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**CONSTRUCTION AND APPLICATION OF INSURING
AGREEMENT D**

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V. Introduction.

Financial institutions and businesses must, by necessity, always endeavor to insure themselves from losses resulting from fraud and unfaithful employees. This paper highlights the specific type of commercial fidelity insurance that addresses claims involving forgery and the fraudulent alteration of financial documents.

Fidelity insurance, like other types of insurance contracts, limits the carrier's liability to the payment of covered losses. The judicial construction process by which courts determine whether a fidelity insuring agreement provides coverage for a claim is discussed in the first part of this presentation. From this foundation, this paper will review the specific fidelity coverage provided under Insuring Agreement (D) of the Financial Institution Bond Standard Form 24, revised to January 1986 ("FIB") through examination and analysis of the express standard form language of this Insuring Agreement and through the exploration of recent decisions by courts throughout the United States.

V. The basic rules of FIB construction.

A carrier has no duty to pay claims that fall outside the scope of coverage afforded by its policy.¹ Indeed, both the carrier and the insured are bound by the terms and conditions that are expressly set forth in the contract.

It is well settled that the construction of an insurance policy is governed by the same principles generally applicable to the construction of other contracts.² The meaning and legal effect of the insurance contract, *i.e.* ascertaining the scope and limitations of an insurance policy in order to determine whether there is coverage, will generally be

¹ See *e.g.* *G&C Construction Corp. v. St. Paul Fire & Marine Ins. Co.*, 731 F.2d 183, 185 (4th Cir. 1984); *Martinez v. Hawkeye-Security Ins. Co.*, 195 Colo. 184, 576 P.2d 1017 (1978) (which held that courts should enforce the insurance contract as made and the insurer should be required to pay damages only on property intended to be insured and to answer only for those risks intended to be assumed.); *Harbor Ins. Co. v. United Services Auto Ass'n.*, 114 Ariz. 58, 559 P.2d 178 (1976) (holding that courts will not indulge in forced construction of a policy so as to fasten liability on an insurance company that it has not assumed.).

² See *e.g.* *Essex Ins.Co. v. Vincent*, 52 F.3d 894 (10th Cir. 1995); *Western World Ins. Co. v. Stack Oil Inc.* 922 F.2d 118 (2d Cir. 1990), *New Castle County v. Hartford Acc. & Indem. Co.*, 970 F.2d 1267 (3d Cir. 1992); *Rocon Mfg. Inc. v. Ferraro*, 605 N.Y.S.2d 591 (NY App. Div. 4th Dept. 1993); *Holland v. Hawkeye Security Ins. Co.*, 230 N.W.2d 517, 521 (Iowa 1975); *Ohrel v. Continental Cas. Co.*, 138 N.J. Super. 170, 350 A.2d 310, 315 (1975); *Mitchell v. AARP*, 140 Md.App. 102, 116, 779 A.2d 1061 (2001); *Prudential Property, Etc. v. District Court*, 617 P.2d 556, 559 (Colo. 1980); *Perkins v. Clinton State Bank*, 593 F.2d 327 (5th Cir. 1979); *Sharp v. FSLIC*, 858 F.2d 1042, 1044 (5th Cir. 1988); *Calcasieu-Marine Nat'l Bank of Lake Charles v. American Employers Ins. Co.*, 533 F.2d 290, 295 (5th Cir. 1976), cert. denied, 429 U.S. 922 (1976); *M.S. Walker, Inc. v. Travelers Indem. Co.*, 470 F.2d 951, 952 (1st Cir. 1973). *Southeast Bakery Feeds, Inc. v. Ranger Insurance Co.*, 974 S.W.2d 635 (Mo.App.1998); see also RESTATEMENT (SECOND) OF CONTRACTS § 200 (1981) "Interpretation of a promise of agreement or a term thereof is the ascertainment of its meaning;" see also ERIC MILLS HOLMES, ET AL., HOLMES'S APPLEMAN ON INSURANCE, § 5.1 at 7 (1996).

determined by the court as a matter of law.³ Whether a loss or a specific risk of loss is covered by the bond is determined through the process of interpretation and construction, which starts with a careful review of the language of the insurance policy. The meaning of the applicable provisions of the policy must be ascertained, so the legal effect of those provisions may be determined.

Interpretation and construction are distinct exercises; however, in practice, courts often blur the line between construction and interpretation, frequently using the terms interchangeably.⁴ Nonetheless, the distinction between construction and interpretation is useful in that it helps us understand what courts do with written contracts since all contracts that come before a court must be construed: even if a writing requires no interpretation because the objective meaning of the words and symbols used is sufficiently clear, the court must still construe the writing before giving it legal effect.

If there is an ambiguity in the policy language, courts, in theory, attempt to construe the intent of the parties at the time of entering into the contract by taking the contract as a whole into consideration. If the ambiguity cannot be resolved by reference to the whole document or by discerning the intent of the parties, then the ambiguity is usually construed against the party that drafted the contract, *i.e.* the issuer of the policy especially when the policy provision in question is an exclusion or limitation of the policy.⁵ It must not be supposed, however, that an attempt is made to ascertain the actual mental processes of

³ See *e.g.* *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424 (9th Cir. 1995); *Atlas Pallet, Inc. v. Gallagher*, 725 F.2d 131, 134 (1st Cir. 1984) (“Generally, where the facts upon which liability is claimed or denied under an insurance policy are undisputed and the existence or amount of liability depends solely upon a construction of the policy, the question presented is one of law for the court to decide.”); *Fister v. Allstate Life Ins. Co.*, 366 Md. 201, 210, 783 A.2d 194 (2001); *United Nat’l Ins. Co. v. Jacobs*, 754 F.Supp. 865 (M.D.Fla. 1990); *Ethicon, Inc. v. Aetna Cas. & Sur. Co.*, 737 F.Supp. 1320 (S.D.N.Y. 1990); *Cochran v. Aetna Cas. & Sur. Co.*, 99 Md.App. 350, 637 A.2d 509 (1994); *Atlas Pallet, Inc. v. Gallagher*, 725 F.2d 131, 134 (1st Cir. 1984) (“[W]here the facts upon which liability is claimed or denied under an insurance policy are undisputed and the existence or amount of liability depends solely upon a construction of the policy, the question presented is one of law for the court to decide.”); *Morrisville Water & Light Dept. v. USF&G.*, 775 F.Supp. 718, 722 (D.Vt. 1991).

⁴ See 4 WILLISTON ON CONTRACTS 320 (3d ed.) which discusses the technical distinctions between interpretation and construction of a contract as follows:

While interpretation and construction are generally regarded as synonyms and used interchangeably, it is not only possible, but desirable to draw a distinction. The word "interpretation" is used with respect to language itself; it is the process of applying the legal standard to expressions found in the agreement in order to determine their meaning. "Construction," on the other hand, is used to determine, not the sense of the words or symbols, but the legal meaning of the entire contract; the word is rightly used wherever the import of the writing is made to depend upon a special sense imposed by law.

