LIMITS OF LIABILITY: A MULTI-FACETED PERSPECTIVE

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I. Introduction

Fidelity practitioners often find novel liability theories make for interesting and challenging cases. Fortunately for their clients such cases are relatively rare. Much more common is the situation where the insured discovers that one of its employees has been stealing from it. The loss resulting from this activity while regrettable is, on an actuarial basis, foreseeable and accounted for during the underwriting process.[1] Fidelity losses, unlike many other insurable risks, tend to be hidden from the insured. In other words, it is not uncommon for the insured to discover a fidelity loss well after the event(s) resulting in the loss has occurred. Dishonest employees typically do not flaunt their wrongful activities and, as a consequence, fidelity losses can remain undetected for many years. Thus, from the underwriter's perspective, the risk is often not so much when the dishonesty happens but when it comes to light.

Another feature of fidelity losses, which distinguish them from most types of property or casualty losses, is that a fidelity loss is often comprised of a series of related acts occurring over a number of years. A classic example is the employee who commits a series of thefts against his employer over a course of a number of years. While it is uncommon for an insured to get hit from a particular peril more than once or twice in a number of years, dishonest employees tend to engage in pattern behavior which can result in many separate instances of loss over the length of their employment.

Sureties have crafted their products to account for the peculiar nature of fidelity losses. The two principal instruments, the Financial Institution Bond Standard Form No. 24 ("FIB")(formerly know as the "Bankers Blanket Bond") and the standard Commercial Crime Policy ("CCP"), have developed very different approaches to the unique timing and discovery issues presented by fidelity losses. The facts of the particular claim at issue and the nature of coverage acquired can greatly effect the allocation of loss among the insured and one or more carriers. Surety claim professionals are routinely confronted with such allocation challenges.

To assist the fidelity practitioner's efforts in wading through loss allocation issues, this paper will analyze the pertinent provisions of two standard commercial fidelity instruments, explore the ramifications of different policy language, discuss the various time-related factors which can influence allocation outcomes and review relevant case law on the subject. In order to make this paper as concrete a loss allocation guide as possible, a number of appendices have been prepared which graphically illustrate some of the issues discussed in this paper.

II. Pertinent Policy Provisions

For purposes of this paper it is helpful to bear in mind a fairly typical loss scenario of an employee stealing from his or her employer over the course of several years. We may embellish upon this simple scenario from time to time to illustrate particular issues. Nevertheless, the focus of the discussion will be upon the allocation issues presented by this rather straightforward factual scenario. Even this fairly simple loss scenario can implicate a significant number of policy provisions. This is due in large part to the facts not expressly accounted for in the scenario. Perhaps the most important of these is the nature of the insured's coverage during the period of time the losses were incurred and/or discovered.

While there are a number of fidelity products being marketed today, for our discussion we will focus on the following two standard form coverages. The FIB, which is a standardized form jointly developed by the American Bankers Association and the Surety Association of America (SAA), affords coverage designed particularily for the risks faced by financial institutions. While the coverage and limitations on coverage may be changed by the parties through the use of one or more endorsements, it is unusual for the parties to change the language of the basic form.[2] The CCP, on the other hand, is subject to more variation. By the late 1970's and early 1980's a great variety of crime forms were available on the market. Eventually the Insurance Services Office (ISO) introduced a more simplified system of commercial property and liability insurance forms. The crime portion of the commercial lines program was developed under the joint jurisdiction of the ISO and the SAA. The SAA took responsibility for the employee dishonesty and forgery coverages while the ISO was responsible for the other coverages. This paper will focus upon Crime General Provisions Form (CR 10 00 as revised December, 1990).[3]

A. FIB STANDARD FORM NO. 24

There is no one provision which determines the extent of the surety's liability in all loss situations. Instead there are a cluster of clauses which permit one to analyze any given loss situation and arrive at a solution. As one might expect, certain provisions play more of a role than others. Most often the analysis starts with the provision establishing the coverage trigger.

1. COVERAGE TRIGGER

Most FIB's are written on a discovery basis. Such bonds respond to covered losses sustained at any time as long as the loss was discovered during the bond period. Section 3 of the FIB's Conditions and Limitations Form reads "this bond applies to loss discovered by the Insured during the Bond Period."

It is less often that an FIB is written on a "loss sustained" basis. Such a bond responds to covered losses that are both sustained by the insured and discovered during the bond period. An FIB written on a loss sustained basis tends to function like a standard commercial crime policy. These bonds often contain a discovery period provision allowing for coverage for losses sustained during the bond period but discovered after the term of the bond but during the discovery period (often one year). Such bonds often contain a superseded suretyship provision which addresses losses which were sustained before the bond period of the current bond and would have been covered under the previous bond but for the expiration of the discovery period. These provisions will be addressed in more detail during the discussion on commercial crime coverage.

The difference between a discovery and a loss sustained bond cannot be overemphasized. The coverage outcome can change dramatically depending upon the specific trigger employed. For example, in *Ashwell & Co., Inc. v. TransAmerica Ins. Co.*[4] an insured sought reformation on a brokers' blanket bond (Standard Form 14) to eliminate a discovery Rider which it claimed was improperly incorporated into the bond. The discovery Rider had the effect of turning a loss sustained instrument into a discovery bond. The insured acquired a $100,000 bond that expired by its terms on December 1, 1966. The subsequent bond secured by the insured was in the amount of $50,000. The insured sought recovery of the full penal sum of the first bond claiming that the discovery Rider was erroneously attached to the bond and that in reality it was a loss sustained bond with a discovery period of one year. Because the insured discovered its loss within the discovery period and the acts resulting in the loss were committed during the bond period, the insured would be entitled to $100,000 if it was correct in its contention that the discovery Rider was not part of the bond. The surety offered to pay $50,000 on the theory that the second bond responded to the loss. The court ruled in favor of the insured on evidence that the initial request for coverage sought a Standard Form 14 bond which " is not a discovery bond".[5]

2. Bond Period

The term of the bond is critically important. Item 2 of the declarations page sets forth the bond period. Most FIB's are written on a one year fixed-term basis period. Less often bonds are written on a three year or in some cases a continuous basis.

3. Termination Declaration

Item 6 of the declarations page is a provision wherein the insured acknowledges that its acceptance of the current bond is notice to the insurer of the cancellation of prior bonds or policies listed in the declaration. This provision, with one possible exception, essentially removes prior bonds from any coverage equation.[6] This exception involves situations where the prior insurance is on a loss sustained basis wherein the discovery period has not expired at the time the insured discovers its loss. In such cases Conditions and Limitations Section 8, entitled "Limit Of Liability Under This Bond Or Prior Insurance", applies to the situation.

4. Limit of Liability

Section 4 of the FIB's Conditions and Limitations form addresses two distinct items. The first is the insurer's total liability for all losses discovered during the bond period. This sum may not exceed the aggregate limit of liability set forth in item 3 of the declarations. Any recoveries obtained by the insurer do not operate to increase the limits of insurance.

In addition to an aggregate limit of liability, each single loss shall not exceed the single loss limit of liability set forth in item 4 of the declarations. For purposes of our scenario, wherein an employee working alone or in collusion with others commits a number of dishonest acts for over the years resulting in numerous losses, all such losses would be considered a single loss.

5. Limit of Liability under This Bond and Prior Insurance

Section 8 addresses a situation where the coverage in effect before the current bond is written on a loss sustained basis. In other words, the coverage prior to the current bond provides for recovery only in the event that the insured sustained its loss during the term of the bond. Because the loss sustained coverage form usually has a discovery period which would extend into the period of time of the current discovery bond it is conceivable that, in the absence of this provision, an insured could have coverage under both instruments. This provision prevents such a situation. In the event that the prior coverage is afforded through the same company, then the insured is entitled to either the amount of coverage available under the current bond or the prior policies, whichever amount is the larger. In the event that the prior coverage is issued by another insurer then the current bond becomes excess coverage notwithstanding an "other insurance" provision contained in the prior policy or bond.

6. Other Insurance or Indemnity

Section 9 is an "Other Insurance" clause. This clause, whether in the FIB or the CCP insurance products, states that the current policy or bond applies only as excess over any other valid and collectable insurance or indemnity obtained by the insured. This will be discussed more at length below. Because many insurance products contain such provisions the courts have adopted a variety of means to allocate loss in situations where more than one insurer claims it excess by virtue of an "other insurance" provision.

7. Deductible Amount

Section 11 states that the insurer is only responsible for losses exceeding the single loss deductible amount applicable to the insuring agreement or coverage.

8. Recoveries

Section 7, addresses, among other things, any recoveries secured by the insured or the surety. Any recoveries secured are first applied to satisfy the insured's loss in excess of the single or aggregate limit of liability. Next, recoveries are to be used to reimburse the surety. Only after the surety has been reimbursed may recoveries be used to satisfy the insured's deductible amount.[7] In the absence of a recovery clause, the surety has no right of subrogation until the insured has obtained full recovery.[8] The effect of the recoveries provision is that the surety must indemnify the insured up to the limits of the bond for losses directly resulting from covered acts, less net recoveries, if any, over and above the insured's uncovered losses.[9]

B. THE COMMERCIAL CRIME POLICY

As one might expect, the CCP contains a number of provisions which are similar to those found in the FIB. Yet because the CCP is written on a loss sustained basis, the ramifications of the limits of liability and allocation provisions can be strikingly different. The primary provisions relating to limits of liability and loss allocation are the following:

1. COVERAGE TRIGGER

General Condition 13 of the 1990 ISO form entitled "Policy Period," refers back to the declarations page setting forth the policy term. More importantly, however, this provision makes it clear that, unlike the FIB, this policy only responds to "loss that is sustained through acts committed or events occurring during the Policy Period." This language is generally interpreted to mean that the insured's losses must occur during the policy period.[10] Indeed, this policy is known as a "loss sustained" form.

What is the relationship between loss and the acts or events resulting in such loss? It is quite clear that this language mandates that such acts or events must occur during the policy period. Is it possible for dishonest acts to be committed at one point in time and for losses to be sustained as a result of those acts at a different point in time? If so, may this policy language be read to allow recovery for losses sustained outside the policy period due to acts committed or events occurring during the policy period? These issues do not arise from the fact scenario set forth earlier in this paper as the act of stealing money or property necessitates that the loss occurs at the time of the act.

What about loans?[11] Given the eligibility rules, it is unlikely that a CCP would be used for an institution making loans. Nevertheless, while discussed in the context of a discovery trigger, most courts that have looked at the issue treat dishonesty and loss as contemporaneous events. This is sometimes expressed in terms of discovery of facts that would cause a reasonable person to assume that a loss covered by the bond had been or would be incurred.[12] Other times distinction is made between discovering a loss and knowing the extent of or the exact amount of the loss.[13]

Another way that the courts have addressed this issue is to conclude that loss occurs when liability arises subjecting the insured to paying damages or suffering a loss in the future.[14] For example, in *United Bank & Trust Co. v. Kansas Bankers Sur. Co.*[15], a bond containing a "loss sustained rider," which restricted coverage to losses sustained and discovered after a specified date, did not respond to a loss found when credit was extended to a customer who supplied counterfeit securities as collateral prior to the effective date of coverage even though the default and judgment against the insured occurred after the bond was issued.[16]

As loss will most often be assumed to exist at a time of the commission of the acts, the key is to establish when the dishonest acts were committed. This is apparent from the Second Circuit Court of Appeals decision in *Leucadia, Inc. v. Reliance Insurance Co*[17], wherein the insured claimed that one of its employees had fraudulently and dishonestly loaned millions of dollars.[18] Reliance had issued two bonds. The earlier bond insured against losses resulting solely from "acts committed" during the bond period. The later bond provided indemnification for "losses sustained" during the bond period. The insured claimed that coverage of the second bond was broader than the first insofar as it responded to losses sustained during the bond period regardless of when the acts resulting in those losses occurred. The Court rejected the insured's contention finding that, regardless of the language employed in the second bond, coverage was limited to losses sustained as a result of acts committed during the bond period:

> Judge Daronco [trial court] ruled that, although the wording of the bonds differed, Reliance's intention was the same, namely, to insure for acts occurring only during the bond period (May 1, 1976 to October 25, 1977). Any other reading would require a fidelity bond company to assume responsibility for acts committed prior to the coverage period of which it could have had no knowledge . . . . We find no error in the district court's ruling that Reliance was liable only for those fraudulent acts committed during the period the bonds were in force. . . . It is well established that, "[i]n the absence of clearly expressed contrary intent, fidelity guaranty contracts have perspective operation only, and they do not cover default occurring prior to the date when such contracts became effective." Thus, the December bond [the later bond], with its absence of language specifying the time frame during which acts must have been committed, is presumed to have perspective operation only.[19]

While the Second Circuit could have chosen to follow the FIB line of cases which hold that loss is sustained when dishonesty occurs, it chose a different analysis to arrive at essentially the same result.[20] The "loss sustained" bond might more appropriately be termed the "acts committed" form. However, the present moniker is descriptive as in most cases an insured's loss will be sustained at the time that the dishonest acts are committed. Nevertheless, the possibility that the two events may not occur contemporaneously gives rise to interesting allocation issues.

2. RELEVANT DECLARATIONS

As with the FIB, the policy declarations setting forth the policy period are critical to any allocation analysis. Similarly, declarations setting forth coverage limits and the deductible play a role in most allocations. Like the FIB, a common declaration contained in a CCP is a representation with regard to the cancellation of prior insurance. In other words, the insured's acceptance of the current policy is notice of the cancellation of prior policies or bonds listed on the declarations page. To the extent that prior coverage expires by its own terms prior to or at the time the current policy becomes effective then this provision reinforces the intent of the prior insurance. If, however, prior coverage extends into the time period covered by the current policy then it should be identified as cancelled on the declarations.

3. DEFINITION OF "OCCURRENCE"

Coverage Form A (employee dishonesty), like most of the coverage forms, is written on an occurrence basis. In other words, the most the insurer is responsible for in any one of "occurrence" is the applicable limit of insurance shown in the declarations. An "occurrence" means all loss caused by, or involving, one or more "employees," whether the result of a single act or a series of acts. The insurer will not pay for loss from any one "occurrence" unless the amount of loss exceeds the deductible amount shown in the declarations [or schedule, if the schedule form is used]. The insurer's obligation is to pay the amount of covered loss in excess the deductible amount, up to the limit of insurance.

The definition of "occurrence" changes somewhat depending upon whether the bond is written on a blanket coverage form or a scheduled form. The blanket form provides coverage on a "per loss" basis. The definition of "occurrence" given in the preceding paragraph is that set forth in the blanket form. In the scheduled form, coverage is determined on a "per employee" basis. This is the case whether the employee is "named" in the schedule or is one who occupies a "covered position." In a scheduled form, the definition of "occurrence" is "all loss caused by each employee whether the result of a single act or series of acts."

In our scenario the multiple acts of stealing by the same employee under either a blanket form or a scheduled form would result in one occurrence. The outcome may change significantly if more than one employee is involved in the theft. Under the blanket form, if two or more employees are stealing from the insured with knowledge of each other's acts or are otherwise acting in concert to commit the thefts, then there is only one occurrence. Under the scheduled form, however, the situation can differ significantly. If both employees were listed in the schedule or occupied a "covered position" then regardless of whether they were acting together, there would be two occurrences. The limits of coverage would be determined by the limits shown in the schedule for each employee. If only one of the employees was listed in the schedule, then there would only be one occurrence.

The situation can become somewhat more complex if the policy is written on a covered position basis and more than one employee serves in the covered position. Then the limit applicable to that position will be reduced by multiplying the limits shown in the schedule by a factor obtained by dividing the number of employees listed by the actual number serving in the position at the time that loss is discovered. **[Illustration #1]** Similarly, an employee may serve in more than one covered position. In this case, one does not add up the limits for both positions but rather the limit of insurance is the largest for the positions scheduled and occupied by the employee in question. For example, some of the nuances of coverage that can be presented by a scheduled form **[Illustration #2]**.[21]

4. THE DEDUCTIBLE AMOUNT

The insurer's deductible applies to each occurrence. The deductible amount is specified in the declarations or in the schedule if the schedule form is used. The insurer's liability is to pay up to the limit of insurance for a covered loss in excess of the deductible. The deductible is not subtracted from the limit of insurance thereby reducing the insurer's obligation for a loss in excess of the limit:

> The insurer pays the amount of loss in excess of the deductible, up to the limit of insurance. If, for example, the insured has a $10,000 limit with a $250 deductible, the insurer will pay $750 for a $1,000 loss. If the same insured has a $15,000 loss in a later occurrence, the insurer will pay the full amount of $10,000, since the amount of the loss above the deductible exceeds $10,000.[22]

5. DISCOVERY PERIOD FOR LOSS

Except in the rare occasions where an FIB is written on a loss sustained basis, this provision is unique to the CCP. General Condition 3 states that the insurer "will pay only for covered loss discovered no later than one year from the end of the policy period." The reason for this provision is due to the nature of fidelity losses. As mentioned above, many employee thefts or embezzlements occur over long period of time. The discovery period grants the insured an additional 12 months within which to discover loss. Thus, under a CCP, the acts creating the loss must occur during the policy period and the insured must discover its loss no later than one year after the end of the policy period. Therefore, the CCP, like the FIB, has a discovery component which is crucial to coverage. Unlike the FIB, however, discovery of loss is not the coverage trigger under the CCP.

