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**AUTOMATIC TERMINATION?
IT DEPENDS ON THE MEANING OF THE WORD
“DISHONESTY”**

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AUTOMATIC TERMINATION? IT DEPENDS ON THE MEANING OF THE WORD “DISHONESTY”

by Martha L. Perkins and Gerald N. Carozza, Jr.

I. INTRODUCTION

Commercial crime policies and fidelity bonds have provisions that set forth the circumstances under which the policy or bond is automatically and immediately terminated as to a particular employee of an insured, upon discovery, by the insured or any one of various specified members of the insured’s organization, not in collusion with the employee, of the employee’s dishonesty. Such a cancellation as to a specific employee is referred to as “automatic termination” of coverage.¹ Because language in standard policy and bond forms differs and because insurer’s proprietary forms may differ even more, it is critically important to review the relevant termination provision.

There is a large volume of case law on the application of the automatic termination provision, construing differing policy and bond language. The various types of automatic termination clauses provide that discovery by the insured of “and dishonest act” or “any dishonest or fraudulent act” will terminate coverage as to that particular employee. The litigation often involves the issue of what acts are deemed “dishonest,” under the policy or bond, in order to trigger the automatic termination clause. While the term “dishonesty” is defined in such policies and bonds, it is defined in the context of insuring agreements, not in the context of the automatic termination provision. Accordingly, whether a court will deem an automatic termination provision to be triggered will often depend on the meaning of the word “dishonesty” and whether a court considers a specific act “dishonest” in order to invoke the provision.

This paper will explore the various issues involving the meaning of the word “dishonesty” in the context of the automatic termination provision.² Because automatic termination depends on what the meaning of “dishonesty” is.

II. FORMS OF TERMINATION PROVISIONS

Set forth below are the automatic termination provisions contained the current ISO Commercial Crime Policy and the Financial Institution Bond. Because the rights and obligations of the insurer and insured under the “automatic termination clause” are contractual, not statutory, it is critical to carefully review and analyze the termination provision in the policy or bond at issue. One version of the operable policy language, published by the Insurance Services Office, Inc. provides as follows:

¹ The reader is invited to review two excellent commentaries on termination of coverage in the context of fidelity bonds and commercial crime policies: Carol Pisano, *Pulling the Trigger on Fidelity Coverage: Termination of Coverage Based on Discovery or Warping Time* (unpublished paper at Surety Claims Institute Meeting 2003); and Edward Etcheverry & Guy W. Harrison, *Employee Dishonesty—When Does Your Bond “Automatically Terminate”?* VI FID. L.J. 71 (2000).

² Various portions of this paper have previously been published. See Martha L. Perkins & Lana M. Glovach, *Cancellation and Termination of Coverage* in COMMERCIAL CRIME POLICY, 2ND ED., 471 (Randall I. Marmor & John J. Tomaine eds. 2005).

B. Commercial Crime Policy

Cancellation as to any Employee:

This insurance is cancelled as to any “employee”:

a. Immediately upon discovery by:

(1) You; or

(2) any of your partners, “members”, “managers”, officers, directors or trustees not in collusion with the “employee”; of “theft” or any other dishonest act committed by the “employee” whether before or after becoming employed by you.

b. On the date specified in a notice mailed to the first Named Insured. That date will be at least 30 days after the date of mailing.

We will mail or deliver our notice to the first Named Insured’s last mailing address known to us. If notice is mailed, proof of mailing will be sufficient proof of notice.³

The automatic termination provision of the Crime Protection Policy, published by the Surety and Fidelity Association of America, provides as follows:

C. Financial Institution Bond

Termination or Cancellation

Section 14. . . .

This bond terminates as to any Employee, or any partner, officer or employee of any Electronic Data Processor, (a) as soon as any Insured, or any director or officer of an Insured who is not in collusion with such person, learns of any dishonest or fraudulent act committed by such person at any time, whether in the employment of the Insured or otherwise, whether or not of the type, covered under Insuring Agreement (A), against the Insured or any other person or entity, without prejudice to the loss of any Property then in transit in the custody of such person or (b) 15 days after the receipt by the Insured of a Written notice from the Underwriter of its desire to cancel this bond as to such person.

