

**TWELFTH ANNUAL
SOUTHERN SURETY AND FIDELITY
CLAIMS CONFERENCE**

**FIDUCIARY BONDS:
WHEN GOOD PRINCIPALS GO BAD**

PREPARED BY:

**DUANE A. DAIKER, ESQUIRE
TAMMY N. GIROUX, ESQUIRE
SHUMAKER, LOOP & KENDRICK, LLP**
101 E. Kennedy Boulevard, Suite 2800
Tampa, Florida 33602
(813) 229-7600
(800) 677-7661
ddaiker@slk-law.com
www.slk-law.com

FIDUCIARY BONDS: WHEN GOOD PRINCIPALS GO BAD

I. Introduction

In recent years, sureties have issued increasing numbers of specialty bonds. A large number of these specialty bonds are fiduciary bonds, which include Personal Representatives' Bonds and Guardianship Bonds. Fiduciary bonds guarantee a particular fiduciary's faithful performance of his or her duties as a Personal Representative or Guardian. Each state has enacted laws that specifically govern probate issues, such as the proper administration of an estate or guardianship. These statutes include specific provisions establishing the duties and responsibilities of a Personal Representative or Guardian, as well as specific provisions for the removal of any Personal Representative or Guardian that has failed to properly abide by his or her responsibilities and obligations. If a Personal Representative or Guardian is removed from their fiduciary capacity as a result of any wrongdoing, a court may direct the fiduciary's Surety to forfeit all or part of its bond as required to correct the harm done to the estate or to the ward. The following is a brief overview of the bonding and claims process.

The Fiduciary Bonding Process

II.

A proposed Personal Representative or Guardian first submits an application to a Surety seeking issuance of a bond for the pending probate action. If the application meets the Surety's underwriting requirements and the Surety accepts the application, the surety issues a bond in the pending probate estate administration or pending guardianship, bonding the Personal Representative or Guardian. However, past experience indicates that fiduciary bonds, unless extremely large, appear to be written like insurance on a casualty basis. The fiduciary bond expressly states that the Surety is held and firmly bound unto the Governor of a specific state in the specific penal amount ordered by the court. All bonds must be issued in a penal sum deemed sufficient by the court after consideration of the gross value of the estate or guardianship, the relationship of the Personal Representative or Guardian to the beneficiaries, and the type and nature of the assets.¹

The Indemnity Agreement

III.

As part of the application process for the issuance of a Personal Representative's Bond or Guardianship Bond, the applicant should be required to execute a contractual indemnification agreement. If no contractual indemnification agreement is executed as part of the application process, the Surety will have to rely upon its common law indemnification rights to obtain repayment from its Principal in the event of a successful demand upon the Bond.

Furthermore, the applicant usually agrees to procure, at the request of the surety, the release and discharge of the Surety from any further liability under the bond, and should the applicant fail or refuse to do so, the Surety is given the right to proceed in any manner to secure or attempt to secure its discharge. The applicant waives any and all claims against the Surety for damages arising out of any such proceedings and agrees to reimburse the Surety

¹ Many fiduciary bonds are issued in the \$10,000 to \$15,000 range for average estates and guardianships.

for all expenses, including reasonable attorney fees, that the Surety may incur as a result of any demand on the bond.

If the surety fails to obtain a contractual indemnification agreement from its principal, the surety generally has common law rights of indemnification available for purposes of recovering not only sums paid pursuant to valid demands on the bond, but also the attorney fees and costs incurred by the surety in responding to the demand on the bond, whether the demand was made formally or informally. However, common law rules of indemnification vary from state to state. The better practice is to obtain a contractual indemnification as part of the application process.

The Alleged Wrongdoing by the Principal

IV.

