

STATE OF MICHIGAN  
COURT OF APPEALS

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ALCONA COUNTY,

Plaintiff/Counter-Defendant-  
Appellant/Cross-Appellee,

V

MICHIGAN MUNICIPAL LEAGUE LIABILITY  
& PROPERTY POOL,

Defendant/Counter-Plaintiff-  
Appellee/Cross-Appellant.

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UNPUBLISHED  
March 10, 2011

No. 292155  
Alcona Circuit Court  
LC No. 07-001052-NM

Before: MURPHY, C.J., and BECKERING and M.J. KELLY, JJ.

PER CURIAM.

In this bond coverage dispute, plaintiff/counter-defendant Alcona County (the County) appeals as of right from the trial court's April 30, 2009 order granting in part defendant/counter-plaintiff Michigan Municipal League Liability & Property Pool's (the Pool's) motion for summary disposition with respect to three finance director bonds. The Pool cross-appeals from the trial court's October 17, 2008 order requiring it to pay the County \$100,000 on each of three separate treasurer bonds. We affirm in part and reverse in part.

I. Facts

In 1993, Thomas Katona was elected treasurer of Alcona County. He served in this position, being re-elected multiple times, until his removal by the County Board of Commissioners in November 2006. During his tenure as County Treasurer, Katona also maintained a private business as an accountant. In July 1998, Katona was arrested and charged with two counts of forgery and two counts of uttering and publishing a false, forged, altered or counterfeit document. These charges arose from Katona's filing of one or more altered documents with the State of Michigan, representing them to be accurate, on behalf of a client of his private accounting business. Katona was prosecuted by the Presque Isle County prosecuting attorney at the request of the Alcona County prosecuting attorney. In November 1998, Katona pleaded guilty to one count of uttering and publishing and one count of forgery, in exchange for which the remaining charges were dropped and Katona was given a conditional delayed sentence. Katona's plea was entered, and he was sentenced, in Alcona Circuit Court. As part of his sentence Katona was ordered to pay certain fees, to perform community service, to return all

business records to the victim, to report to his probation officer and to refrain from any criminal activity for one year. At the conclusion of that year, with Katona having successfully completed the agreed upon requirements, the charges against him were dropped. As a result, Katona was left without a criminal record.<sup>1</sup> Because of Katona's position as County Treasurer, his arrest and consequent legal proceedings were covered by the local newspaper, which, on more than one occasion, gave the issue front page prominence.

In 2006, the County became aware of certain irregularities in its financial dealings,<sup>2</sup> and after investigation, it was determined that Katona had embezzled County funds and forged financial documents resulting in a loss to the County in excess of \$1.2 million.<sup>3</sup> After it became suspicious of his activities, the County Board of Commissioners, acting within the authority granted to it by MCL 46.11(k),<sup>4</sup> directed Katona to report in writing the facts and circumstances surrounding certain irregular financial transactions and to provide a bond in the amount of \$7,000,000 to secure his faithful performance of his duties as County Treasurer. When Katona

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<sup>1</sup> Katona thus avoided potential removal from office under MCL 168.207, which affords the governor with the authority to remove a county officer who, after his election or appointment, is convicted of a felony.

<sup>2</sup> These included wire transfers from County accounts to foreign banks, in apparent violation of MCL 129.12, which prohibits investment of public monies overseas.

<sup>3</sup> Apparently, Katona fell victim to the well-publicized "Nigerian Advance Fee Fraud Scam," as the result of which he not only lost \$70,000 of his own funds, but he also lost most, if not all, of the funds he misappropriated from the County.

