thus, under this analysis, a fiduciary who fails to recover misappropriated assets from himself, whether the theft occurred before or after the issuance of the bond, is *continually* in breach of his duty to the estate, for which the surety is liable. See Mitchell v. Columbia Cas. Co., 106 P.2d 344 (Mont. 1940); Aetna Indem. Co. v. State ex rel. Gallaspy, 101 Miss. 703, 57 So. 980 (1912).[1]

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[1] In many of the reported decisions, the "continuing duty" analysis is activated where successive sureties are involved, or later-filed, additional bonds are issued. In those instances, liability has been predicated upon the fiduciary's breach of his continuing duty to account for and pay over the assets of the estate during the term of the later-filed bond. There, according to these courts, the surety is *not* held liable for the defalcations or misappropriations committed prior to the bond's issuance, *per se*; rather, it is the fiduciary's *failure to account* for those misappropriated funds and to *pay* these assets over during the term of the later-filed bond that implicates the surety. See, e.g., In re Tabasinksy's Estate, 293 N.W. 578 (Iowa 1940); Wilkins v. Deal, 128 Neb. 78, 257 N.W. 486 (1935); Bromen v. O'Connell, 185 Minn. 409, 241 N.W. 54 (1932)(surety held liable for principal's failure to account, even though wrongdoing antedated bond, because there was a malfeasance following the issuance of the bond to account and faithfully discharge duties of trust); Bellinger v. Thompson, 26 Or. 320, 37 P. 14 (1894)(failure to account and to pay over amounts ascertained to be due is a breach of the bond, rendering the surety liable, no matter when the bond was executed, or when the funds were actually misapplied); Pinkstaff v. People, 59 Ill. 148 (1871).

The older cases require the fiduciary to remain solvent before liability under the "continuing duty" approach will be imposed on the surety for pre-bond defalcations. According to these courts, when the solvent fiduciary fails to restore funds to the estate following the issuance of the bond, there is at that point a breach of trust, for which the surety is liable. See, e.g., In re Munsell's Guardianship (surety held *not* liable for pre-bond defalcations under "continuing duty" approach where principal became insolvent and was otherwise unable to repay amounts following issuance of the bond); Fidelity & Deposit Co. v. Norwood (surety on guardian's bond executed after principal's conversion of wards' properties is liable for breach, *if* guardian was solvent when bond was executed and could have restored assets to the estate, but failed to do so).

Courts applying the "continuing duty" approach often acknowledge that fiduciary bonds are *not* to be applied retrospectively and, in fact, deny giving the bonds such effect. Instead, as previously noted, it is the principal's breach of a duty *after* the issuance of the bond to account for and collect from himself amounts owed to the estate for which the surety is held liable. See, e.g., Bromen v. O'Connell, 241 N.W. at 56; Fidelity & Deposit Co. v. Norwood, 144 S.E. at 393; Aetna Indem. Co. v. State ex rel. Gallaspy, 57 So. 2d at 982.

The "continuing duty" line of cases clearly runs counter to the general rule that sureties are not liable for past acts, absent the presence of bond language indicating a contrary intent. Carried to its logical extreme, the "continuing duty" approach could mean that *every* bond, *no matter how written*, would apply to the acts of the principal that occurred before the issuance of the bond. Construction by courts of the surety's obligation in this manner unfairly penalizes the surety and clearly defeats the purpose of bonds meant only to apply to future acts and conduct.

II. PRE-APPOINTMENT DEFAULTS AND DEFALCATIONS

The majority viewpoint is that the surety should not be liable for funds obtained and misappropriated before the appointment of its principal, as fiduciary, in an estate. A few courts, however, have held the surety liable for such pre-appointment defalcations. Two cases illustrating these opposite extremes are Martin v. Hanshu, 241 Kan. 21, 738 P. 2d 96 (1987) and In re Estate of Camarda, 103 Misc. 2d 362, 425 N.Y.S. 2d 1012 (N.Y. Sur. Ct.1980).