6. PRIOR INSURANCE

This is one of the provisions that addresses most directly a loss situation that occurs over more than one policy period. The provision reads as follows:

> *Loss Sustained During Prior Insurance*
>
> a. If you, or any predecessor in interest, sustained loss during the period of any prior insurance that you or the predecessor in interest could have recovered under that insurance except that the time within which to discover loss had expired, we will pay for it under this insurance, provided:
>
> (1) This insurance became effective at the time of cancellation or termination of the prior insurance; and
>
> (2) The loss would have been covered by this insurance had it

been in effect when the acts or events causing the loss were committed or occurred.

b. The insurance under this Condition is part of, not in addition to, the Limits of Insurance applying to this insurance and is limited to the lesser of the amount recoverable under:

(1) This insurance as of its effective date; or

(2) The prior insurance had it remained in effect.

The key elements of this provision are:

- loss sustained during the period of any prior insurance.
- recoverable except time for discovery time gone.
- the current insurance became effective at the end of the prior insurance.
- the current insurance would afford coverage had the acts occurred during its term.
- the limits of insurance are not increased by this provision.
- the insured is limited to the lesser of the amount recoverable under the current insurance (as of its effective date) or the prior insurance.

This provision (or clauses similar to it), from time to time, have been interpreted by the courts. As a general rule, if the losses in question do not extend beyond the commencement of the prior insurance there is little interpretive difficulty. For example, in *United States v. Indiana Bonding and Surety Co.*[23], the United States, acting on behalf of the Commodity Credit Corporation (CCC), brought suit against Indiana Bonding because of losses incurred due to the dishonest acts of an agricultural commodity inspector. Indiana Bonding's bond was effective from February 1, 1972 to January 31, 1977. CCC previously had acquired a bond from another surety, United, covering the period of January 20, 1967 to January 31, 1972. Indiana Bonding, however, entered into a reinsurance and assumption agreement with United on December 31, 1970 wherein it assumed United's liability under the first bond. The Insured discovered its loss in June of 1972, 18 months after the termination of the United bond. Indiana Bonding argued that the United bond had not been terminated when it entered into the assumption agreement with United and, therefore, the insured discovered its loss within the discovery period of the United bond.[24] The court rejected Indiana Bonding's argument and determined that under the prior insurance provision Indiana Bonding was responsible for CCC's losses under its bond even though the dishonest acts occurred while United's bond was in effect.[25]

The requirement that the loss would have been covered under the prior policy was discussed in *Traders State Bank v. Continental Insurance Co.*[26] While the instrument at issue was an FIB, it was written on a "loss sustained" basis with a superseded suretyship or retroactive extension of coverage clause (i.e. prior insurance provision). The prior surety had paid out the limits of its bond as a result of losses incurred due to a check kiting scheme. The same employee also engaged in the sale of forged notes which did not become known to the insured until the second bond was in place. Continental, the surety underwriting the second bond, claimed no coverage because the obligee's losses would not have been recoverable under the first bond as its limits had been exhausted due to the check kiting scheme. The court agreed:

> Its [prior insurance provision coupled with limitation of liability language] purpose was, rather, to provide the bank with coverage, which it would not otherwise have had, for losses discovered but not sustained during the life of a "loss sustained" bond. The effect of this construction is to limit Continental's liability for losses sustained during the life of the antecedent bond but discovered during the life of its bond to amounts that would have been recoverable under the antecedent bond if it had been in effect at the time the losses were discovered. This being so, the payment by National Surety of $25,000, before Continental's performance was due, exhausted its liability according to the terms of Section 6(c) [limit of liability]. National Surety's liability being exhausted, there was no further recoverable loss under the coverage of the Continental bond.[27]

7. Prior Insurance Issue by Current Insurer

Condition 9 of the CCP pertains to renewals. If an insured renews its policy with the same company or purchases coverage from an affiliate of the carrier issuing the prior coverage then this provision may apply to prior losses. The provision reads as follows:

> *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 cancelled 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 the prior insurance.

This provision anticipates prior, expired policies issued by the same (or affiliated) company that may still respond to the loss as the discovery period is still open.[28] In the event that a loss may have occurred during the period of a prior policy, now expired, coverage for that prior loss is limited to the greater of either the present or the expired policy's limit but there is to be no aggregation of coverages.[29] This provision applies only when the prior insurance was issued by the same company or one of its affiliates.[30]

Language similar to this provision has been found to be clear and unambiguous. In *State v. Hanover Ins. Co.*[31] a division of the state of Missouri incurred more than $15,000 in damages as a result of fictitious claims submitted by one of its case workers. The surety had issued two bonds. The first bond carried a limit of liability of $5,000. The second bond was identical to the first except that it contained a penal sum of $10,000. The state's losses were sustained during both bond periods. The surety offered to pay the sum of $10,000 representing the limit of its current bond contending that a provision similar to CCP Condition 9 limited its loss to the greater of either prior bond or the current bond. The insured sought both penal sums ($15,000). The court agreed with the surety:

> We are of the opinion that the limitation of liability contained in section 5 [precursor to CCP condition 9] is plain and unambiguous and that we are not at liberty to change or modify the contract . . . It must be conceded that a company engaged in issuing fidelity bonds may, by clear and unambiguous language, limit its liability to a single stated amount. This is so whether its obligation is continuing or separate and distinct from year to year.[32]

8. Cumulative Liability

General Condition 10 of the 1990 CCP drives home the point that there's only one limit of insurance regardless of the number of years coverage is in place or the number of premiums paid by the insured. This provision is invoked to counter the desire of many insureds to stack successive policies (or each year of a multi-year policy) in cases where losses have occurred over a number of years and exceed the limit of liability of the current policy.

Surprisingly, courts have had difficulties with this or similar provisions, sometimes finding them to be ambiguous. The California Court of Appeals decision in *A.B.S. Clothing Collection, Inc. v. Home Insurance Co.*[33] is one such decision. This case, like so many other opinions discussing the issue, tends to focus on the question of whether the policies in question are one continuous contract or a series of separate independent contracts.[34] Couched in these terms it is perhaps less surprising that the courts have wrestled with the issue. The challenge of arguing that a series of policies for which the insured has paid a separate premium are in reality one continuous contract can prove difficult. This proposition is not immediately intuitive to many courts.[35] Insurers, however, do not need to prevail on this argument in order to avoid stacking. The language of General Conditions 8 and 9 should be sufficient. Section 8 clearly states that the insured is entitled to the lesser amount recoverable under the current insurance or the prior insurance. Section 9 gives the insured the greater of the amount recoverable under this insurance or the prior insurance.

Ironically, however, these prior insurance provisions have also given some courts trouble. For example, in *Cincinnati Insurance Co. v. Hopkins Sporting Goods, Inc.*[36], **[Illustration #3]** the Iowa Supreme Court found that the bond's prior insurance provision created an ambiguity:

> Cincinnati first argues there should be no allowance for any losses

occurring prior to February 1, 1989, the commencement date of the second policy. Section 1 of the endorsement previously quoted [loss covered only if discovered within one year of termination], clearly supports Cincinnati's view. We agree, though, that the meaning of the language is clouded by provision C of the general agreements, also previously quoted [prior insurance provision]. That provision, a clear incentive for insureds to continue to purchase coverage with Cincinnati, can be understood to extend the limitations period into the period of a new policy.[37]

Similarly, the California Court of Appeals in *ABS Clothing* found the prior insurance clause difficult to interpret:

> Assuming, however, this "prior loss" provision is susceptible to the interpretation giving it by the *Kavaney* court, it is also reasonably susceptible to an interpretation the insured's intent was simply to purchase "prior loss" coverage insuring it against the risk it might recover nothing under the previous policy if it failed to discover the loss until after the limitations period for filing claims on that policy had run. Thus the parties' intent to enter into one continuous contract can not be clearly and unambiguously established by this "prior loss" provision of the contract.[38]

These decisions reflect the challenges that arise when courts attempt to interpret the CCP in the context of an insured who wishes to stack the limits of multiple policies and an insurer who claims there is really only one policy. There should not be any confusion over the insurer's limit of liability in any given loss situation. A plain and straightforward reading of the standard policy's non-cumulation provision coupled with the prior insurance provisions and the "per occurrence" language of the standard form should be sufficient to prohibit a stacking of limits.[39] Furthermore, the language in the declarations page to the effect that prior insurance is cancelled reinforces this conclusion.[40]

9. Other Insurance

The CCP, like the FIB, contains an "other insurance" clause. The language of this provision is, however, somewhat different from that contained in the FIB. The provision reads as follows:

> *Other Insurance:* This insurance does not apply to loss recoverable or recovered under other insurance or indemnity. However, if the limit of the other insurance or indemnity is insufficient to cover the entire amount of the loss, this insurance will apply to that part of the loss, other than that falling within any deductible amount, not recoverable or recovered under the other insurance or indemnity. However, this insurance will not apply to the amount of loss that is more than the applicable Limit of Insurance shown in the DECLARATIONS.
>
> This provision does not come into play when loss is sustained under prior

> insurance and discovered during the discovery period. In this event there simply is no coverage afforded under the current insurance. In other words, General Condition 8 (prior insurance) does not apply. Instead, General Condition 13 (policy period) makes it clear that loss will only be reimbursed in the event that the acts were committed during the policy period. General Condition 8 is a limited exception to this requirement and expressly requires that the insured not be able to recover under the prior insurance because the discovery period has expired.

Nevertheless, there are instances where more than one policy may apply. A parent and subsidiary may very well purchase separate coverages which can both apply to a particular loss. Mixing "loss sustained" and "discovery" policies can also result in overlapping of coverage. For example, if the current policy is a discovery policy and the prior coverage is written on a "loss sustained" basis, the insured may very well have coverage under both policies for a loss resulting from acts committed during the prior policy and discovered within its discovery period as well as the period of the current insurance.

Because most fidelity policies contain "other insurance" provisions which make coverage excess over the other insurance, the effect of these provisions is to cancel each other out. The courts have treated the situation in a number of different ways. Underlying the different approaches is a general attitude of weariness over the problems such clauses cause:

> When judges first said about the task of interpreting insurance policies, we looked confidently to tried and true principles of contract law. . . . We failed utterly to anticipate the linguistic excesses to which the insurance industry would resort in order to avoid paying claims when "other insurance" may be available. This is an area in which hair splitting and nit picking has been elevated to an art form. "Other insurance" clauses have been variously described as: the catacombs of insurance policy English, a dimly lit underworld where many have lost their way," a circular riddle, and [clauses] which cross one's eyes and boggle one's mind.[41]

Much of the dilemma faced by the courts in interpreting "other insurance" clauses results from the fact that there are a number of different types of such clauses. The CCP and FIB contain what are known as "excess" clauses. An excess clause limits an insurer's liability to the amount by which the loss exceeds coverage provided by other valid and collectible insurance. These clauses are in contrast to "pro rata" and "escape" clauses. A pro rata clause restricts an insurer's liability to a proportionate share of the loss. Often the loss is apportioned according to the amount that the insurer's policy limit bears to the aggregate limit of all other valid and collectible insurance. An escape clause, on the other hand, purports to avoid all liability for loss covered by other insurance. Escape clauses are disfavored and sometimes disregarded as being against public policy.[42]

As a general rule, an "other insurance" provision will not affect the insured's recovery rights. In other words, these clauses affect the rights that insurers have against one another. Thus, in

American Physicians Ins. Exch. v. Garcia[43], the Texas Supreme Court held that insurers are each independently responsible for meeting their responsibilities to the insured and must pursue their allocation rights amongst themselves.[44] Most courts have held that multiple excess "other insurance" clauses are mutually repugnant and operate to cancel each other out resulting in a finding that all the applicable policies must be considered primary insurance. The effect is a proration between the available coverages.[45] The New York Court of Appeals explained the theory behind this treatment:

> If we were to take the language literally and give effect to each of these "other insurance" clauses, we would be required to conclude that neither policy provided primary coverage. But that would be a logical impossibility since, quite obviously, there can be no excess insurance absent a policy providing primary coverage and, in the absence of such other policy, each would be primary. To give effect to the excess clause in either of the policies would defeat the similar provision in the other and it follows, therefore, that the "excess" clauses operate to cancel each other, both coverages must be treated as primary and each company is obligated to share in the cost of the settlement and the expenses.[46]

A proration was arrived at in a fidelity context in *Continental Co. v. Morgan, Olmstead, Kennedy & Gardner, Inc.*[47] **[Illustration #4]** In this case, two successive brokers blanket bonds written on a discovery basis were deemed to cover the same risk because the first carrier sought to withdraw from the fidelity market, causing the insured to obtain a subsequent bond from another company. The court determined that the period of coverage stated in each of the bonds was ambiguous when applied to the facts of the case. As a result of this ambiguity it concluded that both bonds responded to the insured's loss. In discussing the allocation issues between the insureds due to similar "other insurance" clauses, the court held:

> Both Aetna and INA bonds contain and "Other Insurance" clause. . . . Here both bonds are subject to a reasonable construction with affords coverage. The applicable principle of construction of insurance contracts requires that both be held to cover Morgan's attorneys' fees and court costs incurred at bench. Because both bonds purport to be excess insurance to other insurance, neither excess clause can be given any effect. Rather, the loss must be prorated in proportion to coverage.[48]

The *Morgan* decision follows the majority rule that proration is to be performed in proportion to the policy limits of the respective policies. There are, however, other means to apportion loss. In *T.S.I. Holdings, Inc. v. Buckingham*[49] ***[Illustration #5]*** the Kansas Federal Court applying Illinois law prorated liability by equal shares as opposed to policy limits. The insurance industry has adopted certain "Guiding Principles" to allocate loss between carriers which is beyond the scope of this paper. However, the application of the "Guiding Principles" can result in significantly different allocations than common law apportionment.[50]

10. Recoveries

General Conditions 15 entitled "Recoveries" sets forth the same general allocation scheme as that contained in the FIB. Recoveries do not include recovery from insurance, suretyship, reinsurance, security or indemnity taken for the insurer's benefit.

C. Miscellaneous Provisions

1. In General

As one might expect, any number of policy provisions can play a role in determining the insurer's ultimate liability in any given claim situation. To address all possibly pertinent provisions is beyond the scope of this paper. Nevertheless, there are a few provisions that merit brief mention.

2. Valuation

Stealing Canadian dollars is not the same as stealing U.S. dollars. Currencies fluctuate as do securities. As a result the insurer's liability (or the insured's loss) can differ at different points in time. One of the purposes of the valuation provision is to fix the point in time at which loss or liability will be calculated.

The FIB and CCP treat the valuation of money and securities differently. The FIB determines the dollar equivalent of any foreign currencies at the exchange rate existing at the time the surety makes payment. The obligee has the option of being paid in the stolen currency or U.S. dollars.

The CCP, on the other hand, grants the insurer the option of choosing to pay a foreign currency loss at the face value of the money issued by that country or in U.S. currency. Moreover, the dollar equivalency is determined by the rate of exchange on the day the loss was discovered rather than paid. Essentially the same situation applies to the valuation of securities.

3. Joint Insured

A fidelity bond is not a liability policy. While the "additional insured" is a fixture of liability coverage, there is no such status under a fidelity instrument. There can, however, be more than one insured. There are specific rules governing who may be joint insureds under a fidelity policy, which are beyond the scope of this paper. As a general rule, joint insureds tend to be affiliates, including welfare and pension plans. Where one instrument covers more than one insured, the insurer will not pay more for a loss sustained by more than one insured than the amount it would pay if all loss had been sustained by one insured.[51] Thus, for example, if company A and its subsidiary B are joint insureds under a $100,000 FIB and an employee of A commits a covered act which generates a $75,000 loss to company A and a $50,000 loss to company B, the insurer's total liability would be $100,000[52]

The failure to carefully limit the insurer's liability when dealing with multiple insureds is demonstrated in *TransAmerica Premier Ins. Co. v. Roy Miller*[53], **[Illustration #6]** where the court determined that the insured (obligee) of the bond was not the escrow company that had obtained the bond but rather its customers. Because the escrow company had numerous customers the court concluded that the insurer's (surety's) limit of liability was $10,000 times the number of customers. The end result was that instead of running the risk of losing $10,000 due to the issuance of the bond the surety incurred a loss of nearly $700,000.