<sup>4</sup> MCL 46.11(k) provides that:

A county board of commissioners, at a lawfully held meeting, may do 1 or more of the following:

\* \* \*

(k) Require a county officer whose salary or compensation is paid by the county to make a report under oath to the county board of commissioners on any subject connected with the duties of that office and require the officer to give a bond reasonable or necessary for the faithful performance of the duties of the office. An officer who neglects or refuses either to make a report or give a bond within a reasonable time after being required to do so may be removed from office by the board by a vote of 2/3 of the members elected or appointed, and the office declared vacant. The board may fill the vacancy for the unexpired portion of the term for which the officer was elected or appointed. If an election occurs before the expiration of the unexpired term, and if the office is elective, the vacancy shall be filled at that election. The board shall give reasonable notice of the election to fill the vacancy.

failed to comply with this request, the County Board of Commissioners removed him from office as permitted by MCL 46.11(k). In January 2007, Katona was arrested and charged with nine counts of embezzlement by a public officer and two counts of forgery. In May 2007, Katona pleaded guilty to the charges against him and, subsequently, he was sentenced to serve 112 to 168 months in prison.

The County became a member of the Pool in 1997 and began to purchase comprehensive general liability insurance and bonds from the Pool on an annual basis.<sup>5</sup> For each of the fiscal years from July 1, 2003 through June 30, 2007, the County obtained fidelity bonds from the Pool in the amount of \$100,000 each to indemnify the County against a failure by certain of its officials to faithfully perform the duties of their respective offices.<sup>6</sup> At issue here are two separate series of “position” bonds purchased by the County, one to insure the faithful performance of the county treasurer and one to insure the faithful performance of the finance officer or finance director.<sup>7</sup> After Katona’s embezzlement of County funds came to light, the County sought payment under both series of position bonds for the 2003 through 2006 bond years, asserting that Katona was serving as both the County treasurer and the County finance director at the time he committed his misdeeds, and further, that the County had suffered loss resulting from Katona’s misdeeds in each bond year. When the Pool did not pay on the bonds as the County requested, the County filed the instant action seeking to recover on all eight bonds it identified as providing indemnity for losses caused by Katona’s misconduct. The Pool paid the County \$100,000 for the 2006 Treasurer bond, but denied that any additional monies were due to the County.<sup>8</sup> In further response to the County’s action, the Pool filed a counterclaim seeking a declaratory judgment that no further moneys were owed under the bond contracts.

Following cross-motions for summary disposition under MCL 2.116(C)(10), the trial court ultimately ruled that the Pool was liable for the full \$100,000 on each of three Treasurer

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<sup>5</sup> According to the Pool, it began a program in 2003 wherein it provided certain coverages, including position fidelity bonds, at no charge to members of the Pool. Consequently, the County did not pay a premium for its fidelity bonds beginning in 2003.

<sup>6</sup> The County apparently operates on a July –June fiscal year. Thus, the bonds at issue provided coverage for the County’s fiscal years from July 1, 2003 through June 30, 2004 (the “2003 bond year”), July 1, 2004 through June 30, 2005 (the “2004 bond year”), July 1, 2005 through June 30, 2006 (the “2005 bond year”), and July 1, 2006 through June 30, 2007 (the “2006 bond year”).

<sup>7</sup> A “position” bond is a bond applicable to a specific position within the County; it provides indemnity for losses suffered as a result of a failure by the individual holding the specified position, whoever he or she may be, to faithfully perform the duties of that position.

<sup>8</sup> The Pool has indicated that while it discovered Katona’s prior fraud and dishonesty after it had already paid the County \$100,000 on the 2006 treasurer bond, and contends that no coverage therefore existed, it will not demand return of that payment from the County.

bonds, issued for the 2004, 2005, and 2006 bond years,<sup>9</sup> but that the Pool was not required to pay the County any monies on the finance director bonds. The trial court's ruling was premised on a finding that Katona was serving only as County treasurer, and not also as the finance officer or finance director, when he committed his crimes. Relying on the doctrine of statutory bond liability set forth in *Gen'l Electric Corp v Wolverine Ins Co*, 420 Mich 176, 191; 362 NW2d 595 (1985), the trial court declined to enforce the non-aggregation language in the bond contract, which purported to limit the Pool's liability to a total of \$100,000 on each series of bonds regardless of whether the conduct occurred, or caused losses, in more than one bond year. Although it was raised by the Pool, the trial court did not address the effect of language in each of the bond contracts that precludes coverage for losses resulting from an employee's fraudulent or dishonest conduct after the County has knowledge of a prior fraudulent or dishonest act by that employee.