⁵ See *Just v. Land Reclamation, Ltd.*, 155 Wis.2d 737, 746, 456 N.W.2d 570, 573 (1990); and see *Home Ins. Co. v. Thunderbird, Inc.*, 338 So.2d 391, 394 (Miss. 1976) (“In accord with the general standard of giving effect to the purpose of the contract, the rule is that provisos, exceptions, or exemptions, and words of limitation in the nature of an exception, are strictly construed against the insurer, where they are of uncertain import or reasonably susceptible of a double construction,” quoting 2 George J. Couch, COUCH ON INSURANCE § 15:92 (2nd ed. 1959)).

the parties to a particular contract. The law presumes that the parties understood the import of the contract and that they had the intention that the terms of the contract manifest.⁶ Accordingly, it is not within the function of the judiciary to look outside of the instrument to get at the intention of the parties and then carry out that intention regardless of whether the instrument contains language sufficient to express it.⁷

In deciding the issue of coverage under a financial institution bond, as with other contracts, the court analyzes the plain language of the contract according to the words and phrases in their ordinary and accepted meanings. The concept of the phrase “ordinary and accepted meanings” is usually defined by what a reasonably prudent lay person would understand the words to mean.⁸ A court should not, however, torture words of an insurance policy to import ambiguity where the ordinary meaning leaves no room for ambiguity.⁹ Thus, the rights and obligations under the terms of the insurance policy, and therefore the intent of the parties, are primarily to be determined by the express language of the contract of insurance itself.

Courts begin this process by examining the “four corners” of the FIB forms, and they should enforce the policy in accordance with that contract’s express language as long as there is no dispute that the policy language is clear and unambiguous.¹⁰ Where the language is clear on its face, and no ambiguity is asserted, the plain and literal language of the policy itself controls the scope of the coverage provided.¹¹ The “four corners” analysis does not require a court to literally construe an instrument; rather, it limits the quantum of evidence a court may consider in making its threshold determinations of whether the insuring agreement’s substance is clear and unambiguous.

⁶ See e.g. *Byrd v. Rees*, 251 Miss. 876, 171 So.2d 864, 867-69 (Miss. 1965); *State Farm Life Ins. Co. v. Gutterman*, 896 F.2d 116 (5th Cir. 1990).

⁷ *Id.* see also *Brown v. Royal Maccabees Life Ins. Co.*, 137 F.3d 1236 (10th Cir. 1998) (the complexity of insurance policies and the failure of the insured to read the policy do not justify special rules of construction for insurance contracts.).

⁸ See e.g. *Universal Underwriters Ins. Co. v. Lowe*, 135 Md.App. 122, 137, 761 A.2d 997 (2000); *Constitution State Ins. Co. v. Iso-Tex, Inc.*, 61 F.3d 405 (5th Cir. 1995); *ABS Clothing Collection, Inc. v. The Home Insurance Co.*, 34 Cal.App. 4th 1470, 41 Cal.Rptr. 2d 166 (1955).

⁹ *Redmond v. State Farm Insurance Company*, 728 A.2d 1202 (D.C. 1999); see also *Cherry v. Anthony, Gibbs, Sage*, 501 So.2d 416, 419 (Miss. 1987) (“A court must effect a determination of the meaning of the language used, not the ascertainment of some possible but unexpressed intent of the parties.”); *Sowinski v. Ramey*, 36 Ill.App.3d 690, 344 N.E.2d 635 (1976); *Novern v. John Hancock Mut. Life Ins. Co.*, 107 N.J.Super. 570, 259 A.2d 504 (N.J.Super.Ct. 1969).

¹⁰ *Sharp*, *supra*, 858 F.2d at 1044; see also *Lynch Properties, Inc. v. Potomac Insurance Company of Illinois*, 962 F.Supp. 956 (N.D. Tex. 1996).

¹¹ *Alpine State Bank v. Ohio Cas. Ins. Co.*, 941 F.2d 554, 559 (7th Cir. 1991); *Bullwinkel v. New England Mut. Life Ins. Co.*, 18 F.3d 429, 431 (7th Cir. 1994) (words used in insurance policy are interpreted in light of plain meaning when applying federal common-law rules of contract interpretation); *Blue Ridge Ins. Co. v. Stanewich*, 142 F.3d 1145, 1147 (9th Cir. 1998); *Aetna Cas. & Sur. Co., Inc. v. Pintlar Corp.*, 948 F.2d 1507, 1512 (9th Cir. 1991).

Importantly, an insurance contract is not ambiguous merely by the parties' failure to agree on the interpretation of the provision in question.¹² Moreover, a policy should not be considered ambiguous merely because a word or phrase, isolated from its context, is susceptible to more than one meaning, or because, in its context, it is susceptible to one reasonable and one unreasonable meaning.¹³

Where the policy language is actually found to be ambiguous, or if the meaning of the words employed is doubtful or uncertain, courts, whenever possible, will liberally interpret the bond in favor of the insured, and strictly construe the ambiguous provision against the insurer.¹⁴

Despite all of the above, many courts, presumably with the best intentions, nonetheless take the position that the insurance policy should be construed in accordance with the "reasonable expectations" of the insured even if the contract language is not necessarily ambiguous, thereby justifying what is arguably best described as a result-oriented construction of the policy.¹⁵

The Standard Form 24 Financial Institution Bond is an insurance policy in which the individual categories of coverage are captioned "Insuring Agreements" and consist of "Fidelity" coverage (Insuring Agreement A), which covers dishonest acts of employees as defined in the policy, "On Premises" coverage (Insuring Agreement B), which provides coverage for loss of property within the offices of the insured under various circumstances, such as robbery, burglary, and false pretenses, "In Transit" coverage (Insuring Agreement C), which insures against losses of property due to robbery, larceny, theft, and mysterious and unexplained disappearance while the property is being transferred or in the custody of certain agencies or employees, "Forgery or Alteration" (Insuring Agreement D), which will be discussed in detail in this paper and covers losses resulting from forgery or alteration of financial documents as defined in the policy, "Securities" coverage (Insuring Agreement E), which provides coverage for losses resulting from acquiring or giving value on original securities under circumstances in which the bank had actual physical possession and relied upon the genuineness of the securities; and "Counterfeit Currency" coverage (Insuring Agreement F), which covers losses sustained as a result of the receipt of counterfeit

¹² *Cameron v. USAA Property and Casualty Insurance Company*, 733 A.2d 965 (D.C. 1999).

¹³ *Dodge v. Allstate Ins. Co.*, 89 Ill.App.2d 405, 233 N.E.2d 100 (1967); *McGowan v. Connecticut General Life Ins. Co.*, 110 R.I. 17, 289 A.2d 428 (1972).