Termination of this bond as to any Insured terminates liability for any loss sustained by such Insured which is discovered after the effective date of such termination. Termination of this bond as to any Employee, or any partner, officer or employee of any Electronic Data Processor, terminates liability for any loss caused by a fraudulent or dishonest act committed by such person after the date of such termination.⁴

³ COMMERCIAL CRIME POLICY, CR 00 22 07 02, § E.1.a (ISO Proprs., Inc. 2001) (Discovery Form) & Commercial Crime Policy, CR 00 23 07 02, § E.1.a (ISO Proprs., Inc. 2001) (Loss Sustained Form).

⁴ FINANCIAL INSTITUTION BOND, Standard Form No. 24 (revised April 1, 2004), *reprinted in* STANDARD FORMS OF THE SURETY AND FIDELITY ASSOCIATION OF AMERICA [hereinafter Financial Institution Bond].

Of course, these are standard provisions. Some policies and bonds will contain manuscripted automatic termination provisions with different and/or unusual language that will change the analysis of whether the automatic termination clause has been triggered.

III. PURPOSE OF THE AUTOMATIC TERMINATION CLAUSE

The purpose of the automatic termination provision is to place the risk of employing an individual known to have acted dishonestly on the employer, not on the insurer. The automatic termination provision puts the insured/employer on notice that the insurer will not provide coverage for losses caused by an employee whom the insured has discovered committed a prior dishonest act. As one court succinctly stated concerning an insured's knowledge of its employee's dishonesty, the insured was "perfectly free to retain [the dishonest employee] in a position of trust if it chose to do so, but [the insurer] did not agree to continue to insure against his possible acts of dishonesty."⁵ Such an immediate termination of coverage as to an employee upon the employer's discovery of prior dishonesty motivates an insured employer to be diligent both in its hiring practices and in supervising its employees. A number of courts have recognized the importance of the policy behind the automatic termination clause.

In *Verneco v. Fidelity & Casualty Co. of New York*,⁶ the court held that an insured, who knew that its employee had previously been imprisoned for theft, was precluded from recovering under a blanket crime policy for losses occasioned by its employee's dishonest act. The relevant policy language was a "Prior Fraud, Dishonesty or Cancellation"⁷ provision, and the court opined on the policy underpinning the clause:

We think it is implicit in these situations that the parties approach the installation of the policy assuming that all employees are honest until they are known to be otherwise. Thus, if the insured then has knowledge of a dishonest person in his employ, he is aware, by the terms of the exclusion clause, that he is not insured for the dishonest acts of that employee. A contrary view of the exclusion clause such as the plaintiff urges us to adopt would permit the insured to obtain insurance against the dishonest acts of employees he knows were dishonest before employment, although the exclusion clause plainly indicates there can be no coverage after the insured "shall have knowledge" of dishonesty of his employees. Our interpretation is supported by the very language of the exclusion clause for it explicitly applies to dishonest acts "committed before or after the date of employment by the insured."⁸

⁵ *Alfalfa Elec. Coop. v. Travelers Indem. Co.*, 376 F. Supp. 901, 912 (W.D. Okla. 1973).

⁶ 219 So. 2d 508 (La. 1969).

⁷ *Id.* at 510. The clause provided as follows:

The coverage of this policy shall not apply to any employee from and after the time that the insured or any partner of [sic] officer 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 insured or otherwise, whether such act be committed before of [sic] after the date of employment by the insured.

