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**THE CURRENT HEALTH OF “MANIFEST INTENT” AND  
DIRECT LOSS**

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# The Current Health of “Manifest Intent” and Direct Loss

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This paper is meant to serve as an update on current developments and interpretations of the “direct loss” and “manifest intent” requirements in the fidelity bond. As it was being written, an extensive handbook was published which is intended to serve as a comprehensive desk reference setting forth reported decisions that interpreted “manifest intent” for purposes of fidelity coverage. See SAMUEL J. ARENA, JR., ET AL, THE “MANIFEST INTENT” HANDBOOK (2002). To avoid duplication, the scope of this paper is limited to decisions interpreting and applying “manifest intent” that have been rendered since the publication of The “Manifest Intent” Handbook and opinions interpreting the “direct loss” requirement within the last two years.

## Manifest Intent

A Fidelity Bond is commonly defined as “[a] guaranty of personal honesty of officer furnishing indemnity against his defalcation or negligence. A contract whereby, for a consideration, one agrees to indemnify another against loss arising from the want of honesty, integrity, or fidelity of an employee or other person holding a position of trust.”<sup>3</sup> Due to broad judicial interpretations of fidelity bonds, fidelity insurers incorporated the “manifest intent” requirement into the bond. In 1976, the rider provided:

Dishonest or fraudulent acts as used in this Insuring Agreement shall mean only dishonest or fraudulent acts committed by such employee with the manifest intent:

- (a) to cause the Insured to sustain such loss; and
- (b) to obtain a financial benefit for the Employee, or for any other person or organization intended by the Employee to receive such benefit, other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions, or other employee benefits earned in the normal course of employment.<sup>4</sup>

The purpose of the “manifest intent” requirement was to narrow the kinds of claims the fidelity bond would cover. The Surety Association intended to restrict coverage to claims of embezzlement and embezzlement type acts.

There is, as is typically the case with insurance contracts and bonds, an ongoing battle between the sureties and claimants relative to the scope of coverage of the fidelity bond.

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<sup>3</sup> See BLACK’S LAW DICTIONARY 431 (6th ed. 1991).

<sup>4</sup> See Edward G. Gallagher, et al., *A Brief History of Financial Institution Bond*, in *Financial Institution Bonds*, (Duncan L. Clore ed. 2d ed. 1998), cited in SAMUEL J. ARENA, JR. ET AL, THE “MANIFEST INTENT” HANDBOOK (2002).

Claimants seek to dilute the “manifest intent” requirement while the sureties seek to have the “manifest intent” language strictly construed. There have been two recent decisions applying the “manifest intent” requirement, *Shoemaker v. Lumbermens Mutual Cas. Co.*, 176 F.Supp. 2d 449 (W.D.Pa. 2001) and *Banclnsure, Inc. v. BNC National Bank*, 263 F.3d 766, 771 (8th Cir. 2001).

### ***Shoemaker v. Lumbermens Mutual Casualty Co.***

Shoemaker was a diversity action in which Joan Shoemaker (“Shoemaker”), in her capacity as Administratrix of the Estate of Abbot Ross, sued for breach of contract and alleged bad faith claims arising out of an Employee Dishonesty Policy issued by Lumbermens Mutual Casualty Company (“Lumbermens”).<sup>5</sup> Abbot Ross (“Ross”) was adjudicated incapacitated and eventually passed away.<sup>6</sup> In connection with Ross’s incapacity, Patricia Gibbs (“Gibbs”), an employee of Guardianship Services of Allegheny County, Inc. (“Guardianship”), was appointed the permanent guardian.<sup>7</sup> After Ross died, another employee of Guardian, William Moore (“Moore”), petitioned for and was granted letters of administration by the Register of Wills for Allegheny Country relative to Ross’s estate.<sup>8</sup> Ross’s sister, his sole intestate heir, eventually became the executrix of Ross’s estate and filed a petition to compel an inventory and accounting of Ross’s estate—neither Guardianship nor Moore complied.<sup>9</sup> In litigation relative to the petition to compel, the court held that Moore stole approximately \$ 60,100.00.<sup>10</sup> The question in *Shoemaker* was whether the insurer, Lumbermens, was obligated to provide coverage for the loss under the “Employee Dishonesty” policy held by Guardianship.<sup>11</sup> The policy provided:

We will pay for loss of, and loss from damages to, Covered Property resulting directly from ‘Employee dishonesty.’