4. AUTOMATIC TERMINATION AND CANCELLATION UNDER PRIOR INSURANCE

When a carrier writes fidelity coverage, it is taking the calculated risk that the premium will be sufficient to cover the loss exposure presented by an insured's employees. As between the insured and the insurer, the risk of loss from a covered act falls upon the insurer up to the limit of insurance. This risk allocation scheme works only insofar as the insured and insurer have relatively the same state of knowledge regarding the loss exposure presented by the employees. Where the insured has knowledge that one or more of its employees presents a special risk by virtue of having learned of prior instances of dishonest conduct, the risk of loss should fall upon the insured as a party with superior knowledge regarding the risks presented by such employees. To hold otherwise makes nonsense out of the fidelity policy business model.[54]

In keeping with this risk allocation philosophy, both the FIB and the CCP contain provisions which terminate coverage with respect to any employee about whom the insured discovers or learns has committed a dishonest act.[55] In addition, the CCP contains an exclusion for employees cancelled under prior insurance.[56]

The effect of these provisions is to allocate the risk to the insured of losses caused by an employee about whom the insured discovers has committed a dishonest act (whether related to the loss or not). For example, in ***Community Savings Bank v. Federal Insurance Co.***[57] once the board of directors of a community savings bank became aware that its president and chief executive officer had violated banking policies and federal regulations in connection with a particular loan then all subsequent loan losses were beyond the scope of the bond.[58]

III. Factors Affecting Allocation

A. THE FIB

Allocating loss among sureties that write successive FIB's written on a discovery basis does not generally present much difficulty. A multi-year embezzlement, being a "single loss" becomes the responsibility of the surety issuing the bond at the time the loss is discovered. Discovery occurs "when the insured first becomes aware of facts that would cause a reasonable person to assume that a loss of a type covered by a [the]bond has been or will be incurred. . . ."[59] If a dispute arises as to which bond responds to the loss, it is not strictly of an allocation dispute but rather a dispute over when discovery occurred thereby establishing the trigger from which liability flows. As one might expect, there are numerous cases discussing what constitutes discovery in a particular fact situation.[60] A brief discussion is in order.

Disputes over when an insured under an FIB discovered its loss do not generally implicate more than two carriers. Expressed in simplistic terms, these disputes tend to consist of the insured claiming that it discovered its loss within the term of the bond and the surety contending that discovery actually occurred earlier, usually within the term of a prior bond.[61] If the surety is correct, then the insured faces significant obstacles to recover under the prior instrument. The insured is often faced with the defenses of late notice and late submission of a proof of loss.[62]

This discovery dilemma can lead to some unusual claims. One of the more notorious efforts was Drexel Burnham's suit against 39 different fidelity insurers issuing 51 separate bonds for losses arising out of the activities of Michael Milken and Dennis Levine.[63] Drexel Burnham claimed that Milken and Levine committed dishonest acts from 1986 through 1990. As a result of these acts it ultimately had to pay fines and penalties of $300 million and was required to disgorge funds of another $350 million. Because the policies were written on a discovery basis, Drexel Burnham sought to avoid being tied down on just when it discovered the losses caused by Levine and Milken. Lack of precision in this regard did not favor the plaintiff:

> It is manifestly clear that under bonds providing coverage for losses discovered during their term, the discovery that a particular employee has been dishonest can be made only once. If the activities of Levine came to light in 1986, as the complaint alleges, there is no conceivable basis upon which claims can also be made arising out of his activities for subsequent years. Similarly, if Milken's manipulations became known in broad outline in 1987, claims on policies covering for the years thereafter are precluded.
>
> Although the complaint very artfully seeks to avoid any statement as to when particular losses were discovered, plaintiff contends that it can plead in the alternative that discovery took place in 1986, or 1987, or 1988, or 1989, or 1990. Not so. . . . [The rules] permit a plaintiff to request relief in the alternative, but the occurrence of a fact such as a date must be set forth with specificity. Theories as to the basis for legal recovery may be inconsistent, but not facts. It can not be alleged that maybe a fact occurred or maybe it didn't. The fact of discovery, which had to be known to plaintiff, had to occur in a given year. Discovery is not a gradual awakening of consciousness. It did or it did not occur. It does not take years for the dawn to break. Before discovery there is, presumably, blissful ignorance, but once that ignorance, that lack of knowledge, is dispelled, then, like virginity, it is gone forever.[64]

B. COMMERCIAL CRIME COVERAGE

Most allocation challenges are presented by commercial crime coverage. The reason for this is readily apparent. Because the CCP is written on a loss sustained basis but looks both forward in time (e.g. the discovery period provision) and backward in time (e.g. the prior insurance provision), the successive coupling of commercial crime policies sometimes presents difficult allocation issues where losses have been sustained over long periods of time. Matters can become even more complicated if the successive policies are not identical but rather contain language variations which present interpretive challenges. This can come in a number of different of forms. Change may be fundamental insofar as it relates to the coverage trigger (e.g. changing the loss sustained bond form into a discovery or claims made form). **[Illustration #7]** Even subtle changes such as a plain language form or inclusion of company-specific language can create interpretation issues and, consequently, allocation issues. One of the more interesting questions is just how far back does the CCP extend in the case of a multi-year loss?

1. Continuous versus Contiguous Coverage

For purposes of our discussion, assume an insured has recently changed fidelity carriers after 10 years with one company. It has acquired a $100,000 CCP covering the time period of January 1, 1997 to December 31, 1997 (the 1997 policy). Prior coverage, also in the amount of $100,000 was secured for the previous 10 years from another carrier. Further assume that in February of 1998 the insured discovers that a trusted long time employee had been embezzling from it. This employee has embezzled $10,000 a year for the last 10 years (but no losses occurred in 1998).

Who pays what? Under this scenario the only insurer on the exposure is the carrier issuing the 1997 policy. **[Illustrations #8 and 9]** The prior carrier avoids liability as the insured discovered its loss more than 12 months after the termination of the policy and thus it is outside of the discovery period of the prior policy. The current policy (covering the 1998 calendar year) is not implicated as no dishonest acts or events occurred during the policy period.

What can the insured recover under the 1997 policy? This requires an interpretation of General Condition 8, the "loss sustained during prior insurance" clause. In this scenario, the question is whether the prior insurance clause entitles the insured to recover ten years of loss or something less.

Most industry professionals believe that coverage under the prior insurance clause is continuous and reaches back as many years as the dishonest acts were committed as long as there are no gaps **[Illustration #8]** in coverage:

> Many employee dishonesty losses go undetected for several years, but the discovery period is only one year long. An insured who is aware of these two facts might think twice before changing insurance companies, since coverage might be jeopardized. This condition [prior insurance clause] alleviates that concern, subject to two important provisions:

1. The current policy must be effective at the same time that the prior insurance is terminated, with no gaps in the continuity of coverage.

2. For the loss to be covered by the current policy, it must be the type of loss that would have been covered by the current policy had it been in effect when the loss occurred.

* * *

> Insureds should retain old insurance policies, since they might need evidence of the prior insurance to satisfy the current insurance company that there has been no gap in coverage. Recently the risk manager of a large corporation had to prove to its current insurance company that coverage had existed for the previous twenty-three years, because an employee had been stealing for twenty-four years before being caught.[65]

Is this really the import of General Condition 8? Why is it critical that there be no gaps in coverage anywhere along the continuum of loss? While the provision does require the current coverage to become effect at the time of cancellation or termination of the prior insurance, this would suggest a "no gap" requirement exists immediately prior to the existence of the current coverage. Does this language imply no "gaps" prior to this period of time?

What does it mean to say that the insured's liability is limited to the lesser of the amount recoverable under the current insurance or "[t]he prior insurance had it remained in effect"? The "continuous" interpretation would seem to suggest that one has to take into account the coverage limits of all the prior policies to make this determination. In a long term loss situation this "lesser of" calculation would often result in the current policy's limit of liability being the applicable amount. **[Illustration #9]**

The meaning of General Condition 8 boils down to a question of what is meant by "prior insurance." Does "prior insurance" mean all prior policies or just the immediately preceding policy? Does the policy provide any clues? What about the term "this insurance?" It appears to refer to the current policy. [66] Does this suggest that the term "prior insurance" refers to the immediate prior policy? Whether so or not, there appears to be nothing in the language of Section 8 that compels the conclusion that coverage is extended to losses occurring during all prior continuous policies.

Is it necessary to interpret "prior insurance" to mean the sum of all prior continuous (no gaps) policies in order to accomplish its purported purpose of not penalizing an insured for switching carriers? This would only be the case if, had the insured stayed with the same carrier throughout the period of time that losses were sustained, it would have recovered its prior losses. In our scenario, what would have occurred had the insured never switched carriers but maintained continuous coverage for ten years with the same company? Does General Condition 9 permit such recovery? Not under the facts currently set forth as no losses were sustained during the 1998 policy. Even if there had been such losses, General Condition 9 does not net the insured recovery for losses sustained under policies with expired discovery periods. Section 9 applies only to loss that *is* covered, i.e., prior insurance for which the discovery period remains open. To read Section 9 any other way would be tantamount to stacking all prior policies and nullifying General Condition 10 (non-cumulative provision).

No one in the industry interprets General Condition 9 to permit stacking as it makes no economic sense and is plainly inconsistent with General Condition 10. Even commentators who hold the "continuous" interpretation of General Condition 8 find that General Condition 9 speaks in terms of two consecutive policy periods:

> *Condition 9, Loss Covered Under This Insurance and Prior Insurance Issued by Us or Any Affiliate,* deals with rewrites by the same insurance company or another insurance company within a group of affiliated companies. It indicates that if a loss occurs during two consecutive policy periods, each containing different limits of insurance, the maximum amount that the company will pay is the larger of the two amounts.[67]

Thus, for an insured to recover for losses that occurred more than a couple of years prior to discovery, the insured must access General Condition 8 and allege a "continuous" theory of coverage. In other words, the act of switching carriers is a relatively neutral event in the determination of what coverage is afforded the insured. Had the insured remained with the same carrier, it still must make use of General Condition 8 (prior insurance) in order to recover the majority of its losses. If the insured had switched carriers, it again must avail itself of General Condition 8 to recover such prior losses.[68]

Just what did the industry seek to accomplish through General Condition 8? Was it to give assurance to insureds who maintained continuous coverage with one company or another that by doing so they may be protected from loss regardless of when the acts occurred? The continuous theory is in keeping with such an intent. It does have the effect of placing most of the risk of a long-term loss after the switch of carriers upon the prior carrier until such time as its discovery period runs out. Thus, the current carrier has a one-year window as General Condition 8 by its terms would not apply to it until the prior carrier's discovery window has closed. There is no real pricing advantage, however, as what is now current insurance will, with the passage of time, bear the risk of prior insurance.

Yet this interpretation tends to reward a lack of diligence on the part of insureds. As long as they maintain coverage, they do not need to ferret out dishonesty. In and of itself, this is not inherently wrong as long as insurers are willing to accept the risks. Nevertheless, there is nothing compelling about a "continuous" coverage interpretation of General Condition 8. **[Illustration #8]** It is neither a clear incentive to remain with one's existing company, nor is it necessary to avoid injustice in the event one decides to switch companies.[69] The issue is really one of policy. Who is the more appropriate party to bear the risk of fidelity loss that remains undetected for several years? If an insured has failed to discover such a loss for a number of years and has, in a sense, "moved on" with its business in spite of such losses, does it make sense to have the insured continue to shoulder these past losses? On the other hand, what has the insured bought with its premiums – indemnity from all loss whenever incurred or the more limited protection of reimbursement against recent loss? Is CCP coverage underwritten and priced more or less the same as FIB coverage? If so, should CCP coverage "look back" as clearly is the case with FIB "discovery" coverage? These questions are not answered by examining the language of the CCP.

The answer to the question of just what coverage is available under General Conditions 8 and 9 is, in some respects, moot as most commentators and courts have concluded that coverage extends back in time through all continuous prior policies.[70] **[Illustration #8]** Whether the pricing of fidelity coverage takes this risk into account is open to question. It is, however, interesting to note that there are forms in the marketplace that use language suggesting a more limited coverage interpretation (i.e., a contiguous coverage theory wherein only the immediate preceding policy comes into play, and only then if the discovery window has expired. **[Illustration #9]**). For example, the authors are aware of a plain language version of the prior insurance provision that reads as follows:

> **Prior coverage.** You may have been insured by a previous bond or policy that covered the same losses that this agreement covers and that ended at the time this agreement became effective. If you were, but can't recover on a loss that was caused while the previous bond or policy was in effect because its discovery period has run out, we'll cover your loss. But the loss must be the kind that would be covered by this agreement if it had been in effect at the time the loss occurred. You must also discover your loss no later than one year after this agreement ends.
>
> We won't pay more than the limit of coverage for the loss under the previous bond or policy or under this agreement after it became effective, which ever limit is smaller. And the amount we pay will be part of your coverage under this agreement-not in addition to it.

Because there is only one "previous bond or policy" that ends at the time the subject policy becomes effective, it is apparent that what is being referenced is the immediate prior policy.

What is the extent of coverage provided to the insured under the above clause? The answer lies in the language "loss that was caused while the previous bond or policy was in effect." This language means that if the insured incurred a loss during the period of the prior policy for which it could have recovered except the discovery period had expired, the current policy will pick up the loss. The key is that the current insurer's responsibility is to pick up the loss sustained during the prior policy-not the loss that the prior policy would have covered, had it been in effect. Accounting for losses caused during the prior policy nets only those losses caused by acts committed during the prior policy period. Whereas, losses caused by the prior policy reach back via the prior insurance provision to one or more prior policy periods. In our scenario, the recovery is $20,000. **[Illustration #9]** Of course, an insurer can always choose to interpret as equivalent to the industry's view of the ISO form and provide continuous coverage.

In sum, the continuous theory (ISO form) nets a recovery for the insured of $100,000. **[Illustration #8]** The contiguous theory (company specific form), on the other hand, nets a recovery of $20,000. **[Illustration #9]**

2. COURT COSTS AND ATTORNEYS' FEES

Some insurers have added a general agreement in their commercial crime policies indemnifying the insured against court costs and attorneys' fees incurred in connection with a suit rising out of an act that would otherwise constitute a collectable loss under the policy. Such defense-type obligations raise additional allocation issues. Unless the insurer is careful to expressly specify an allocation scheme in the provision, determining responsibility for litigation costs can be quite challenging. Insurers writing directors and officers liability insurance are well aware of the allocation problems that legal expenses can present. Questions can arise as to whether a claim or all counts of a given lawsuit arise directly from the covered act. In the D & O context, the seminal case is *Continental CAS. Co. v. Board of Education*[71], where the court set forth a "reasonably related" test for allocation of defense expenses. The court ruled that so long as defense expenses are reasonably related to the defense of a covered claim, they may be wholly allocated to that covered claim, even though the defense of uncovered claims may be incidentally benefited. However, other courts have concluded that the mere presence of insurance is insufficient to allow all defense costs to be shifted to the insurer.[72]

With the possible exception of situations involving the refusal to honor forged or altered checks, standard fidelity coverage does not automatically cover defense costs. Under general agreement (F) entitled "Notice of Legal Proceedings Against Insured-Election to Defend," the FIB gives the insurer the election to defend the insured, in whole or in part. If it so elects, any court costs or attorneys' fees, as well as any judgment or settlement arising out of the insurer's defense will be treated as a loss covered by the bond.

The possible methods of allocation become quite varied when insurers add coverages to the standard fidelity policies which are more in the nature of third party liability coverage rather than first party indemnity insurance. As a general rule, when deciding allocation issues involving third party insurance, courts look at such factors as the insurer's time on the risk, as well as the policy limits.[73] Some courts have held insurers jointly and severely liable to the extent that they run a risk at anytime during the trigger period.[74] But insureds have not escaped allocation for periods when no insurance was in place.[75] Other courts have taken the position that allocation of defense cost to the insured can occur only where the risks associated with the uninsured periods increase the defense costs.[76] In addition, the courts have prorated an insured's deductibles when making an allocation among insurers.[77]

IV. Case Studies

The following cases involve loss allocations in situations where losses have occurred over two or more consecutive years:

- Brigham Young Univ. v. Lumbermens Mut. Cas. Co.[78] [Illustration #10]:

Brigham Young University (BYU) incurred losses over more than a 10 year period due to thefts from its art collection by one of its full-time professors. The issue on appeal was the extend on coverage provided by a fidelity policy written by Lumbermens for BYU effective in 1982 to replace previous policies written by others. The "discovery period" for losses had expired under all prior policies, but not for the current Lumbermens policy. There were "no time gaps" in the previous coverage. Previous coverage, the amount of loss occurred by BYU and the amount paid by Lumbermens was as follows:

Insurance Company	**Limit of Liability**	**Deductible**	**Coverage**	**Value of Missing Art**	**Amount Paid**
Lumbermens	$1,000,000	$2,500	12/1/82 to present	$9,250	$6,750
Federal	$1,000,000	$2,500	12/1/78 to 12/1/82	$17,200	$14,700
Fidelity	$ 500,000	$50,000	11/1/75 to 12/1/78	$116,038	$66,038
Western	$ 50,000	0	9/19/68 to 11/1/75	$721,862	$50,000
TOTALS				$864,350	$137,488[79]

BYU claimed that Lumbermens Liability was $860,000 rather than $137,488.[80] The crux of BYU's position was that the policies loss covered provision (General Condition 9 of the ISO form but designated as section 10 of the Lumbermens policy) applied and required Lumbermens to pay up to the million dollar limit of its policy. Lumbermens objected to this construction of its policy as the provision pertained only to instances where the prior policies were written by Lumbermens or one of its affiliates for which the discovery period had not yet expired.[81] Instead, Lumbermens contended that the policy's prior insurance (designated as General Agreement C) governed. The court agreed with Lumbermens:

> Given the clarity of General Agreement C it is unreasonable to believe that the drafter of the policy would include superseded suretyship coverage in another section of the policy, namely Section 10 [Loss Covered provision], and that the second provision would then contradict the language of a prior section. The University's interpretation of Section 10 can not be applied.

