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IS THERE REALLY NONCUMULATION OF LIMITS OF LIABILITY?

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INTRODUCTION

When preparation for this paper began, it was not intended to be an exercise in literary criticism. However, in reviewing the recent cases addressing this topic, the most striking aspect of the cases questioning the Fidelity Insurer's limit of liability is the interpretation given to words and phrases over which there should be no dispute. This paper will not endeavor to do a detailed review of the history of the decisions dealing with cumulation or non-cumulation of the Fidelity Insurers limits of liability.[1] As pointed out in Mr. Hacker's article, there have been decisions, annotations, and law review opinions dating to the early 1900's addressing the issue of whether or not the surety's liability is cumulative from year to year.

In general, there are two lines of cases. One line of cases resolved the issue of cumulation of liability by analyzing whether or not each policy period covered was a separate contract. If the court found a separate contract, then the insurer's liability was not limited to a single policy limit. See, City of Miami Springs v. Travelers Indemnity Co., 365 So.2d 1030 (Fla.App., 1978), White Dairy Co. v. St. Paul Fire and Marine Insurance Co., 222F.Supp. 1014 (N.D.Ala. 1963).

The contrary line of cases found, in general, the renewal of the policy did not create a separate policy. Thus, there was one continuous policy limiting the insurer's liability to the stated policy limits regardless of the number of years the policy was in force and the number of years in which the loss occurred. See, Leonard v. Aetna Casualty & Surety Co., 80 Fed. 205 (4th Cir. 1935).

In the 1980's, the commercial crime policy was modified to contain the following relatively standard definitions which, while appearing in slightly different variances, are now common in the commercial crime policy.

B. Limit of Insurance. The most we will pay for loss in any one "occurrence" is the applicable Limit of Insurance shown in the DECLARATIONS.

3.b. "Occurrence" means all loss caused by, or involving one or more "employees", whether the result of a single act or series of acts.

9. Loss Covered Under This Insurance and Prior Insurance Issued by Us or Any Affiliate

If any loss is covered:

a. Partly by this insurance; and

b. Partly by any prior cancelled or terminated insurance that we or any affiliate had issued to you or any predecessor in interest;

[1] For an excellent discussion of this topic and a complete historical background see William J. Hacker's article in Commercial Crime Policy, Torts and Insurance Practice Section, American Bar Association, 1997, Gilbert J. Schroeder, Editor.

the most we will pay is the larger of the amount recoverable under this insurance or the prior insurance.

10. Non-Cumulation of Limit of Insurance:

Regardless of the number of years this insurance remains in force or the number of premiums paid, no Limit of Insurance cumulates from year to year or period to period."

The surety claims professional faced with the not uncommon claim situation involving an employee engaged in a series of dishonest acts causing a loss to insured which extends over several policy periods with the loss exceeding the policy limits, has no problem understanding this language. The definition of "occurrence" is clear and unambiguous. The fidelity carrier, subject to the terms and conditions of the policy, is liable for all loss caused by the acts of the employee or employees. The fidelity carrier's liability for that loss is set forth in the declarations. There is no question of continuous or separate policies regardless of the number of years the policy is in force. The policy limit is the extent of the carrier's liability. If the occurrence spans multiple policy periods, the fidelity carrier's liability is limited to the policy limits. The insured does not get the benefit of "stacking" or accumulating (adding) the limits of liability over multiple years. This is a straight forward proposition.

This standard language generally withstood challenge. The surety's liability was found to be limited to the policy limit regardless of the amount of the loss and time frame in which the loss occurred. See, Diamond Transportation System, Inc. v. Travelers Indemnity Co., 817 F.Supp. 710 (N.D. Il., 1993), Reliance Insurance Co. v. Treasure Coast Travel Agency, Inc., 660 So.2d 1136 (Fla.App., 1995), Bethany Christian Church v. Preferred Risk Mutual Insurance Co., 942 F.Supp. 330 (S.D.Tx., 1996).

There were contrary decisions, but those decisions were less well reasoned and appear to be a minority result oriented position. See, Penalosa Co-Op Exchange v. Farm Land Mutual Insurance Co., 789 P.2d 1196 (Kan.App., 1990). In Penalosa, the Court admitted its reading of the policy language was strained but, the court found that the carrier had not utilized the standard policy language to limit its liability and therefore, it would extend coverage to the insured. See, Penalosa at p. 1200.

In recent years, there have been several additional attempts to attack the standard language contained in the modern commercial crime policy to find additional coverage under the fidelity policy.

RECENT DEVELOPMENTS

In A.B.S. Clothing Collection, Inc. v. Home Insurance Co., 41 Cal.Rptr. 2d 166 (Cal.App., 1995), the California Appellate Court stretched contract interpretation to a new level to find ambiguity in the standard policy language to find maximum coverage for the insured. Home issues blanket crime policies for the periods of April 4, 1989 to April 4, 1990, April 4, 1990 to April 4, 1991, and April 4, 1991 to April 4, 1992. Each policy was a renewal of the previous policy and carried a different policy number. See, A.B.S. supra p. 167.

