

Public Official Bonds in Tennessee

By: John Evans

Performance bonds and shuretyship have been around since the beginning of civilization. As it applies to public officials, bonds first appear in statute in the 19th century. At that time, as now, there was a need to somehow add assurance that the public official would do what was required of the office other than just giving his or her word. This is where politicians got the phrase, "My word is my bond". Unfortunately, history has told us that a person's word being substituted for his bond did not reimburse the coffers when a loss occurred.

Many times, before the advent of mass media, an official could be elected who was entirely unknown to most constituents. Since there was little media to introduce, vet and investigate a potential candidate, it was not uncommon to elect a person to office whose prime objective was personal gain. Since there was no such thing as public entity insurance in those days, it became necessary to get someone who was well known and respected in the community or constituency to vouch for the official's honesty and ability. The best way to add credibility to this third party's recommendation of this official was to ask him to "put his money where his mouth was", by posting an amount of cash with the entity to be drawn upon in the event his political friend did something dishonest. This is known as a third party bond as one person guarantees the performance of another to the benefit of the third party. It works much the same today with the vouching individual being replaced by a corporate surety or insurance company, although statute continues to permit personal cash bonds in some cases.

Certain public officials in Tennessee are required to post a bond before assuming the duties of their office. Such officials who are required to post the bond are listed in Title 8 of the Tennessee Code. The penal amount of these bonds is established both by regulation and statute. The bond amounts are set by statute for certain elected officials while the amount is set by a formula established by the Tennessee Comptroller for officials having access and control over financial dealings of counties, schools and other political subdivisions of the State.

What characterizes these bonds is the fact that they must be written on an individual basis, meaning that the person bonded is the only person covered by the bond. It cannot be written on a blanket bond form; even though there exists a statute that says they can be written on a "blanket basis". The fact is that each public official bond must be individually written and signed by a "Corporate Surety" (insurance company) on a form required by the Comptroller. This leaves no room for inclusion of the public official bond on an otherwise blanket bond form.

The public official bonds are known by numerous names throughout Tennessee Code. Such names are also used to describe many other forms of surety not connected with the public official bonds. This becomes very confusing when those unfamiliar with the concept of surety and insurance attempt to understand the objective of bonding. A simple explanation and definition is that all the bonds, whether they be public official bonds, surety bonds, dishonesty bonds, employee blanket bonds, performance bonds, faithful performance bonds or any other bond by whatever name are all a form of "SURETY".

"Surety" is defined by many sources in many different ways but a generally accepted definition of the purpose of a performance bond comes from Webster's Dictionary and captures the essence of what a bond is designed to accomplish. It is as follows: Performance bonds protect the obligee from

financial loss if the principal does not perform according to the bond form. Notice that the “bond form” is referenced. This will be discussed later.

By definition, “surety” is a three party contract including an obligee (the entity), an obligor (the surety or insurance company) and a principal (the public official). For purposes of contrast, general liability insurance is a simple two-party contract wherein an insurance company assumes tort liability claims against an entity from lawsuits or legal obligations in tort while bonds do not cover tort liability. Therefore, bonds do not insure members of the general public while general liability or public official’s liability does not pay tort liability settlements to the named insured (local government). It is important to remember this as it is common for the two separate and distinct types of insurance to become confused. Suffice it to say that bonds pay an entity for losses from within while tort liability or public official’s liability pays for losses from without.

When a public official bond is purchased, the principal (elected official or financial officeholder) is required by statute to provide a bond on a form the State has approved. The obligor (the insurance company) is required to actually sign the State’s bond form on which the conditions of the bond are stated, agreeing to indemnify the obligee (the public entity) if the principal (public official) does not perform according to the conditions of the bond form. Hence, a three party contract.

Again by definition, bonds (surety contracts) are used to guarantee performance in financial matters. Therefore, the purpose of the comptroller’s form is to guarantee that the public official performs the financial duties of his office faithfully. By review of the conditions in the comptroller form, the conclusion is that the State is requiring the public official to post a bond guaranteeing that he/she will properly account for all financial transactions under his/her control and properly use the public’s money according to the scope of his/her authority and responsibility.