> Therefore, General Agreement C controls the amount that Lumbermens owes the University as a result of losses under prior policies.[82]

Yet Lumbermens was willing to reach back to 1968 to cover losses incurred during the first policy issued by Western Casualty in calculating its liability. It is simply because of the specific nature of the losses in this case, namely that most of the loss was determined to have occurred on Western Casualty's watch which had by far the smallest limit of liability, that Lumbermens liability was so contained.

- Bethany Christian Church v. Preferred Risk Mut. Ins. Co.[83] [Illustration #1]:

Bethany Christian Church ("the Church") incurred more than $80,000 of losses as a result of thefts committed by one of its employees. The coverage and losses are summarized as follows:

Date	Insurer	Loss	Coverage limit
12/91-12/92	Atlantic Mutual	$1,493.97	$50,000
12/92-12/93	Atlantic Mutual	$29,629.92	$50,000
12/93-12/94	Preferred Risk	$52,421.24	$50,000
TOTAL		$82,545.13[84]	

The Church discovered the theft on or about November 1, 1994. Because the Church's discovery was within the discovery period of Atlantic Mutual's-92-93 policy, that insurer paid the Church $31,123.89. The Church then sought $50,000 from Preferred Risk on the grounds it had incurred more than that in losses during the Preferred Risk policy. Preferred Risk took the position that under the policy's definition of "Occurrence," all of the Church's losses amounted to one occurrence entitling it to no more than $50,000, the per occurrence limit under each policy. As a result, Preferred Risk tendered a check in the amount of $19,776.54 to the Church.[85]

The Court agreed with Preferred Risk:

> This Court determines that the series of thefts by Smith at issue herein are a single occurrence under the three identical policy definitions of occurrence in the insurance industry's standard Employee Dishonesty Coverage Form . . . The Church may only recover from all its insurers, a combine total of $50,000, the policy limit in effect at the time the loss was discovered.[86]

- Graphics Arts Mut. Ins. Co. v. C.W. Warthen Co., Inc..[87] [Illustration #12]:

Warthen's bookkeeper embezzled approximately $114,000 from the company during a 10 year period. Warthen was insured by Graphic Arts initially under a policy that commenced August 1, 1983 and terminated on August 1, 1986. Graphic Arts renewed the policy for a one-year period commencing August 1, 1986 and expiring August 1, 1987. The coverage limit during each year of coverage was $10,000. Warthen asserted that it was entitled to recover $10,000 for each year the policy was in effect, for a total of $40,000. Graphic Arts argued that its total liability was $10,000. Interpreting the non-cumulation clause of the policies, the Court agreed with Graphic Arts:

> The insurance contract explicitly limits Graphic Arts liability to a maximum of $10,000 for the entire coverage period, regardless of the number of years the contract was in effect. We must interpret the contract is written. We are not free to rewrite its terms and thereby extend coverage. . . . [88]

- Santa Fe General Office Credit Union v. Gilberts[89] [Illustration #13]:

A former treasurer of an insured credit union stole more than $176,000 from his employer from 1948 until 1965. National Surety had issued fidelity bonds to the credit union over this period of time. From 1948 through 1957 National Surety issued a position bond and from 1958 through 1965 it issued a blanket bond. The amount of the credit union's coverage and its losses over the 18 year period were as follows:

Stolen 1948-1957 Inclusive
(Position Bond)

Year	Loss	Coverage Limit
1948	$ 6,300.00	$ 6,000.00
1949	10,815.00	6,000.00
1950	13,455.00	6,000.00
1951	16,230.00	6,000.00
1952	17,040.00	10,000.00
1953	17,890.00	10,000.00
1954	12,480.00	10,000.00
1955	4,710.00	10,000.00
1956	5,935.00	10,000.00
1957	6,290.00	10,000.00

Stolen 1958-1965 Inclusive
(Blanket Bond)

Year	Loss	Coverage Limit
1958	$ 6,670.00	$ 8,000.00
1959	9,425.00	10,000.00
1960	10,180.00	10,000.00
1961	10,995.00	10,000.00
1962	11,885.00	10,000.00

1963	12,825.00	10,000.00
1964	12,120.00	10,000.00
1965	7,382.45	10,000.00[90]

The credit union claimed that National Surety was liable to it for $144,092.45. The surety, on the other hand, claimed its liability was limited to $12,629.11. The court agreed with the surety:

> [T]he [non-cumulation] language in both the position bond and the blanket bond and the accompanying documents is clear and unambiguous and impels forcefully to the conclusion that the liability of the surety shall not be cumulative from year to year or from period to period irrespective of the total amount of the employer's losses.[91]

- Kavaney Realtor v. Travelers Ins. Co.[92] [Illustration #14]:

A real estate developer incurred losses in excess of $80,000 over a three-year period. Its coverage and losses were as follows:

Policy Term	**Policy Amount**	**Losses**
5/83 to 5/84	$20,000	$4,000
5/84 to 5/85	$20,000	$46,125
5/85 to 5/86	$22,000	$31,550[93]

The insured claimed to be entitled the full policy limits for each of the three policies. The Travelers countered by contending that its total liability could not exceed $22,000. The court agreed with Travelers:

> This provision [Prior Insurance clause or General Condition 8] extends the coverage of the present policy to losses caused by acts occurring while a prior policy was in effect. The opening sentence declares that the extension of coverage does not increase the limit of liability. It extends the present policy's coverage to a loss which would have been recoverable under the prior policy if there were no lapse in coverage and the loss would have been recoverable under the present policy, had it been in effect at the time of the acts causing the loss, and if the time within which to discover losses under the prior policy has expired. The amount recoverable for such a loss under the present policy, however is limited to the limit applicable to Coverage B [insurance for personal property up to liability limit of $22,000.00] of the present policy or the amount recoverable under the prior policy if that is smaller. We agree with the district court that this provision "adds impetus to the argument that the policy is continuous." A combination of the provision against cumulation of coverage and this provision extending coverage to prior losses, indicates the intention that the policies constitute one continuous and non-cumulative contract. We conclude that the district court correctly construed the insurance policies as constituting one "continuous and non-cumulative" contract, and that Travelers' liability cannot exceed $22,000.[94]

- Cincinnati Ins. v. Hopkins Sporting Goods, Inc.[95] [Illustration #3]:

In 1992, a Hopkins sporting goods retailer discovered that it had suffered employee theft during the years of 1987 through 1991. These losses exceeded $44,000. The retailer was insured through Cincinnati which issued two policies, one for 1986 through 1989 and another for 1989 through 1992. The coverage limit was $15,000 for each year. Cincinnati paid the insured $15,000 and brought a declaratory judgment action to determine the extent of any further liability it might have under the policies. Its position was that no coverage existed prior to February 1, 1989, the commencement date of the second policy. The court disagreed:

> Section 1 of the endorsement [noting that loss covered only if discovered within one year of cancellation], . . . quoted clearly supports Cincinnati's view. We agree, though, that the meaning of the language is clouded by provision C [prior insurance clause] of the general agreement, ... That provision, a clear incentive for insureds to continue to purchase coverage with Cincinnati, can be understood to extend the limitations period into the period of a new policy. . . . [Furthermore,] although Cincinnati claims otherwise, we think there is an ambiguity by reason of the policy's non-accumulation clause. That clause, especially the word "cumulatively" can be interpreted as supporting the position of either Cincinnati or Hopkins. . . . The trial court was correct in applying the canon construing insurance policies against the insurer and in holding that the "[d]efendant is not limited to a total $15,000 recovery but is limited to that amount in any one year of these type losses concerning the same employee."[96]

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Table of Illustrations

What follows are a number of illustrations which graphically set forth certain loss allocation situations that can arise in connection with fidelity claims (a number have been referenced in the text – others have not).

18. Overlap in Coverage Between Primary and Excess Commercial Crime Policies Without Endorsement for Excess Insurance.

ENDNOTES

1. For discussion of underwriting considerations for both fidelity/forgery coverage forms and financial institution bonds. *See e.g.*, D.P. Felton & K. G. Sears, FIDELITY BONDS, 1st ed., chs. 2 & 6 (Insurance Institute of America 1992).

2. A financial institution bond has a long and interesting evolution. Modern commercial fidelity coverage began at the end of the 19th century. As early as 1916, the Surety Association of America and the American Banker's Association worked in cooperation to draft the first fidelity bond-Bankers Blanket Bond, Standard Form No. 1. *See e.g.*, Gallagher, et al., *A Brief History of the Financial Institution Bond*, in FINANCIAL INSTITUTION BONDS, 2d ed., ch. 1, at 3 (Duncan L. Clore ed., 1998).

3. This form is reprinted in ABA, COMMERCIAL CRIME POLICY, Exhibit G (Gilbert J. Schroeder ed., 1996) (This publication contains numerous commercial crime forms). A copy of FIB Standard Form No. 24 can be found in *ABA*, FINANCIAL INSTITUTION BONDS, 2d ed., Exhibit 1 (Duncan L. Clore ed. 1998). (This text also contains numerous riders and statements of change relative to the financial institution bond or its predecessor the Banker's Blanket Bond.)

4. 407 F. Supp. 762 (7th Cir. 1969)

5. *Id.* at 765 n.4. The court also noted that the language of the rider stated that it was not appropriate for Note Brokers, which was the insured's business.

6. *See e.g., Diamond Transp. Sys., Inc. v. Travelers Indem. Co.*, 817 F. Supp. 710, N.D. ILl. 1993) (Similar language in fidelity policy prevented stacking of insurance policies and limited insurance recovery on $750,000 loss over three years to the $250,000 coverage limit of current policy.)

7. *See e.g., Aetna Cas. & Sur. Co. v. Oak Park Trust & Sav. Bank,* 523 N.E. 2d 117 (ILL. App. 1 Dist. 1988) (Surety entitled to reimbursement before insured entitled to recover its deductible.)

8. *See e.g., In re Endeco, Inc.*, 718 F.2d 879, 882 (8th Cir. 1983); *Illinois Sur. Co., v. United States*, 226 F. 665 (7th Cir. 1915).

9. *Federal Deposit Ins. Corp. v. United Pacific Ins. Co.*, 20 F.3d 1070, 1080 (10th Cir. 1994).

10. *See e.g.*, D.P. Felton & K.G. Sears, FIDELITY BONDS, 1st ed. at 31 (Insurance Institute of America 1992).

11. *See e.g., Fitchburg Savings Bank v. Massachusetts Bonding Ins. Co.*, 174 N.E. 324, 328 (Mass. 1931) (loss occurs when funds are diverted); *Citizens of Oregon v. American Ins. Co.*, 289 F. Supp. 211 (D. Or. 1968) (loss occurs when funds leave bank); *FDIC v. United Pacific Ins. Co.*, 20 F.3d 1070, 1080 (10th Cir. 1994) (same).

12. *See e.g., In re Conticommodity Servs., Inc.*, Securities Litigation, 733 F. Supp. 155 (N.D. Ill. 1990).

13. *See e.g., Boomershine Pontiac-GMC Truck, Inc. v. Globe Indem. Co.*, 466 S.E.2d 915 (Ga. App. 1996); *FDIC v. Aetna Cas. & Sur. Co.*, 426 F.2d. 729, 735 (5th Cir. 1970) (FDIC disposed of nonconforming notes after the termination of bond and suffered a net loss of $408,362.97).

14. *See e.g., First Nat'l Bank of Bowie v. Fidelity Cas. Co. of New York*, 634 F.2d 1000, 1005 (5th Cir. 1991); *Jefferson State Bank & Trust Co. v. Central Sur. & Ins. Corp.*, 408 S.W.2d 825, 831 (Mo. 1966) ("The time of discovery of loss mentioned in the bond is not intended to be the time when a claim of a depositor or customer is established ultimately by entry of judgment."); *Perkins v. Clinton State Bank*, 593 F.2d 327, 336 (8th Cir. 1979) (Bank discovered loss when served with complaint).

15. 901 F.2d 520 (10th Cir. 1990).

16. *But see Home Sav. & Loan v. Aetna Cas. & Sur. Co.*, 817 P.2d 341, 355-56 (Utah App. 1991) ("However, the discovery of Glad's dishonesty, by itself, and whenever that discovery occurred, did not constitute discovery of a fidelity loss: the remaining necessary element, i.e., a loss, remained to be discovered. Until that loss actually occurred, Home had no claim under the bond. As succinctly put by the trial court, the bond covers loss, not dishonesty."); *Contra, Fidelity & Cas. Co. of New York v. Central Bank of Houston*, 672 S.W.2d 641 (Tex. App. 1994); *First Nat'l Bank of Fleming v. Maryland Cas. Co.*, 581 P.2d 744 (Colo. App. 1978); *United States Fidelity Guar. v. Empire State Bank*, 448 F.2d 360 (8th Cir. 1971); *U.S. LIFE Sav. & Loan Ass'n v. National Sur. Corp.*, 115 Cal. App. 3d 336, 171 Cal. Rptr. 393, 398 (1981). *But see Pacific-Southern Mortgage Trust Co. v. Insurance Co. of N. Am.*, 166 Cal. App. 3d 703, 212 Cal. Rptr. 754, 758 (1985) (criticizing U.S. LIFE's failure to analyze whether loss occurred).

17. 864 F.2d 964 (2d Cir. 1988).

18. *Id.* at 966.

19. *Id.* at 971 (citations omitted).

20. *See e.g., Reserve Ins. Co. v. General Ins. Co. of Am.*, 395 N.E.2d 933 (Ill. App. 1979) (four improperly executed construction bonds resulted in losses at the time of execution rather than

when default on bonded construction jobs occurred); *Elliott Sav. Bank v. Aetna Cas. & Sur. Co.*, 38 N.E.2d 59 (Mass. 1941) (loss on forged note and power of attorney pertaining to stock occurred when used as collateral rather then a few years later when stock issuer sued insured on guaranty).

21. If the insured is a governmental entity then coverage forms O and P apply. As with coverage form A, there is a difference in the definition of "occurrence" depending upon whether the form is a "per loss" (blanket) or "per employee" (schedule) form. There are also, however, some other differences to keep in mind. The maximum coverage one can generally secure for each employee under coverage P is $100,000. Governmental entities wishing to secure greater coverage on a per loss basis can do so by endorsing coverage form O onto the policy as excess coverage. Because the excess coverage is written on a per loss basis it will not recognize each employee involved in a theft but respond to the total loss. If three employees together steal $500,000 in the following manner:

Employee 1	$200,000
Employee 2	$125,000
Employee 3	$175,000

Coverage form P would pick up $300,000 of the loss (assuming all employees were covered at the maximum) and coverage form O would pick up $200,000 (assuming that the excess amount was $200,000 or greater).

22. The National Underwriter Company, THE FIRE, CASUALTY & SURETY BULLETINS, A.18-2 (May 1996).

23. 625 F.2d 26 (5th Cir. 1980).

24. For some reason the government chose to sue only on the later bond even though Indiana Bonding would have been responsible for any liability incurred under the prior (United) bond. *Id.* at 29.

25. *Id.* at 30. The prior insurance provision has been around for quite a long time. In its earlier manifestations it has been sometimes been referred to as the superseded suretyship clause or rider. *See e.g., Hansen & Rowland v. Fidelity & Deposit Co. of Maryland*, 72 F.2d 151 (9th Cir. 1934) (Superseded suretyship rider limited surety's liability to the larger of the amounts carried under the two bonds in question); *Fort Smith Tobacco & Candy Co. v. American Guar. & Liab. Ins. Co.*, 208 F. Supp. 244 (W.D. Ark. 1962) (Insured not entitled to recover from current bond as losses occurred during prior bond and/or discovered by insured within the discovery period).