⁸ *Id.* at 510-11. See also *In re Prime Commercial Corp.*, 187 B.R. 785, 804 (Bankr. N.D. Ga. 1995) (fidelity bond) (termination provision limits coverage "because leaving a demonstrably dishonest person in a position to cause losses through dishonesty increases the risk beyond the one that the insurer believes it can make a profit on the premium charged"); *Home Sav. & Loan v. Aetna Cas. & Sur. Co.*, 817 P.2d 341, 351 (Utah Ct. App. 1991) (fidelity

In the context of a broker's blanket bond, the court in *William C. Roney & Co. v. Federal Insurance Co.*⁹ articulated a lucid rationale for the application of the automatic termination clause:

Roney [the insured] expected to be covered, and Federal to be at risk, only for brokers with no known history of fraudulent or dishonest acts. Under any other construction Roney could hire a veritable Rogue's Gallery of new brokers and secure their coverage under Federal's fidelity bond because their known dishonest or fraudulent acts occurred prior to their employment with Roney. This would be unreasonable and unnatural since a reasonable expectation would be that Roney would not hire dishonest brokers.¹⁰

Similarly, in the context of a broker's blanket bond, the court in *Newhard, Cook & Co. v. Insurance Co. of America*,¹¹ the court opined that the automatic termination provision "rests upon the policy that the employer should responsibly supervise its employees, particularly since the insured is in a better position than the insurer to monitor the activities of its employees."¹²

IV. WHAT THE MEANING OF "DISHONESTY" IS

The salient question in this paper is what acts are sufficient to constitute "dishonesty" in order to trigger the automatic termination provision. Whether a particular act is deemed "dishonest" is the frequent subject of litigation--both in the context of automatic termination and coverage disputes. The cases that analyze and discuss what acts trigger automatic termination are often very fact intensive.

A. Does the Act Have to Qualify for Coverage Under a Fidelity Insuring Agreement?

Most courts have held that, in order for the automatic termination provision to be triggered, the particular dishonest act does not have to qualify for coverage under a fidelity insuring agreement. In *Alfalfa Electric Cooperative, Inc. v. Travelers Indemnity Co.*,¹³ the court observed that "the moment [the insured] discovered any act of dishonesty on the part of [the

bond) ("The hiring or retention of an employee who is known to be dishonest is effectively a conscious decision to increase the risk of loss due to employee dishonesty. [Automatic termination provisions] properly shift such increased fidelity loss risk to the employer.").

⁹ 674 F.2d 587 (6th Cir. 1982).

¹⁰ *Id.* at 591.

¹¹ 929 F.2d 1355 (8th Cir. 1991).

¹² *Id.* at 1358.

¹³ 376 F. Supp. 901 (W.D. Okla. 1973). See also *Home Sav. & Loan v. Aetna Cas & Sur. Co.*, 817 P.2d 341 (Utah Ct. App. 1991) (court held that the automatic termination provision of a Savings and Loan Blanket Bond can apply to bar coverage even if the conduct that reveals the dishonesty is unrelated to the subsequent conduct that causes the loss).

employee] (not just one for which claim is made in this lawsuit), coverage for him under the policy automatically terminated.”¹⁴

The court in *St. Joe Paper Co. v. Hartford Accident & Indemnity Co.*¹⁵ observed similarly: “Those provisions are much broader than somewhat similar provisions which have been construed to limit the exclusion to fraudulent or dishonest acts which would give rise to a claim under the policy.”¹⁶

However, if the policy or bond provides that “dishonest,” as used in the termination clause, means a dishonest act causing a covered loss—not just any dishonest act—a court will enforce such language. For example, *In re Conticommodity Services, Inc.*,¹⁷ the court found that coverage under a financial institution bond automatically terminated as to an employee only upon the insured’s discovery of a dishonest act causing a covered loss. The court found that a rider that amended the definition of covered losses and defined the term “dishonest or fraudulent act” “makes it clear that ‘dishonest or fraudulent act’ as used in the cancellation clause means a dishonest or fraudulent act causing a covered loss, not just any dishonest act.”¹⁸ Thus, according to the court, “[the insured’s] belief that [the employee] was dishonest did not invoke the cancellation clause; only learning of a dishonest act causing a covered loss could do that.”¹⁹

B. A Criminal Act Will Terminate Coverage, But Will Lack of Prosecution or a Pardon Preclude Automatic Termination?

An oft-cited case in which the court discusses the type of act sufficient to terminate coverage is *Ritchie Grocer Co. v. Aetna Casualty & Surety Co.*²⁰ In this case, the insured, while investigating the background of a job applicant, discovered that the applicant, a teenager, had broken into a garage and stolen some tires and money. Everyone concerned, including the sheriff and the judge, believed the theft a youthful indiscretion and dismissed the charges. The insured’s branch manager, “[w]ith this knowledge and information,” hired the teenager as a truck driver for the insured.²¹ Not unexpectedly, the teenager embezzled again, during the next eighteen months, over \$17,000. As the court noted, unless coverage terminated as to the employee, the insured’s loss would be covered under the policy.