¹⁴ *Ross v. State Farm Mut. Auto. Ins. Co.*, 132 Wash.2d 507, 940 P.2d 252 (1997) (which held that when there is ambiguity, an inclusionary clause should be construed liberally, while an exclusionary clause should be construed strictly against the insurer.); *Certain Underwriters at Lloyds of London v. C.A. Turner Construction Co.*, 112 F.3d 184 (5th Cir. 1997) (holding that a court will resolve any ambiguity in favor of coverage if a contract is susceptible of more than one reasonable interpretation.).

¹⁵ See e.g. *Oritani Savings and Loan Ass'n v. Fidelity and Deposit Co. of Maryland*, 741 F.Supp. 515, 520 (1990) ("[T]he controlling, overriding goal in interpreting a contract of insurance is to fulfill the reasonable expectations of the insured. To the extent there are any hidden pitfalls in the policy language which conflict with the insured's reasonable expectations, the pitfalls should be applied to defeat coverage.").

currency.

Because the FIB is a unified document and not merely a collection of separate and unrelated parts, a court, when analyzing a coverage issue, must look to the entire bond and construe it as a whole.¹⁶ Accordingly, each part of the policy must be read in connection with all other parts. For example, restrictions on the scope of coverage provided by the FIB are set forth under the separate headings, such as general agreements, conditions, limitations, definitions, and exclusions. Other restrictions or provisions that expand coverage are contained in riders or endorsements that are designed to be attached to the original policy, and consequently must be construed so as to give effect to all policy provisions.¹⁷

V. The language of Insuring Agreement (D) and specified contractual obligations.

Under Insuring Agreement (D), the FIB Standard Form No. 24,¹⁸ provides indemnity coverage for losses sustained by financial institutions for the forgery and alteration of checks and certain other defined instruments. Note that while some FIB providers alter the standard form language of this Insuring Agreement, this paper focuses on the standard language published by the Surety Association of America, which is closely, if not exactly, incorporated by most carriers.

The Underwriter, in consideration of an agreed premium, and in reliance upon all statements made and information furnished to the Underwriter by the Insured in applying for this bond, and subject to the Declarations, Insuring Agreements, General Agreements, Conditions and Limitations and other terms hereof, agrees to indemnify the Insured for:

* * * * *

FORGERY OR ALTERATION

(D) Loss resulting directly from

5. Forgery or alteration of, on or in any Negotiable Instrument (except as Evidence of Debt¹⁹),

¹⁶ *Jameson v. Mutual Life Ins. Co. of New York*, 415 F.2d 1017 (Tex. 1969); *Brown v. Farmers Auto Ins. Ass'n*, 106 Ill.App.2d 360, 245 N.E.2d 260 (1969).

¹⁷ *Aetna Ins. Co. v. Getchell Steel Treating Co.*, 395 F.2d 12 (8th Cir.. 1968).

¹⁸ As of this writing, the 1986 Standard Form No. 24 published by the Surety Association of America is still in use; however, significant revisions are expected for the 2004 Edition of Standard Form 24, which should be available for use upon the completion of the approval process.

¹⁹ "Evidence of Debt" is defined in the FIB, and loss resulting from an insured acquiring, selling, delivering, giving value, extending credit, or assuming liability on the faith of any "Evidence of Debt" is provided for in Insuring Agreement (E). The preeminent case addressing "evidence of debt" is *Merchants National Bank of Winona v. Transamerica Insurance Co.*, 408 N.W. 2d 651 (Minn. Ct. App. 1987). In that case, GHK Construction Company applied for several commercial loans from Merchants National Bank. As a condition of issuing the loans, Merchants National required GHK to present it with fully executed construction contracts. Between 1980 and

Acceptance, Withdrawal Order, receipt for the withdrawal of Property, Certificate of Deposit or Letter of Credit,

5. transferring, paying or delivering any funds or Property or establishing any credit or giving any value on the faith of any written instructions or advices directed to the Insured and authorizing or acknowledging the transfer, payment, delivery or receipt of funds or Property, which instructions or advices purport to have been signed or endorsed by any customer of the Insured or by any banking institution but which instructions or advices either bear a signature which is a Forgery or have been altered without the knowledge and consent of such customer or banking institution. Telegraphic, cable or teletype instructions or advices, as aforesaid, exclusive of transmissions of electronic funds transfer systems, sent by a person other than the said customer or banking institution purporting to send such instructions or advices shall be deemed to bear a signature which is a Forgery.

A mechanically reproduced facsimile signature is treated the same as a handwritten signature.

Thus, section (D) (1) of the FIB insures against loss resulting directly from the forgery or alteration of the defined instruments and documents recited in the Insuring Agreement. Many of the terms in this section are specifically defined in the Conditions and Limitations – Definitions section. In particular, as discussed below, "Forgery" is defined in the FIB as "the signing of one's own name with intent to deceive; it does not mean a signature which consists in whole or in part of one's own name signed with or without authority, in any capacity, for any purpose."

Section (D)(2) of the Insuring Agreement covers loss resulting from the forgery of written instructions to the insured transferring, paying or delivering any funds or property, establishing any credit, or giving any value in reliance on the forgery. Fraudulent written instructions or advices sent by a customer of the insured or another banking institution

1981, GHK's principal owner assigned two forged construction contracts to Merchants National. GHK eventually defaulted on the loans, and Merchants National filed a claim with its insurer, Transamerica, requesting indemnification for its losses under its FIB. Transamerica denied the claim on the grounds that the bond did not provide coverage for forged construction contracts. Merchants National filed suit, alleging that the forged construction contracts were "evidence of debt" under the FIB. The trial court disagreed, and on appeal, the Court of Appeals of Minnesota held that "evidence of debt" refers to primary indicia of debt, such as promissory notes or other instruments that reflect a customer's debt to the bank.

purporting to send them, except transmissions of electronic funds transfer systems, are deemed by the FIB to bear a forged signature. In addition, for the purposes of Insuring Agreement (D) "[a] mechanically reproduced facsimile signature is treated the same as a handwritten signature." It should be noted that use of "facsimile" in this Insuring Agreement refers to a copy or reproduction of a signature and not a signature generated by a telecopier machine; thus, it is now common for insureds to specifically request this coverage in the FIB.

V. Definitions and exclusions applicable to Insuring Agreement (D).

The FIB contains twenty one separate definitions, set forth in the Conditions and Limitations Section 1, and twenty six exclusions, set forth in Section 2, which impact the construction and application of Insuring Agreement (D).²⁰ In addition to the FIB definitions, the provisions and definitions included in Articles 3 and 4 of the Uniform Commercial Code ("UCC"), which govern negotiable instruments, bank deposits, and collections, are important to FIB coverage analysis involving forged or altered checks and who ultimately bears the loss. In connection with the Forgery or Alteration Insuring Agreement, it is helpful to consult the UCC as adopted in each respective state especially for guidance with regard to terms that are not defined in the FIB.