A. Examples of Wrongdoing by a Surety's Principal

On a state by state basis, case law has developed enumerating specific grounds warranting removal of a Personal Representative or Guardian. Valid reasons for removal of a fiduciary include: (1) adjudication of incompetency, or physical or mental incapacity; (2) failure to comply with any order of the court; (3) failure to account for the sale of property or to produce and exhibit the assets of the estate or guardianship; (4) the wasting or maladministration of the estate or guardianship; (5) conviction of a felony; and (6) the acquisition by the fiduciary of conflicting or adverse interests that may adversely interfere with the administration of the estate or guardianship.²

If the Personal Representative or Guardian's actions concerning the estate or guardianship are improper or in bad faith, he or she can be liable to interested persons for all damage or loss resulting from the breach of his or her fiduciary duty to the same extent as a trustee of an express trust. If an action is commenced challenging the proper exercise of a Personal Representative's or Guardian's powers, a court also has discretion to award costs and attorney fees.³

There are an infinite number of possible situations where a Surety's liability pursuant to its fiduciary bond may arise. The following are a few real world examples of a Surety's response to particular fiduciary bond claims:

! Example 1

Surety receives notification that its principal, a Personal Representative, who is also an attorney, is the subject of a criminal investigation involving embezzlement and civil theft. Surety has issued at least five bonds to this particular principal. Surety receives numerous informal demands on its bonds and instructs its local counsel to begin a detailed investigation into

² Florida Statutes §§733.504 and 744.474.

³ *In Re: Estate of Pearce*, 507 So.2d 729 (Fla. 4th DCA 1987)(holding that pursuant to Florida Statutes §733.609, a Personal Representative may be liable to interested persons for damage or loss resulting from conduct which is improper or in bad faith to the extent the Personal Representative breaches his fiduciary duty).

the validity of the allegations of wrongdoing by its principal. All wrongdoing is validated. The principal has pled guilty to criminal charges and admitted to a complicated scheme of kiting checks from one estate account into others and even into accounts related to a business owned by principal. Surety is liable up to the penal limit of its bonds. The police investigation reveals a loss in excess of \$1 million. Luckily, Surety's bonds only total approximately \$200,000.00.

! Example 2

Surety's in-house claims counsel is copied by mail on a Petition for Surcharge against Guardian. The petition does not specifically name Surety as a defendant but includes vague language referencing the bond and implies that recovery against the bond is available. The surcharge proceeding includes allegations of maladministration, conversion and improper distributions by the Guardian. Specifically, the Surety's principal is accused of concealing knowledge of an earlier will, failing to provide a proper accounting in the Guardianship, and making improper distributions to herself and her lineal descendants while the ward was alive. The key issue is whether those distributions were truly authorized by the ward, given the fact that the concealed will showed a different testamentary intent by the ward. Surety's principal denies any wrongdoing and holds steadfast in her position that the distributions were valid estate tax reduction gifts. The principal prepares defenses to the Petition for Surcharge and demands Surety do the same. The principal states she will challenge any action against her on the indemnification agreement if Surety pays the penal sum of its bond in response to the demand on the bond over her asserted defenses to the surcharge action.

! Example 3

The Personal Representative files a Petition for Discharge. The court, on its own motion, removes the Personal Representative. An Attorney Ad Litem is appointed. The Attorney Ad Litem files an Objection to the Petition for Discharge as well as the Final Accounting. The court enters an order on the Attorney Ad Litem's Objections to the Petition for Discharge and Final Accounting, ruling that the Personal Representative is ordered and directed to pay to the Attorney Ad Litem a sum in excess of \$25,000.00. The Personal Representative had made an improper gift to her church,

improperly paid creditors that had not filed Statements of Claim in the estate, paid approximately \$5,000.00 for cleaning services to a person later identified as a family member, and paid herself extraordinary fees in an amount far exceeding the percentage allowed by the applicable statute. The order entered by the court also grants the Attorney Ad Litem full power to ask, demand, sue for, recover and receive the property of the decedent from not only the Personal Representative but the Surety on the bond, holding both jointly and severally liable. Once that order is entered, the Attorney Ad Litem initiates contact with Surety's claims counsel. Surety undertakes an independent investigation and confirms the validity of the allegations of wrongdoing as well as the amounts set forth in the court's surcharge order against the principal. Surety and the Attorney Ad Litem enter into a settlement agreement whereby the Surety forfeits the penal sum of its bond, obtains a release and discharge of its bond, and reserves its rights to pursue final judgment against the principal in the pending probate action.