## II. Analysis

On appeal, the County asserts that the trial court erred by denying payment on the finance director bonds, and contends that Katona was serving as both the County's treasurer and its finance director. On cross-appeal, the Pool argues that the trial court erred by declining to apply the non-aggregation language in the bond contracts and ruling that it owed the County the full \$100,000 indemnification limit on each of three treasurer's bonds. The Pool also contends that the prior fraudulent acts exclusion in the bond contracts precludes coverage altogether. In response to the cross-appeal, the County contends that the doctrine of statutory bond liability prohibits application of either the non-aggregation language or the prior fraud exclusion in the bond contracts, and that even if the prior fraud exclusion does apply, it does not exclude coverage because Katona's prior acts were not against the County. For the reasons set forth below, we conclude that Section 7 of the Conditions and Limitations portion of the bond contracts is not limited by the doctrine of statutory bond liability, and pursuant to that section, the County was not covered for Katona's acts against the County. Consequently, the trial court erred by not granting summary disposition to the Pool with respect to each series of bonds.

This Court reviews a trial court's decision on a motion for summary disposition de novo on the basis of the entire record to determine if the moving party is entitled to judgment as a matter of law. *Maiden v Rozwood*, 461 Mich 109, 118; 597 NW2d 817 (1999). We likewise review the interpretation of a contract and any questions of statutory interpretation or application de novo. *Henderson v State Farm Fire and Casualty Co*, 460 Mich 348, 353; 596 NW2d 190 (1999); *In re MCI Telecommunications*, 460 Mich 396, 413; 596 NW2s 164 (1999).

MCL 48.35 requires that:

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<sup>9</sup> The trial court found that the County had not established any losses resulting from conduct by Katona occurring during the 2003 bond year, and the County is not pursuing coverage for that year.

As determined by the county board of commissioners, the county treasurer either shall be covered by a blanket bond or shall give a bond of a surety company authorized to do business in this state for the faithful and proper discharge of the duties of the county treasurer's office and the duties required by virtue of the office of county treasurer as directed under this chapter. The cost of the individual bond shall be paid from the general fund of the county.

In accordance with its statutory obligation, as noted above, the County obtained a series of bonds from the Pool, in the amount of \$100,000 each, to secure the faithful and proper discharge of the duties of its treasurer.<sup>10</sup> Additionally, although not required to do so by statute, the County also obtained bonds for the faithful and proper discharge of the duties of its finance director or finance officer.<sup>11</sup> Each of the bonds issued by the Pool to the County at issue here contained the following provisions:

In consideration for payment of Premiums to the Pool, and subject to the terms and limits of this Coverage Document, the Pool agrees to provide coverage as stated in this Contract. . . .

## **COVERAGE AGREEMENTS**

### **I. Employee Dishonesty and Faithful Performance of Duty Blanket Coverage**

- A. Employee Dishonesty Coverage is extended to include loss resulting from the failure of any Employee to faithfully perform duties prescribed by state law . . . .
- B. Loss of Money, Securities and other property which the Member shall sustain, to an amount not exceeding in the aggregate the amount stated in the Limit of Liability Section shown on the Declarations page applicable to Coverage Agreement I, resulting directly from one or more fraudulent

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<sup>10</sup> At the time in question here, applicable statutes did not set a minimum requirement for the statutorily-required treasurer bonds. However, following Katona's misconduct, the Legislature amended the applicable statutory scheme to require a minimum of \$1,000,000 in bond coverage to secure "the faithful and proper discharge of the duties of the county treasurer's office and the duties required by virtue of the office of county treasurer." MCL 48.40.a

<sup>11</sup> The County cites MCL 46.11(k) [see footnote 4] and MCL 45.381(2) as the statutory authority under which it obtained a bond for the position of finance director. MCL 45.381(2) provides that "[t]he county board of commissioners shall determine whether a single bond for all officers and employees or individual bonds for all officers or employees or a combination of a blanket bond and individual bonds best serves the county."

or dishonest acts committed by an Employee, acting alone or in collusion with others.