...  
‘Employee Dishonesty’ ... means only dishonest *acts committed by [ ]employee[ ] ... with the manifest intent to ... [c]ause [the insured] to sustain loss[,] and also [to o]btain financial benefits (other than employee benefits earned in the normal course of employment ...) for [t]he [ ] employee [ ] or [a]ny person or organization intended by the [ ]employee[ ] to receive that benefit.*<sup>12</sup>

The court held that the plaintiff could not establish that Moore’s conduct met the “manifest

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<sup>5</sup> *Shoemaker v. Lumbermens Mutual Cas. Co.*, 176 F.Supp. 2d 449, 450 (W.D.Pa. 2001).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 451.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* (emphasis added).

intent” language in the policy.<sup>13</sup> The court noted that its task in the case was limited to deciding the meaning of the term “manifest intent.”<sup>14</sup> As the court sat in diversity jurisdiction, it looked to Pennsylvania law construing the meaning of “manifest intent.” Finding no Pennsylvania Supreme Court authority, the court found the reasoning in *Resolution Trust Corp. v. Fidelity and Deposit Co. of Maryland*<sup>15</sup> and *Susquehanna Bancshares, Inc. v. National Union Fire Insurance Co. of Pittsburgh*<sup>16</sup> persuasive. The court found *Resolution Trust* persuasive because that court surveyed the cases regarding “manifest intent” on a circuit-by-circuit basis and its specific holding was tied directly to federal precedents.<sup>17</sup> Additionally, the holding in *Resolution Trust* was consistent with *Susquehanna*, a Pennsylvania case.<sup>18</sup>

### ***Resolution Trust***

The court in *Resolution Trust* applied New Jersey law.<sup>19</sup> As the New Jersey Supreme Court had not determined the meaning of “manifest intent” under New Jersey law, the Third Circuit Court of Appeals was called on to predict how that court would decide the issue.<sup>20</sup> In doing so, the Third Circuit undertook a survey of the interpretation of “manifest intent” in other jurisdictions.<sup>21</sup> In its survey, the court discovered that the term “manifest” has been interpreted to mean that the intent of the employee must be apparent or obvious.<sup>22</sup> There was, however, a divergence of opinion relative to the “intent” aspect of the phrase and whether the court is required to delve into the employee’s actual purpose in engaging in the conduct at issue.<sup>23</sup> The court noted that: “While the fidelity provision covers only those dishonest or fraudulent acts undertaken with the manifest intent both to (1) cause the insured (who is also the employer) to sustain a loss, and (2) obtain a certain type of financial benefit, the question of the meaning of “intent” usually arises in the context of determining whether the proofs show that the former

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<sup>13</sup> *Id.* at 452.

<sup>14</sup> *Id.* at 453.

<sup>15</sup> 205 F.3d 615, 643 (3d Cir. 2000).

<sup>16</sup> 659 A.2d 991 (Pa. Super. 1995).

<sup>17</sup> *Shoemaker*, 176 F.Supp 2d at 453.

<sup>18</sup> *Id.*

<sup>19</sup> Pursuant to 12 U.S.C. § 1441(a)(1)(1) and 12 U.S.C. § 1819(b)(2)(A), because *Resolution Trust Corporation* and the *Federal Deposit Insurance Corporation* were parties, the court applied New Jersey law. See *Resolution Trust*, 205 F.3d at 626.