! Example 4

Surety's Principal, a Personal Representative for his father's estate, is removed as Personal Representative after failing to respond to the court's Order to Show Cause. The Personal Representative does not reside in the same state as the pending probate action and continues to ignore the state's requirements. The court appoints a Successor Personal Representative and directs that Successor Personal Representative to investigate any possible wrongdoing by the Personal Representative and to prepare a final accounting for the estate. In preparing the final accounting, the Successor Personal Representative discovers possible wrongdoing and files a petition for entry of an order holding the Principal in contempt of court and forfeiting the Personal Representative's bond. The court directs the Successor Personal Representative to provide a copy of the Petition to Surety. In the interim, the Successor Personal Representative files a Motion to Surcharge Bond and Fix Liability of Surety. In that motion, the Successor Personal Representative asserts that the former Personal Representative, the Surety's Principal, failed to faithfully perform his duties by failing to file an inventory, failing to pay a valid claim, failing to file a Final Accounting, and otherwise failing to account for at least \$52,000.00. Surety undertook an investigation and determined that its exposure was far less than the penal sum of its bond, which was \$52,000.00. The exposure was approximately

\$7,500.00 to \$10,000.00, based on documentation provided to it by the Successor Personal Representative. Values were agreed to for the proven wrongdoing and a settlement agreement was reached.

B. Timing of Notification of Demand

The timing of a Surety's receipt of notification of alleged wrongdoing by its Principal can vary greatly. An interested party in a guardianship or estate may decide to provide notification to the Surety early in the controversy, giving the Surety adequate time to conduct an independent investigation as to the merits of any purported wrongdoing. However, the Surety often does not receive notification of alleged wrongdoing on the part of its principal until such time as the court, on its own motion or on the motion of interested parties, has instituted proceedings for the removal of the Personal Representative or Guardian. Petitions for removal are usually accompanied by petitions for surcharge and demands for an accounting. Often, the court may have already removed the Personal Representative or Guardian and appointed an Administrator Ad Litem, Successor Personal Representative, Curator or Successor Guardian. The court may even go as far as to enter a surcharge order against the principal that includes language that the Surety has also been surcharged. In such situations, the Surety has been denied its opportunity to appear and defend the claim against the bond.

No matter what stage in the proceeding the Surety receives notification of purported wrongdoing, the Surety should immediately contact all parties and attorneys involved and request a reasonable amount of time to conduct an independent investigation. As a matter of course, the Surety should immediately send a letter to its principal demanding that the principal hold the Surety harmless and assume its defense. The Surety must put the principal on notice of the Surety's rights of indemnification and inform the principal that he or she will be liable to the Surety not only for all sums of money the Surety is obligated to pay to the estate or guardianship, but all amounts incurred in attorney fees and costs in defending the demand on the bond.⁴ Traditional rules of contract interpretation determine the liability of Surety under the laws of most states.⁵

When the Surety has notice of an action against its principal and is afforded an opportunity to appear and defend, a judgment rendered without fraud or collusion is conclusive against the Surety as to all issues determined.⁶ In order to avoid liability, a Surety must rebut the prima facie evidence that the Surety is liable by showing that the judgment against the

⁴ A bond is a contract, and therefore subject to general contract law. A Surety's liability for damages is limited to the terms of its Bond. *American Home Assurance Co. v. Larkin General Hospital, Ltd.*, 593 So.2d 195 (Fla. 1992). Some indemnity contracts include a provision providing that indemnitees must provide indemnitor, upon demand, with an amount sufficient to discharge any claim made against the indemnitor on any bond and that the sum would be used to pay the claim or be held as collateral security against any loss on the bond. *Safeco Insurance Company of America v. Schwab*, 739 F.2d 431 (9th Cir. 1984). See also, *Marine Midland Trust Co. of New York v. Alleghany Corp.*, 28 F.Supp. 680 (1939).