The court sought support in the words of Chief Justice Cardozo, regarding the meaning of the word “dishonest”:

¹⁴ *Id.* at 911-12.

¹⁵ 376 F.2d 33 (5th Cir. 1969).

¹⁶ *Id.* at 35.

¹⁷ 733 F. Supp. 1555 (N.D. Ill. 1990).

¹⁸ *Id.* at 1579.

¹⁹ *Id.*

²⁰ 426 F.2d 499 (8th Cir. 1970).

²¹ *Id.* at 502.

The late Mr. Justice Cardozo in construing an act to be “dishonest” within the meaning of a fidelity suretyship bond states there must exist an element of moral turpitude or want of integrity. He declared: “Dishonesty, unlike embezzlement or larceny, is not a term of art. Even so, the measure of its meaning is not a standard of perfection, but an infirmity of purpose so opprobrious or furtive as to be fairly characterized as dishonest in the common speech of men.”²²

The court observed that “it is common knowledge that the breaking and entering and the taking of property belonging to another without the consent of the owner is contrary to law”²³ and judicially noticed that the employee’s acts constituted burglary and larceny. The court held that the employee’s acts were “dishonest” so as to trigger automatic termination. The *Ritchie Grocer* court opined that the fact that the court and authorities had refrained from imposing the penalty of the law on the miscreant teenager was immaterial to whether the act was a dishonest act or whether the insured had prior knowledge of the dishonest deed.²⁴

A criminal act will trigger termination;²⁵ and, as *Ritchie Grocer* illustrates, lack of prosecution will not preclude automatic termination of coverage. Nor, indeed, does a pardon by the State somehow erase an employee’s prior dishonest behavior so that the automatic termination clause is not triggered. In *Verneco, Inc. v. Fidelity & Casualty Co. of New York*,²⁶ the court held that the State’s pardon for the employee’s prior dishonesty, for which he had been incarcerated in the penitentiary, did not change the fact that the employee had committed a dishonest act under the policy:

Although we recognize the effect of a pardon insofar as the offender’s relations with the State are concerned, the pardon has no effect upon the contract of these parties. A pardon is simply an act of grace from the governing power which mitigates the punishment the law demands for the offense and restores the rights and privileges forfeited on account of an offense. A pardon does not reduce the moral risk of insuring a thief and can have no effect upon exclusion of coverage on account of dishonest acts.²⁷

C. Does Restitution Vitiating the Application of the Automatic Termination Provision?

While an employer might forgive an employee’s past or present dishonest conduct, and while such a dishonest employee might make restitution for an embezzlement or thievery, such forgiveness, or restitution, does not preclude the triggering of the automatic termination clause.

²² *Id.* (quoting *Commercial Banking Corp. v. Indemnity Ins. Co. of N. Am.*, 1 F.R.D. 380, 381 (E.D. Pa. 1940) (quoting *World Exch. Bank. v. Commercial Cas. Ins. Co.*, 173 N.E. 902, 903 (N.Y. 1930)).

²³ *Id.*

²⁴ *Id.* at 504.

²⁵ See *Drexel Brunham Lambert Group, Inc. v. Vigilant Ins. Co.*, 595 N.Y.S.2d 999 (1993). In this case, the court found that the insured was not entitled to coverage under Bankers and Brokers Blanket Bonds for claims arising from transactions for which the insured had pleaded guilty to criminal charges. *Id.* at 1006.

²⁶ 219 So. 2d 508 (La. 1969).

²⁷ *Id.* at 728-29.