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D. Dishonest or fraudulent acts *as used in this Coverage Agreement* shall mean only dishonest or fraudulent acts committed by such Employee with manifest intent:

1. to cause the Member to sustain loss; and
2. to obtain financial benefit for the Employee, or for any other person or organization intended by the Employee to receive such benefit, other than salaries, commissions, fees bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment. . . . [Emphasis added.]

The coverage provided by Coverage Agreement I of the bonds was subject to the following exclusions and restrictions, set forth in the bond contract section titled “CONDITIONS AND LIMITATIONS”:

***SECTION 7 – PRIOR FRAUD, DISHONESTY OR CANCELLATION***

This coverage under Coverage Agreement I *shall not apply to any Employee from and after the time that the Member or any appointed or elected official thereof not in collusion with such Employee shall have knowledge or information that such Employee has committed any fraudulent or dishonest act in the service of the member or otherwise*, whether committed before or after the date of service on behalf of the Member commenced. . . . [Emphasis added.]

The Pool argues that this provision excludes coverage for Katona’s defalcation of County funds under each series of position bonds issued by the Pool to the County due to Katona’s prior fraudulent and dishonest acts in 1998. We agree.

In general, “‘the rules of . . . construction [of surety contracts] are not different from those employed in the interpretation and construction of other written agreements.’” *Gen’l Electric Credit Corp v Wolverine Ins Co*, 420 Mich 176, 185; 362 NW 2d 595 (1985), quoting *Comm’r of Banking v Chelsea Savings Bank*, 161 Mich 691, 699; 125 NW424 (1910). If the language in an agreement is clear and unambiguous, this Court must enforce the terms of the agreement as written. *Auto-Owners Ins Co v Churchman*, 440 Mich 560, 567; 489 NW2d 431 (1992); *In re Smith Trust*, 274 Mich App 283, 285; 731 NW2d 810 (2007), citing *Quality Products & Concepts Co v Nagel Precision, Inc*, 469 Mich 362, 375; 666 NW2d 251 (2003). This holds true for exclusionary provisions as well, although such provisions are strictly construed against their issuer. *Michigan Basic Prop Ins Assoc v Wasorovich*, 214 Mich App 319, 323; 542 NW2d 367 (1996).

That said, however, these general rules of construction do not adequately describe the interpretation of a surety bond whose terms are mandated by statute. *Gen’l Electric Credit Corp*,

420 Mich at 185. As set forth in *Gen'l Electric Credit Corp*, “[t]he terms of a statutorily required surety bond are interpreted in light of the meaning of the language of the statute and the apparent intent of the Legislature.” *Id.* In *Lawrence v American Surety Co of New York*, 263 Mich 586, 597; 249 NW 3 (1933), our Supreme Court described the rule of statutory bond liability as follows:

It is the general rule that existing law becomes part of a statutory bond, i.e., one commanded or provided by statute, so that omitted conditions required by the law are read into the bond, and conditions not so required, which limit or restrict liability, are read out of it as surplusage. The rule governs, not only the bonds of public officials, but others.

A bond that is required for the protection of the public, if its terms permit, should be construed so as to accomplish that purpose. *Gen'l Electric Credit Corp*, 420 Mich at 188. It is not every provision of the bond not found in the statute that is void, but rather, “only those provisions which have the effect of limiting or restricting the liability imposed by statute which are surplusage.”<sup>12</sup> *Lawrence*, 263 Mich at 598. In that regard, “[t]he statute must be consulted to appraise the controverted clauses.” *Id.*

Consulting the statute at issue, MCL 48.35 clearly requires that a county treasurer be covered by a bond. The statute allocates to the county board of commissioners the determination whether it will cover the position by way of a blanket bond or a separate position fidelity bond. MCL 46.11(k) also gives a county the authority to require a county officer to give a bond reasonable or necessary for the faithful performance of the duties of the office.<sup>13</sup> The statute does not, however, mandate the amount of the bond or other terms of coverage. Although the obtaining of a bond is statutorily required under MCL 48.35, we do not find that the statute conflicts with a bond that excludes coverage for losses resulting from an employee’s fraudulent or dishonest conduct after the county has knowledge of a prior fraudulent or dishonest act by that employee. Nor does such exclusion conflict with the other statutes cited by the County, MCL 46.11(k) or MCL 45.381, associated with its procuring a position bond for a County finance director. Although the doctrine of statutory bond liability may regulate the coverage type and payout for a position, it should not serve to protect coverage over a specific individual and