<sup>20</sup> *Id.* at 637

<sup>21</sup> See generally *id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

requirement has been satisfied.”<sup>24</sup> Apparently, the Court of Appeals for the Sixth, Seventh and Tenth Circuits adopted the standard that “[a]lthough the concept of manifest intent does not necessarily require that the employee actively wish for or desire a particular result, it does require more than a mere probability.... Manifest intent exists when a particular result is substantially certain to follow.”<sup>25</sup> In contrast, the Second, Fourth and Fifth Circuits applied the term “manifest intent” differently to require that the insured establish that the employee acted with the specific purpose or desire to both injure the insured and obtain a benefit.<sup>26</sup> The Third Circuit adopted the approach taken by the Second, Fourth and Fifth Circuits.<sup>27</sup> In doing so, the court relied on *General Analytics* as an instructive example of the approach utilized by the Second, Fourth and Fifth Circuits.<sup>28</sup>

In *General Analytics*, the court reversed a grant of summary judgment and found that reasonable minds could differ as to whether the loss was caused by employee misconduct undertaken with the “manifest intent” to obtain a financial benefit for a third party.<sup>29</sup> The court recognized that “employee dishonesty policies” are “designed to provide coverage for a specific type of loss characterized by embezzlement, which involved the direct theft of money.”<sup>30</sup> The court explained that:

Because employee dishonesty policies like CNA Insurance’s require proof that the employee have acted to accomplish a particular purpose, they require that the insured establish a specific intent, analogous to that require by the criminal law. Thus, if a dishonest act has the unintended effect of causing a loss to the employer or providing a benefit to the employee, the act is not covered by the policy....

As a state of mind, intent is often difficult to prove. And because it is abstract and private intent is revealed only by its connection with words and conduct.... Thus, evidence of both words and conduct is probative of intent, ... and, because context illuminates the meaning of words and conduct, evidence of the circumstances surrounding such words or conduct, including motive of the speaker or actor, similarly is admissible.

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<sup>24</sup> *Id.* at 637-38.

<sup>25</sup> *Id.* at 638 (citing *People Bank & Trust Co. v. Aetna Cas. & Surety Co.*, 113 F.3d 629, 635 (6th Cir. 1997); *Heller Int’l Corp. v. Sharp*, 974 F.2d 850, 857-59 (7th Cir. 1992); *First Federal Savings & Loan Ass’n v. Transamerica Ins. Co.*, 935 F.2d 1164, 1167 (10th Cir. 1991)).

<sup>26</sup> *Id.* at 639-40 (citing *General Analytics Corp. v. CNA Ins. Cos.*, 86 F.3d 51, 54 (4th Cir. 1996); *First Nat’l Bank v. Lustig*, 961 F.2d 1162, 1166-67 (5th Cir. 1992); *Glusband v. Fittin Cunningham & Lauzon, Inc.*, 892 F.2d 208, 210-12 (2d Cir. 1989)).

<sup>27</sup> *Id.* at 642.

<sup>28</sup> 205 F.3d at 640.

<sup>29</sup> *Id.* at 641.

<sup>30</sup> *Id.*

The court in *General Analytics* required proof of the employee's specific intent or purpose to cause the insured loss and to obtain a certain type of financial benefit for herself or a third party, but in adopting that state of mind requirement as the standard for "manifest intent," it recognized that the employee's subjective intent may be proven circumstantially by reference to evidence of the employee's words, conduct, and the context in which his or her actions took place.<sup>31</sup>

Thus, in *Resolution Trust*, the Third Circuit held that "the term 'manifest intent' as it is used in the fidelity coverage requires the insured to prove that the employee engaged in dishonest or fraudulent acts with the specific purpose, object or desire both to cause a loss and obtain a financial benefit."<sup>32</sup> Recognizing that subjective intent is difficult to prove, the Third Circuit held that the insured may prove the employee's subjective intent by introducing objective evidence of the employee's intent.<sup>33</sup> Proof of recklessness or the employee's knowledge of the likelihood that a loss was to result are manifestations of the employee's intent and a jury "may consider those factors, along with any other objective indicia of intent, in ascertaining the employee's state of mind in engaging in the wrongful conduct."<sup>34</sup> Recognizing its role as interpreting New Jersey law, the Third Circuit also relied on the "well established rules for contract interpretation" as developed under New Jersey law.<sup>35</sup>

### ***Susquehanna Bancshares, Inc. v. National Union Fire Insurance Company of Pittsburgh***

The *Shoemaker* court relied not only on *Resolution Trust*, but also on *Susquehanna*. In *Susquehanna*, a Pennsylvania appellate court interpreted "manifest intent" as used in a Financial Institution Bond.<sup>36</sup> The litigation began when Citizens National Bank of Greencastle sued National Union Fire Insurance Company of Pittsburgh ("National Union") to obtain fidelity coverage for losses sustained due to an employee's actions overseeing loans under a Financial Institution Bond issued by National Union.<sup>37</sup> The court noted two lines of cases from other

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<sup>31</sup> *Id.* at 640-41.