In *Frank Gardner Hardware & Supply Co. v. St. Paul Fire & Marine Insurance Co.*,²⁸ the court held that a salesman, who was known by his employer to have embezzled money, was excluded from coverage under the blanket employees' fidelity bond, despite the fact that the dishonest employee made restitution for the prior embezzlement.²⁹

D. Is a General Disposition to Lie and Cheat Sufficiently "Dishonest" to Invoke the Automatic Termination Provision?

While criminal acts, such as embezzlement and embezzlement-like acts, are obvious examples of dishonesty, dishonesty, in the context of automatic termination, encompasses a whole host of conduct. In *C. Douglas Wilson & Co. v. Insurance Co. of North America*,³⁰ the court, finding that the insured's knowledge of the employee's prior dishonesty was sufficient to invoke the automatic termination clause, found persuasive the following definition of "dishonesty":

"Dishonesty," as used in a fidelity bond, is to be interpreted according to its usual and ordinary meaning. To constitute dishonesty, the conduct need not amount to a crime and need only involve bad faith or a want of integrity or untrustworthiness or a disposition to lie or cheat or a faithlessness to a trust. To constitute dishonesty, there need not be an intent to profit or to cause a monetary loss to the employer.³¹

Thus, at least for some courts, a propensity to lie and cheat is sufficiently "dishonest" to invoke the automatic termination provision. For example, in *Newhard, Cook & Co. v. Insurance Co. of North America*,³² the court held that the automatic termination clause was triggered to bar coverage. In finding that the insured had learned of the employee's prior dishonesty, the court emphasized in particular, that the broker/insured's vice president characterized the employee's unauthorized limited partnership offering as "at best, deceitful."³³

E. Is an Act "Dishonest" If the Employee Intends to Benefit the Employer?

A dishonest act will terminate coverage for a particular employee, even if the employee intends to benefit the insured. In *St. Joe Paper Co. v. Hartford Accident & Indemnity Co.*,³⁴ the

²⁸ 148 So. 2d 190 (Miss. 1963). See also *Ritchie Grocer Co. v. Aetna Cas. & Sur. Co.*, 426 F.2d 499 (8th Cir. 1970) (applying Arkansas law); *In re J.T. Moran Fin. Corp.*, 147 B.R. 335 (Bankr. S.D.N.Y. 1992) (security dealer blanket bond); *E. Udolf, Inc. v. Aetna Cas. & Sur. Co.*, 573 A.2d 1211 (Conn. 1990); *Verneco, Inc. v. Fidelity & Cas. Co.*, 219 So. 2d 508 (La. 1969); *Employers' Liab. Assurance Co. v. S. Produce Co.*, 129 So. 2d 247 (La. Ct. App. 1961); *Ciancetti v. Indemnity Ins. Co. of N. Am.*, 335 P.2d 1048 (Cal. App. Dep't Super. Ct. 1959).

²⁹ *Id.* at 194.

³⁰ 590 F.2d 1275 (4th Cir. 1979) (fidelity bond).

³¹ *Id.* at 1278-79 (quoting *City Loan & Sav. Co. v. Employers' Liab. Assurance Corp.*, 249 F. Supp. 633, 656 (N.D. Ohio 1964) (citations omitted)).

³² 929 F.2d 1355 (8th Cir. 1991) (broker's blanket bond).

³³ *Id.* at 1357.

court held that discovery of prior dishonest acts terminated coverage for losses from the acts of a salesman, despite the assertions that the acts discovered were performed to increase the insured's business and, in fact, did increase the business.³⁵

In *Central Progressive Bank v. Fireman's Fund Insurance Co.*,³⁶ the court determined that coverage had terminated under a bankers blanket bond because the insured had prior knowledge that the bank president had made fictitious loans to allow use of bank funds for political contributions. The court affirmed this result even though the purported goal of these political contributions was to obtain additional business for the bank.³⁷

F. Are There Temporal Limitations on Dishonesty for Purposes of Automatic Termination?

For automatic termination to be triggered, it does not matter when the dishonest act occurred, or whether it occurred when the employee was "in the employment of insured or otherwise." The disqualifying act could have occurred at any time, in the recent past or the distant past, because the automatic termination clause generally contains no temporal limitation. The specific language of each policy or bond, however, must be carefully reviewed, as some do include certain temporal limitations.