26. 448 F.2d 280 (10th Cir. 1971).

27. *Id.* at 284.

28. *See* discussion at III B (1) and footnote 67 *supra.*

29. *Kavaney Realtor & Developer, Inc. v. Travelers Ins. Co.*, 501 N.W.2d 335, 341 (N.D. 1993) (language differed somewhat insofar as it also required the prior policies discovery period not to have expired); *see also Eddystone Fire Co. No. 1 v. Continental Ins. Cos.*, 284 Pa. Super. 260, 425 A.2d 803 (1991); *Columbia Hosp. v. United States Fidelity & Guar. Co.*, 188 F.2d 654 (D.C. Cir. 1951).

30. *See e.g., White Tire Distributors, Inc. v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 367 S.E.2d 518, 519 (Va. 1988) (Provision did not apply where prior carrier sought to avoid coverage on grounds that later carrier paid its limits).

31. 431 S.W.2d 141 (Mo. 1968).

32. *Id.* at 143. *See also Diamond Transp. Sys., Inc. v. Travelers Indem. Co.*, 817 F. Supp. 710, 712 (N.D. Ill. 1993) (". . . plaintiff seeks to circumvent the $250,000 policy limit and recover its entire $750,000 loss. . . The court holds as a matter of law that the restrictive language of General Condition 9 precludes plaintiff from recovering anything beyond $250,000 already paid by Travelers").

33. 34 Cal. App. 4th 1470, 41 Cal. Rptr. 2d 166 (Cal. App. 1995)

34. *Id.* at 1484 & 174.

35. Many courts find that a renewal of a fidelity policy constitutes a separate and distinct contract for the period of time covered by such renewal unless it appears to be the intention of the parties as evidence by the provisions of the policy or bond that the renewal shall constitute one continuous contract. *See* e.g., *City of Miami Springs v. Travelers Indem. Co.*, 365 S.2d 1030, 1032 (Fla. App. 1978); *Krey Packing Co. v. Employers' Liab. Assur. Corp.*, 127 S.W.2d 780 (Mo. App. 1939); *Great American Indem. Co. v. State*, 229 S.W.2d 850, 853 (Tex. App. 1950); *Massachusetts Bonding & Ins. Co. v. Board of Co. Comm'rs*, 68 P.2d 555, 556 (Colo. 1937). Decisions that have found one continuous contract include *Kavaney Realtor & Developer, Inc. v. Traveler's Ins. Co.*, 501 N.W.2d 335 (N.D. 1993); *Columbia Hosp. v. United States Fidelity & Guar. Co.*, 188 F.2d 654 (D.C. Cir. 1951); *Santa Fe General Office Credit Union v. Gilbert*, 12 ILL. App. 3d 693, 299 N.E.2d 65 (1973); *United States Fidelity & Guar. Co. v. Barbara*, 70 F.2d 220 (6th Cir. 1934).

36. 522 N.W.2d 837 (Iowa 1994).

37. *Id.* at 839. *See also White Dairy Co. v. St. Paul Fire & Marine Ins. Co.*, 222 F. Supp. 1014, 1017-18 (N.D. Ala. 1963). The Cincinnati Court also found, without explanation, that the

non-accumulation clause was ambiguous as the word "cumulatively" could be interpreted as supporting the position of either the insurer or the insured. To understand how some courts has interpreted the non-accumulation clause, the Federal District Court's decision in *White Dairy* is instructive:

> It seems to the court that there is no ambiguity when this condition [prior insurance] is placed in proper perspective with the general insuring clause of the bond, although this may be an oversimplification. Its function may be illustrated by suppositions—assume that the coverage afforded plaintiff as to Mrs. Chandler in 1958 was $2,500, in 1959, $10,000 and in 1960, $10,000, and that she embezzled the sum of $5,000 in 1958, the sum of $15,000 in 1959 and the sum of $2,500 in 1960. The limitation against cumulative liability under the 1960 bond, if it is not meaningless, would prevent the carry forward of the excess of $2,500 for 1958, and that of $5,000 for 1959 and the aggregation of such amounts with the 1960 loss to claim the full penalty of the 1960 bond. Under the assumed facts the total liability of defendant under its separate and distinct obligations would be $15,000 and not $22,500.

White Dairy Co. v. St. Paul Fire & Marine Ins. Co., 222 F. Supp. 1014, 1018 (N.D. Ala. 1963).

38. *ABS Clothing Collection, Inc. v. Home Ins. Co.*, 34 Cal. App. 4th 1470, 1483, 41 Cal. Rptr. 2d 166, 173 (Cal. App. 1995). The prior insurance provision in the *ABS Clothing* case did not appear to contain the language that the insurer will pay only the larger of the amount recoverable under this insurance or the prior insurance. For an excellent article on the role of non-cumulation provisions in the context of an insurer's limit of liability *see* William J. Hacker, *Limit of Liability in ABA*, COMMERCIAL CRIME POLICY, ch. 14 (Gilbert J. Schroeder ed. 1996).

39. *See e.g.*, *Hanson Ins. Co. v. Treasure Coast Travel,* 660 S.2d 1136 (Fla. App. 1995) (Non-cumulative provision alone insufficient to restrict coverage to one of the policies but when coupled with the prior insurance provision only one policy in play.)

40. This is not to suggest, of course, that the prior insurance provision provides little benefit to the insured. In certain situations the benefit can be quite substantial. William Hacker explains:

> For example, assume two successive policies are purchased from different carriers, the first with a $50,000 limit and the second with a $250,000 limit. A $200,000 loss, $100,000 occurring each policy period, is discovered after the one year discovery "tail" of the first policy expires. How much is recoverable? One hundred and fifty thousand dollars, $100,000 loss occurring during the second policy period, and $50,000, which is the "lesser" of the amount recoverable under the first policy ($50,000) and the

$150,000 in coverage remaining available under the second policy.

William J. Hacker, *Limit of Liability*, in ABA COMMERCIAL CRIME POLICY, ch. 14 at p. 3 (Gilbert J. Schroeder ed. 1996).

41. *S. Carolina Ins. Cove v. Fidelity & Guar. Ins. Underwriters, Inc.*, 489 S.E.2d 200, 201-202 (S.C. 1997).

42. *See e.g., CC Housing Corp. v. Ryder Truck Rental Inc.*, 746 P.2d 1109 (N.M. 1987).

43. 876 S.W. 2d 842 (Tex. 1994)

44. The insurer's right to allocation can arise under a number of different legal theories. *See e.g., Employers Cas Co. v. Transport Ins. Co.*, 444 S.W.2d 606 (Tex. 1969) (Subrogation rather than contribution was the means of recovery). Subrogation may arise from contract or equity. In any event, however, the carrier seeking subrogation may be limited by any failure the insured committed which jeopardizes coverage. *See e.g., Westchester Freyer Ins. v. Heddington Ins. Ltd.*, 883 F. Supp. 158 (S.D. Tex. 1995).

45. *See e.g., Lumber Mut. Ins. Co. v. Lumbermen's Mut. Cas. Co.*, 588 N.Y.S.2d 630 (App. Div. 1992); *T.S.I. Holdings, Inc. v. Buckingham*, 885 F. Supp. 1457 (D. Kan. 1995); *Lumbermen's Mutual Cas. v. Allstate Ins. Co.*, 417 N.E. 2d 66 (N.Y. 1980).

46. *Federal Ins. Co. v. Atlantic Nat'l Ins. Co.*, 250 N.E. 2d 193, 194-95 (N.Y. 1969)

47. 83 Cal. App. 3d 593, 607-08, 148 Cal. Rptr. 57, 65-66 (Cal. App. 1978)

48. *Id.* at 607-608 & 65-66. *See also Continental Cas. Co. v. Zurich Ins. Co.*, 57 Cal. 2d 27, 35, 17 Cal. Rptr. 12, 366 P.2d 455 (1961). (The court also determined that where two insurers cover the same defense the costs must be shared between them pro rata in proportion to the respective coverage afforded by them to the insured.)

49. 885 F. Supp. 1457 (D. Kan. 1995)

50. *See e.g.,* Mutual Loss Research Bureau, GUIDING PRINCIPLES, (November 1, 1963). The "Guiding Principles" follow the "limit of liability" rule. Under this rule each insurer's "contribution," unless otherwise specified in the general principles, shall be on the basis of the "applicable limit of liability" under each respective policy or group of concurrent policies as though no other insurance existed. While this is labeled the "limit of liability" rule the name is somewhat misleading as the applicable limit of liability is the smallest of (a) the amount of insurance, (b) the amount of loss, or (c) the amount payable after applying the policy limitations. *See e.g.*, Property Loss Research Bureau, *Property Loss Managers Desk Reference Guide: Guiding Principles & Other Insurance* at 10 (1999). While the "Guiding

Principles" are of some interest particularily where allocation disputes are arbitrated between carriers, courts find them less persuasive. *See e.g.*, *Pittsburgh Bridge & Ironworks v. Liberty Mut. Fire Ins. Co.*, 338 N.Y.S.2d 501 (App. Div. 1972) (Guiding Principles not enforced as they were deemed only recommendations and not legally binding on the parties); *Hendrix v. Farmers Fire Ins. Co.*, 1974 Fire & Casualty Cas. (CCH) 1466 (U.S.D.C. S.D.N.Y. 1974) (U.S.D.C. S.D.N.Y. 1974); *Brockway-Smith Co. v. Boston & Maine Co.*, 497 F. Supp. 814 (D. Mass. 1980) (While Guiding Principles might be enforceable between insurers, they can in no way effect the insured.) *But see Pasker v. Harley S. Ville Mut. Ins. Co.*, 469 A.2d 41 (N.J. App. 1983) (Guiding Principles enforced as court erroneously believed that the parties were signatories to them); *Commercial Union Ins. Co. v. Petumina Cas. Corp.*, 851 F.2d 1998 (3d Cir. 1988) (Court receptive to applying principles).

51. *See* General Condition 5(e).

52. *See* ABA, *The Commercial Blanket Bond Annotated* at 59 (William F. Haug ed. 1985.)

53. 41 F.3d 438 (9th Cir. 1994)

54. One court explained the basis for allocating the risk of loss to the insured with regard to losses caused by employees about whom the insured had prior knowledge of dishonest acts:

> The policy provision in question [section 7 of a 3D policy] should be enforced for the additional reason that it is simply unfair to impose upon and insurer the risk of loss from an employee whom the employer knows or has ample reason to suspect is dishonest, but continues to employ.

Cooper Sportswear Mfg. Co. v. Hartford Cas. Ins. Co., 818 F. Supp. 721, 725 (D.N.J. 1993).

55. FIB, Standard Form No. 24, Section 12 and CCP, Employee Dishonesty Coverage Form, § D 2a(1) & (2).

56. CCP, Employee Dishonesty Coverage Form, D1(a).

57. 960 F. Supp 16 (D. Conn. 1997).

58. *See* also Michael R. Davisson, *Conditions to Recovery: Termination and Cancellation, in Financial Institution Bonds*, 2d (Duncan L. Clore ed. 1998) (Author lists a series of automatic cancellation cases under numerous fidelity instruments.)

59. FIB, Standard Form No. 24, § 3.

60. *See e.g.*, Duncan L. Clore & Michael Keeley, *Discovery of Loss: The Contractual Predicate to the Claim*, in Financial Institution Bonds, 2d ed. at 137(Duncan L. Clore ed. 1998)

61. Pursuant to section 12 of the FIB the surety's liability terminates "for any loss sustained by such insured which is discovered after the effective date of such termination."

62. *See e.g.,* Richard S. Mills & Frederick M. Zauderer, *At the Apex of the Arc of the Pendulum: Does FDIC v. INA Spell the Beginning of the End of the Notice Prejudice Rule in Fidelity Cases?*, Vol. IV The Fidelity Law Association Journal 127 (September 1998) (Authors provide exhaustive state by state analysis of notice and proof of loss requirements.) The obligee may also encounter an automatic cancellation problem where losses occur subsequent to the date upon which it is determined to have discovered its loss.

63. *Drexel Burnham Lambert Group, Inc. v. Vigilant Ins. Co.*, 157 Misc. 2d 198, 595 N.Y.S.2d 999 (1993).

64. *Id.* at 207-08 & 1006. This case contains a wealth of commentary on the act of discovery. The court goes on to make it clear that discovery of loss is different from discovering the details of the loss or the amount of the loss. With respect to the insured's obligations that arise upon discovery the court noted:

> The insured is required to give notice of the discovery of a loss or of an occurrence or act which may give rise to a claim for loss even though no loss is then sustained. The particulars can come later with the proof of loss, time for filing of which may be (and here was) extended. . . . Under the circumstances, no matter what claims for liabilities may have been asserted against Drexel thereafter, no additional coverage would come into play based upon the dishonesty of Milken, Levine and the other employees named or who acted in collusion with them for the bonds in effect after 1986. "The event triggering an insured's obligation under the policy with respect to proof of loss is 'discovery' not 'determination' of the loss." It would be inconceivable for any rational insurer to assume coverage from a predecessor insurer for dishonesty previously discovered but not yet delineated. All the primary bonds provide that upon discovery of any dishonest act, further coverage is terminated as to that employee. Once discovery takes place, the time to give notice and to file proofs of loss starts to run. It is an unwarranted imposition on those defendant insurers whose policies can not be deemed to cover for Milken, Levine and associates to compel them to appear and defend, and possibly endure years of extensive and expensive pre-trial discovery when even their potential liability cannot be demonstrated. The bonds in effect at the date of discovery may be implicated, but all other bonds are exonerated.

Id. at. 208-09 & 1006-07.

65. D. P. Felton & K. G. Sears, FIDELITY BONDS, 1st ed. at 27-28 (Insurance Institute of America 1992).

66. In the preamble to the CCP's general provisions, the language makes reference to both "this policy" and "this insurance." The use of the terms appears to suggest they are interchangeable:

> Throughout this policy the words "you" and "your" refer to the Named Insured shown in the DECLARATIONS. The words "we come" "us" and "our" refer to the company providing this insurance.

CCP, Crime General Provisions, CR10 00 10 90 (ISO 1989).

67. D. P. Felton & K. G. Sears, FIDELITY BONDS, 1st ed. at 30 (Insurance Institute of America 1992). It is possible that more than the prior policy could be implicated if the policies before it had lengthy discovery periods (e.g., three year discovery window). Under the Standard Form (General Condition 3) this would not occur. Furthermore, what does this language really say? Does it say that one gets the larger of the two policy limits or that the insured is entitled to the larger of the amount *recoverable* under the current or prior insurance? Contrary to the former interpretation, the language does not state that the insured is entitled to recover its losses up to the larger of the amount of the current insurance or prior insurance. Rather, it states the most the carrier will pay is the larger of the amount recoverable under the current insurance or the prior insurance. Read literally, this clause would seem to mean that the insured does not receive coverage for the losses otherwise covered by one of the policies – the one that provides less recovery. Under this reading, the clause is triggered if all loss situations were the same carrier has two policies in play – not just when the two policies have different coverage limits. This reading is more restrictive than the interpretation the industry applies to the provision.

68. There is nothing inherent in the language of General Condition 8 that makes it applicable only to situations where the prior coverage is with an unrelated company. Similarly, there is nothing in the language of General Condition 9 which limits its application only in instances where General Condition 8 does not apply. In other words, by their terms, it is possible to interpret both provisions as applying to the same loss (e.g., situation where a ten-year loss is incurred by an insured who has maintained coverage with the same carrier for the ten-year period).

69. If one were to remove General Condition 8 entirely from the policy, an insured would not be any more compelled to stay with the same carrier because of coverage concerns. Without General Condition 8 all policies would be forward looking and the insured would bear the risk of all past losses beyond the discovery period of the immediate prior coverage(s). General Condition 9 provides little benefit to the insured to stay with the same carrier. This provision states that if losses are partly covered under both policies,

then the insured is entitled to one amount—the larger of the amount recoverable under either one or the other of the two policies. Had the insured switched carriers it would then be entitled to recover its covered losses incurred during its current coverage up to its limits and those sustained during the prior coverage (as the discovery window remained open) up to its limits (subject perhaps in both cases to the "per occurrence" limitation). *See e.g. Bethany Christian Church f. Preferred Risk Mut. Ins. Co.*, 942 F.Supp. 330 (S.D. Tex. 1996). Depending upon the particular loss and coverage situation, staying put could prove either more beneficial or problematic for the insured than switching.

70. *See e.g., Brigham Young University v. Lumbermens Mut. Cas. Co.,* 965 F.2d 830 (10th Cir. 1992).

71. 489 A.2d 536 (Md. 1985)

72. *See e.g., Reliance Group Holdings, Inc. v. National Union Fire Ins. Co.*, 594 N.Y.S.2d 20, 188 A.D.2d 47 (App. Div. 1993).

