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“RECENT DEVELOPMENTS IN FIDELITY LAW”

PRESENTED BY:

**SHARON A. WOODARD, ESQUIRE
STARNES & ATCHISON**
Seventh Floor, 100 Brookwood Place
Post Office Box 598512
Birmingham, Alabama 35259-8512
(205) 868-6000

RECENT DEVELOPMENTS IN FIDELITY LAW

To provide as broad a sampling as possible, recent cases have been drawn from Alabama, Florida, Georgia, Louisiana, Mississippi, North Carolina, Tennessee, Texas, Virginia, West Virginia.

These cases illustrate current developments in several aspects of fidelity law, including:

1. **MANIFEST INTENT - FINANCIAL BENEFIT;**
2. Evidence of **DISHONESTY;**
3. **OCCURRENCE** of dishonesty;
4. **FORGERY** coverage;
5. **INVENTORY COMPUTATION** exclusion;
6. Coverage limits;
7. Bad faith;
8. Guardian bond - attorney fees.

1. **MANIFEST INTENT - FINANCIAL BENEFIT.**

ALABAMA:

An employee must have **MANIFEST INTENT** to obtain a financial benefit other than commissions. **Auburn Ford-Lincoln-Mercury v. Universal Underwriters Insurance Company, Inc.**, No. 96-839-E, (M.D.Ala., Jan. 8, 1997) (judgment and memorandum opinion).

In this case, a federal judge granted summary judgment for the fidelity Insurer, following the general rule that the **MANIFEST INTENT** definition requires an employee to obtain something other than "commissions" normally paid the employee as compensation, even if the compensation is wrongfully obtained.

The Insured, a car dealership, claimed that its fleet manager provided Ford with false information to dupe Ford into selling cars to government workers at discounted "fleet" prices. When the dealership could not provide documentation to support the manager's sales, Ford made "charge-backs" against the dealership for the fleet discounts. The dealership filed suit against the Insurer and ultimately admitted that the only **FINANCIAL BENEFIT** received by the manager was additional commissions. The policy's definition of **MANIFEST INTENT** required evidence of an intent to obtain a **FINANCIAL BENEFIT** other than "salaries, commissions," etc., received in the normal course of employment. The Court rejected the dealership's argument that the commissions, resulting from dishonesty, were **not** earned "in the normal course of employment." The Insured has appealed the Court's ruling.

VIRGINIA:

MANIFEST INTENT requires more than an accidental intent to obtain a **FINANCIAL BENEFIT** for the employee or another under an "employee dishonesty" policy. **General Analytics Corp. v. CNA Insurance Co.**, 86 F.3d 51 (4th Cir. 1996).

In this case, the Surety showed that the dishonest acts were committed solely to revenge the employer's firing of a co-employee. The Court ruled that the employee's intent to get revenge was outside coverage of the policy, even if some **FINANCIAL BENEFIT** to the employee or another resulted from the revenge.

2. EVIDENCE OF DISHONESTY

MISSISSIPPI:

An accountant's expert testimony is not (yet) admissible evidence of the **DISHONESTY** of a bank employee. **First United Financial Corp. v. United States Fidelity & Guaranty Company**, 96 F.3d 135, 137 (5th Cir. [Miss.] 1996) (Garza, J., specially concurring).

The bank made a claim against a Financial Institution Bond, for the alleged dishonesty of bank employees in causing the bank to buy loan participations. The trial court granted summary judgment for the Surety, rejecting the opinions of two accountants who audited the bank's records offered by the bank as the sole evidence of the **DISHONESTY** of the employees. The judgment was affirmed by the federal appeals court.

While the opinion is favorable to the Surety in rejecting an accountant's opinion as evidence that a bank employee is dishonest, the concurring opinion by Judge Garza makes some disturbing suggestions. First, the Judge suggests that an employee's dishonesty is an appropriate subject for an accountant's opinion. Second, the Judge suggests that if an accountant could explain some "process of reasoning" for his opinion that an employee was dishonest, the accountant's opinion would be sufficient to defeat a Surety's motion for summary judgment.

3. OCCURRENCE OF DISHONESTY.

LOUISIANA:

On-going and repeated acts of dishonesty by one employee constitute one **OCCURRENCE**. **Jefferson Parish Clerk of Court Health Ins. Trust Fund v. Fidelity and Deposit Co. of Maryland**, 673 So.2d 1238 (La.App. 1996), *rehearing denied*.

A county employee repeatedly failed to transfer health insurance premiums paid by other county employees to the insurance trust fund. Instead, the employee allowed the funds to be used for unrelated operating expenses. This series of acts constitute only one **OCCURRENCE** of dishonesty under a Commercial Crime policy.

NORTH CAROLINA

On-going and repeated acts of embezzlement by one employee constitute one **OCCURRENCE**. **Christ Lutheran Church v. State Farm Fire & Casualty Co.**, 122 N.C.App. 614, 471 S.E.2d 124 (1996).