Under the unlimited possibilities of factual scenarios, any number of FIB and UCC definitions and exclusions could apply to a claim for losses under Insuring Agreement (D); however, the FIB definitions of forgery and negotiable instrument, and the UCC definitions of alteration and signature obviously arise in coverage litigation more frequently and are briefly discussed.

A. Forgery

Forgery means the signing of the name of another person or organization with the intent to deceive; it does not mean a signature which consists in whole or in part of one's own name signed with or without authority, in any capacity, for any purpose.²¹

The definition of the word "forgery" was first added to the FIB in 1980, and was slightly modified in the 1986 edition of the FIB. Until 1980, since the FIB did not define forgery, the term was often found to be uncertain and courts applied their own definition, which often took various forms. Courts turned to outside sources for guidance and used for purposes of policy construction the forgery definitions set forth in the criminal statutes in their jurisdiction, common law definitions, and common usage definitions contained in

²⁰ A new definition for Written has been added to the proposed 2004 FIB to restrict coverage to paper transactions, and a new exclusion has been added for loss resulting directly from accepting checks payable to an organization for deposit into a natural person's account.

²¹ See Financial Institution Bond, Standard Form No. 24 (Revised to January 1986) at Section 1(i).

dictionaries. Needless to say, the lack of uniformity in the definition of forgery resulted in inconsistent construction and application of Insuring Agreement (D).²²

It is noteworthy that the definition of forgery is re-written in the proposed 2004 edition of the FIB to limit forgeries to handwritten signatures or reproductions of handwritten signatures, such as facsimile signatures. Therefore, electronic or digital signatures are intentionally not forgeries.²³

B. Negotiable Instrument

Negotiable Instruments means any writing
(1) signed by the maker or drawer; and
(2) containing any unconditional promise or order to pay a sum certain in Money; and
(3) is payable on demand or at a definite time; and
(4) is payable to order or bearer.²⁴

E. Alteration

Alteration means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.²⁵

²² See e.g. *State Bank of Poplar Bluff v. Maryland Casualty Co.*, 289 F.2d 544 (8th Cir. 1961) (where the court held that forgery was the fraudulent making or altering of a writing to the prejudice of another's right, and thus, no forgery existed when the only evidence of falsity is that of false representations contained in an instrument); *Century Bank v. St. Paul Fire & Marine Ins. Co.*, 4 Cal.3d 319, 93 Cal.Rptr. 569, 82 P.2d 193 (1971) (wherein the court concluded that the definition of forgery is to be construed in accordance with the reasonable understanding of a layman rather than in accordance with the technical definitions and refinements of criminal statutes); *Filor, Bullard & Smyth v. Insurance Company of North America*, 605 F.2d 598 (2d Cir. 1978) (holding that forgery included an unauthorized signature even though the signature was genuine).

²³ See *The New Standard Form No. 24 Financial Institution Bond*, Tort, TRIAL & INSURANCE PRACTICE COMMITTEE NEWS FIDELITY & SURETY LAW COMMITTEE NEWSLETTER, Winter 2004, at 1,6.

²⁴ See *Financial Institution Bond, Standard Form No. 24 (Revised to January 1986)* at Section 1 (o); see also UCC § 3-104(a) (2002) (“‘negotiable instrument’ means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder; (2) is payable on demand or at a definite time; and (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money...”).

²⁵ See Uniform Commercial Code § 3-407 (2002). The Official Comment to § 3-407 states that former §3-407 defined a “material” alteration as any alteration that changes the contract of the parties in any respect. The revised § 3-407 refers to such a change as an alteration.

E. Signature

A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.²⁶

E. FIB Exclusions (a), (e), (g), (h) and (o).

The exclusions specifically relating to the forgery or alteration Insuring Agreement are set forth in Section 2 at subparts (a), (e), (g), (h) and (o).

Under Section 2(a), loss is excluded for any forgery or alteration except when it is covered under Insuring Agreements (A), (D), (E), or (F). Therefore, if a forgery or alteration loss is claimed, but does not fit into one of the four referenced FIB Insuring Agreements, the loss is not covered by the bond.

A claimed loss is also not covered under Section 2(e) if it results directly or indirectly from the complete or partial nonpayment of, or default upon, any loan or an extension of credit unless such loss is covered under Insuring Agreements (A), (D), or (E). Therefore, if a claimed loan loss involves a forgery, but it does not meet the coverage requirements set forth in the employee dishonesty, forgery or alteration, or securities Insuring Agreements, the loss is excluded.²⁷

Under FIB exclusion (g), claimed losses due to the payment on forged or altered traveler's checks are not covered unless the losses result from employee dishonesty as set forth in Insuring Agreement (A).

Exclusion (h) bars coverage under Insuring Agreement (D) (and Insuring Agreement (E)) when the forgeries or alterations are caused by an employee of the insured.

Losses that are claimed to result directly or indirectly from payments made or withdrawals from a depositor's account involving items of deposit that are not finally paid for any reason, including but not limited to forgery or any other fraud, are excluded under exclusion (o) unless the losses are covered under Insuring Agreement (A). This exclusion is meant generally, though not exclusively, to prohibit coverage for losses due to a check - kiting scheme.²⁸

²⁶ See Uniform Commercial Code § 3-401 (2002).

²⁷ See e.g. *Lyons Fed. Sav. & Loan Ass'n v. St. Paul Fire & Marine Ins. Co.*, 863 F.Supp. 1441 (D.Kan.1994); *RTC v. Aetna Cas. & Sur. Co. of Illinois*, 831 F.Supp 610 (N.D.Ill 1993).

²⁸ See e.g. *United States Fidelity and Guaranty Co., v. Planters Bank & Trust Co.*, 77 F.3d 863 (1996); *Affiliated Bank/Morton Grove v. Hartford Accident and Indemnity Co.*, 1992 WL 91761 (N.D.Ill.), *Bradley Bank v. Hartford Accident & Indem. Co.*, 737 F.2d 657 (7th Cir. 1984); *Oxford Bank & Trust Co. v. Hartford Accident & Indem. Co.*, 698 N.E.2d 204 (Ill.App.1998).

V. Issues recently litigated under Insuring Agreement (D).

Certainly numerous construction and interpretation issues have been litigated and continue to arise under Insuring Agreement (D). The remainder of this paper sets for those issues that are litigated more often than others and the more recent court decisions relating to those issues.

A. Forgery within the meaning of the bond form.

The essence of forgery does not so much consist in counterfeiting as in endeavoring to give the appearance of truth to a mere deceit and falsity. As stated earlier in this paper, forgery is defined in the FIB as “the signing of the name of another with the intent to deceive” and does not include “the signing of one’s own name with or without authority, in any capacity, for any purpose.”²⁹

Thus, if a person signs his own name to a negotiable instrument, such signature is generally not considered a forgery even though he falsely pretends to represent someone that he does not in fact represent.³⁰ It is a very different analysis if, on the other hand, a person signs an illegible name or the name of an imposter or an unknown third person. Arguably, the signing of the name of “another person” explicitly contemplates the act of an actual living person. Coverage under this scenario would therefore most likely turn on whether the insured can adequately demonstrate that it relied upon the faith of the signature, even if the signature is of someone who does not exist.