73. *See e.g., Outboard Marine C22p v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740 (Ill. App. 1996), *appeal denied*, 675 N.E. 634 (Ill. 1996); *Northern States Power Co. v. Fidelity Co. v. Fidelity & Cas. Co.*, 523 N.W. 2d 657 (Minn. 1994) (Allocation according to time on risk); *Stonewall Ins. Co. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178 (2d Cir. 1995) (Same); *Stonewall Ins. Co. v. City of Palos Verdes*, 46 Cal. App. 4th 1810 (1996) (Allocation according to time on risk and policy limits).

74. *See e.g., Benoy Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 679 N.E. 2d 414 (______ 1997).

75. *See e.g., Owens Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. 1984); *OMC v. Liberty Mut. Ins. Co.*, 670 N.E. 2d 740 (Ill. App. 1996).

76. *See e.g., Aerojet-General Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 70 Cal. Rptr. 2d 118 (Cal. 1997).

77. *See e.g., Nationwide Mut. Ins. Co. v. Lafarge Corp.*, 910 F. Supp. 1104 (D.Md. 1996); *Lafarge Corp. v. National Union Fire Ins. Co. of Pittsburgh PA*, 935 F. Supp. 675 (D.Md. 1996).

78. 965 F.2d 830 (10th Cir. 1992). Additional facts are available in the District Court Opinion *Brigham Young University v. Lumbermens Mutual Cas. Co.*, 1990 WL 364471 (D. UTAH).

79. *Id.* at 832

80. The University calculated its claim as follows:

$ 864,350.00	value of missing works of art
$ 864,350.00	value of missing works of art
$ 148,320.14	recovery costs

$1,012,670.14	amount owed to University
(12,670.14)	less amount in excess of policy limit
(2,500.00)	less deductible under Lumbermens bond
(137,488.00)	less amount already paid by Lumbermens

$860,012.00	University's total claim

80. Id.

81. Lumbermens policy expressly stated that at the prior policy's discovery period must still be available at the time the loss is discovered. This requirement is implied in the ISO form of General Condition 9 insofar as it states that the loss *is* covered partly by this insurance and partly by prior cancelled insurance. Presumably the only way that such loss could actually be covered under such prior insurance is if the discovery period had not yet expired.

82. *Id.* at 835.

83. 942 F. Supp. 330 (S.D. Tex. 1996)

84. *Id.* at 332.

85. While the difference between what Atlantic Mutual paid and $50,000 was $18,876.11, Preferred Risk tendered a greater amount for a reason that is not explained in the opinion. *Id.* at 333, n.2

86. *Id.* at 335. The court also went on to address the Church's argument that the policy limits could be stacked:

> In order for the Church to recover $50,000 from Preferred, as opposed to the difference between the $50,000 policy limit and $31,123.89 Atlantic Mutual paid, the Church would have to stack the policy limits of all three policies in effect during the thefts. . . . The Texas Supreme Court has held that where two insurance policies do not overlap chronologically, the limits of those policies may not be stacked. However, where there are multiple

> policies in effect for the same coverage, those limits may be stacked. . . . In this case, the Church was covered by three non-overlapping policies with identical $50,000 policy limits. The theft occurrence triggered coverage by all three policies. This court applies the rule in *Garcia* and determines that the policy limits of the three applicable policies can not be stacked. The Church's total recovery for Smith's thefts is therefore, limited to $50,000.

Id. at 337-38.

87. 397 S.E.2d 876 (Va. 1990)

88. *Id.* at 877-78.

89. 299 N.E.2d 65 (Ill. App. 1973).

90. *Id.* at 70-71.

91. *Id.* at 73-74. The court does not set forth how the amount of liability ($12,629.11) was arrived at nor was there information indicating what the deductible was for the years in question.

92. 501 N.W.2d 335 (N.D. 1993).

93. *Id.* at 336-37.

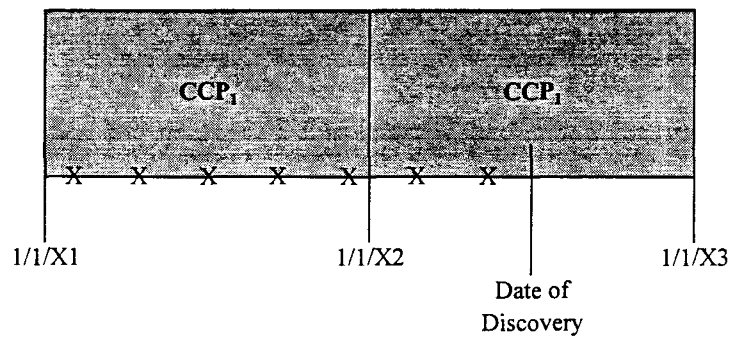
94. *Id.* at 341-42. *See also Diamond Transp. Sys., Inc. v. Travelers Indem. Co.*, 817 F. Supp. 710 (N.D. Ill. 1993) (General Condition 9 operated to limit insurer's liability to the sum of current bond/$250,000, rather than stacking prior limits/$750,000); *Eddystone Fire Co., No. 1 v. Continental Ins. Cos.*, 425 A.2d 803 (Pa. Super. 1981); *Columbia Hosp. v. United States Fidelity & Guar. Co.,* 188 F.2d 654 (D.C. Cir. 1951); *But see Globe Indem. Co. v. Wolcott & Lincoln, Inc.*, 152 F.2d 545 (8th Cir. 1945); *A.B.S. Clothing Collection, Inc. v. Home Ins. Co.*, 34 Cal. App. 4th 1470, 41 Cal. Rptr. 2d 166 (Cal. App. 1985).

95. 522 N.W.2d 837 (Iowa 1994).

96. *Id.* at A.39-840. The court did not explain how the word "cumulatively" could be interpreted in the insured's favor. *See also White Dairy Co. v. St. Paul Fire & Marine Ins. Co.*, 222 F. Supp. 1014 (N.D. Ala. 1963); *City of Miami Springs v. Travelers Indem. Co.*, 365 S. 2d 1030 (Fla. App. 1978); *Columbia Heights Motors, Inc. v. Allstate Ins. Co.*, 275 N.W. 2d 32 (Minn. 1979).

CONTINUOUS POSITION SCHEDULE COVERAGE - COMMERCIAL CRIME POLICY

Illustration 1 - Illustrates the reduction of limits due to more employees serving in a covered position than were scheduled.



Facts

	Period 1/1/X1 to 1/1/X2	Period 1/1/X2 to 1/1/X3
Scheduled Bookkeepers	2	2
Actual Bookkeepers	3	3

Each X represents $10,000 misappropriated in that period.

Position Schedule Coverage
Each policy period is 12 months; and each policy has a discovery period of 12 months.

Coverage
Assume the following:

Carrier	Limits	Deductible	Policy Period
CCP_1	$100,000	$0	1/1/X1 - 1/1/X3

Solution
Step 1 - Compute the reduction factor.

Number of Scheduled Employees in Position	2
Divided by: Number of Employees Serving in Position	3
Reduction Factor	2/3

Step 2 - Apply the reduction factor to largest limit of insurance and applicable to the position.

Limits	$100,000
Times: Reduction Factor	2/3
Reduced Limits for the Position	$66,667

Step 3 - The liability for CCP_1 equals $66,667, compared to the insured's loss of $70,000.

OCCURRENCE COVERAGE BETWEEN FORM O (BLANKET) AND FORM P (SCHEDULE)

Illustration 2 - Illustrates the application of governmental entities forms O and P. Form O is a "per loss" (blanket) and Form P is "per employee" (schedule).

Facts

Three employees work together to steal the following:

$Employee_1$	$200,000
$Employee_2$	125,000
$Employee_3$	175,000
Total	$500,000

Coverage

The insured has 2 policies:

Form	Limits	Deductible
O (excess)	$100,000 (per loss)	$0
P	$100,000 (per employee)	$0

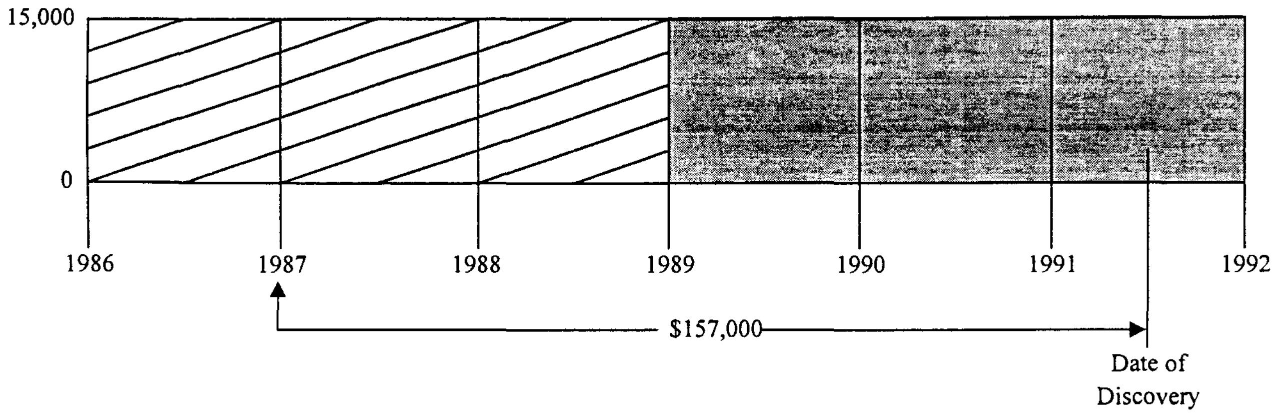
Solution

After determining how much each of the employees misappropriated, apply the limits of coverage applicable to each employee by Form P. Be aware if there are more employees in the position than were scheduled, see illustration 1. After applying Form P to the loss by employee, apply Form O to the remaining loss amount.

	Loss	Form P Limit	Excess	Form O Limit	Insured's Loss
$Employee_1$	$200,000	$100,000	$100,000		
$Employee_2$	125,000	100,000	25,000		
$Employee_3$	175,000	100,000	75,000		
Total	$500,000	$300,000	$200,000	$100,000	$100,000

Form P pays	$300,000
Form O pays	100,000
Insured pays	100,000
Total	$500,000

CINCINNATI INSURANCE V. HOPKINS SPORTING GOODS
522 N. W. 2d 837 (IOWA 1994)



Coverage

Carrier	Limits	Deductible	Policy Period
Cincinnati	$15,000	$0	1986 to 1989
Cincinnati	$15,000	$0	1989 to 1992

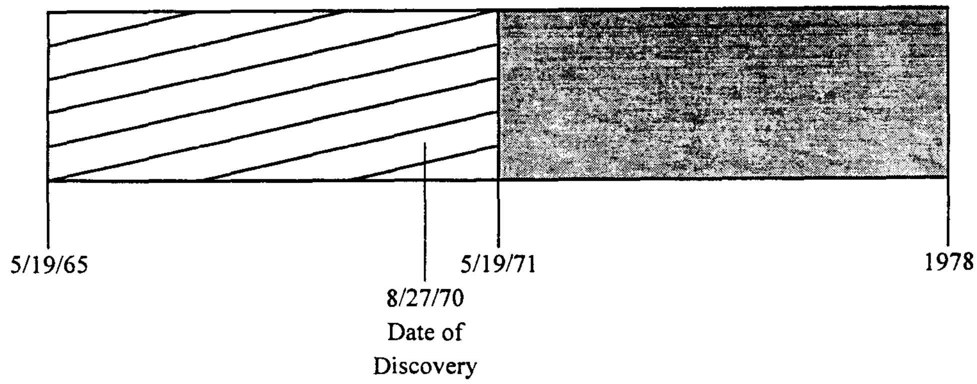
Period of Loss is 1987 to 1992	
Claimed	$157,000
Documented	$44,000

Solution

Per the court, "the non-accumulation clause for employee dishonesty coverage of $15,000 was ambiguous and had to be construed in favor of insureds so coverage was $15,000 for each year of three-year policy, rather than total of $15,000 for three years". The court held policy covered loss incurred during period of policy period, but discovered during subsequent one. Therefore, the insured has, for each policy period between 1987 and 1992, $15,000 per year and not in excess of $15,000 per year, up to $75,000 ($15,000 * 5 years) in total.

CONTINENTAL INSURANCE COMPANY V. MORGAN, OLMSTEAD, KENNEDY & GARDNER, INC.
83 Cal. App. 3d 593, (CALIFORNIA 1978)

Illustration 4 - Apportionment of loss based on policy limits.



Facts

Assume total loss is $500,000.

Coverage

Authors assumed the following is the coverage, reasoning by implication, as the coverages are not expressly set forth in the court's opinion. Assumed the following:

Carrier	Limits	Policy Period
Aetna	$500,000	5/19/65 - 5/19/71
INA	$1,000,000	5/19/71 - 1978

Solution

In the majority view, "Both Aetna and INA bonds contain an "Other Insurance" clause. . . . Here both bonds are subject to a reasonable construction which affords coverage. The applicable principle of construction of insurance contracts requires that both be held to cover Morgan's attorney's fees and court costs incurred at bench. Because both bonds purport to be excess insurance to other insurance, neither excess clause can be given any effect. Rather, the loss must be prorated in proportion to coverage."

<u>Step 1</u> - Establish limits of liability.

	Limits
Aetna	$500,000
INA	1,000,000
Total	$1,500,000

<u>Step 2</u> - Assess loss separately to the policy which alone affords coverage. - None in this situation.

<u>Step 3</u> - Contribution to areas of common coverage:

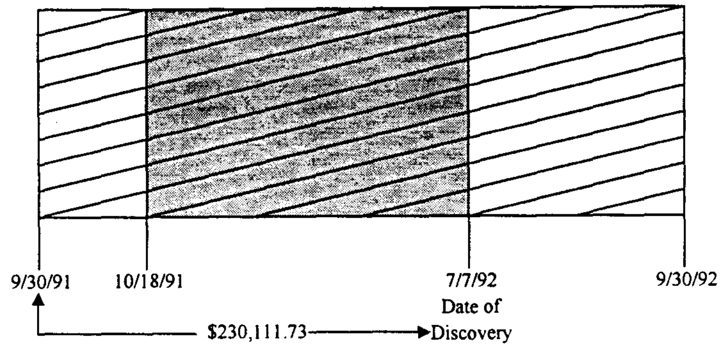
	Limits	Percentage	Pays
Aetna	$500,000	33.3%	$166,667
INA	1,000,000	66.7%	333,333
Total	$1,500,000		$500,000

<u>Step 4</u> - Claim under each policy and the insured based on assumed limits and loss and court's interpretation.

Aetna	$166,667
INA	333,333
Insured	0
Total Loss	$500,000

T.S.I. HOLDINGS V. BUCKINGHAM
885 F. Supp. 1457 (KANSAS 1995)

Illustration 5 - Apportionment of loss based on equal shares.



Facts

New Progress incurred a loss of $230,111.73.

Coverage
Assume the following:

Key	Carrier	Limits	Policy Period	Insureds
	Cincinnati	$200,000	9/30/91 - 9/30/92	New Progress - wholly owned subsidiary of T.S.I.
	Federal Insurance	$200,000	10/18/91 - 7/7/92	T.S.I. and subsidiaries

Solution

The court found that Cincinnati was correct in denying the claim submitted by New Progress (a wholly-owned subsidiary of T.S.I. Holdings), because Mr. Buckingham did not fit the definition of employee as defined in the Cincinnati policy. However, the court also found that an "other insurance" clause in the Cincinnati policy does not excuse Cincinnati from liability, because Illinois law proivdes for equal division of liability when an insured carries excess coverage (Footnote #49).

Step 1 - Establish limits of liability based on number of carriers and loss amount.

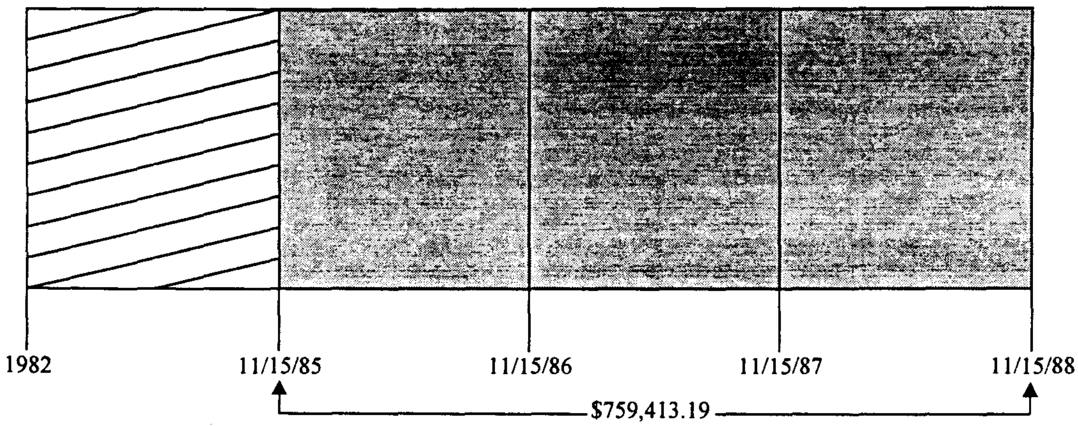
	Carrier Percentage	Loss	Loss Percentage	Pays
Cincinnati	50%	$230,111.73	50%	$115,055.86
Federal Insurance	50%	$230,111.73	50%	$115,055.87

Step 2 - Claim amount under each policy and the insured:

Cincinnati	$115,055.86
Federal Insurance	115,055.87
Insured	0.00
Total	$230,111.73

TRANSAMERICA HOLDING COMPANY V. ROY MILLER
41 F. 3d 438 (MONTANA 1994)

Illustration 6 - Limit of liability based on "party of interest" was not the company, but the company's customers.