⁵ See *Institute of Mission Helpers of Baltimore City v. Reliance Ins. Co.*, 812 F.Supp. 72 (D.Md. 1992); *General Authority for Supply Commodities v. Insurance Company of North America*, 951 F.Supp. 1097 (S.D.N.Y. 1997); *Carriage Town, Inc. v. Landco, Inc.*, 998 F.Supp. 646 (D.S.C. 1998).

⁶ *Von Engineering Co. v. R.W. Roberts Construction Co., Inc.*, 457 So.2d 1080 (Fla. 5th DCA 1984).

Surety was obtained through fraud or collusion, or that the loss or liability created by the judgment arose from acts other than those indemnified against under the terms of the bond.⁷ In other words, a judgment against a Surety obtained in an action for which the Surety had full knowledge and opportunity to defend, precludes every defense except that of fraud or collusion in obtaining the judgment.⁸

Jurisdictions differ on the effect on a Surety of a judgment against its Principal. That specific topic has been the subject of papers in the past and is not discussed in depth in this paper.

Dangers and Risks

C.

There are numerous dangers and risks to the surety in handling fiduciary bond claims. The following are important factors to consider in handling any claims:

- Whether a surcharge order has been entered against the Surety without notice to the Surety.
- Whether a judgment or a surcharge order has been entered against the principal and the Surety without notice to the Surety.
- Whether the principal has asserted defenses or intends to assert defenses to any allegation of wrongdoing.
- Whether the principal can and will obtain legal representation for not only himself or herself, but for the Surety as well.
- Whether the demand on the bond includes inflated or false representations of wrongdoing by the Principal.
- Whether the person(s) making a demand on the bond can provide documentation to support the demand.
- Whether the alleged wrongdoing occurred during the effective period of the bond.
- Whether the Surety has compromised or will compromise its action against the principal for indemnification by paying the demand on the bond.

⁷ *Heritage Insurance Company of America v. Foster Electric Co., Inc.*, 393 So.2d 28 (Fla. 3rd DCA 1981). See also Restatement of Suretyship, §67; *MacArthur v. Gaines*, 286 So.2d 608 (Fla. 3rd DCA 1973).

⁸ *Lake County v. Massachusetts Bonding & Insurance Co.*, 75 F.2d 6 (5th Cir. 1935); *Carey Transportation, Inc. v. The Greyhound Corporation*, 80 B.R. 646 (Bkrtcy S.D.N.Y. 1987).

Investigation of the Claim

V.

Bond Coverage

A.

Occasionally, the demand on the bond encompasses wrongdoing by a personal representative or a guardian that is outside the effective period of the bond. A Surety can successfully defend against liability for wrongdoing by its principal if the wrongdoing occurred prior to the effective date of the bond or after the effective date of the bond. For example, a guardian, who is a family member, may make improper distributions or engage in other maladministration prior to issuance of the bond and the filing of the bond with the probate court. The investigation conducted by the Surety or the Surety's counsel should be very comprehensive and pay particular attention to dates. Furthermore, demands on bonds may include requests for recovery for alleged wrongdoing that may be unrelated to whether the principal has faithfully performed his or her duties as Personal Representative or Guardian. Sureties must always obtain documentation to support the demand on the bond and then compare that data to the coverage period of the bond and the nature of any proven wrongdoing. A bond is a contract, and since the general law of contracts apply, a surety must argue that its liability for damages is limited to the terms of its bond, including the effective dates.⁹

Additional Damages for Bad Faith Delay

B.

Some case law holds that a Surety's liability can exceed the penal limit of its bond if a determination is made that the Surety wrongfully delayed in responding to the valid claim on the bond. Thus, a Surety must always communicate with the interested parties and promptly undertake its investigation into the merits of the demand.