<sup>32</sup> *Id.* at 642.

<sup>33</sup> *Id.* at 642-43.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 642. The court noted that New Jersey adheres to the principle of *contra proferentum* that requires ambiguities in an insurance contract to be resolved in favor of the insured. The court rejected the possible argument that the divergence of opinion relative to the correct standard for determining an employee's "manifest intent" means there is ambiguity because an ambiguous term under New Jersey law means that the "phrasing of the policy is so confusing that the average policyholder cannot make out the boundaries of coverage. Instead, the court adhered to the principle that courts "should not write for the insured a better policy of insurance than the one purchased." *Id.* at 643.

<sup>36</sup> *Susquehanna Bancshares, Inc. v. National Union Fire Insurance Co. of Pittsburgh*, 659 A.2d 991 (Pa. Super 1995).

<sup>37</sup> *Id.* at 992.

jurisdictions interpreting the “manifest intent” language of the Banker’s Blanket Bond.<sup>38</sup> The first line holds that the court should only consider the natural and probable consequences of the employee’s acts and the employee’s subjective intent should be ignored when determining an employee’s “manifest intent.”<sup>39</sup> The second line of cases hold that the broad range of evidence *including* the natural and probable consequences of the employee’s acts should be used to determine an employee’s “manifest intent.”<sup>40</sup> The court held that in reviewing whether an employee has the requisite “manifest intent” to harm the employer, the court must “look at all the surrounding circumstances.”<sup>41</sup> “The fact finder should look at all the evidence presented, and from this, it *may* infer the employee’s manifest intent that stems from actions which evidence knowledge that the losses are substantially certain to result. However, the fact finder must be free to consider all the surrounding fact and circumstances which may possibly aid in determining the actor’s intent and may reject such inference.”<sup>42</sup> Thus, the court rejected the line of cases holding that the “fact finder may look *only* at the natural and probable consequences of an employee’s act....”<sup>43</sup>

With the *Resolution Trust* and *Susquehanna* as persuasive authority, the court in *Shoemaker* dealt with the issue of “manifest intent” by summary judgment.<sup>44</sup> The court noted that although summary judgment is not normally appropriate in cases when there are issues of intent, summary judgment is appropriate if the plaintiff is unable to make an initial evidentiary showing relative to intent and thereby fails to identify a credibility issue for the jury.<sup>45</sup> In reaching its decision whether the plaintiff met the standards announced in *Susquehanna* and *Resolution Trust*, the court quoted from *Susquehanna*:

Looking backwards, all but freak results are the natural consequence of preceding acts. Many are foreseeable. Most employers’ losses are the natural and foreseeable consequence of employee acts.... *The fact that an injury is the natural result of an act is a causation issue and does not answer the question of whether that injury was manifestly intended by the actor.* The point of inquiry is misplaced.

*The question of manifest intent to cause the employer to suffer a loss must be answered by looking at the point in time when the acts were committed or were contemplated. Was the actor’s purpose to cause the loss? Did the actor know that the loss was an inevitable result of his acts?* These are the questions that

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<sup>38</sup> *Id.* at 993.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 996.

<sup>43</sup> *Id.*

<sup>44</sup> *Shoemaker*, 176 F.Supp. 2d 453-53.

<sup>45</sup> *Id.* at 455.

should be asked.<sup>46</sup>

The *Shoemaker* court held that at the point in time when the employee, Moore, acted, there was no basis for concluding that he intended to cause a loss to anyone other than the Ross estate nor was there evidence indicating the employee, Moore, stole from the estate knowing that a loss to Guardianship Services would ensue.<sup>47</sup>

*Shoemaker* illustrates an interesting point. Although the loss at issue would appear to have been an indirect, rather than direct, that issue does not appear to have been raised. If that, in fact, did occur, it would be interesting to know what was factored into the determination.