Coverage

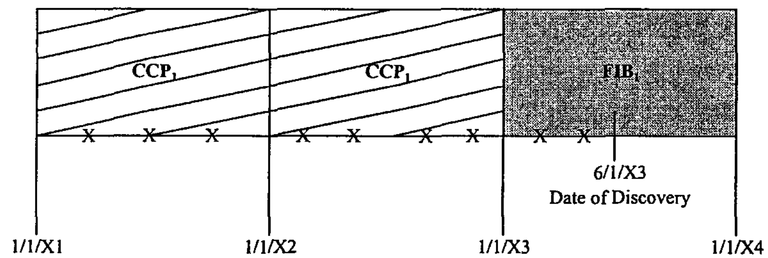
Carrier	Limits	Policy Period
Prior	N/A	1982 - 1985
Transamerica	$10,000	11/15/85 - 11/15/88

Solution

The appeals court affirmed the decision by the district court that determined that the bond intended that all of the customers of Guaranty Escrow Services, Inc. to be covered under the bond (Footnote #53). Therefore, the $10,000 limit of liability applies to each escrow customer, for a total loss of $699,626.58 plus interest of $172,774.98. The $10,000 did not apply to the loss as a whole.

OVERLAPPING COVERAGE BETWEEN DISCOVERY BOND AND COMMERICAL CRIME POLICY (LOSS SUSTAINED)

Illustration 7 - Overlapping coverage between financial institution bond and commerical crime policy with a discovery date within the discovery period of the prior commercial crime policy.



Coverage

Carrier	Limits	Deductible	Policy Periods
CCP$_1$	$200,000	$0	1/1/X1 - 1/1/X3
FIB$_1$	$100,000	$0	1/1/X3 - 1/1/X4

Each X represents $10,000 misappropriated in that period.

Depending on the claims personnel's interpretaion as to whether the policies are concurrent (common law apportionment), or nonconcurrent (limit of liability apportionment), we provide for comparison purposes both solutions and the results therein:

Solution

Common Law Apportionment Solution

Step 1 - Establish policy limits of liability.

	CCP$_1$	FIB$_1$
Insurance	$200,000	$100,000
Loss	90,000	90,000
Claim	70,000	90,000
Limit of Liability	70,000	90,000

Step 2 - Assess loss separately covered to FIB$_1$ which alone affords coverage of $20,000 from 1/1/X3 - 1/1/X4.

The difference between the highest and the lowest of the deductible of $0 is assessed on the policy, and the rermaining liability amount of $70,000 participates with other policies to pay loss to common area of coverage.

Step 3 - Contribution to area of common coverage of $70,000 ($90,000-$20,000) based on policy limits.

	Limits of Liability	Percentage	Pays
CCP$_1$	$200,000	67%	$46,667
FIB$_1$	100,000	33%	23,333
Total	$300,000	100%	$70,000

Step 4 - Claim under each policy is:

		Pays
CCP$_1$		$46,667
FIB$_1$	(23,333+20,000)	43,333
Total		$90,000

Limit of Liability Solution

Step 1 - Establish limits of liability.

	CCP$_1$	FIB$_1$
Insurance	$200,000	$100,000
Loss	90,000	90,000
Claim	70,000	90,000
Limit of Liability	70,000	90,000

Step 2 - Assess loss separately covered to FIB$_1$ which alone affords coverage of $20,000 from 1/1/X3 - 1/1/X4.

The difference between the highest and the lowest of the deductible of $0 is assessed on the policy, which alone affords coverage, and the remaining liability amount of $50,000 participates with other policies to pay loss to common area of coverage.

Step 3 - Contribution to area of common coverage of $70,000 ($90,000-$20,000) based on limits of liability.

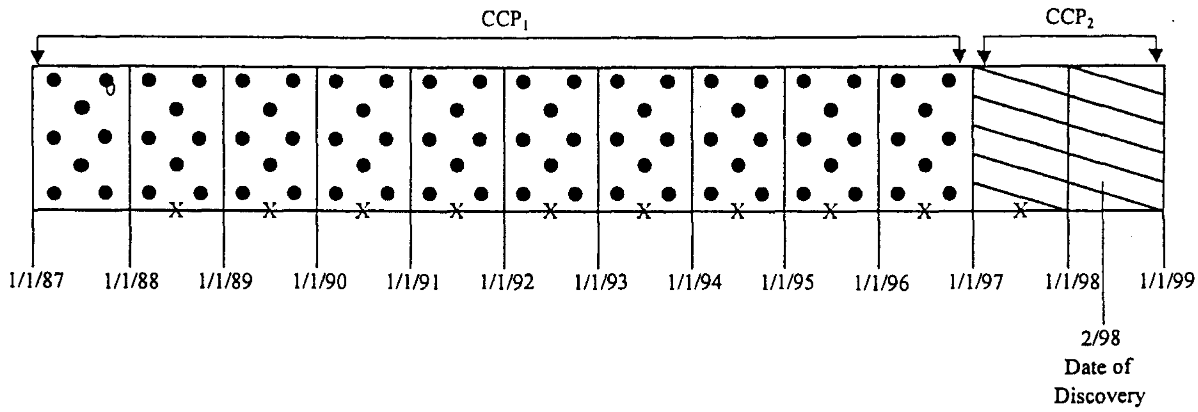
		Limits of Liability	Percentage	Pays
CCP$_1$		$70,000	50%	$35,000
FIB$_1$	(90,000-20,000)	70,000	50%	35,000
Total		$140,000	100%	$70,000

Step 4 - Claim under each policy is:

		Pays
CCP$_1$		$35,000
FIB$_1$	(35,000+20,000)	55,000
Total		$90,000

CONTINUOUS PRIOR POLICY COVERAGE INTERPRETATION

Illustration 8 - Insurance coverage provided on a continuing basis, over the loss period, by two or more commercial crime policies, with the date of discovery within the twelve months of the prior policy.



Coverage
Assume the following facts:

Carrier	Limits	Deductible	Policy Period
CCP_1	\$100,000	\$0	1/1/87 - 1/1/97
CCP_2	\$100,000	\$0	1/1/97 - 1/1/99

Each policy period is 12 months; and each policy has a discovery period of 12 months.

Each X represents \$10,000 misappropriated in that period. The principal misappropriated \$10,000 a year for 10 years.

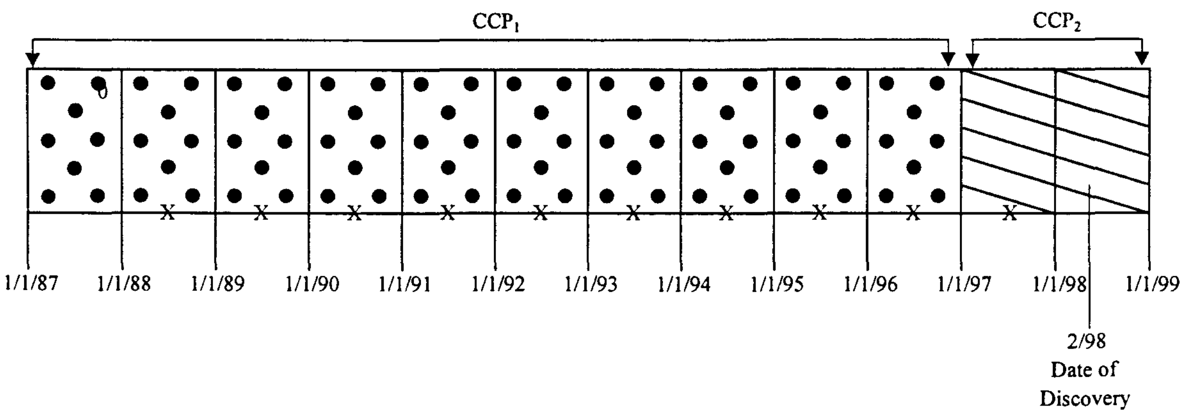
Solution
Then the liability for each carrier is:

CCP_1 Liability = \$0

CCP_2 Liability = \$100.000

CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION

Illustration 9 - Insurance coverage provided on a continuing basis, over the loss period, by three or more commercial crime policies, with the date of discovery within the twelve months of the prior policy.



Coverage
Assume the following facts:

Carrier	Limits	Deductible	Policy Period
CCP_1	$100,000	$0	1/1/87- 1/1/97
CCP_2	$100,000	$0	1/1/97 - 1/1/99

Each policy period is 12 months; and each policy has a discovery period of 12 months.

Each X represents $10,000 misappropriated in that period. The principal misappropriated $10,000 a year for 10 years.

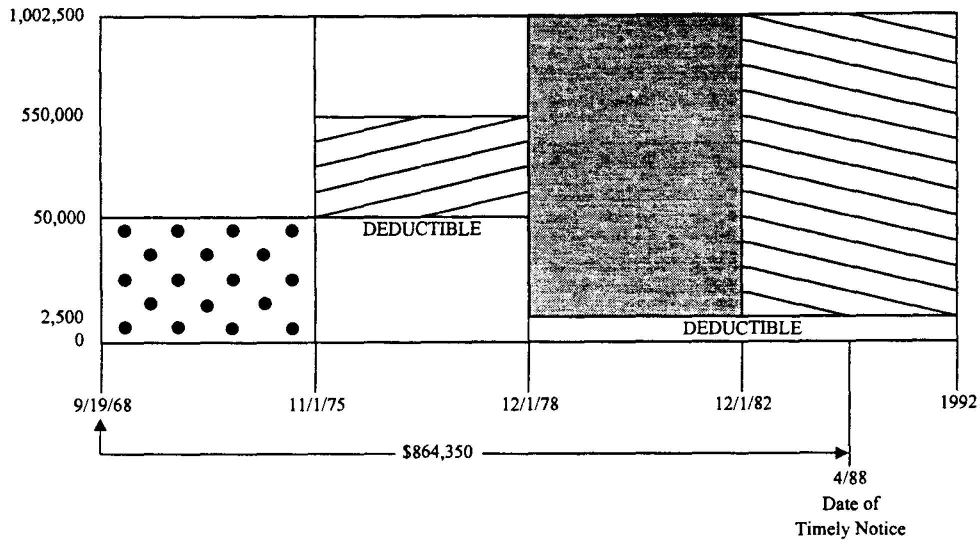
Solution
Then the liability for each carrier is:

CCP_1 Liability = $0

CCP_2 Liability = $20,000

BRIGHAM YOUNG UNIVERSITY V. LUMBERMENS MUTUAL CASUALTY COMPANY
965 F. 2d 830 (UTAH 1992)

Illustration 10 - Insurance coverage provided on a continuous basis, over the loss period.



Coverage

Carrier	Limits	Deductible	Loss Amount	Policy Period
Western Casualty & Surety	$50,000	$0	$721,862	9/19/68 - 11/1/75
Fidelity Deposit Co.	$500,000	$50,000	$116,038	11/1/75 - 12/1/78
Federal Insurance Co.	$1,000,000	$2,500	$17,200	12/1/78 - 12/1/82
Lumbermen's Mutual	$1,000,000	$2,500	$9,250	12/1/82 - 1992
			$864,350	

Solution

Step 1 - Establish limits of liability.

	Western	Fidelity	Federal	Lumbermen's
Insurance	$50,000	$500,000	$1,000,000	$1,000,000
Loss	721,862	116,038	17,200	9,250
Claim	50,000	66,038	17,200	9,250
Limit of Liability	0	0	0	

Step 2 - Assess loss separately covered to the policy which alone affords coverage is the Lumbermen's Mutual Policy, as the discovery date of prior carriers had expired. Lumbermen's Mutual is liable to the lesser of the limits or losses during the prior insurance (Condition #8).

Step 3 - There is no area of common coverage as Lumbermen's Mutual is the only carrier available to the extent of prior carrier limits and its own. The loss is discovered after the discovery period of the prior carrier.

Step 4 - Claim under each policy period:

	Limits	Deductible	Loss	Payable
Western Casualty & Surety	$50,000	$0	$721,862	$50,000
Fidelity Deposit Co.	500,000	50,000	116,038	66,038
Federal Insurance Co.	1,000,000	2,500	17,200	14,700
Lumbermen's Mutual	1,000,000	2,500	9,250	6,750
Total			$864,350	$137,488

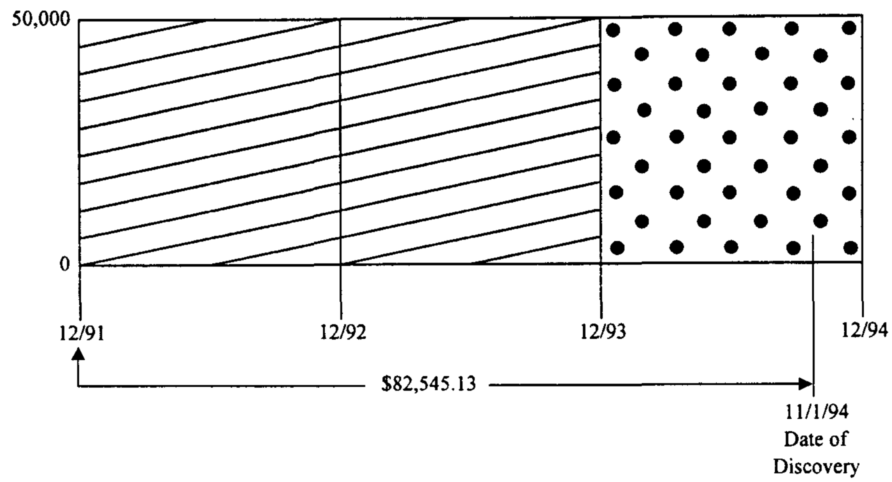
Due to the expiration of the prior carriers' discovery period, Lumbermen's was liable (per the courts) for $137,488.

Possible Apportionment Issues

1) Art that was stolen, but with an unknown date of theft, were put in Western Casualty and Surety period.
2) Kemper applied $50,000 deductible in Fidelity Deposit policy period, when $50,000 was addressed in Western Casualty & Surety period.
3) Kemper applied two $2,500 deductibles: Lumbermen's policy period and the prior carrier, Federal Insurance.

BETHANY CHRISTIAN CHURCH V. PREFERRED RISK MUTUAL INSURANCE COMPANY
942 F. Supp 330 (S. D. TEXAS 1996)

Illustration 11 - The insured loss claimed to amount to more than one insurance.



Coverage

Key	Carrier	Limits	Loss	Policy Period
	Atlantic Mutual	$50,000	$1,493.97	12/91 - 12/92
	Atlantic Mutual	$50,000	$29,629.92	12/92 - 12/93
	Preferred Risk	$50,000	$51,421.24	12/93 - 12/94
			$82,545.13	

Solution

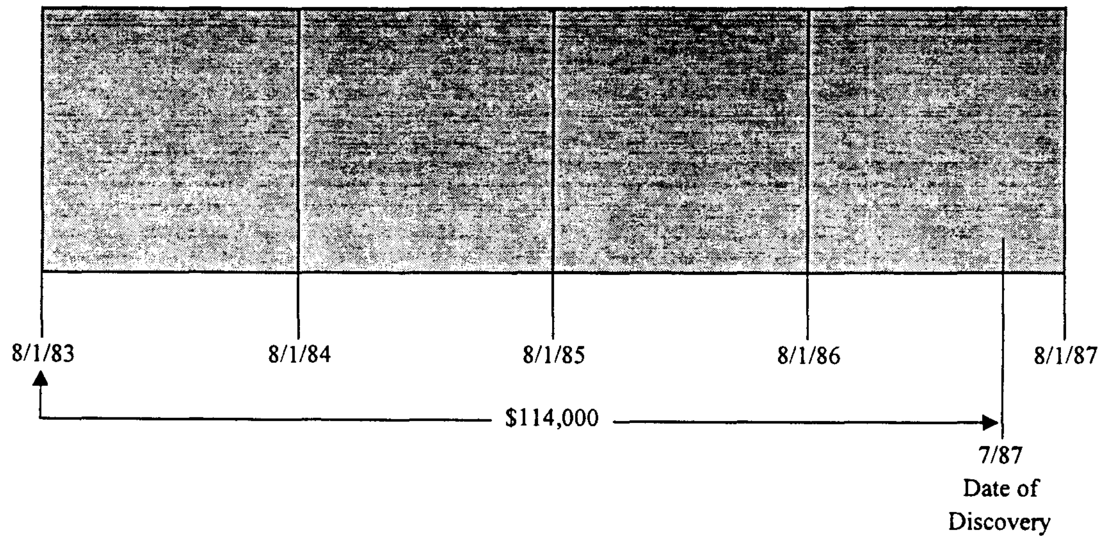
	Limit of Liability
Atlantic Mutual	$31,123.89
Preferred Risk	18,876.11 (A)
Total	$50,000.00

Based on the foregoing, the Court finds that an occurrence, as defined in the Preferred insurance policy and as interpreted by Texas law, means all loss caused by or involving, one or more employees, whether the result of a single act or series of acts. As such, the series of thefts over a three-year period by the Church's employee, Linda Smith, constitutes one occurrence. Furthermore, the Court finds that the Church may not stack its policy limits, even though the claim occurrence extends throughout several policy periods, because the three insurance policies cover three separate policy periods and do not overlap chronologically. Accordingly, the Church is entitled to receive from Preferred the $50,000 policy limit amount less the $31,123.89 already paid to the Church by Atlantic Mutual or $18,876.11.