For example, in Florida, payment by a Surety on a Guardianship Bond becomes due when the misconduct of the principal occurs, not when the principal's liability is established by court order.¹⁰ If the Surety forces litigation to secure payment of its bond, the court may assess against the Surety the attorney fees and costs of opposing counsel, even if such sum exceeds the penal limit of the bond. The Surety must show justification in delaying payment under the bond to avoid a potential damage award exceeding the penal sum of the Bond.¹¹

⁹ *American Home Assurance Co. v. Larkin General Hospital, Ltd.*, 594 So.2d 195 (Fla. 1992); *Ragan v. Tri-County Excavating, Inc.*, 62 F.3d 501 (3rd Cir. 1995); *Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F.Supp. 91 (D.R.I. 1993); *Carriage Town, Inc. v. LandCo, Inc.*, 998 F.Supp. 646 (D.S.C. 1998); *In the Matter of Ridgemont Apartment Associates, Ltd.*, 127 B.R. 934 (Bkrtcy.N.D.Ga. 1991).

¹⁰ *Old Republic Surety Co. v. Reischmann*, 713 So.2d 434 (Fla. 2d DCA 1998).

¹¹ *Id.* at 436. See also, *Nichols v. Preferred National Ins. Co.*, 704 So.2d 1371 (Fla. 1997)(Court may award attorney fees and costs against Surety in an amount greater than the amount of the bond where attorney fees and costs were incurred because of Surety's failure to diligently investigate and timely pay claim under bond where Principal failed to perform his guardianship duties).

Surety's Response to Demand

VI.

Settle

A.

As explained in detail above, the Surety places itself at risk for damages in an amount exceeding the penal sum of the bond if the Surety does not diligently undertake its investigation and make a determination of the validity of the demand on the bond. If the Surety confirms the validity of the allegations of wrongdoing by the principal, the Surety must enter into a settlement.

If the Surety has already been made a party to a pending surcharge action, the Surety and the Successor Personal Representative, Successor Guardian, or Attorney Ad Litem, can jointly execute the necessary settlement agreement, release, and discharge of Surety. The most important objective is to obtain the discharge and release of the Surety. If the Guardian or Personal Representative has not yet been removed by the Court, the Surety will want to seek that removal in conjunction with any payment on the bond so that the bond can be released and discharged. A court cannot allow the original Personal Representative or Guardian to continue in his or her capacity without a bond in place.

If, however, a formal surcharge action is not pending and the Surety has not been made a party to the probate action, the Surety can settle with the interested party or parties and then pursue an independent action against the Principal under the indemnification agreement or pursuant to its common law indemnification rights. As an alternative, at least in Florida, the Surety can move to be added as a party in the probate action pursuant to Rule 1.625, Florida Rules of Civil Procedure. Once a proper party to the action, the Surety can answer the surcharge action or the pending objection and file a crossclaim against its principal. The court has jurisdiction over the crossclaim and the Surety avoids the extra expense of a filing fee and service of process that accompany the initiation of a new, independent lawsuit. Once again, the Surety must execute the necessary settlement agreements, assignments of claim, releases, and obtain a discharge of its bond from the court. If the Surety has diligently investigated the claim and responded to the demand on the claim in a reasonable amount of time, the Surety's liability will be limited to the penal sum of its bond.

B. Litigate

Occasions arise when the Surety quickly determines that the demand on the bond is not legitimate, either in whole or in part. For example, the Surety might determine that some of the facts and supporting documentation shows a defalcation by the Personal Representative or the Guardian before the effective date of the bond. Occasionally, a claim will be presented to a Surety that has absolutely no relation to whether the Personal Representative or Guardian has faithfully performed his or her duties as a fiduciary. If the amount in controversy is significant, the Surety must make a business decision to either fight the demand or reach a compromised settlement. As discussed above, there are risks inherent with the decision of the Surety to litigate; however, a Surety should not be coerced into settlement when settlement is not justified merely because a risk of exposure beyond the penal sum of the bond exists.

Surety's Recovery Pursuant to Laws of Indemnification

VII.

Contractual Indemnification

A.

As explained in Section III of this paper, most bond principals execute indemnification agreements as part of the application process for bonding. Most Sureties request financial statements or basic financial information from any applicant prior to issuing the bond. Written indemnification agreements are very specific and the indemnitor clearly covenants and agrees to indemnify and hold the Surety harmless from all liability, including reasonable attorney fees, that the Surety may incur. After sustaining a loss on its bond, the Surety can obtain a judgment against its principal in the full amount paid by the Surety on the bond, plus all reasonable attorney fees and costs incurred.¹² The Surety will usually pursue its judgment against its principal within the pending probate action. However, situations may arise that require the Surety to file a new, independent cause of action in a circuit civil court to enforce the indemnification agreement.