### ***Banclinsure, Inc. v. BNC National Bank, N.A.***

Another recent case interpreting “manifest intent” is *Banclinsure, Inc. v. BNC National Bank, N.A.* The Eighth Circuit reiterated its definition of “manifest intent” in *Banclinsure*.<sup>48</sup> The coverage of a Financial Institution Bond was at issue in *Banclinsure*.<sup>49</sup> In determining whether the actions of an employee were covered under the law, the district court relied on the definition of “manifest intent” as set forth in *First Dakota National Bank v. St. Paul Fire & Marine Insurance Company*.<sup>50</sup> The Eighth Circuit held that the district court did not err by applying the definition of “manifest intent” set forth in *First Dakota*.<sup>51</sup>

### ***First Dakota National Bank v. St. Paul Fire & Marine Insurance Company***

In *First Dakota*, St. Paul argued that the district court “eviscerated the manifest requirement by instructing the jury that an employee who causes the bank to incur a loss is

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<sup>46</sup> *Id.* (emphasis in original) (citations omitted).

<sup>47</sup> *Id.*

<sup>48</sup> 263 F.3d 766, 771 (8th Cir. 2001).

<sup>49</sup> *Id.* at 768. The bond contained the typical language:

The underwriter ... agrees to indemnify the issuer for ... loss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others.

Such dishonest or fraudulent acts must be committed by the Employee with the manifest intent:

- (a) to cause the issuer to sustain such loss; and
- (b) to obtain financial benefit for the Employee or another person or entity.

However, if some or all of the Insured’s loss results directly or indirectly from loss, that portion of the loss is not covered unless the Employee was in collusion with one or more parties to the transactions and has received, in connection therewith a financial benefit with a value of at least \$2,500. *Id.*

<sup>50</sup> 2 F.3d 801 (8th Cir. 1993).

<sup>51</sup> *Banclinsure*, 362 F.3d at 771.

deemed to intend the natural consequences of his action.”<sup>52</sup> St. Paul argued that the jury instruction created an impermissible mandatory presumption in violation of Supreme Court precedents.<sup>53</sup> St. Paul objected to the language in the instruction that read: “A person is deemed to intend the natural consequences of his actions.”<sup>54</sup> The court rejected St. Paul’s argument and held the language was permissible because it did not “require the jury to reach a particular conclusion and that it could not “fairly be concluded that the jury seized on the ‘deemed’ language and felt that it was obligated or required to infer” that the employees acted with “manifest intent.”<sup>55</sup> Although St. Paul did not win its argument, the court noted that “[I]n the future, we suggest that the initial instructions where necessary to be given should not include any ‘deemed to intend’ language or any ‘law preserves’ language, but instead should be couched in nonmandatory terms that clearly provide a jury with a choice of whether or not to make an inference.”<sup>56</sup>

With *First Dakota* as guiding authority, the *BancInsure* Court addressed the issues raised in that litigation. In *BancInsure*, Gronlie, who was employed by BNC National Bank, N.A. (“BNC”), worked as a loan officer.<sup>57</sup> Gronlie, who had lending authority of \$ 200,000, provided loans to James Harper (“Harper”) and his various business entities.<sup>58</sup> One of Harper’s business entities, either inadvertently or intentionally, submitted false documents to support various loans.<sup>59</sup> Eventually, Gronlie’s husband and Harper created a company in which each owned a fifty percent interest.<sup>60</sup> Subsequently, the Gronlies bought out Harper’s interest in the

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<sup>52</sup> *First Dakota*, 2 F.3d at 813. The jury instruction on “manifest intent” was as follows: “Manifest intent” as used in these instructions, means a clearly evident intent.

Intent ordinarily may not be proved directly because there is no way of fathoming or scrutinizing the operation of the human mind. But you may infer a person’s intent from surrounding circumstances. You may consider any statement made or act done or omitted by a party whose intent is in issue, on all of the facts and circumstances which indicate his state of mind. You may consider it reasonable to draw the inference and find that a person intends the mutual and probable consequences of acts knowingly done or knowingly omitted. It is for you to decide what facts have been established by the evidence. The intent with which an act is done is shown by the circumstances surrounding the act, the manner in which it is done, and the means used. *Id.* at 813.