Note:
(A) The difference between the $50,000 policy limit and what Atlantic Mutual has paid is actually $18,876.11. Nevertheless, Preferred tendered $19,776.54 to the Church (See p. 6 of Preferred's Response to the Church's Motion for Summary Judgment/Counter-Motion for Summary Judgment, Document No. 19).

GRAPHIC ARTS MUTUAL INSURANCE COMPANY V. C. W. WARTHEN COMPANY, INC.
240 Va. 457, 397 S.E. 2d 376 (VIRGINIA 1990)

Illustration 12 - The insured claimed policy limits per policy period versus per loss.



Coverage

Carrier	Limit	Deductible	Policy Period
Graphic Arts Mutual	$10,000	$0	8/1/83 - 8/1/87

The insured suffered a loss of $114,000 over a ten year period.

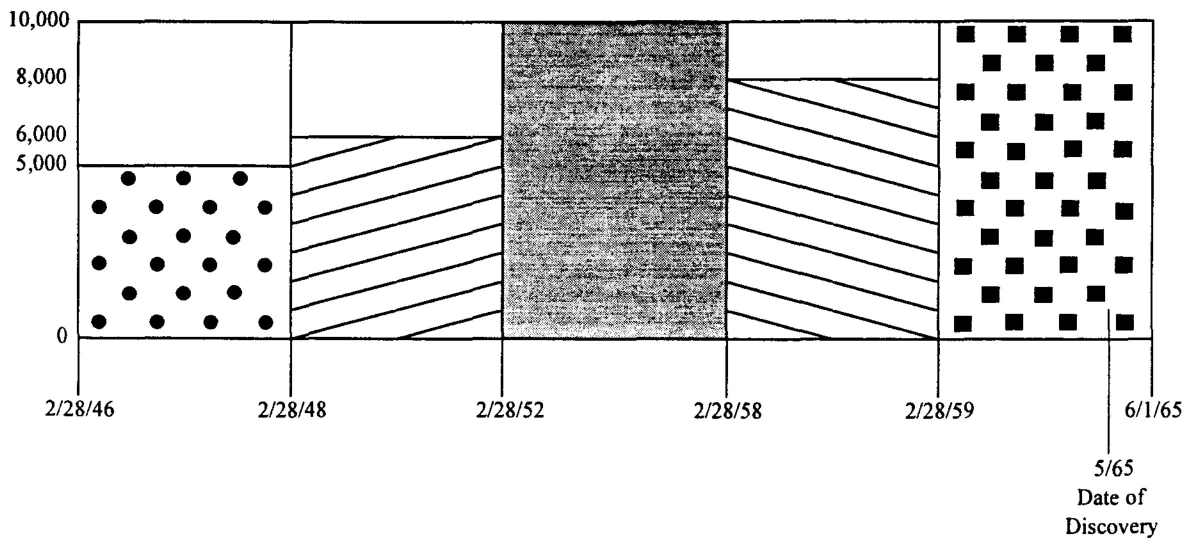
Solution

The court found that the $10,000 limit applied to the entire period of loss, not from year to year, based on Section 11 of the Comprehensive Crime Coverage Endorsement, which states, in part:

"Regardless of the number of years, this endorsement shall continue in force and the number of premiums which shall be payable or paid, the limit of the Company's liability as specified in the Table of Limits of Liability of this endorsement shall not be cumulative year to year or period to period."

	Pays
Graphic Arts Mutual	$10,000

SANTA FE GENERAL OFFICE CREDIT UNION V. GILBERTS
12 Ill. App. 3d 693, 299 N. E. 2d 65 (ILLINOIS 1973)



Coverage

Carrier	Limits	Deductible	Policy Period
National Surety	$5,000	$0	2/28/46 - 2/28/48
National Surety	$6,000	$0	2/28/48 - 2/28/52
National Surety	$10,000	$0	2/28/52 - 2/28/58
National Surety	$8,000	$0	2/28/58 - 2/28/59
National Surety	$10,000	$0	2/28/59 - 6/1/65

The principal misappropriated monies each year from 1948 to 1965.

The insured's loss is calculated as follows:

Total misappropriated monies	$192,617.45
Less: Amount repaid by principal	16,535.85
Net loss	$176,081.60

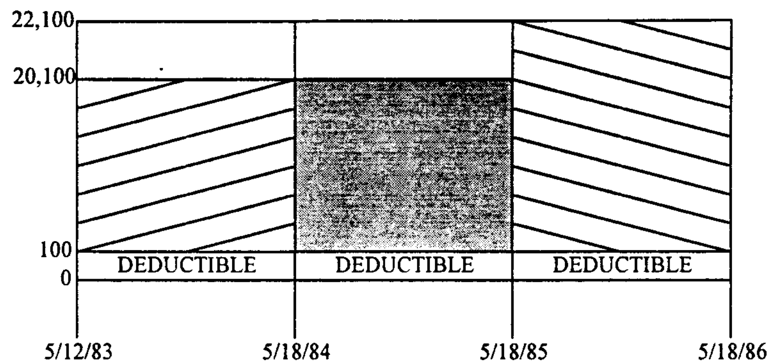
Solution

The court concluded that the bonds constituted a single, continuing contract. In addition, the blanket bond also provided a "non-accumulation of liability" clause which states, in part:
"Section 7. Regardless of the number of years this bond shall continue in force and the number of premiums which shall be payable or paid, the liability of the Underwriter under this bond with respect to any loss or losses specified in the PROVIDED clause of Section 6 of this bond shall not be cumulative in amounts from year to year or from period to period."

Therefore, National Surety is only liable up to its limit of liability, $10,000, for the loss.

KAVANEY REALTOR & DEVELOPER V. THE TRAVELERS INSURANCE COMPANY
501 N. W. 2d 335 (NORTH DAKOTA 1993)

Illustration 14 - The insured claimed the policy limits for each policy period with the same carrier.



Coverage

Carrier	Limits	Deductible	Loss Amount	Policy Period
Travelers	$20,000	$100	$4,000	5/12/83 - 5/18/84
Travelers	$20,000	$100	$46,125	5/18/84 - 5/18/85
Travelers	$22,000	$100	$31,550	5/18/85 - 5/18/86
			$81,675	

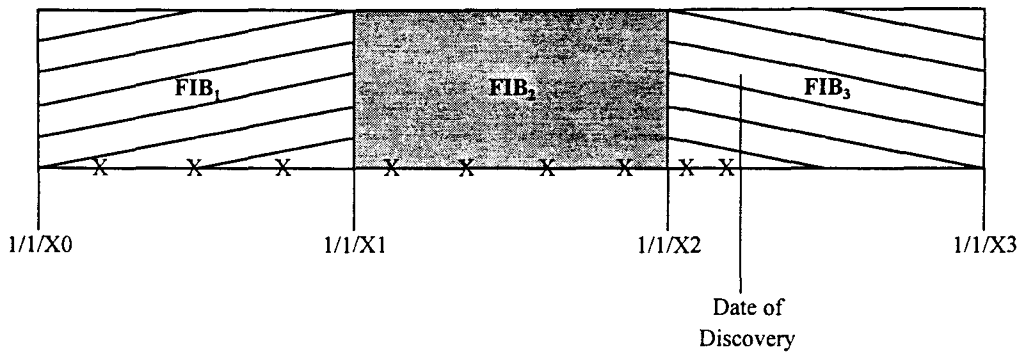
Solution

The court found Travelers' contract "to be continuous and noncumulative", and that Travelers' liability could not exceed $22,000, based on Condition #9. Claim under each policy and the insured:

	Pays
Travelers	$22,000
Insured	59,675
Total	$81,675

CONTINUOUS COVERAGE - MULTIPLE FINANCIAL INSTITUTE BONDS (FIB)

Illustration 15 - Insurance coverage provided on a continous basis, over the loss period, by two or more financial institution bonds.



Coverage
Assume the following facts:

Carrier	Limits	Deductible	Policy Period
FIB_1	$100,000	$0	1/1/X0-1/1/X1
FIB_2	$100,000	$0	1/1/X1-1/1/X2
FIB_3	$100,000	$0	1/1/X2-1/1/X3

Each X represents $10,000 misappropriated in that period.

Solution
Then the liability for each carrier is:

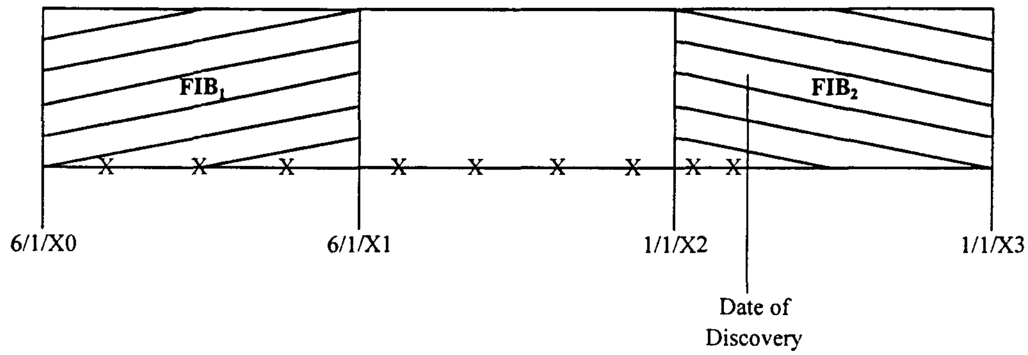
FIB_1 Liability = $0

FIB_2 Liability = $0

FIB_3 Liability = $90,000

NON-CONTINUOUS COVERAGE - MULTIPLE FINANCIAL INSTITUTE BONDS

Illustration 16 - Insurance coverage is on a noncontinuous basis, over the loss period, by two or more financial insitution bonds.



Coverage
Assume the following facts:

Carrier	Limits	Deductible	Policy Period
FIB$_1$	$100,000	$0	6/1/X0-6/1/X1
FIB$_2$	$100,000	$0	1/1/X2-1/1/X3

Each X represents $10,000 misappropriated in that period.

Here there is a lapse in the coverage during the period of 6/1/X1 to 1/1/X2 for 6 months.

Solution
Then the liability for each carrier is:

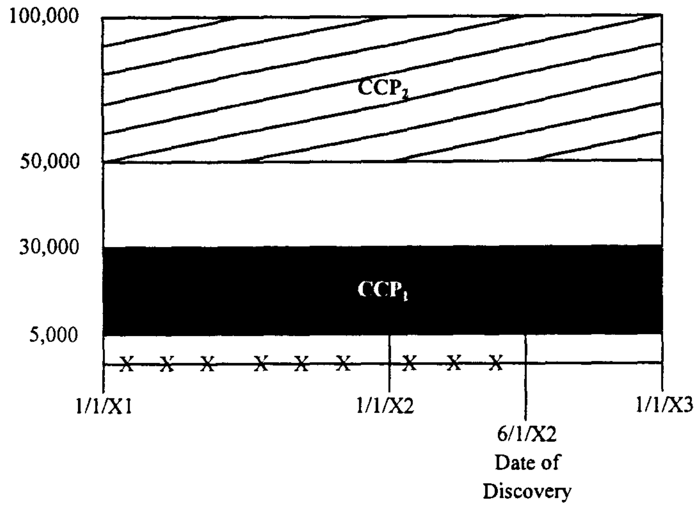
FIB$_1$ Liability = $0

FIB$_2$ Liability = $90,000

Each carrier's liability is dictated by the discovery of the loss.

GAP IN COVERAGE BETWEEN PRIMARY AND EXCESS COMMERICAL CRIME POLICIES

Illustration 17 - Gap in coverage between primary and excess commercial crime policies.



Coverage

Carrier	Limits	Deductible	Policy Periods
CCP_1	$25,000	$5,000	1/1/X1 - 1/1/X3
CCP_2	$50,000	$50,000	1/1/X1 - 1/1/X3

Each X represents $10,000 misappropriated in that period.

Solution

For illustrative purposes, assume a date of discovery of 6/1/X2.

Step 1 - Establish limits of liability.

		CCP_1		CCP_2
Insurance		$25,000		$50,000
Loss		90,000		90,000
Claim	(90,000-5,000)	85,000	(90,000-50,000)	40,000
Limit of Liability		25,000		40,000

Step 2 - Assess loss separately covered to the policy which alone affords coverage.

The difference between the highest and the lowest of the deductible of $45,000 ($50,000-$5,000) is assessed on CCP_1, which alone affords coverage of $25,000, and the remaining liability amount of $40,000 ($90,000-$50,000) participates with other policies to pay loss to common area of coverage.

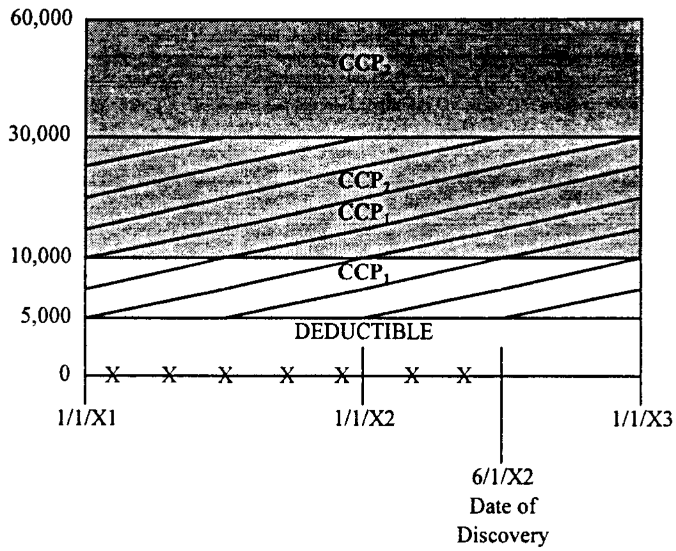
Step 3 - Area of common coverage is $0.

Step 4 - Claim under each policy and insured is:

	Pays
CCP_1	$25,000
Insured	25,000
CCP_2	40,000
Total	$90,000

OVERLAP IN COVERAGE BETWEEN PRIMARY AND EXCESS COMMERCIAL CRIME POLICIES WITHOUT ENDORSEMENT FOR EXCESS INSURANCE

Illustration 18 - Overlapping coverage between primary and excess commercial crime policies.



Coverage

Carrier	Limits	Deductible	Policy Periods
CCP_1	\$25,000	\$5,000	1/1/X1 - 1/1/X3
CCP_2	\$50,000	\$10,000	1/1/X1 - 1/1/X3

Each X represents \$10,000 misappropriated in that period.

Solution
For illustrative purposes, assume a date of discovery of 6/1/X2.

Step 1 - Establish limits of liability.

	CCP_1	CCP_2
Insurance	\$25,000	\$50,000
Loss	70,000	70,000
Claim	25,000	50,000
Limit of Liability	25,000	50,000

Step 2 - Assess loss separately covered to the policy which alone affords coverage.
The difference between the highest and the lowest of the deductible of \$5,000 (\$10,000-\$5,000) is assessed on CCP_1, which alone affords coverage, and the remaining liability amount of \$60,000 (\$70,000-\$10,000) participates with other policies to pay loss to common area of coverage.

Step 3 - Contribution to area of common coverage on basis of available limits of liability.

		Limits of Liability	Percentage	Pays
CCP_1	(\$25,000-\$5,000)	\$20,000	28.6%	\$17,160
CCP_2		50,000	71.4%	42,840
Total		\$70,000		\$60,000

Step 4 - Claim under each policy and insured is:

		Pays
CCP_1	(\$17,160+\$5,000)	\$22,160
CCP_2		42,840
Insured		5,000
Total		\$70,000