*Alpine State Bank v. Ohio Casualty Insurance Co.*³¹ illustrates judicial construction of “Forgery” in the FIB as applied to a rubber endorsement stamp. For a period of over 14 months, William Secrest, a customer of the Alpine State Bank and owner of account number 58-070-8, misappropriated more than \$100,000 in checks that had been drawn to the order of his employer by endorsing the checks with a rubber stamp that read “for deposit only - account number 58-070-8.” The deposit slips Secrest used recited his own name followed by that of his employer.

The lower court found in favor of coverage for the bank by relying, in part, on the definition of forgery in the Illinois criminal code, and stated that it did not believe that “the terms used by the bond in defining fraud change the result in this case” because “while Secrest did not sign the actual name of another in endorsing the checks, in practicality he did so.”³²

²⁹ See FIB Conditions and Limitations, Definitions, Section 1 (i).

³⁰ See e.g. *United Pac. Ins. Co. v. Idaho First Nat. Bank*, 378 F.2d 62 (9th Cir. 1967).

³¹ *Alpine State Bank v. The Ohio Casualty Insurance Co.*, 941 F.2d 554 (7th Cir. 1991).

³² *Alpine State Bank*, 941 F.2d at 557.

The United States Court of Appeals for the Seventh Circuit reversed the federal district court's grant of summary judgment for the bank and held that Secret's actions did not constitute forgery within the meaning of the bond because Secret did not sign the name of another by using the rubber stamp endorsement. In addition, the court was persuaded by the fact that the deposit slips contained Mr. Secret's name in addition to that of his employer: "[t]herefore, even if we were to interpret the rubber stamp endorsement as a signature, it identifies Secret and is excluded from the definition of coverage under the bond."³³

The Seventh Circuit also corrected the lower court's failure to follow the basic rules of contract construction:

[B]ecause the bond contained no ambiguities, the district court erred when it went beyond the definition contained in the bond and resorted to defining signature and forgery through extrinsic definitions. . . . It is well accepted that . . . definitions contained within the Policy are controlling. This is particularly true when an insurance policy defines terms in a manner which differs from the ordinary understanding of the terms.³⁴

In another recent case, *Reliance Insurance Co. v. Capital Bancshares, Inc./Capital Bank*,³⁵ the Fifth Circuit distinguished forgery from counterfeit, as those terms were defined in a blanket bond similar to the standard form FIB. The court was called upon to decide whether the bond provided coverage for losses suffered by Capital Bancshares, Inc. as a result of accepting fraudulently created stock certificates of an actual existing corporation with publicly traded common stock, AIG. The fake stock certificates bore the falsely made, unauthorized purported signatures of the president and secretary of AIG.

The Court of Appeals for the Fifth Circuit affirmed the lower court's decision that to be covered under the bond, "the allegedly counterfeit instrument must be an imitation of an actual existing (or previously existing) original genuine document."³⁶ Given that the fake stock certificates were not copies of original instruments, rather fraudulently created similar stock certificates, the Court of Appeals held that the bank's losses were not covered under the bond. In its holding, the Court explained:

[B]ecause there never existed any one or more particular genuine AIG stock certificates which the bogus certificates could be said to purport to be or represent or imitate, and because the bogus certificates, by virtue of their facially apparent physical

³³ *Alpine State Bank*, 941 F.2d at 560.

³⁴ *Id.* quoting *Filip v. North River Ins. Co.*, 201 Ill.App.3d 3511, 559 N.E.2d 17, 18 (1990).

³⁵ *Reliance Insurance Co. v. Capital Bancshares, Inc./Capital Bank*, 912 F.2d 756 (5th Cir. 1990).

³⁶ *Reliance Insurance Co.*, 912 F.2d at 765 quoting *Bank of the Southwest v. National Surety Co.*, 477 F.2d 73 (5th Cir. 1973).

characteristics and the objective facts relating to their creation, as well as the subjective intent of their creator, do not constitute attempted or intended physical imitations or duplications of either the general form of genuine AIG stock certificates or any particular genuine AIG stock certificate.³⁷

Thus, a counterfeit is not a forgery. A counterfeit is defined by Section 1(e) of the FIB as "an imitation which is intended to deceive and to be taken as an original." This should be contrasted with the definition of Forgery from Section 1(i) ("the signing of the name of another person or organization with intent to deceive..."). However, for purposes of coverage, the distinction between a counterfeit -- which purports to be something it is not, and a forgery -- which purports to be the signature of someone other than the person who wrote it -- needs to be recognized; and particularly, because exclusion (p) of the FIB excludes from coverage "loss resulting directly or indirectly from counterfeit, except when covered under Insuring Agreements (A), (E), or (F)," (*i.e.*, Fidelity, Securities, or Counterfeit Currency).

The Second Circuit affirmed a finding that fraudulent bills of lading that a lender accepted as security for a loan, which were signed in illegible script by an unknown person and which described shipments of goods that had never taken place, were not forgeries, as defined in a standard form bond, in *French American Banking Corp. v. Flota Mercante Grancolombiana, S.A.*³⁸ The court noted that there was a total lack of evidence that the illegible handwriting on the bills of lading in issue were the signing of the name of another, with or without authority or the intent to deceive, and reasoned that the signature must be identifiable in order to constitute a "forged" signature:

[The claimant who bore] the burden of proving a forgery offered no proof that the signer of the documents wrote someone else's name...The parties stipulated that the signatures were illegible and did not represent the name of any person known to the parties. This, of course, left the real possibility that the signatures were by an unauthorized person signing his own name, or simply scribbling no name.³⁹

A. Proximate cause of the insured's loss.

Coverage under all of the FIB Insuring Agreements, including Insuring Agreement (D), depends on the insured's ability to demonstrate that the losses it sustained resulted

³⁷ *Reliance Insurance Co.*, 912 F.2d at 757.

³⁸ *French American Banking Corp. v. Flota Mercante Grancolombiana, S.A.*, 925 F.2d 603 (2nd Cir. 1991).

³⁹ *French American Banking Corp.*, 925 F.2d at 604. The Second Circuit also found that the bills of lading were not counterfeits since they described wholly fictitious transactions for which there existed no genuine bills of lading. Therefore, they could not be characterized as "attempts to stimulate another document or writing which is authentic." *Id.*

“directly from” the specified causes of loss.⁴⁰ The words “resulting directly from” indicate an intent to limit the coverage available and are especially significant because the language appears in those sections of the policy that specifically address the scope of coverage.

It is noteworthy that a number of courts have found that the bond's requirement that a loss "result directly from" an event, requires a standard of proximate causation.⁴¹ There is no disagreement, however, that the mere occasion of a forgery or an alteration, without a clear causal connection between the loss and the forgery, is not sufficient for coverage under the FIB. Indeed, the FIB is not a policy of credit insurance and does not, by the express terms and intent of the bond, protect the insured when it simply makes a bad business deal.