In *F.L. Jursik v. Travelers Indemnity Insurance Co.*,³⁸ the court enforced the "clear and specific" automatic termination clause in the employee dishonesty policy because the insured knew, when it hired the embezzling employee, that he had just completed serving a sentence for breaking and entering and larceny.³⁹ The court was unpersuaded by the insured's suggested interpretation of the automatic termination clause that all "dishonest acts" must be committed in the course of employment with the insured.⁴⁰

Similarly, in *C. Douglas Wilson & Co. v. Insurance Co. of North America*,⁴¹ an insured mortgage broker, prior to the effective date of three fidelity policies, discovered during the course of a routine audit that the vice president was falsely certifying preadvances for certain HUD/FHA loans. The court held that the bonding companies were not liable for losses

³⁴ 359 F.2d 579 (5th Cir. 1966), *aff'd on reh'g*, 376 F.2d 33 (1967). See also *Drexel Burnham Lambert Group, Inc. v. Vigilant Ins. Co.*, 595 N.Y.S.2d 999, 1007 (1993) (automatic termination clause for a bankers blanket bond terminated coverage, even though the dishonest employees "did not steal *from* the company, they stole *for* the company").

³⁵ *Id.* at 583-84.

³⁶ 658 F.2d 377 (5th Cir. 1981).

³⁷ *Id.* at 382.

³⁸ No. 199913, 1997 WL 33332724 (Mich. Ct. App. Nov. 4, 1997) (unpublished opinion). See also *Larson v. Peerless Ins. Co.*, 362 S.W.2d 863, 864 (Tex. App. 1962) (where an employer knew an employee had misappropriated \$500 of the employer's funds before the fidelity bond was issued, the subsequent misappropriation by that employee was excluded from coverage under the bond's automatic termination provision).

³⁹ *Id.* at *3.

⁴⁰ *Id.* at *2.

⁴¹ 590 F.2d 1275 (4th Cir. 1979) (applying S.C. law).

sustained by the insured because of the vice-president's false certification of letters of credit after the effective date of the policies.⁴²

In *Hodges v. Employers Mutual Casualty Co.*,⁴³ the insurer under a Businessowners Policy moved for summary judgment on the insured's employee dishonesty claims because the insured knew of prior dishonesty by the employee who caused the loss. The insured argued that the agent never gave her the policy, that she never signed the policy, and that she was unaware of the exclusion.⁴⁴ The court denied the summary judgment motion because it found there were genuine issues of material fact.⁴⁵ The opinion does not explain the alleged prior dishonesty except to note that it occurred over twenty years before the acts giving rise to the claim.⁴⁶

In a bizarre case to the contrary, *Home Savings Bank, SSB v. Colonial American Casualty & Surety Co.*,⁴⁷ the court essentially disregarded the automatic termination clause of the fidelity bond and affirmed summary judgment for the insured bank.⁴⁸ After hiring a certain employee, the insured learned that that employee had been convicted of embezzling funds from a previous employer. The court rejected the insurer's correct argument, predicated on the express language of the bond, that "the termination clause operates to disqualify from coverage any employee whom [the insured bank] knows to have committed a dishonest act, regardless of whether [the insured bank] first learned of the act *before* or *after* the bond's coverage period commenced."⁴⁹ The court incorrectly held that the automatic termination provision was ambiguous and that the bank's interpretation was reasonable—that coverage terminated only if the insured initially discovers the employee's dishonesty after coverage commences.⁵⁰

G. Must the Prior Dishonesty Have Resulted in a Loss?

A prior dishonesty that results in automatic termination need not have resulted in a loss to the insured or a prior employer, unless the language of the specific policy so provides.⁵¹ Nor, unless the policy provides otherwise, must the dishonest act involve a large sum of

⁴² *Id.* at 1280.

⁴³ No. 1:05CV161-D-A, 2006 WL 2033887 (N.D. Miss. July 18, 2006).