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<sup>12</sup> *Lawrence* warned against overbroad interpretations of the statutory bond liability doctrine:

At the outset, we must brush aside the stressed contention that public welfare demands that the state have such construction of the law and bonds as will certainly preserve its funds inviolate. The state is entitled to the full protection of the laws it enacts, but citizens dealing with it are entitled to like protection. There can be no virtue in a ruling which will favor the state at the expense of the legal rights of those who deal with it. When a decision is right, the government wins though it loses the suit. [*Lawrence*, 263 Mich at 596, quotation omitted.]

<sup>13</sup> See footnote 4.

should not place the responsibility of performing a background check on each employee in the hands of the bond agent where the agent was selling position bonds and not bonds covering specific employees. Because we find that the doctrine of statutory bond liability does not apply to prohibit or “read out” the prior fraud exclusion, we must look to the language of the bond to assess coverage.

Section 7 of the Conditions and Limitations portion of the bond agreement plainly excludes coverage for losses to the County resulting from Katona’s embezzlement and forgery. Indisputably, Katona committed, and the County had knowledge or information that he committed, dishonest or fraudulent acts several years before his misappropriation of County funds. The actions underlying Katona’s 1998 guilty pleas to forgery and to uttering and publishing a false, forged or altered document, each of which necessarily include an element of dishonesty, clearly constitute “fraudulent or dishonest act[s]” within the meaning of Section 7 of the bond’s Conditions and Limitations.<sup>14</sup> Further, Katona was prosecuted in Alcona Circuit Court, by the Presque Isle County prosecutor acting at the special request of the Alcona County prosecutor, amid significant local media coverage. Section 7 excludes coverage “from and after the time that the Member or any appointed or elected official thereof not in collusion with such Employee shall have knowledge or information that such Employee has committed any fraudulent or dishonest act. The policy defines “Member” as meaning:

1. The Pool Member;

2. *All persons who were, now are or shall be lawfully elected or lawfully appointed officials of the Pool Member and members of the public entity; and* [Emphasis added.]

3. Members of commissions, boards or other units operating by and under the jurisdiction of such public entity and within apportionment of the total operating budget indicated in the application form, provided that the coverage afforded shall not extend to any of the following boards, commissions or units unless specifically endorsed hereon: schools, airports, transit authorities, hospitals, municipally owned gas or electric utilities or housing authorities. [Conditions and Limitations, Section 3.]

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<sup>14</sup> While the phrase “any fraudulent or dishonest act” is not defined in Section 7, and could be construed as ambiguous in terms of what falls within its parameters, we need not determine its scope. Whatever else it may mean, any reasonable reading of the phrase “any fraudulent or dishonest act” must necessarily include an act or acts, committed by an employee during his tenure with the County, which results in the employee pleading guilty to a felony offense involving elements of fraud or dishonesty, such as those to which Katona pleaded guilty in 1998. Further, it is immaterial that Katona’s criminal record was subsequently expunged. The exclusion does not require a criminal conviction, it merely requires that the employee commit a fraudulent or dishonest act. Plainly, Katona did so, as evidenced by his admission of guilt to the criminal charges lodged against him in 1998.

The County prosecutor, being an elected or appointed official of the County, falls within the definition of “Member” provided in the policy. Thus, even absent actual knowledge by any other individual employed by the County, the knowledge of, or information received by, the County prosecutor was sufficient to trigger the prior fraud or dishonesty exclusion set forth in the bond agreement. Therefore, even without regard to the significant publicity surrounding Katona’s 1998 guilty pleas, there is no basis in law or fact for the County to assert that it lacked sufficient knowledge or information to prevent triggering of the prior fraud or dishonesty exclusion. In fact, the County has not made any such assertion. Thus, we have no choice but to enforce that exclusion, and to conclude that the County is not entitled to payment on any of the bonds at issue in this action.