<sup>53</sup> *Id.*; *Cody Sandstrom v. Montara*, 442 U.S. 510 (1979).

<sup>54</sup> *See generally First Dakota*, 2 F.3d at 813-14.

<sup>55</sup> *Id.* at 814.

<sup>56</sup> *Id.* at 814 n. 6.

<sup>57</sup> *BancInsure*, 362 F.3d at 768.

<sup>58</sup> *Id.* at 768-69.

<sup>59</sup> *Id.* at 769.

<sup>60</sup> *Id.*

company.<sup>61</sup> The various loans to Harper were insufficiently secured and were not repaid.<sup>62</sup> The issue was whether the losses BNC suffered as a result of the loans were covered under the Financial Institution Bond issued by Banclnsure, Inc. providing fidelity coverage.<sup>63</sup> The district court held that only two of the various Harper loan transactions reflected a “manifest intent,” on Gronlie’s part, to cause loss to BNC.<sup>64</sup> After holding that the trial court did not err in its application of the law of “manifest intent” as set forth in *First Dakota*, the Eight Circuit deferred to the trial court’s factual determinations relative to Gronlie’s “manifest intent.”<sup>65</sup>

While the Court’s discussion of “manifest intent” is the primary focus of this paper, the manner in which the case arose is also of interest. Banclnsure did not require the execution of a release or satisfaction and made payment to its insured pursuant to a full reservation of rights which did not specifically reserve its right to seek a refund from its insured. Thereafter, Banclnsure filed a declaratory judgment action seeking a determination of its obligations under the Financial Institution Bond at issue. Over the insured’s argument, Banclnsure was not precluded from seeking a refund and the district court’s judgment ordering the refund was affirmed on appeal.

### Direct Loss

The Financial Institution Bond, Standard Form No. 24 provides that the underwriter agrees to indemnify the insured for “[l]oss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others.” This language mandates that there be a causal connection between the defalcator’s fraudulent act and the losses claimed by the Insured against the Bond and that those losses be direct, rather than indirect. Cause and effect is an easier “test” to grasp than the “manifest intent” requirement but can, nonetheless, limit the surety’s exposure under the bond to the kinds of damages typically associated with embezzlement from an insured.

The Third Circuit reiterated its interpretation of the “resulting directly from” language in *Resolution Trust Corp. v. Fidelity and Deposit Company of Maryland*.<sup>66</sup> The Court reiterated its view that the “conventional proximate cause standard was the correct formulation.”<sup>67</sup> In

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<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *See generally id.* at 766-69.

<sup>64</sup> *Id.* at 771 (the loans reflecting “manifest intent” on Gronlie’s part amounted to 181,508.85 of the approximately two million dollars of loan losses in the case).

<sup>65</sup> *Id.* at 771-72.

<sup>66</sup> *See supra* n. 10, 205 F.3d 615, 654-55 (3d Cir. 2000).

<sup>67</sup> *Id.* at 655; *Jefferson Bank v. Progressive Cas. Ins. Co.*, 965 F.2d 1274 (3d Cir. 1992). In *Jefferson Bank*, the Third Circuit applied Pennsylvania law; however, the *Resolution Trust* Court applied New Jersey law. The Third Circuit ruled that the New Jersey Supreme Court had not addressed the meaning of “losses resulting directly from” and held that the New Jersey Supreme Court would follow the opinion in *Jefferson Bank* applying the proximate cause language.