Common Law Indemnification

B.

In the absence of a written indemnification agreement, a Surety may pursue its common law rights of indemnification based upon the laws of the state in which the loss was incurred. For a party to prevail on a claim of common law indemnity, a party must satisfy a two-prong test. First, the party seeking indemnification must be without fault, and its liability must be vicarious and solely for the wrong of another. Second, indemnification can only come from a party who was at fault.¹³ In the context of probate cases, specifically estates and guardianships, a Surety satisfies the two-prong test for common law indemnification.

As a general rule, a common law indemnitee is entitled to recover, as part of its damages, reasonable attorney fees and legal costs and expenses that it is compelled to pay as a result of suits by or against it relating to the matter for which it is indemnified.¹⁴ Therefore, reasonable attorney fees may usually be recovered in an indemnity action whether the indemnity is implied by law or arises from contract.¹⁵

¹² *Schneider v. National Railroad Passenger Corp.*, 987 F.2d 132 (2nd Cir. 1993)(holding that Attorney fees are recoverable when incurred in defending a claim where a party is entitled to indemnification); *Promuto v. Waste Management, Inc.*, 44 F.Supp.2d 628 (S.D.N.Y. 1999)(holding that an agreement by a party to a contract to indemnify the other for attorney's fees incurred in litigation must be unmistakably clear from the language of the promise).

¹³ *Dade County School Board v. Radio Station WQBA*, 731 So.2d 638 (Fla. 1999).

¹⁴ *American and Foreign Ins. Co. v. Avis Rent-A-Car System, Inc.*, 401 So.2d 855 (Fla. 1st DCA 1981).

¹⁵ *Borg-Warner Acceptance Corp. v. Philco Finance Corp.*, 356 So.2d 830 (Fla. 1st DCA 1978); *Washington Electric Cooperative, Inc. v. Massachusetts Municipal Wholesale Electric Co.*, 894 F.Supp. 777 (D.Vt. 1995); *Rubin Quinn Moss Heaney & Patterson, P.C. v. Kennel*, 832 F.Supp. 922 (E.D.Pa. 1993); *Fleck v. KDI Sylvan Pools, Inc.*, 981 F.2d 107 (3rd Cir. 1992); *Dent v. Beazer Materials and Services, Inc.*, 993 F.Supp. 923 (D.S.C. 1995).

Surety's Response to Principal Filing Bankruptcy

VIII.

An individual who is serving as a Personal Representative or Guardian, and to whom the Surety has issued a bond, may file for Chapter 7 or Chapter 13 bankruptcy protection. The principal should list the Surety as a creditor on his or her schedules and Statement of Financial Affairs, so the Surety will receive notification of the bankruptcy filing. In addition, the principal may need to name the estate or the guardianship as a creditor if the principal has reason to believe that his or her defalcation will exceed the penal sum of the bond and a financial obligation will be owed to the estate or guardianship. More times than not, the principal fails to list the Surety as a creditor and significant time passes before the Surety receives notification of the bankruptcy.

The principal's debt to the Surety, once liquidated, is nondischargeable pursuant to 11 U.S.C. §523(a)(4), relating to fraud or defalcation by an individual while acting in a fiduciary capacity.¹⁶ If the liability of the principal and Surety has already been established in the probate case, and the Surety has paid the claim on its bond or will pay soon, the Surety must file a Complaint to Determine Dischargeability of Debt in the bankruptcy action. Once a Chapter 7 or Chapter 13 bankruptcy action is commenced, the Bankruptcy Court establishes deadlines for all Complaints Objecting To Dischargeability of Debt and Complaints Objecting to Discharge. Pursuant to 11 U.S.C. §523(a)(4), the Surety has grounds to file a Complaint to Determine Dischargeability of Debt since the Principal's financial obligation to the Surety arose as a result of the Principal's defalcation while in a fiduciary capacity. The bond itself illustrates the necessary trust of the fiduciary relationship.