The policy had a $100,000 limit of liability. Home acknowledged A.B.S. sustained a covered loss caused by employee dishonesty in excess of $100,000 for the first three policy years and approximately $78,000 for the fourth policy year. Home acknowledged the validity

of the claim and paid $100,000 which it contended was its policy limit. See, A.B.S. supra p. 168. The Home's policy contained the standard policy language set forth earlier.

The Court phrased the issue before it as to whether or not there were separate policies which would allow the insured, A.B.S., to recover the policy limits for each policy period. Alternatively, if there is one continuous contract, then the insured can only recover the limit of liability no matter how long the policy is in effect. See, A.B.S. at p. 167. While acknowledging that language and words in insurance contracts are to be given their ordinary meaning, the Court proceeded to find the standard policy definitions to be ambiguous and found that there were separate policies entitling the insured to recover up to the policy limit for each of the four years in which the insured sustained an economic loss.

The Court first addressed the non-cumulation of liability provision. The Court found that arguably this clause could be read to mean that the insured, in the event there were dishonest acts causing a loss in excess of the policy amount in one year, could not carry that loss into the next year when its economic loss may be less than the limit. See, A.B.S. at p. 171. Because this clause could be read in that manner, the non-cumulation of liability clause was ambiguous. This certainly was not the Home's intended result.

The Court then turned to the prior loss provisions and found those provisions to be ambiguous. The Court's reasoning for finding this language ambiguous is unclear. The Court found that even, if the prior loss provision was evidence of an attempt to create a continuous contract and limit the insured's recovery, other provisions of the policy were sufficiently ambiguous for the Court to find that Home had issued separate policies allowing A.B.S. to recover. See, A.B.S. at p. 173. The Court found the issuance of separate policy documents to be strong evidence that the renewals were intended to be separate and distinct contracts. See, A.B.S. at p. 173.

Moreover, most remarkably, the Court found the definition of occurrence to be ambiguous stating the definition of occurrence "... as all loss suggests there can be only one occurrence during the life of the insurance, the provision restricting liability "for any one occurrence" suggest that there could be more than one occurrence. See, A.B.S. at p. 173. This statement implies the Court believes, if two employees acting independently caused separate and distinct financial losses to the insured then, the fidelity carrier would contend that there was only one occurrence. Thus, the Fidelity Insurer would argue the policy limits would be limited to the total loss caused by the independent acts of different employees. This is certainly a dubious proposition at best. Notwithstanding reliance upon this proposition, the California court found the provisions to be ambiguous and therefore, because the policy, according to the Court, could be subject to more than one interpretation, there were separate policies with separate independent contracts allowing the insured to recover its economic loss in each period up to the maximum amount of the surety's liability.

Subsequently, the Ninth Circuit took the A.B.S. decision one step further. In Karen Kane, Inc. v. Reliance Insurance Co., 202 F.3d 1180 (9th Cir., 2000), the Ninth Circuit reviewed a decision by the United States District Court for the Central District of California dismissing the insured's claim, with facts virtually identical to the A.B.S. case, Reliance's liability was limited to the amount set forth in the declarations of the standard blank crime policy.

In Kane, Reliance issued three insurance policies containing employee dishonesty coverage with a limit of $250,000. Reliance's policies were in effect from December 1993 through December 1996. Commencing in 1992, one of the insured's employees started a scheme to falsify invoices in order to generate payments to non-employee co-conspirators. The scheme lasted from 1992 through 1996. The insurance losses were $434,978 in 1993 through 1994, $767,298 in 1994 through 1995, and $213,737 in 1995 through 1996. Relying upon the standard policy provisions, Reliance tendered $250,000 to the insured in full satisfaction of the insured's claim. The insured rejected this offer and filed suit.

The United States District Court entered judgment on behalf of Reliance. The District Court found the standard definition of "occurrence" and the prior loss provisions limited Kane's recovery to the liability limit for the last of the three policies. See, Kane at p. 1183. The Ninth Circuit reversed the District Court. The Ninth Circuit acknowledged that it was bound to follow state law in deciding this case under its diversity jurisdiction. The Ninth Circuit rejected the District Court's attempt to distinguish Kane from A.B.S. The Court found that the facts and the policy language were virtually identical. Apparently, the District Court had no difficulty in finding that the definition of "occurrence" was plain and unambiguous. Moreover, the District Court found that the multiyear employee dishonesty scheme was clearly within the definition of "occurrence" as provided by the policy. The prior loss provision coupled with the "occurrence" definition limited the insured's recover under the current policy. See, Kane supra at p. 1185. Rejecting this, the Ninth Circuit found the definition of "occurrence" in the Reliance policy to be identical to the definition contained in the Home policy. Thus, the District Court should have reached the same conclusion as the court did in A.B.S. because the District Court was bound to follow California law. See, Kane supra at p. 1185.