There is a condition in the comptroller’s form that defies understanding. This condition requires the State to be the loss payee (receive any funds collected from the bond). Why it is difficult to understand is because any money in the coffers of the political subdivision belongs to the political subdivision. Why, then, should any recovery from the bond be paid to the State? It could be that the comptroller needs standing to pursue collection from the bond or it could be that the State believes all assets owned by the political subdivision actually belong to the State. Hopefully, someone can offer an explanation and define the objective.

The similarity between “Faithful Performance” and “dishonesty” as a condition in a surety bond is an extremely elusive discussion as it relates to the Tennessee Comptroller’s bond form. When you use the term “will faithfully discharge the duties of the office”, you really open the door for coverage for anything the official does that someone or some entity determines to be malicious, incompetent, incorrect or dishonest. Some believe (incorrectly) that the general public can sue the official and his bond will stand good for the judgment. However, the bond is obligated ONLY to the OBLIGEE, which is the entity. This leaves members of the general public to sue either the official’s general liability where immunity has been removed or the entity’s errors and omissions insurance in the case of misfeasance or malfeasance.

Add to the confusion that the Tennessee Tort Liability Act (GTLA) removes immunity (makes local governments responsible) for certain acts of negligence but does not address what a political subdivision must or should do to protect themselves from the perils of errors or omissions (other than negligence) on the part of the officials. Could it be that the objective is to cover the general public for the torts of the entity while a “faithful performance” bond covers the

entity for all errors or omissions on the part of the public officials? This is possible but leaves the resulting coverage and concept far from comprehensive in protecting the taxpayers under the bond wording required by the State.

Part of the answer to this question could be surmised from the actual construction of the statutes dealing with liability of local governments. As stated, the State has made local governments responsible for certain elements of negligence which could harm its citizenry while merely permitting local governments to cover misfeasance and malfeasance by purchasing insurance or self-insuring if they wish. This would lead to a conclusion that the State assumes that the local government will do what is necessary to cover its own internal assets to the benefit of its taxpayers. If this is true, why, then, would the State mandate a public official's bond that is incomplete in its objective to cover the assets for benefit of its constituency and why would the State not also require the local government to protect itself in other areas where there is vulnerability?

How does all of this relate to public official's bonds as required by the State? To summarize, the State removes immunity for certain activities and negligent acts of employees and officials of a local government to protect the public from torts by the local government. The State also requires public official bonds to guarantee the faithful performance of local government officials but pays the penal amounts of the bonds to the State in the event of a loss. All other insurance that may be purchased by a local government is permissive. Therefore, it would appear that if the State is interested in protecting the rightful owners of assets protected by a public officials bond, it would require the local government to be the recipient of any proceeds collected from a bond. Further, it would appear that the bond should go much further in defining, through the bond form, exactly what activities and lack of performance would be covered by the bond and which would not be covered.

It is impossible to discuss public official's bonds and their implications without discussing the implications of other insurance coverage required or available to local governments. These will be discussed and enumerated below.

General Liability: In order to adequately protect a local government from financial loss, it is necessary to be prepared to pay the general public for torts against their person or property where immunity has been removed. This is mandated by the GTLA

Public officials Liability; This area of liability is generally thought of as emanating from an action or inaction which runs afoul of laws outside the purview of the GTLA or other claims whose definition may be included in the coverage forms such as misfeasance and malfeasance. Insurance coverage for this area of liability is permissive by state statute.

Faithful performance: This area of potential loss has been discussed above and is mandatory by statute for public officials. The mandatory part is as per the form required by the State.

Employee Dishonesty: This area of potential loss, as the name implies, indemnifies the local government for acts of theft or dishonesty by its employees. Until the last legislative session, this coverage was permissive. The State now mandates that local governments cover employee dishonesty at a minimum of \$150,000 per occurrence.

