Bloomberg
Law Reports®

March 5, 2012

Commercial Insurance

BLAW Q&A

Fidelity Insurance

The Termination Provision in Fidelity Insurance Policies: Practitioners Discuss a Split in Authority

This month, Bloomberg Law Reports®–Commercial Insurance asked leading insurance coverage practitioners to weigh-in on the applicability of the termination provision in fidelity insurance policies.

Courts are split over the applicability of the termination provision in commercial crime policies. Some courts hold that the termination provision applies only if a manager becomes aware of an employee's dishonest conduct during the policy period. (*See Waupaca Northwoods, LLC v Travelers Cas. & Sur. Co. of Am.*, No. 10-C-459, 2011 BL 109466 (E.D. Wis. Apr. 25, 2011). Other courts, such as the Appellate Division of the Supreme Court of New York, Third Department, have held that a policy terminates upon inception as to the particular employee, if the manager knew of prior dishonest acts at the time the policy was issued. (*See Capital Bank & Trust Co. v. Gulf Ins. Co.*, 2012 NY Slip Op 00451 (App. Div. Jan. 26, 2012). Which is the more sound holding?

Edward J. Stein
Anderson Kill & Olick, P.C.

The divergent results in *Waupaca* and *Capital Bank* follow from their particular facts and policy wordings. However, prudent policyholders should consider not only the fine print, but also the broader risk of continuing to employ any person known to have engaged in dishonesty.

In *Waupaca*, the court denied an insurance company's motion for summary judgment under a commercial crime policy, based on a clause terminating employee theft coverage as to any employee "*as soon as*" any management or supervisory employees "not in collusion with the Employee becomes aware of any dishonest or fraudulent employment related act." The court reasoned that because the termination clause applied "as soon as" the policyholder learned of dishonest conduct, it implied that the dishonesty, or at least its discovery, must occur while the policy is in effect, not beforehand. Thus, a vice president's knowledge prior to the policy period that an employee was accused of dishonesty by a prior employer did not defeat coverage (especially since the VP had also worked for the prior employer and was thought to be in collusion with the employee there).

In contrast, *Capital Bank* involved a "known dishonesty" exclusion of coverage for "loss arising out of or in connection with any circumstances or occurrences known to [the policyholder] prior to the [bond's] inception." The court granted summary judgment dismissing a bank's claim for losses resulting from an employee's forgery, because the bank's president admitted that before the bond took effect, he discovered that the officer was forging signatures, and the officer admitted to forgeries and was warned about violating company policy. The insurance company also cited a termination clause similar to the clause in *Waupaca*. However, any argument that termination "as soon as" dishonesty was discovered required discovery during the policy (as in *Waupaca*) would have been futile, given the express exclusion for known dishonesty.

W*aupaca* better reflects policyholders' reasonable expectations and the settled principle of resolving ambiguities in favor of coverage. The *Waupaca* court correctly noted that underwriters could more precisely state any intent to exclude knowledge of dishonesty prior to the policy period (e.g., through the language at issue in *Capital Bank*). Underwriters also could use insurance applications to require disclosure of known dishonesty .

While policyholders should understand the contours of their own coverage, they should also recognize that if they knowingly continue to employ persons who have been dishonest, it may be at their own peril. Brokers might assist by procuring policies with more favorable language. For example, underwriters could be persuaded to clarify that "knowledge" of dishonesty does not include knowledge of persons colluding with a dishonest employee, and that the "knowledge" exclusion (and "discovery" trigger) requires knowledge or discovery by specified individuals or departments. Such clarifications would help large organizations avoid forfeiting coverage for employee dishonesty that may be known to lower-level or remote personnel, but not those responsible for risk management and insurance matters.

Edward J. ("Ted") Stein (estein@andersonkill.com) is a shareholder of Anderson Kill, admitted to practice in New York, Massachusetts, and California. His practice concentrates on insurance recovery, including fidelity insurance recovery, exclusively on behalf of policyholders.