In rejecting the District Court's finding, the Ninth Circuit stated:

> "Thus the policy is silent as to whether the term "occurrence" refers to "a single act or series of acts" within a single policy period or across multiple periods. If "occurrence" is construed as limited by policy period, then Dantzler's approximately 150 individual acts of theft, spanning over three years, constitute three separate "series of acts," one for each of the three policy periods and recoverable within each period as such." Kane supra at p. 1187.

The court found this language to be ambiguous and must be construed in favor of the insured and found the limit of liability for each policy period.

With all due respect to my colleagues from California, these two decisions could be dismissed as aberrational and strictly result oriented to favor California consumers. Unfortunately, the Fourth Circuit recently joined the bandwagon.

In Spartan Iron & Metal Corporation v. Liberty Insurance Corporation, 2001 WL 301111 (4th Cir. 2001), the Fourth Circuit was faced with similar facts and policy language as in the A.B.S. decision. Relying upon the reasoning of the California Court, the 4th Circuit found Liberty's policy ambiguous. First, the Fourth Circuit found the definition of "occurrence" to be ambiguous because the definition did not state that a series of acts, as defined by the term "occurrence", includes acts occurring outside the policy term. See, Spartan supra at 2. The Court's reasoning appears to be that, absent a statement that a continuing scheme of dishonesty covering more than one policy a period is one occurrence then, the definition of

“occurrence” is ambiguous. Again, this reasoning appears to stretch the limit of contract interpretation and normal sentence structure.

The Court next rejected Liberty’s argument that its liability was limited by paragraphs 9 and 10 (prior insurance and cumulation of liability) of the policies because these provisions are ambiguous. The Court does not explain its reasoning. The Court relied upon decisions in other jurisdictions. The Fourth Circuit held Liberty was liable for the loss sustained by the insured in each individual policy period because Liberty had issued separate contracts and, other case law found that the surety’s liability hinges on whether or not there is one contract or separate contracts.

In other words, the Court found that the policy definition of “occurrence” could be read to mean that each individual act which the employee committee to cause the economic theft to be a separate occurrence. This stretch of interpretation certainly appears questionable.

Fortunately, the Fourth Circuit’s decision is unpublished and should have no precedential value. However, it does exist and may ultimately be utilized by an insured. The A.B.S., the Kane, and the Spartan case all seem to hinge on a determination by the courts to find coverage regardless of the policy language. Fortunately, the final recent case on this issue has resulted in a better reasoned decision and better result for the surety.

In Shared-Interest Management, Inc. v. CNA Financial Ins. Group, 725 N.Y.S.2d 469 (2001), the New York Appellate Court reversed the finding of the Supreme Court Appellate’s Division for an insured which had suffered a loss under facts very similar to the A.B.S., Kane, and Spartan cases. The insured has sustained losses of $460,316.15 as a result of the thefts of an employee over a period of three years. The policy at question contained virtually the same policy language quoted in this paper and present in the other three cases. The lower court found that there were separate policies and allowed recovery for each period up to the maximum coverage. The Appellate Court found this to be erroneous as a matter of law.

The policies were originally issued by Fireman’s Insurance Company of Newark which was a subsidiary of Continental Insurance Company. After the Continental merger with CNA Financial Insurance Group, CNA changed the policy number to reflect CNA’s numbering system. In a slightly different twist from the A.B.S. case, the policy provided that it was issued from the commencement date until cancelled. The Court rejected the insured’s argument that the merger between Continental and CNA somehow resulted in a different insurance company issuing a new policy. See, Shared-Interest Management supra at p. 472. While the Court’s decision is based upon its finding that while there was only one policy and the separate policy periods were established to define the premium, the Court, in favorable dicta, also rejected the reasoning of the Spartan case. See, Shared-Interest Management at p. 472.

The Court found that the unambiguous non-cumulation (anti-stacking) provisions and the prior insurance provisions were plain and unambiguous which would limit the insured’s recovery to the policy limit. See, Shared-Interest Management at p. 472 and 473.

The New York Court fortunately followed the dictates of contract construction principles of not stretching or distorting language when there is no reason to do so.

CONCLUSION

Fidelity Carriers, relying upon the standard policy provisions, believe liability is limited to a single amount for any one occurrence. There will likely be continued attempts to stack coverage or cumulate liability. In the recent cases, the distinction between the decisions is fairly clear. In the cases adverse to the Fidelity Carrier, the courts have strained to find ambiguity. In New York, the court read the language with its ordinary and plain meaning to find no ambiguity. As additional attacks mount on the Fidelity Carriers, it is simply suggested that the surety claims professional and counsel must rely upon the clear and unambiguous policy provisions to assert that there is not and should not be a stacking of coverage. Finally, the answer to the question posed in the title, is yes, if the courts rely upon the basic tenets of English grammar.

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