A federal court in Tennessee recently analyzed the above-referenced issue in a coverage dispute matter entitled *KW Bancshares, Inc. and Federal Savings Bank v. Syndicates of Underwriters at Lloyd's London Subscribing Policy G538944*.⁴² In that case, Whitman, an executive vice president at National Mortgage Company (“NMC”), requested a \$450,000 personal loan from Federal Savings Bank (the “Bank”). Whitman assured the Bank that he would repay the loan with proceeds from his annual bonus from NMC, and that NMC would guaranty the loan.⁴³ In connection with his request, Whitman submitted a personal financial statement that indicated his personal net worth was in excess of \$106 million.

Before the Bank acted on his loan request, Whitman informed the Bank that he wanted to amend the loan request: instead of NMC’s personal guaranty, he would assign to the Bank a portion of his bonus from NMC.⁴⁴ In support of this proposal, Whitman submitted four documents: (1) a “confidential memo” purportedly signed by the president

⁴⁰ The phrase “resulting directly from” a specified peril, in order to be covered, has been present in every Insuring Agreement since at least 1980. See William T. Bogart & Andrew F. Caplan, *Loss and Causation Under the Financial Institution Bond*, FINANCIAL INSTITUTION BONDS, Ch. 1 (Duncan L. Clore ed., 2d ed. 1998).

⁴¹ See, e.g., ***Resolution Trust Corp. v. Fidelity & Deposit Co. of Md.*, 205 F.3d 615, 654-56 (3d Cir. 2000)** (language in bond covering losses "directly resulting from . . ." construed under New Jersey law as equivalent to traditional proximate causation standard); ***Jefferson Bank v. Progressive Cas. Ins. Co.*, 965 F.2d 1274, 1281-82 (3d Cir. 1992)** ("loss resulting directly . . . from" language in bond was equivalent, under Pennsylvania law, to proximate causation; rejecting argument that a "but-for" causation standard applied and noting that commentators have demonstrated the "nearly universal rejection and unworkability" of an immediacy, rather than a substantiality, standard); ***Mid America Bank of Chaska v. American Cas. Co. of Reading, Pa.*, 745 F.Supp. 1480, 1485 (D. Minn. 1990)** (applying proximate cause analysis to policy language covering losses "resulting directly" from the fraudulent or dishonest acts of employees); ***Hanson PLC v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 58 Wn. App. 561, 573, 794 P.2d 66, 73 (1990)** ("courts apply a proximate cause analysis when confronted with the term 'resulting directly' in an insurance policy."); ***Nash v. Prudential Ins. Co. of Am.*, 114 Cal. Rptr. 299, 302, 303, 39 Cal. App. 3d 594, 598 (Ct. App. 1974)** (deeming the question whether an injury is a "direct result" under an insurance policy to be one of proximate causation).

⁴² *KW Bancshares, Inc., et al v. Syndicates of Underwriters at Lloyd's, London Subscribing Policy G538944*, 965 F.Supp. 1047 (W.D. Tenn. 1997).

⁴³ *KW Bancshares, Inc.*, 965 F.Supp. at 1049.

⁴⁴ *Id.*

and chairman of NMC indicating that each board member at NMC would be receiving an annual bonus of \$811,500; (2) a letter from the president and chairman explaining that Whitman had been “a long-time, trusted leader” of NMC who had the president’s “full support in any and all actions he deems necessary and that will be of help to him;” (3) another letter from the president of FMC explaining that Whitman was “empowered ... to take charge of the day-to-day activities” at NMC; and (4) a letter signed by the vice-president and controller of NMC explaining that Whitman had earned a bonus of \$811,500 and that \$410,000 of that bonus would be paid to the Bank.⁴⁵ All of these documents contained forged signatures, and Whitman defaulted on the loan from the Bank. The Bank filed a proof of loss with its FIB provider, and sued the provider when coverage for the loss was denied.

The federal court granted summary judgment in favor of the carrier, and found that the Bank failed to show that its loss resulted “directly from” having made the Whitman loan on the faith of the forged documents. The court reasoned that the Bank would have suffered the loss even if the signatures on the supporting documents were genuine because (a) there was no bonus due and (b) Whitman could not, and NMC would not, repay the loan:

In this case, plaintiff’s loss did not result directly from having made the Whitman loan on the faith of the [forged] letter. Here....plaintiff’s loss was caused by the fact that the statements contained in the [forged] letter were not true – Whitman was not entitled to an annual bonus of \$811,500 from NMC. Even if [the forged] signature on the ...letter had been genuine, plaintiff’s loss would have occurred nonetheless because the alleged security, the [forged] letter, was worthless. It was worthless not because it was forged, but because Whitman was not entitled to a bonus from NMC. Plaintiff’s loss, therefore, did not result directly from having made the Whitman loan on the faith of the [forged] letter.⁴⁶

The court also provided other reasons for granting judgment in favor of the FIB provider, including the finding that the forged documents Whitman used to support his scheme were not “instructions or advices” in that the letters neither ordered nor directed the Bank to do anything. Instead, the documentation merely “confirmed” that Whitman was to receive a bonus and that a portion of that bonus would be paid to the Bank.⁴⁷

⁴⁵ *KW Bancshares, Inc.*, 965 F.Supp. at 1049 - 1050.

⁴⁶ *KW Bancshares, Inc.*, 965 F.Supp. at 1049 - 1050.

⁴⁷ *KW Bancshares, Inc.*, 965 F.Supp. at 1052. In fact, the court found that while the documents contained information that could possibly be construed to be “instructions or advices” within the intent of the bond, Insuring Agreement (D) deals principally with cases resulting from forgery of commercial paper of the nature of checks or drafts. See e.g. *Liberty Nat’l Bank & Trust Co. of Louisville v. National Sur.Corp.*, 330 F.2d 697, 699 (6th Cir. 1964).

This conclusion by the Tennessee federal court should not be unexpected given the purpose of the FIB. The FIB insures that the documents submitted to the bank in connection with a loan are genuine and authentic. A bank cannot protect itself against counterfeit and forged documents. On the other hand, the bonding company does not guarantee the truth of the supporting documents. A bank can and should investigate the assertions made in supporting documents through credit checks, appraisals, title searches, financial statements, and the like.⁴⁸

Similarly, the Eighth Circuit upheld the denial of coverage under Insuring Agreement (D) on the ground that the losses were not proximately caused by forgeries. In *Empire Bank v. Fidelity and Deposit Co. of Maryland*,⁴⁹ a customer made company checks payable to her household employees, forged those employees' signatures, and then cashed the forged checks at Empire Bank. The bank's tellers, following the instruction of one of the bank's officers, allowed her to cash the checks even without endorsing them, which violated the bank's official policy of requiring that a presenter endorse third-party checks before cashing them.