⁴⁴ *Id.* at *1.

⁴⁵ *Id.* at *2.

⁴⁶ *Id.* at *1.

⁴⁷ No. COA03-1110, 2004 WL 1486153 (N.C. Ct. App. July 6, 2004).

⁴⁸ *Id.* at *5.

⁴⁹ *Id.* at *3.

⁵⁰ *Id.*

⁵¹ Indeed, the automatic termination clause can apply to bar coverage "even if the conduct through which the dishonesty is revealed is unrelated to subsequent conduct that actually causes a loss." *Home Sav. & Loan v. Aetna Cas. & Sur. Co.*, 817 P.2d 341, 348 (Utah Ct. App. 1991) (fidelity bond) (citing *St. Joe Paper Co. v. Hartford Acc. & Indem. Co.*, 376 F.2d 33, 35 (5th Cir. 1967)).

money, if any money at all. Such conclusions that invoke automatic termination comport with the standard for “dishonesty” as lacking an “element of moral turpitude or want of integrity” and a “disposition to lie or cheat.”

In *Ciancetti v. Indemnity Insurance Co. of North America*,⁵² the owner/operator of a furniture store was barred from recovering under a fidelity bond because she knew about the defalcating bookkeeper’s prior embezzlement. It did not matter that the prior embezzled amount was the sum total of \$20, nor did it matter that the bookkeeper had paid back the \$20 to the insured; the bookkeeper “fraudulently appropriated to his own use twenty dollars which belonged to” the insured.⁵³

Similarly, in *Troy State Bank v. Bancinsure, Inc.*,⁵⁴ the insured bank discovered that an employee had surreptitiously raised the limit on her credit card issued by the bank. The bank disciplined the employee, required her to pay off the credit card account, and gave the insurer notice of the incident.⁵⁵ The insurer drafted a response that coverage for the employee was terminated but never sent the response to the bank. However, as the court noted, “no good deed goes unpunished.”⁵⁶ Two years later, the employee stole \$53,000 from customer accounts, and the bank submitted a claim. The insurer denied the claim based on the automatic termination provision.⁵⁷ The appellate court reversed judgment for the bank, finding the automatic termination provision clear and unambiguous:

Under the law, [the employee’s] surreptitious and unauthorized act of raising her personal credit limit constituted dishonest conduct within the meaning of Section 12 of the bond. The fact that the plaintiff suffered no economic loss and that [the employee] intended no financial loss to her employer does not make the conduct honest.⁵⁸

The court observed with approval that other jurisdictions had given the term “dishonesty” a broad definition.⁵⁹

On the other hand, if the bond or policy provides that the prior dishonest act must have involved loss to the prior employer of a specified dollar amount, then that qualification will be enforced; and for automatic termination to be triggered, the requisite dollar amount of the loss sustained by the prior employer must be established. For example, in *In re Prime Commercial Corp.*,⁶⁰ the court reviewed a coverage exclusion for a loss caused by an employee if the

⁵² 335 P.2d 1048 (Cal. Ct. App. 1959).

⁵³ *Id.* at 1050.

⁵⁴ No. 92,115, 2005 WL 824031 (Kan. Ct. App. Apr. 8, 2005).

⁵⁵ *Id.* at *1.

⁵⁶ *Id.* at *2.

⁵⁷ *Id.*

⁵⁸ *Id.* at *4.

⁵⁹ *Id.*

insured possessed knowledge of dishonest acts committed by the employee “(1) in the service of the Insured or otherwise during the period of employment by the Insured, or (2) prior to employment by the Insured provided that such conduct involved Money, Securities or other property valued at \$10,000 or more.”⁶¹ The court observed that the “outer limits of the type of dishonesty that will result in exclusion of coverage are not specifically defined, except with regard to prior employment, where dishonest conduct must have involved at least \$10,000.”⁶²