Crime: This area of potential loss is thought of as burglary, robbery and theft by someone other than employees. It remains permissive as to whether a local government covers this peril with insurance.

It is hoped that the confusion and duplication of coverage can be clearly seen at this point. Bonds were used before insurance was available to cover all aspects of an official's performance in absence of any other way to guarantee it. However, all Tennessee local governments have purchased many specific contracts of insurance to cover all elements of loss formerly covered, by necessity, by a Public Official's Bond. These bonds are now redundant, time consuming and unnecessary and should no longer be required.

Observations relative to Public Official Bonds in Tennessee

1. I have reviewed the Comptroller's reports of "CASH SHORTAGES AND OTHER THEFTS" for the past seven years. Although it is sometimes difficult to ascertain whether the subject bond was an individual or blanket bond, I have found only 8 losses that MAY have been covered by a public official bond.
2. According to Comptroller reports, the total losses for the past seven years against public official bonds is \$137,546. All of these losses would have been covered under terms of a blanket employee dishonesty bond based on the circumstances of the losses provided by the Comptroller.
3. All losses listed by the Comptroller were employee dishonesty losses or were simply mysterious loss of money due to faulty recordkeeping; the former being the lion's share of loss while most of the recordkeeping losses were resolved on audit.
4. Over the past 25 years, the pool writing 75% of Tennessee's schools and a large number of other governmental entities, paid 58 employee fidelity losses or just over 2 per year on average. The average loss per year was approximately \$104,762.
5. Tennessee Governmental entities spend over \$200 million per year to pay property, casualty and workers compensation losses and their related costs.
6. The Tennessee Tort Liability Act sets out how and when local governments are liable for torts under Tennessee law and for what limits but does not require the purchase of insurance to cover these potential losses.
7. Tennessee statute offers no guidance regarding Federal Liability nor first party (property) losses on how to pay for such losses. This decision is left to the discretion of the local governments.
8. Nowhere in the GTLA or other statute is there any requirement for purchase of insurance to cover the millions of dollars in losses that could be suffered by local governments as this is, again, left to the wisdom and discretion of local government leadership.
9. The only exception to total risk management discretion by local governments is the purchase of individual bonds for public officials and, beginning in 2012, a requirement to purchase a \$150,000 blanket employee fidelity bond. Interestingly, some of the public official bonds, which require applications and presume background checks have a penal amount of \$50,000 while the new blanket bond law requires the purchase of a bond covering all other employees, without a background check or individual application, with a penal amount of \$150,000.
10. With the exception of the official's bonds and the blanket bond, local governments may choose to purchase insurance, pool their risk with other entities, self-insure or simply pay losses as they are presented.
11. The question remains: If a local government may choose whether to insure a \$50 million building, why is it necessary to force the purchase of a bond to cover a possible loss that history tells us has never exceeded \$1 million?
12. The Comptroller's office does an excellent job of perfecting restitution which means that in over half of the employee fidelity losses, an existing bond is not called upon to pay the loss.
13. In cases where bonds are called upon to pay losses, insurance companies ALWAYS pursue restitution through civil court.

14. There is actually another issue driven by the GTLA that was passed in 1972. The pertinent part is as follows: "No claim may be brought against an employee or judgment entered against an employee for injury proximately caused by an act or omission of the employee within the scope of the employee's employment for which the governmental entity is immune in any amount in excess of the amounts established for governmental entities in s 29-20-403, unless the act or omission was willful, malicious, criminal, or performed for personal financial gain, or unless the act or omission was one of medical malpractice committed by a health care practitioner and the claim is brought against such health care practitioner". The definition of "employee" includes "official". Therefore, the only issue that the official can be held personally responsible for would be an act that was, "willful, malicious, criminal, or performed for personal financial gain", all of which are "intentional acts". This basically leaves the individual bond to cover fidelity, which could be easily covered by a blanket fidelity bond.
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16. My opinion is that mandates to purchase faithful performance or employee blanket bonds should be repealed and local discretion should be used as to how losses are to be handled just as is the case with the remainder of risk management issues within local government..