The Eight Circuit upheld the lower court's denial of coverage for the bank's losses incurred in settling a lawsuit involving the forged company checks for the reason that the losses suffered by the bank were caused, not as a direct result of the forged checks, but by the failure of the bank to follow good banking practices:

The forged endorsements were not the reason that Empire suffered a loss; it was Empire's failure to follow their [sic] required practice and insist upon [the customer's] endorsements upon the checks.⁵⁰

C. Covered documents.

The Maryland Court of Special Appeals recently construed the provision in Insuring Agreement (D)(2) pertaining to "written instructions or advices" in *First Union Corp. v. United States Fidelity and Guaranty Co.*⁵¹ The terms "written instructions or advices" are not defined in the bond.

The facts of the *First Union Corp* case are summarized as follows: an agent of the Philip Morris company, Reiners, told an owner of a computer leasing company, Nelson, about a new and secret undertaking called "Project Star." Philip Morris was going to run

⁴⁸ See e.g. *Georgia Bank & Trust v. Cincinnati Insurance Co.*, 245 Ga.App. 687, 538 S.E.2d 764 (Ga.App. 2000) ("[T]he blanket bond did not protect the bank from its bad business deal. Even if the signature on the confirmation was authentic, the bank would have suffered the loss, because the assets did not exist. Furthermore, the bank's responsibility to investigate the assets of its borrowers was never delegated to the insurance company."); *Liberty National Bank v. Aetna Life & Casualty Co.*, 568 F.Supp. 860, 863 (D.N.J. 1983); *Republic Nat'l Bank of Miami v. Fidelity & Deposit Co. of Md.*, 894 F.2d 1255, 1263 (11th Cir. 1990).

⁴⁹ *Empire Bank v. Fidelity and Deposit Co. of Maryland*, 27 F.3d 333 (8th Cir. 1994).

⁵⁰ *Empire Bank*, 27 F.3d at 336.

⁵¹ *First Union Corp. v. United States Fidelity and Guaranty Co.*, 126 Md.App. 499, 730 A.2d 278 (Md. App. 1999).

Project Star, which was an effort to develop harmless tobacco by experimenting with human subjects, “off shore.”⁵² In order to carry out the “top secret” venture, Reiners maintained that he needed to lease \$25 million worth of computer equipment.

Not surprisingly, Reiners also needed a huge loan, \$25 million, in order to fund Project Star. Fortunately for Reiners, Nelson introduced Reiners to “a very good friend” at Signet Bank. Reiners convinced the very good friend and everyone else involved with the loan at Signet to sign a confidentiality agreement not to reveal Philip Morris’ involvement in Project Star or to contact anybody at the company’s headquarters in Richmond.

Signet Bank processed and approved Reiners’ credit application, and proceeded to disburse \$300 million to Reiners to carry out “Project Star.”⁵³

When Reiners’ fraud was eventually discovered, Signet attempted to obtain coverage for its losses on the loans from USF&G under Insuring Agreement (D)(2), among other FIB provisions. Specifically, Signet contended that “incumbency certificates,” which were forged by Reiners and provided statements to the effect that he was a high-ranking official of Philip Morris authorized to act on behalf of the company, were “written instructions” that qualified for coverage under the bond.

While USF&G conceded that Reiners committed many dishonest acts, forged some signatures, and massively deceived those with whom he came in contact, it argued that none of the dishonest acts were covered by the terms of the FIB.⁵⁴ The Maryland Court of Special Appeals agreed with USF&G and reasoned as follows:

Cases addressing the subject ... have held that “instructions and advices” refer principally to commercial paper, such as checks and drafts. See, e.g. *KW Bancshares, Inc. v. Syndicates of Underwriters at Lloyd’s*, 965 F.Supp.1047, 1052 (W.D. Tenn. 1997). The forged incumbency certificates in this case are clearly not commercial paper and, therefore, they do not constitute “instructions or advices.”

Moreover, Insuring Agreement (D)(2) expressly refers to “written instructions or advices ... *authorizing or acknowledging the transfer, payment, delivery or receipt of funds or Property ...*”(emphasis in original). Here, the incumbency certificates neither authorize nor acknowledge the payment or transfer of

⁵² *First Union Corp*, 126 Md.App. at 502, 730 A.2d at 279.

⁵³ *First Union Corp*, 126 Md.App. at 502 - 503, 730 A.2d at 280 - 281.

⁵⁴ *First Union Corp*, 126 Md.App. at 505, 730 A.2d at 281.

money or property; in fact, they do not even mention loans, funds, or payments.⁵⁵

The court also noted that Insuring Agreement (D)(2) provides coverage when the insured transfers, pays or delivers funds “on the faith of” any written instructions or advices. Hence there was no coverage under Insuring Agreement (D)(2) because the record failed to disclose that Signet actually relied on the forged incumbency certificates in approving and issuing the loans to Reiners.⁵⁶

D. Altered Instruments.

Alteration is not defined in the FIB; however, the UCC provides guidance, as discussed earlier in this paper, for purposes of contract construction and defines alteration as an unauthorized change to an obligation or an unauthorized change to an incomplete instrument relating to the obligation of a party.⁵⁷ The definition of alteration presupposes the existence of a genuine instrument that has been fraudulently changed. Hence, a change to a fake instrument is not an alteration.

Cases construing FIB coverage involving altered instruments have consistently reasoned that in order to be covered, an alteration must be material, *i.e.* one that materially changes the contract of a party to the instrument.⁵⁸ A material alteration can be accomplished through a fraudulent change in a genuine instrument or by the completion of an incomplete instrument by someone other than the original signer in a way that is unauthorized.⁵⁹ An instrument that is fraudulent from its inception cannot be considered altered within the terms of the bond because it is not based on any preexisting, genuine instrument.

For example, certificates of deposit for \$200,000, issued on actual deposits of \$2,000, were not “altered” within the meaning of the bond insuring a lending bank for certain losses on altered documents where the certificates were fraudulent from their inception and no genuine certificates ever existed. In creating the phony certificates, the

⁵⁵ *First Union Corp*, 126 Md.App. at 510, 730 A.2d at 283.

⁵⁶ *First Union Corp*, 126 Md.App. at 510, 730 A.2d at 283 - 284. See also *Republic Nat'l Bank of Miami v. Fidelity & Deposit Co. of Maryland*, 894 F.2d 1255, 1263 (11th Cir. 1990); *United States Nat'l Bank in Johnstown v. Reliance Ins. Co.*, 384 Pa.Super. 30, 501 A.2d 283, 285 (Pa. Super. Ct. 1985); *Continental Bank v. Phoenix Ins. Co.*, 24 Cal.App. 3d 909, 101 Cal. Rptr. 392 (Cal.Ct.App. 1972).

⁵⁷ See UCC §3-407 (2002).