H. Where Does Negligence End and “Dishonesty” Begin for Purposes of Automatic Termination?

In spite of the broadness intended in the definition of “dishonesty” for purposes of automatic termination, some courts have strained to avoid the effect of the clause. In *Hartford Accident & Indemnity Co. v. Singer*,⁶³ the court determined that the insured’s practice of permitting its salesmen to overdraw commission accounts or pay themselves out of cash collections, with later repayments, did not automatically terminate coverage for the subsequent loss caused by a salesman. The court observed that, because the practice was permitted by the employer, there was “no moral turpitude or breach of honesty or want of integrity.”⁶⁴ In addition, the court archly noted that “[w]hether it was bad practice for the insured to have permitted their [sic] salesmen to overdraw their commission accounts, or even to pay themselves out of their cash collections” was not before the court.⁶⁵ In this case, the court determined that violation of good business practices did not rise to the requisite level of “dishonesty.”

Courts so inclined have found that prior acts of dishonesty are matters of “mistake,” “negligence,” “inefficiency,” or “poor business practices” rather than dishonesty conduct that triggers automatic termination. In one such case, *USF&G v. Constantin*,⁶⁶ the defalcating employee previously had held customer checks returned unpaid, increased his overhead expenses during prosperous times, carried accounts on his own responsibility, and reported “short.” Even though the defalcator signed a promissory note to repay his employer (in essence, admitting that he acted dishonestly), the supreme court affirmed the trial court, which had determined that his acts were examples of “mere matters of mistake or inefficiency and did not constitute dishonest or criminal conduct” and that coverage had not terminated.⁶⁷

⁶⁰ 187 B.R. 785 (Bankr. N.D. Ga. 1995).

⁶¹ *Id.* at 795.

⁶² *Id.* at 803.

⁶³ 39 S.E.2d 505 (Va. 1946).

⁶⁴ *Id.* at 507.

⁶⁵ *Id.*

⁶⁶ 157 So. 2d 642 (Miss. 1963). See also *Wachovia Bank & Trust Co. v. Manufacturers Cas. Ins. Co.*, 171 F. Supp. 369, 376 (M.D.N.C. 1959) (banker’s indemnity bond); *Sallie Grocer Co. v. Hartford Acc. & Indem. Co.*, 223 So. 2d 5 (La. Ct. App. 1969); *Bank of Commerce & Trust Co. v. Union Indem. Co.*, 142 So. 156 (La 1932) (fidelity policy).

⁶⁷ *Id.* at 645.

Ironically, at trial it was shown that the defalcating employee had been convicted of grand larceny for another, separate crime.⁶⁸

I. Whether the Employee Was “Dishonest” or Not, the Insured Could Not Win

Then there is the case of the insured that could not recover under a Securities Dealer Blanket Bond, whether the employee’s acts were deemed “dishonest” or not. In *In re J.T. Moran Financial Corp.*,⁶⁹ the court granted summary judgment in favor of the insurer, concluding that the stockbroker/employee’s trading for his own account, although a violation of company policy, did not qualify as “dishonest or fraudulent acts” within the meaning of the bond.⁷⁰ Furthermore, the court held that, even if such acts did qualify as dishonest or fraudulent under the bond, coverage terminated pursuant to the automatic termination provision because of the insured’s knowledge of such trading by the employee on one prior occasion. The insured had permitted the employee to continue his brokerage activities after the first violation because the employee covered the loss.⁷¹

V. CONCLUSION

The circumstances that will terminate coverage as to a particular employee are set forth in the automatic termination provisions of commercial crime policies and financial institution bonds. These provisions, once triggered, provide an absolute defense to any claim arising from subsequent losses caused by that defalcating employee. Any automatic termination analysis begins with a careful review of the automatic termination language in the specific policy or bond at issue. The case law on whether the automatic termination clause has been triggered displays a certain amount of both complexity and inconsistency, with regard to, among other things, what acts constitute “dishonesty.” Analysis of whether termination has occurred is highly fact intensive; therefore, it is especially important that practitioners are familiar with the applicable case law.

⁶⁸ *Id.* at 644.

⁶⁹ 147 B.R. 335 (Bankr. S.D.N.Y. 1992).

⁷⁰ *Id.* at 340.

⁷¹ *Id.* at 341.

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