*Resolution Trust*, F&D argued that the phrase “losses resulting directly from” required an inquiry into the factual cause of the loss only.<sup>68</sup> As stated, the Third Circuit takes a more liberal view of the direct loss language and applies a proximate cause standard favoring the Insured.<sup>69</sup> The Third Circuit upheld the district court’s grant of summary judgment to the insured and held that “[b]ased on the record before us, we cannot find, as a matter of law, that a jury could not conclude that the employees’ actions were a substantial factor in bringing about the Northwest loan loss that eventually resulted.”<sup>70</sup>

The Second Circuit has also recently taken up the issue of “direct loss.” The Court, applying New York law, noted that the New York Court of Appeals had not construed the fidelity bond’s causation requirement.<sup>71</sup> In *National Union*, the facts giving rise to the litigation centered around loans and advances made by the Union Savings Bank (the “Bank”) that had a fidelity bond issued by National Union Fire Insurance Company of Pittsburgh.<sup>72</sup> The Bank loaned money to a developing company in which the Bank was a limited partner; the other partner was Micrad Corporation, an entity owned by Seymor Diesenhouse (“Diesenhouse”).<sup>73</sup> One of the Trustees of the Bank, John Folks (“Folks”), unbeknownst to the Bank was a partner in two separate real-estate ventures with Diesenhouse.<sup>74</sup> Folks had knowledge of improper and illegal activities perpetrated by Diesenhouse in connection with real-estate ventures.<sup>75</sup> Folks did not disclose the information to the Bank and eventually the limited partnership failed and the loans remained unpaid.<sup>76</sup> The FDIC sought to recover the Bank’s losses under the fidelity bond issued by National Union and won on a motion for summary judgment for the full amount of the bond’s coverage.<sup>77</sup> In dealing with damages related to the issuance of a loan, the court cited a Fifth Circuit opinion :

A loss is directly caused by the dishonest and fraudulent act within the meaning of the Bond where the bank can demonstrate that it would not have made the loan in absence of fraud.<sup>78</sup>

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<sup>68</sup> *Resolution Trust*, 205 F.3d 654.

<sup>69</sup> *Id.* at 655.

<sup>70</sup> *Id.* at 656-57.

<sup>71</sup> *Federal Deposit Ins. Corp. v. National Union Fire Ins. Co. of Pittsburgh*, 205 F.3d 66 (2d Cir. 2000).

<sup>72</sup> *Id.* at 68-69.

<sup>73</sup> *Id.* at 68.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 70.

<sup>78</sup> *Id.* at 76 (quoting *Lustig*, 961 F.2d at 1167).

The Court held that the Folk's failure to disclose the criminal activities of Diesenhouse to the Bank was the direct cause of the Bank's loss because had the Bank known it would not have continued funding the limited partnership.<sup>79</sup>

The Ninth Circuit also grappled with the direct cause language in an Executive Protection Policy containing language covering the insured for "direct losses of Money ... cause by the Theft or forgery by an Employee of any Insured acting alone or in collusion with others."<sup>80</sup> In *Vons*, the insured was exposed to tort liability via vicarious liability for acts of an employee in a Ponzi Scheme.<sup>81</sup> The insured settled with the employees tort victims and sought recovery for the losses suffered through threat of vicarious liability for the tortious actions of its employee.<sup>82</sup> The Court noted that a similar argument for coverage was rejected in the Fifth Circuit.<sup>83</sup> In rejecting the Insured's claim, the court held that "'direct' means 'direct' and that in the absence of third party claims clause, [the insured's] policy did not provide indemnity for vicarious liability for tortious acts of its employee."<sup>84</sup>

### Conclusion

The Financial Institution Bond language requiring that the employee act with "manifest intent" and that losses to the insured result "directly from" the employee's fraudulent act are important provisions in the bond that can limit the surety's exposure to the types of claims intended to be covered by the bond—primarily embezzlement type claims. As the cases discussed *supra* illustrate, both the "direct loss" requirement and the "manifest intent" requirement evidence the ongoing conflict between broad coverage interpretations of the Financial Institution Bond favoring the insured and narrow interpretations favoring the surety. This conflict is likely to be exacerbated in the future as courts begin to consider manuscripted policy provisions.

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<sup>79</sup> *Id.*

<sup>80</sup> *Vons Companies, Inc. v. Federal Insurance Co.*, 212 F.3d 489 (9th Cir. 2000).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Lynch Properties, Inc. v. Potomac Ins. Co.*, 140 F. 3d 622 (5th Cir. 1998).

<sup>84</sup> *Id.*