⁵⁸ *St. Paul Fire & Marine Ins. Co. v. State Bank of Salem*, 412 N.E.2d 103, 113 (Ind.App. 1980) (“Logically, an alteration on the amount in figures alone should not be considered as changing the contract of the instrument or the effect thereof, and should therefore not be regarded as material...[B]y the weight of authority, the alteration of figures on a check, bill, or note, stating the amount thereof, without changing the words expressing the amount, does not constitute forgery because a change in the figures alone is not a material alteration of the instrument... It is difficult to see how one could suffer a loss due to an alteration that is not material.”) (Citations omitted).

⁵⁹ *Charter Bank N.W. v. Evanston Ins. Co.*, 791 F.2d 379 (5th Cir. 1986).

president of the issuing bank detached the carbons from the originals and typed deposit amount on carbons and enhanced amount on the originals.⁶⁰

The Supreme Court of Virginia, in *Virginia Capital Bank v. The Aetna Casualty & Surety Company*,⁶¹ considered the question of whether a bank suffered a loss covered under Insuring Agreement (D) as a result of the fraudulent alteration of a note. Under the facts of the case, Virginia Capital Bank disbursed loan proceeds in reliance upon a note that had been made in blank and filled in with an unauthorized amount.⁶² It was undisputed that the bank gave value for the note and accepted it in good faith, in the regular course of business, without notice of any defenses. The bank argued that its loss occurred when it paid out money in reliance on the altered note and should be covered under the bond because “the unauthorized completion of the note is an alteration within the ambit of [the Insuring Agreement].”⁶³

The appellate court affirmed the lower court’s ruling that a bank’s loss fell outside of the FIB coverage on the grounds that the loss did not result from the alteration. The court, relying in part upon §3-407 of the UCC, reasoned that even though the note may have been altered, the bank became a holder in due course of the note, entitled to enforce it as completed:

Code §8.3-407(3) makes the note enforceable against the maker as a matter law. A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an instrument has been completed, he may enforce it as completed.⁶⁴

Accordingly, any subsequent loss to the bank if the maker of the note failed or refused to pay the balance due is a product of ordinary business risk, not a loss through altered instruments under the Insuring Agreement.⁶⁵

E. Facsimile signatures.

The Court of Appeals of Ohio recently discussed coverage under Insuring Agreement (D) in a matter involving the unauthorized used of a facsimile stamp in *Bank*

⁶⁰ *Id.*

⁶¹ *Virginia Capital Bank v. Aetna Cas. & Sur. Co.*, 231 Va. 283, 343 S.E.2d 81 (1986).

⁶² *Virginia Capital Bank*, 231 Va. at 285.

⁶³ *Virginia Capital Bank*, 231 Va. at 286.

⁶⁴ *Virginia Capital Bank*, 231 Va. at 287.

⁶⁵ *Virginia Capital Bank*, 231 Va. at 287.

*One, NA v. Buckeye Union Ins. Co.*⁶⁶ Under the facts of that case, O'Mara Enterprises, Inc. ("O'Mara") operated some fast food restaurants in Ohio, West Virginia and Pennsylvania and was owned by Timothy J. O'Mara, W. Gail Smith, Terry Thompson and Rodger Morgan. A sole proprietorship known as the Gail Smith Development Company ("GSD") managed O'Mara's office, accounting and financial affairs.

Terry Thompson, the individual in charge of GSD, was also the person who was principally responsible for making the day to day decisions involving O'Mara's management, including the payment of bills, federal withholding taxes, payroll obligations and preparation of monthly financial statements showing O'Mara's current financial condition.

In order to facilitate the payment by check of O'Mara's monthly obligations, the president of O'Mara entrusted his facsimile signature stamp to Terry Thompson and gave him general authority to use the stamp to sign checks drawn on accounts maintained by O'Mara, including checks written on O'Mara's accounts for payment of federal payroll taxes.

Through the use of O'Mara's facsimile stamp, Mr. Thompson, without express or implied authority, diverted in excess of \$400,000.00 worth of O'Mara checks earmarked for the payment of federal payroll taxes into an account owned by GSD. Thompson stamped the reverse side of O'Mara's checks with the following instruction: Pay to the order of First National Bank & Trust Company in Steubenville, Ohio, FOR DEPOSIT ONLY, GAIL SMITH DEVELOPMENT # 009-9215. Thus, rather than being used to pay the O'Mara federal tax liabilities, the checks were used to pay the personal expenses of W. Gail Smith and to pay obligations of other Smith-related companies.⁶⁷

The appellate court found that the evidence presented in the case clearly established that Mr. Thompson signed the name of another without authority.⁶⁸ He was entrusted with Mr. O'Mara's facsimile signature stamp and was authorized to use it to sign checks for the purpose of paying O'Mara's federal payroll taxes, only. Thus, the court affirmed the lower court's ruling that the facsimile signatures were forgeries as defined in the FIB.⁶⁹

V. Conclusion.

Insuring Agreement (D) of the FIB is specifically designed to address delineated perils and, as with any contract of insurance, the Insuring Agreement should be carefully reviewed and understood along with the rest of the entire policy, all endorsements, definitions, limitations and exclusions.

⁶⁶ *Bank One, Steubenville, NA v. Buckeye Union Ins. Co.*, 114 Ohio App. 3d 248, 683 N.E.2d 50 (1996).

⁶⁷ *Bank One, Steubenville, NA*, 114 Ohio App. 3d at 249 – 250.

⁶⁸ *Bank One, Steubenville, NA*, 114 Ohio App. 3d at 252.

⁶⁹ *Id.*

Courts frequently fail to reveal any principled bases for their coverage decisions, which is frustrating for the practitioner's unending endeavor to find trustworthy guidance for future insurance contract interpretation and construction. Conservative courts, for example, usually, but unfortunately not always, apply traditional rules of construction and refuse to re-write policies on the basis that the contract says what it says. Liberal courts, on the other hand, recreate the agreement and often devise and divine coverage and obligations that contradict reasonably clear and precise bond language.

Insurance law and litigation is neither entirely a turf battle between formal and functional approaches nor a struggle between plain meaning and ambiguity. There is not singular judicial method and no immutable legal (or equitable) principles of interpretation and construction. There is only the judicial common-law method issuing an evolutionary body of law. In the common-law tradition, there will always be two large fields of legal uncertainty – the field of the obsolete and dying, and the field of the newborn and the growing.⁷⁰

Although the law can vary considerably from state to state, the approaches taken by courts when attempting to construe contract terms, coverages, conditions, and exclusions may be divergent, and the particular demands and concerns of the market, brokers, and insureds fluctuate, the underlying issues concerning the legal impact of the financial institution bond language are substantially the same regardless of jurisdiction. The goal of this paper was to highlight and identify patterns, principles and rules existing in the insurance arena through the analysis of judicial interpretation and application of Insuring Agreement (D) of the financial bond.

⁷⁰ ERIC MILLS HOLMES, ET AL., HOLMES'S APPLEMAN ON INSURANCE, 2D VOL. 2 at 2 (1996).

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