The County cites the definition of “dishonest or fraudulent acts” contained in Coverage Agreement I as indicating that the prior fraud or dishonesty exclusion set forth in Section 7 of the Conditions and Limitations is only applicable to prior dishonest or fraudulent acts resulting in loss to the Member. The County thus argues that, because Katona’s prior fraudulent or dishonest act did not cause any loss to the County, the prior fraud or dishonesty exclusion was not triggered by that prior conduct. The County’s argument is without merit. Although Coverage Agreement I defines a dishonest or fraudulent act to include only those actions that cause the member to sustain loss, by its very terms, this definition only applies to “dishonest or fraudulent acts” as used in “this Coverage Agreement.” That is, it defines the type of dishonest or fraudulent acts – those causing loss to the member – that are covered by Coverage Agreement I. The definition set forth in Coverage Agreement I does not apply to the phrase “any fraudulent or dishonest act” as used in Section 7 of the Conditions and Limitations on that coverage. Thus, it is of no consequence that Katona’s 1998 conduct did not cause the County to suffer any loss. Once the County had knowledge or information that Katona had committed dishonest acts, such as those underlying the 1998 proceedings against him, the position bonds issued by the Pool no longer indemnified the County against losses resulting from any subsequent fraudulent or dishonest conduct by Katona.

We are aware that, under these circumstances, the voters’ decision to re-elect Katona to the position of County Treasurer after his 1998 transgressions placed the County in a difficult position. Certainly, the County remained statutorily obligated to obtain a bond insuring Katona’s faithful performance of his duties as the County treasurer despite his prior conduct. MCL 48.35. Yet, the position bonds available to the County from the Pool precluded such coverage for Katona subsequent to the County having knowledge of, or information regarding, that prior conduct. Under these circumstances, the County could have sought coverage by an individual bond covering Katona’s performance as County treasurer; an individual bond could have accounted for Katona’s prior fraud or dishonest conduct in both the coverage provided and the premium charged. *Id.* Alternatively, MCL 46.11(k) provided the County Board of Commissioners with the authority to demand that Katona himself give a reasonable bond to ensure his faithful performance of the duties of his office, and, if he refused to do so, to remove him from office by a two-thirds vote of the board members.<sup>15</sup> Indeed, this was the course of

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<sup>15</sup> See footnote 4.

conduct undertaken by the County Board of Commissioners once it became aware of Katona's suspicious financial dealings on behalf of the County in 2006. Having knowledge of Katona's prior dishonest conduct, it was incumbent on the County to take appropriate action to protect against any possible failure by Katona to faithfully perform the duties of the office of County treasurer. That the County did not take any such measures does not alter the fact that indemnification for the loss resulting from Katona's misdeeds is precluded under the plain language of the bond contracts by the County's knowledge of Katona's prior dishonest conduct.

Because the prior fraud or dishonesty exclusion applies to preclude bond coverage for Katona's embezzlement of County funds under either series of bonds at issue here, the Pool was entitled to summary disposition of the County's complaint in its entirety. Therefore, we reverse the trial court's October 17, 2008 order requiring the Pool to pay the County on each of the three treasurer's bonds and we affirm the trial court's April 30, 2009 order summarily dismissing the County's claim for payment on the finance director bonds, albeit for different reasons than those articulated by the trial court. See *Fisher v Blankenship*, 286 Mich App 54, 70; 777 NW2d 469 (2009) ("this Court will affirm where the trial court came to the right result even if for the wrong reason"). Having reached this result, we need not determine whether the non-aggregation language contained in those bonds is void under the doctrine of statutory bond liability, nor whether the County established a material question of fact as to whether Katona was serving as its finance director or officer, in addition to treasurer, at the time he committed his crimes.

Affirmed in part and reversed in part.

/s/ William B. Murphy  
/s/ Jane M. Beckering  
/s/ Michael J. Kelly