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**ATTACKS ON POLICY LIMITS OF FIDELITY BONDS AND
POLICIES:
MULTIPLE OCCURRENCES AND ACCUMULATION OF
POLICY LIMITS**

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ATTACKS ON POLICY LIMITS OF FIDELITY BONDS AND POLICIES: MULTIPLE OCCURRENCES AND ACCUMULATION OF POLICY LIMITS

A cause for concern among fidelity insurers is the recent judicial trend toward expanding the insurer's liability for losses resulting from employee dishonesty. For many years, courts almost uniformly interpreted non-cumulation clauses in fidelity policies in favor of insurers. However, recent decisions have found a newly discovered ambiguity in insuring agreements that previously were ruled to be unambiguous. As a result, courts have expanded insurer's liability beyond what were generally believed to be policy limits.

This paper will address two specific areas of attack on policy limits. First is the attempt to characterize each separate act in a series of wrongdoing (e.g. the forgery of several checks over a period of time) as an independent "occurrence," as defined in a fidelity policy, rather than construing the entire series of acts as one "occurrence." Second is the attempt to characterize a policy subject to periodic renewals as a series of separate policies, so as to create multiple periodic policy limits.

Both of these arguments have met with success before appellate courts in recent years. In two recent decisions, *Karen Kane, Inc. v. Reliance Surety Company*, 202 F.3d 1180 (9th Cir. 2000) and *Universal Underwriters Ins. Co. v. Ford*, 734 So.2d 173 (Miss. 1999), a federal circuit court of appeal and a state supreme court addressed both of these attacks on policy limits and sided with the insureds. However, the findings of each court were different in material respects. This paper will focus on these two decisions, and the impact of their rulings.

In considering these decisions, one should bear in mind the overriding canon of judicial interpretation of insurance policies: any ambiguity in policy language will be interpreted in favor of the insured. Insurance policies, like all contracts, are construed against the drafter when the court finds a provision to be ambiguous. Because, with certain limited exceptions (e.g. policy limits, deductibles, and *types* of coverage), the terms of insurance policies are not subject to negotiation between the insurer and the insured, they are sometimes, in the eyes of the law, referred to as contracts of adhesion. Courts tend to frown on such contracts, and an "activist" court will search out and adopt an analysis that provides the insured its "reasonable expectation" of coverage. Therefore, the starting point for the court's analysis in cases that have expended insurer's liability is a finding that relevant policy language is ambiguous. In most cases, the factual issues behind the loss are not in dispute.

Universal Underwriters Ins. Co. v. Ford

The characterization of an insured's loss as the result of a series of "occurrences," rather than the result of one ongoing "occurrence," is one way for an insured to attempt to recover a loss in excess of policy declarations. The Supreme Court of Mississippi's adoption of this analysis has a profound effect upon the liability of the insurer. In *Universal Underwriters Ins. Co. v. Ford*, 734 So.2d 173 (Miss. 1999), the court found the definition of "loss" in Universal's policy to be ambiguous; the result of that finding rendered Universal liable to its insured in an amount nearly twenty five times its policy declarations.

Universal issued a series of policies to Buddy Jones Ford Lincoln-Mercury, Inc. ("Jones Ford"). The initial policy was effective for a one year period beginning October 1, 1984, and four successive annual policies provided coverage through October 1, 1998. Each of the policies contained crime coverage with a stated limit of liability for employee dishonesty of \$10,000.00.

On July 25, 1998, during an unannounced independent audit, Jones Ford discovered that Patsy Ellis, a former book keeper and office manager, had misappropriated funds of Jones Ford on 175 separate occasions between 1984 and 1988, resulting in the total loss of \$233,082.97.

Jones Ford submitted a proof of loss itemizing the 175 separate occasions of embezzlement. Universal promptly tendered payment of \$10,000.00 to Jones Ford, contending that Ellis' acts collectively constituted one "loss." Jones Ford disagreed, and commenced litigation.

The litigation addressed two significant issues: (1) whether Ellis' activities constituted one loss, or 175; and (2) whether coverage under any of the policies had expired. In addressing these issues, the following provisions of the policies were considered:

INSURING AGREEMENT--WE will pay for LOSS as defined as follows:

EMPLOYEE DISHONESTY--WE will pay for LOSS of MONEY, SECURITIES, and other property which YOU sustain resulting directly from any fraudulent or dishonest act committed by an EMPLOYEE with manifest intent to:

(a) cause YOU to sustain such a LOSS, and;

(b) obtain financial benefit for the EMPLOYEE, or any other person or organization intended by the EMPLOYEE to receive such benefit other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions, and other EMPLOYEE benefits earned in the normal course of employment.