In Hanschu, the decedent's wife, Lisa Hanschu, sold certain estate assets totaling nearly $35,000.00 without authority following her husband's death. Thereafter, Hanschu was appointed administratrix of her husband's estate, and a bond in the amount of $30,000.00 was provided by Trinity Universal Surety Company ("Trinity"). Hanschu was later removed as administratrix, and the successor administrator petitioned for an order compelling Hanschu and Trinity to reimburse the estate the amount of the proceeds from the sale of the estate property. The trial court held that Hanschu, individually, was liable to the estate for conversion of estate property both before and after her appointment as administratrix, but that Trinity, as surety, was liable only for the value of estate property converted after the date of Hanschu's appointment. The successor administrator appealed the trial court's ruling.

The sole issue before the Kansas Supreme Court in Hanschu was whether a surety on an administrator's bond may be held liable for assets converted before the issuance of a bond *and*

prior to the appointment of the bonded administrator. Martin v. Hanschu, 738 P.2d at 97. After observing that the surety's obligations must be measured and determined by the terms of the bond itself, the Court examined the wording of the bond which provided that Hanschu "shall faithfully discharge all of the duties of her trust." The Court concluded that because Hanschu had no duties of trust until she qualified as administratrix, Trinity, as surety, could not be liable for the conversion or misappropriation of funds by Hanschu occurring prior to her appointment as administratrix. Martin v. Hanschu, 738 P.2d at 98. See also Bockenstead v. Perkins, 73 Iowa 23, 34 N.W. 488 (1887); Cotton's Guardian v. Wolf, 14 Bush 238, 77 Ky. 238 (1878).

In In re Estate of Camarda, one of the daughters of the decedent, Mary Schiavone, was appointed the executrix of the decedent's estate. The Surrogate Court required the executrix to post a $50,000.00 bond after allegations were made by a legatee that the executrix had converted certain property of the estate to her own use. Approximately two years after the appointment, other family members petitioned for an accounting by the executrix. It was established that the executrix converted monies of her mother to her own use on the same or following day of her mother's death, one year *before* she was appointed executrix of the estate. The legatees sought a decree against the executrix's surety for the amounts converted by the executrix.

The surety resisted payment and claimed not to be liable because the misappropriation occurred prior to the date of the executrix' appointment and the issuance of the bond. The bond, in pertinent part, provided that the executrix "shall faithfully execute the trust reposed in her as Executrix . . . and obey all lawful decrees and orders." The surety argued that this undertaking secured future obligations only, and that there could be no liability for past defalcations. The Court rejected this argument, finding the bond was "general in terms, conditioned upon the faithful performance by the Executrix of the duties of her trust," and was not otherwise limited to future transactions. Id., 425 N.Y.S.2d at 1016. Under such circumstances, the Court held, the surety becomes liable for misappropriations and other breaches of trust committed "prior to the filing of the bond *or prior to the time of her appointment as Executrix*." Id. N.Y.S.2d at 1017. (emphasis supplied)

Cases as sweeping and far-reaching as Camarda are troubling. By its express terms, the bond in Camarda protected assets coming into Schiavone's hands *as executrix of the estate*. Because Schiavone did not have any duties of trust until she qualified as executrix and otherwise was not acting as executrix when the loss occurred, but rather was acting in an individual capacity, it was improper to impose liability on the surety.

CONCLUSION

Typically, the terms, conditions and precise wording of the bond will determine whether the surety is liable for the fiduciary's defaults and defalcations which occur prior to the issuance of the bond. The majority and better reasoned rule is that the surety is not liable for such pre-bond conduct absent clear language indicating a contrary intent. Some courts, however, while paying lip service to the majority approach, seek to impose liability based upon the fiduciary's breach of a duty to account for previously converted funds and to pay these assets over to the estate during the term of the bond. To counter such efforts, the surety should be prepared to argue that the

imposition of such liability, particularly where the bond language indicates an intent to cover only future acts and conduct, is contrary to the general rule of non-liability, impermissibly expands the undertaking set forth in the bond and penalizes the surety for acts and conduct never meant to be covered under the bond.