For example, the United States Bankruptcy Court in the Middle District of Florida considered a case where a Surety for a Guardian sought determination of the dischargeability of its debt. The Surety had provided its Principal with a \$1,100,000.00 bond. The state court had issued a judgment against the principal, and the Surety, as a result of its Principal's defalcation, was ordered to pay on its bond. The Surety incurred attorney fees. In the bankruptcy action, the Surety filed a Complaint to Determine Dischargeability of Debt pursuant to 11 U.S.C. §523(a)(4). The Bankruptcy Court held that the Surety was entitled to an award of the damages it sustained as a result of its principal's failure to account for money or property that had been entrusted to him. Thus, the debt to the Surety was found to have arisen while in a fiduciary capacity and was deemed nondischargeable under §523(a)(4).¹⁷ Generally, an indemnity agreement between a debtor and a Surety, whereby the bond issued by the Surety enabled a debtor's corporation to perform public contracts, creates a fiduciary relationship such that the Surety can object to the dischargeability of any debt assessed against that particular Bond pursuant to §523(a)(4).¹⁸

¹⁶ *In re: Allen*, 206 B.R. 602 (Bkrcty M.D.Fla. 1997)(holding that a creditor must prove that debtor was acting in a fiduciary capacity and committed defalcation while acting in that fiduciary capacity); *In re: Pawlinski*, 170 B.R. 380 (Bkrcty N.D.Ill. 1994)(holding that in order to establish defalcation, creditor must show that an express trust existed, debt was caused by fraud or defalcation, and the debtor acted as a fiduciary to the creditor at the time the debt was created); *In re: Polk*, 183 B.R. 1020 (Bkrcty E.D.Mo. 1995)(holding that the three elements necessary for finding of nondischargeability under fiduciary exception include debt, fiduciary relationship, and fraud or defalcation).

¹⁷ *In Re: Butts*, 142 B.R. 1011 (Bkrcty M.D. Fla. 1992).

¹⁸ *In the Matter of Jenkins*, 110 B.R. 74 (Bkrcty M.D. Fla. 1990).

If a Principal that has filed a Chapter 7 or Chapter 13 bankruptcy lists his or her debt to the Surety on its list of creditors in its bankruptcy case, and the Surety fails to file a Complaint to Determine Dischargeability of Debt or a Complaint Objecting to Discharge by the court established deadline, then the principal's debt to its Surety can be discharged through the bankruptcy. If the Surety can show excusable neglect as to why it failed to timely file the necessary Complaint Objecting to Dischargeability or Objecting to Discharge, a Bankruptcy Court may allow the Surety to file a complaint late. Without a showing of excusable neglect, the court will deny any late filing and the Surety will be forever barred from recovering damages against its principal.

Based on the foregoing, the Surety needs to remain aware of the financial condition of its principal and even to question whether its principal is considering bankruptcy when the Surety first learns of the demand on the bond. Usually, if a Personal Representative or Guardian has been taking money from the estate or from the guardianship, that individual has wasted that money and does not have sufficient funds of his or her own to repay the estate or the guardianship. The Surety wants to be sure to protect all of available rights and remedies against its principal, including all rights and remedies available in Bankruptcy Court.

Conclusion

IX.

This paper has provided general information regarding specialty bonds known as fiduciary bonds, specifically Personal Representative's Bonds and Guardianship Bonds. The Surety bonds the faithful performance of a Personal Representative or Guardian. Unfortunately, situations arise where Personal Representatives and Guardians abuse the fiduciary relationship and defalcation occurs. Sureties must diligently investigate the purported defalcation and decide whether to settle or litigate. As set forth in this outline, numerous issues must be considered in making that determination. The Surety must then, in the event of a payment under the bond, seek to enforce its statutory or common law indemnification rights to recoup any bond funds paid to claimants, while also preserving its rights in the event of a bankruptcy of the principal.