* * *

9. THE MOST WE WILL PAY--LOSS payment will not reduce OUR liability for other LOSSES. From the amount of LOSS, WE will deduct the net amount of all recoveries obtained or made by YOU (other than LOSS covered by any other bond or insurance) or US. If the net LOSS is in excess of the deductible stated in the declarations, and regardless of the number of persons or organizations included in YOU, the most WE will pay:

(a) under EMPLOYEE DISHONESTY, is the limit stated in the declarations as applicable to a LOSS caused by one or more EMPLOYEES, or to all LOSS caused by one EMPLOYEE or in which the EMPLOYEE is concerned or implicated;

* * *

Regardless of the number of years this Coverage Part continues in force, the limit stated in the declarations is not cumulative from one period to another, or from one year to another.

Additionally, the policies contained a discovery requirement which reads as follows:

1. DISCOVERY--LOSS is covered only if discovered not later than one year from the end of the Coverage Part period.

The trial court found that the provisions relating to Employee Dishonesty were ambiguous, followed “the directive that said policies shall be strictly construed against Universal and liberally construed in favor of the dealership,” and determined that “the \$10,000.00 limits of liability and \$250.00 deductible under the applicable Uncover policies shall apply to each separate occurrence of embezzlement and shall not apply to the entire loss caused by the employee Ellis.” The court also determined that the discovery provisions of the policies limited Universal's liability to “any loss discovered not later than one year from the end of the coverage part period.” Ultimately, the trial court awarded Jones Ford \$136,510.71, plus interest, under the applicable policies issued by Universal. Both Universal and Jones Ford appealed the judgment.

Before the Supreme Court, Universal argued that the policy language was unambiguous, and clearly stated that the \$10,000.00 limit of liability and the \$250.00 deductible in the declarations for “Employee Dishonesty” apply to “all LOSS caused by one EMPLOYEE or in which the EMPLOYEE is concerned or implicated.” It argued that the limit of liability and deductible apply to the total amount of loss caused by Ellis, rather than to each of the 175 separate occasions of embezzlement in which she engaged.

Jones Ford agreed that the limitation provision applies to all “loss” caused by one employee, but argued, that “loss” was defined in the policies to mean “loss or damage as defined in the Insuring Agreement,” which, in turn, defined “loss,” for the purpose of employee dishonesty, to mean “LOSS of MONEY ... which YOU sustain resulting directly from *any fraudulent or dishonest act* committed by an EMPLOYEE with manifest intent to: (a) cause YOU to sustain such a LOSS, and; (b) obtain financial benefit for the EMPLOYEE.” Jones Ford maintained that the limitations clause applied to all loss resulting directly from each fraudulent or dishonest act committed by an employee. It argued that “[i]f Universal had wished to have the Limitation clause apply to the entire loss caused by all the acts of embezzlement by an employee, Universal simply could have defined ‘loss’ in the Insuring Agreement as loss of money resulting directly from any fraudulent act, or series of related fraudulent or dishonest acts, committed by an employee,” as other policies do.

The Court concluded that both interpretations of the policies were plausible, and affirmed the trial court’s finding that the policy was ambiguous and should be construed against Universal. *Universal*, 734 So.2d at 176. While Universal argued that other jurisdictions had ruled that multiple and separate dishonest acts or occasions of

embezzlement by one employee constituted a single loss to the insured, the Court noted that, in those cases, the policy language clearly and unambiguously stated that multiple acts may constitute one occurrence of loss. (See, e.g., *Business Interiors, Inc. v. Aetna Cas. & Sur. Co.*, 751 F.2d 361, 362 n.1 (10th Cir.1984)(policy provided “[a]s respects any one employee, dishonest or fraudulent acts of such employee during the policy period shall be deemed to be one occurrence for the purpose of applying the deductible”); *American Commerce Ins. Brokers, Inc. v. Minnesota Mut. Fire & Cas. Co.*, 551 N.W.2d 224, 225 (Minn.1996)(coverage limited to policy limit shown in declarations for loss in any one occurrence; policy stated specifically that all loss or damage involving a single act or series of related acts was considered one occurrence; term “series of related acts” found not ambiguous); *Jefferson Parish Clerk of Court Health Ins. Trust Fund v. Fidelity & Dep. Co. of Md.*, 673 So.2d 1238, 1245 (La.Ct.App.1996)(where “[o]ccurrence” means all loss caused by, or involving, one or more employees, whether the result of a single act or a series of acts, only one occurrence of employee dishonesty could be found)). Distinguishing those cases, the court found that the limitations clause “plainly and *unambiguously* applie[d] to each fraudulent or dishonest act committed by an employee,” and that the \$10,000.00 policy limit (and \$250.00 deductible) applied to each occasion of Ellis’ embezzlement. *Universal*, 734 So.2d at 178.