In this first North Carolina case to address the question of whether an employee's embezzlement of 24 separate checks constitute one **OCCURRENCE** under the employee dishonesty coverage form, the Court followed the *Diamond* rule of one **OCCURRENCE**. See *Diamond Transportation System v. Travelers Indemnity*, 817 F.Supp. 710 (N.D.Ill. 1993).

TEXAS:

On-going and repeated acts of embezzlement by one employee constitute one **OCCURRENCE** under an employee dishonesty coverage form. **Bethany Christian Church v. Preferred Risk Mutual Insurance Company**, 942 F.Supp. 330 (S.D.Tex. 1996).

FLORIDA

On-going and repeated acts of embezzlement by one employee constitute one **OCCURRENCE** under an employee dishonesty coverage form. **Reliance Ins. Co. v. Treasure Coast Travel Agency**, 660 So.2d 1136 (Fla. 4th DCA 1995), *rehearing denied*.

4. FORGERY COVERAGE.

GEORGIA:

No **FORGERY** coverage exists when a check is cashed on a true signature, even though the check proceeds are later converted by the signer. **Reliance Ins. Co. v. First Liberty Bank**, 927 F.Supp. 448, 450 (M.D.Ga. 1996).

An attorney signed his own name to a check jointly issued to the attorney and his client. This signature is not a forgery under the Financial Institution Bond definition of **FORGERY** as "signing the name of another person or organization," but not "a signature which consists in whole or in part of one's own name."

LOUISIANA:

Forged checks are **ON PREMISES LOSS** covered under a Financial Institution Bond. **United States Fidelity & Guaranty Company v. Planters Bank & Trust Co.**, 77 F.3d 863 (5th Cir. 1996).

Checks forged as part of a check-kiting scheme, which are not cashed due to insufficient funds, are excluded from coverage by an **UNCOLLECTED FUNDS** exclusion. Other forged checks which are actually cashed on the bank's premises are **ON PREMISES LOSS** which are not excluded by the **UNCOLLECTED FUNDS** exclusion.

5. INVENTORY COMPUTATION EXCLUSION.

TENNESSEE:

An **INVENTORY COMPUTATION** exclusion does not apply when an Insured determines the amount of its loss by counting individually identifiable units of musical equipment. **Strings & Things in Memphis, Inc.**, 920 S.W.2d 652 (Tenn.Ct.App.), *Application for Permission to Appeal Denied by Supreme Court* (1996).

In this case, the Tennessee Court of Appeals follows the *Ace Wire* rule governing an **INVENTORY COMPUTATION** exclusion under a crime coverage form. See *Ace Wire & Cable Co. v. Aetna Cas. & Surety Co.*, 469 N.Y.S.2d 655, 457 N.E.2d 761 (1983), 45 A.L.R.4th 1037.

The rule is that a loss determined by a physical count of individually identifiable units does not come within an **INVENTORY COMPUTATION** exclusion for proving the existence of a loss due to employee dishonesty. As long as the Insured shows a purchase of individual items and the loss of those items from inventory without evidence of a sale, no **INVENTORY COMPUTATION** exists.

6. COVERAGE LIMITS.

TEXAS:

An Insured's recovery is capped by the coverage limit of the policy in effect at the time the Insured discovered of the dishonesty, under an **OTHER INSURANCE** provision. **Bethany Christian Church v. Preferred Risk Mutual Insurance Company**, 942 F.Supp. 330 (S.D.Tex. 1996).

An Insured can not "stack" the policy limits of three consecutive insurance policies to cover on-going embezzlement when the policy periods do not overlap. **Bethany Christian Church v. Preferred Risk Mutual Insurance Company**, 942 F.Supp. 330 (S.D.Tex. 1996).

7. BAD FAITH

MISSISSIPPI:

An Insured's claim that the Surety violated its duties of good faith and fair dealing in handling a claim of employee dishonesty must be dismissed when no issue of dishonesty is shown by the Insured. **First United Financial Corp. v. United States Fidelity & Guaranty Company**, 96 F.3d 135, 137 (5th Cir. [Miss.] 1996) (Garza, J., specially concurring).

However, there is no doubt that bad faith claims will be asserted in the future in attempts to coerce Sureties into paying claims.

WEST VIRGINIA:

A bank unsuccessfully attempted to sue its fidelity bond surety for bad faith, alleging the Surety unreasonably delayed paying the bank's claim. **Bank One, West Virginia, St. Albans, NA v. United States Fidelity & Guaranty Company**, 92 F.3d 1176 (4th Cir. 1996) (unpublished decision).

The federal appeals court refused to allow the bank to amend its complaint to allege bad faith against its Surety after the bank accepted payment from the Surety on its claim under a fidelity bond.

8. GUARDIAN BONDS.

FLORIDA:

The Florida Court of Appeals has certified to the Florida Supreme Court the question of whether attorneys fees may be recovered from a Surety on a guardian bond, under the Florida "general attorney fee" statute, F.S.A. § 627.428(1). **Preferred National Insurance Company v. Nichols**, 682 So.2d 585 (Fla. 1st DCA 1996), *rehearing denied*.

The Court also limits the Surety's liability for attorneys fees (if any) to the penal sum of the bond, plus interest from the date of the breach.