Universal did not fare any better on the second issue presented to the court. Jones Ford appealed the trial court’s judgment that the one year discovery provisions in the policies precluded it from recovering any loss not discovered within one year of the end of any particular policy period. While the terms of that provision appear on their face to be unambiguous, Jones Ford contended that an extension of coverage provision in the policy created another ambiguity:

3. LOSS UNDER PRIOR BOND OR POLICY—If EMPLOYEE DISHONESTY replaces a bond or policy carried by YOU...that is no longer in effect, WE will pay for LOSS...if LOSS would have been covered by the prior bond or policy except that the LOSS was not discovered in the Discovery Period of the prior bond or policy. Provided, however:
- (a) this extension is part of and not in addition to the limit stated in the declarations for EMPLOYEE DISHONESTY;
 - (b) the LOSS would have been covered had this insurance been in effect when the act or event causing the LOSS took place;
 - (c) LOSS recovery is limited to the least of the following:
 - (1) the amount recoverable at the time coverage was replaced by this insurance had it been in force at the time the act or event took place;
 - (2) the amount recoverable if the prior bond or policy had continued in force until the discovery of the LOSS.

The court adopted the ruling of the Iowa Supreme Court in *Cincinnati Ins. Co. v. Hopkins Sporting Goods, Inc.*, 522 N.W.2d 837 (Iowa 1994), which noted that the language of the discovery clause was clear standing alone, but was ambiguous when considered with the extension clause, and that such ambiguity must be construed in favor of the insured. The Iowa court noted that the extension clause was a clear incentive for insureds to continue to purchase coverage with the same insurer, could be understood to

extend the limitations period into the period of a new policy. *Cincinnati Ins. Co.*, 522 N.W.2d at 839. The Mississippi court concluded that the similar ambiguity must be construed in favor of the insured, and found that the trial court erred in limiting Universal's liability to loss discovered not later than one year from the end of the coverage part period. *Universal*, 734 So.2d at 176. Therefore, Universal was held liable for the entire loss submitted by Jones Ford, subject to its deductible.

In many instances, the *Universal* decision will be readily distinguishable from a similar loss. Many crime policies contain specific language relating a policy limit to an "occurrence," which is generally defined as a loss resulting from "a single act, or series of acts" by an employee. As the *Universal* court went to lengths to note, such a provision was absent from Universal's policies. Those policies apparently attempted to convey a similar limitation by stating that the policy limit applied to "all loss caused by one employee or in which the employee is concerned or implicated," but that language was deemed ambiguous. The specific mention of "a series of acts" in other policies appears to render the terms of those policies unambiguous, even in the eyes of the Mississippi court.

Accumulation of Policy Limits: *Karen Kane, Inc. v. Reliance Surety Company*

Subsequent to the Mississippi high court's decision in *Universal*, the United States Court of Appeals for the Ninth Circuit issued its opinion in *Karen Kane, Inc. v. Reliance Surety Company*, 202 F.3d 1180 (9th Cir. 2000). The *Karen Kane* decision addressed the same issues as the *Universal* case, and reached somewhat different conclusions, although they are equally troubling to fidelity insurers.

Karen Kane is a California apparel manufacturer. Reliance issued insurance policies to Karen Kane that included coverage for employee dishonesty, subject to a coverage limit of \$250,000.00, between December 1993 and December 1996.

One of Karen Kane's employees, Norris Dantzler, engaged in a scheme to defraud Karen Kane by having it pay for items it did not order and did not receive. Dantzler began his scheme in late 1992 and continued it until discovered by Karen Kane's president in May, 1996. During the period of Reliance's coverage, Dantzler converted in excess of \$1.4 million from Karen Kane, which submitted to Reliance three proofs of loss for the periods December 1993 to December 1994, December 1994 to December 1995, and December 1995 to May 1996.

Reliance advised its insured that it considered its insurance over the three years to be one continuous policy, and that Dantzler's activities constituted one "occurrence" within the meaning of the policy (defined as "all loss caused by, or involving, one or more employees, whether the result of a single act or series of acts"), and that its liability was therefore limited to \$250,000.00. Reliance further relied upon a prior loss provision in its policy, which provided:

Loss Covered Under This Insurance and Prior Insurance Issued by Us or Any
Affiliate;
If any loss is covered:

- a. Partly by this insurance; and
 - b. Partly by any prior canceled or terminated insurance that we or any affiliate had issued to you or any predecessor in interest:
- the most we will pay is the larger of the amount recoverable under this insurance or prior insurance.

Reliance tendered to Karen Kane \$250,000.00 as the policy limits of its loss. Karen Kane accepted the payment under reservation of rights, and later instituted suit against Reliance for breach of contract and wrongful denial of coverage in California Superior Court. Reliance removed the suit to federal court.

The federal district court granted Reliance summary judgment, finding that the definition of "occurrence" and the prior loss provision clearly limited Karen Kane's recovery to the liability limit for the last policy period of December 1995-December 1996 (before the district court, Reliance conceded that, under California law, it had issued three separate one year policies). The district court also found that, even if the prior loss provision did not limit recovery, Karen Kane could not recover for any loss under the 1993-1994 policy, because of a discovery requirement in the policy, which provided that Reliance "will pay only for covered loss discovered no later than one year from the end of the policy period." Karen Kane appealed.

The Ninth Circuit affirmed the District court's finding that the discovery requirement precluded Karen Kane's recovery under the 1993-1994 policy (the court did not address the "extension clause" argument presented in *Universal*), but reversed the district court in all other respects. In reversing the district court, the Ninth Circuit relied almost exclusively on a split decision from an intermediate California appellate court, *A.B.S. Clothing Collection, Inc. v. Home Ins. Co.*, 41 Cal. Rptr.2d 166 (Cal. Dist. Ct. App. 1995), which, factually, was virtually identical. In each case, an employee stole funds from an employer (both clothing manufacturers, no less) over a period of several years during which the employer carried insurance against employee dishonesty issued by a single insurer. The policies issued to A.B.S. and Karen Kane used language that was identical in all relevant respects. The A.B.S. policy and the Reliance policy defined "occurrence" in the same way and contained prior loss provisions with identical wording.

The Ninth Circuit acknowledged that the A.B.S. decision was not controlling authority, but because no other appellate court had issued an opinion rejecting or expressing disagreement with its analysis, and because no evidence indicated (and neither party contended), that the California Supreme Court would have decided the case differently (it had denied review of the case), it found A.B.S. to be a persuasive statement of California law. Given the factual similarities, the court found that A.B.S., as a functional matter, was indistinguishable. *Karen Kane*, 202 F.3d at 1183.

The A.B.S. court had found that the prior loss provisions and the definition of "occurrence" were ambiguous, and therefore construed the policy at issue to provide coverage to the insured up to the policy limit for each year in force. In its analysis, the A.B.S. court first looked to determine whether coverage was based on a series of separate contracts, or on a single continuous contract. If coverage was based on a series of

separate, independent contracts, the insured was entitled to recover up to the limit of liability for each policy period in which a loss occurs, but if there were only one continuous contract, recovery was limited to the limit of liability stated in the contract. *A.B.S.*, 41 Cal.Rptr.2d 166. The court began this inquiry with a heading stating the following principle, which was suggestive of the ultimate outcome:

An Insurer Seeking to Limit the Amount of Its Liability to the Insured for Losses Incurred During Successive Years of Coverage Must Show by Clear and Unambiguous Policy Language That the Parties Intended to Enter Into One Continuous Contract.”

Id. Under this rule, the *A.B.S.* court said, an insurer *will* be liable up to the policy limit for each separate period, *unless* it can show clear intent by the parties to enter into a single continuous insurance contract. The court then found that the insurer failed to show a clear intent to enter into a single continuous contract. First, the court found that a prior loss provision (like that quoted above), even when read in combination with a “non-cumulation” provision (“Regardless of the number of years this insurance remains in force or the number of premiums paid, no limit of insurance cumulates from year to year or period to period”), failed to show a clear and unambiguous intent to enter into a continuous contract. *Id.* at 166. Second, the court found the policy’s definition of “occurrence” to be ambiguous: “while defining ‘occurrence’ as ‘all loss’ suggests that there can be only one occurrence during the life of the insurance, the limit of insurance provision [“The most we will pay for loss in any one ‘occurrence’ is the applicable Limit of Insurance show in the Declarations”] suggests there could be more than one occurrence.” *Id.* The *A.B.S.* court then concluded that the policy provisions did not clearly and unambiguously show an intent to enter into one continuous contract of insurance, and construed the ambiguities must in favor of the insured. *Id.*

The Ninth Circuit found that, because district court here was called upon to interpret a policy identical to the *A.B.S.* policy and to apply it to facts indistinguishable from those of *A.B.S.*, its ruling should have mirrored *A.B.S.*: “In light of the very strong similarities between *A.B.S.* and this case, it would appear that the district court should have reached the same conclusion that the *A.B.S.* court did: under California law, the provisions at issue are ambiguous and to be construed in favor of coverage.” *Karen Kane*, 202 F.3d at 1185. In criticizing the district court’s finding, the Ninth Circuit noted that the ambiguity found in the definition of “occurrence” by the *A.B.S.* court was present in its case as well. The term “occurrence,” the court noted, “could either (1) refer to the *entire Dantzler conspiracy* (as a ‘series of acts,’ namely, thefts), the position urged by Reliance; or (2) refer to each theft *within the Dantzler conspiracy* (as a ‘series of acts,’ namely, the multiple steps involved in each theft).” *Id.* In so writing, the Ninth Circuit opened the door for an extension of the Mississippi court’s *Universal* ruling to policies that, unlike *Universal*’s, include a “series of acts” in the definition of “occurrence.”

It appears, however, that *Karen Kane* did not advance the theory offered by Jones Ford in *Universal*. Rather, it contended that the term “occurrence” as defined in the policy is ambiguous with respect to whether it was temporally limited *by each policy period*, in

which case Dantzer's ongoing fraudulent scheme would be recoverable as a separate "occurrence" within each period.

The court agreed. It found that the policy placed temporal limitations upon loss coverage: "we will pay only for loss that you sustain through acts committed or events occurring during the Policy Period." However, the policy defined "occurrence" as "all loss caused by, or involving, one or more 'employees,' whether the result of a single act or series of acts," and further provided that "[t]he most [Reliance] will pay for loss in any one 'occurrence' is the applicable Limit of Insurance shown in the Declarations [\$250,000]." The court found that the provisions created an ambiguity as to the extent of the insurer's liability, because while defining 'occurrence' as 'all loss' suggests that there can be only one occurrence during the life of the insurance, the provision restricting liability 'for any one occurrence' suggests there could be more than one occurrence." *Karen Kane*, 202 F.3d at 1187. The policy was silent as to whether the term "occurrence" refers to "a single act or series of acts" within a single policy period or across multiple periods. If "occurrence" is construed as limited by policy period, then Dantzer's approximately 150 individual acts of theft, spanning over three years, constitute three separate "series of acts," one for each of the three policy periods and recoverable within each period as such. The court, ruling in favor of coverage, adopted that construction. *Id.* at 1188.

The court did, however, affirm the district court's finding that the discovery provision in the policy was unambiguous and enforceable. The insured did not present the argument Jones Ford did in *Universal*, but rather asserted that the provision was inconsistent with other provisions, or, alternatively, was tolled. The Ninth Circuit rejected these arguments, and found that the provision "unambiguously barred Kane from recovering under the earliest of the three policies...." *Id.* at 1190.

In some respects, *Karen Kane* is a less troubling decision than *Universal*. The Ninth Circuit recognized the validity of the discovery provision of the policy, which effectively caps an insured's recovery at twice the policy limits. In the case of a loss that has transpired for a period of several years, the discovery provision will preclude claims made on all prior policies except the policy immediately preceding the current policy.

In other respects, *Karen Kane* is a more troubling decision. The Ninth Circuit is court of higher profile than the Mississippi Supreme Court, and the decision is therefore more likely to be offered as persuasive authority (the Fourth Circuit Court of Appeals has already relied on the case in an unpublished decision, *Spartan Iron & Metal v. Liberty Ins. Co.*, 2001 WL 301111 (4th Cir. Mar. 28, 2001)). Because the court relied almost wholly on an intermediate appellate opinion, there is a chance the decision could be questioned if other California courts decline to follow *A.B.S.* Most disconcerting, however, is the fact that the court opened the door to a challenge of the longstanding and generally accepted rule that a series of acts constitutes one "occurrence" under a crime policy. The extension of *Universal's* most significant holding to policies containing that language would be nothing short of a nightmare for fidelity insurers.

The *Karen Kane* analysis is already subject to question. Although the case was not cited specifically, an intermediate appellate court in New York has found that a policy

similar to *Karen Kane* constituted only one policy, and therefore precluded multiple recoveries. *Shared-Interest Management v. CNA Financial Ins. Grp.*, 725 N.Y.S.2d 469 (N.Y. App. Div. 2001). Significantly, the court pointed to language in the policy that identified the policy period as “From June 8, 1990 to until cancelled” in support of this finding. *Id.* at 471. However, the court went further, and stated that, even if two policies existed, the prior loss provision precluded a double recovery. *Id.* at 472.

The Court of Appeals of New York, the highest court in that state, has granted a petition to review the Appellate Division’s ruling. It appears that another influential court has decided to address this issue.