

## Fear Not: The Mystery of Insurance Coverage for Criminal Losses Solved



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A ten-year employee, the Vice President of Finance, absconds with the company car and \$5 million of embezzled company funds. The company immediately reports the

stolen car to the insurance agent but delays reporting the embezzlement. Why?

Despite paying hundreds of millions of dollars in premiums, only 20% of the victims ever end up pursuing insurance coverage for their criminal losses. Why?

First of all, many simply do not realize their companies have insurance coverage for fraud and criminal losses. But, there are two other possible reasons: (1) the company is "embarrassed" because it might be shown that the company was "negligent" in allowing the dishonest acts to take place; and (2) the company cannot prove the "state of mind" requirements of the insurance policy: "manifest intent" and "dishonesty." Both reasons are simply wrong!

### *Policyholder "Negligence" Is Not a Basis for Claim Denial*

Insurance companies frequently prey upon a policyholder's guilt after a fraud loss by pointing to failures in the policyholder's internal controls. However, *there is no negligence exclusion*. The failure of a policyholder's internal controls is not a reason to disclaim coverage. Courts repeatedly have held that negligence is not a defense to fidelity bond coverage.

### *Proof of Intent and Dishonesty of Employee*

The current standard policy form for an Employee Dishonesty Policy Loss is as follows:

The Underwriter, in consideration of the payment of the premium . . . agrees to indemnify the [company] against loss of money or other property which the company shall sustain resulting directly from one or more fraudulent or dishonest acts of an Employee, acting alone or in collusion with others, to an amount not exceeding in the aggregate the amount stated in . . . the Declarations.

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

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

In considering dishonesty coverage, courts start from the presumption that people are presumed to act honestly, and the courts will not infer dishonesty lightly. Against that background, the elements necessary to establish coverage under existing bond provisions include:

1. Improper conduct by an employee which unfairly exposes the employer to a loss or risk of loss;
2. Moral turpitude, i.e., that the employee was aware of the impropriety of his con-

- duct, and that it might or would cause a loss, which knowledge can be inferred from circumstances; and
3. Direct financial gain to the employee, or to some other individual intended by the employee to reap the gain.

### **Manifest Intent**

Under the standard policy form, the employee must have acted with manifest intent. Manifest intent has been the subject of many court decisions. One Tenth Circuit decision addressed the meaning of manifest intent. In *Federal Deposit Insurance Corp. v. United Pacific Insurance Co.*, (10th Cir. 1994), the court stated:

[M]anifest intent means intent that is “apparent or obvious.” Manifest intent does not require that the employee wish for or desire a particular result; rather, manifest intent exists when a particular result is substantially certain to follow from the employee’s conduct. Manifest intent to cause a loss may be inferred from an employee’s reckless conduct and other circumstantial evidence. Direct evidence of the employee’s intent is not required, and a claim by an employee that he intended no loss to the bank is not conclusive.

Policyholders should remember that although insurance companies will not tell you this, intent may be shown circumstantially, substantially easing the burden of proof.

### **Dishonesty**

Insurance companies sometimes allege that the employee’s acts were not truly “dishonest,” or that the theft merely was a “loan” which was intended to be repaid.

Courts have established, however, that dishonesty is to be given a broad meaning in claims under fidelity bonds. The employee’s acts need not be criminal, although there must be more than negligence, mistake, carelessness or incompetence.

### **Insurance Coverage for Criminal Losses**

Standard insurance coverage purchased by most companies usually includes eight different types of insurance for fraud or theft losses:

- “Fidelity” coverage: for losses arising from employees’ dishonest acts;

- “On Premises” coverage: for loss of property (e.g., money, securities, CDs, notes, electronic records, while on the company’s premises (wherever located));
- “In Transit” coverage: for loss of property while in transit due to theft, mysterious disappearance or damage;
- “Forgery or alteration” coverage: for losses arising from the forgery or alteration of negotiable instruments, CDs, letters of credit or certain other instruments;
- “Securities” coverage: losses arising from, for example, forged, altered, lost or stolen securities, titles, deeds, mortgages or guarantees;
- “Counterfeit” coverage: for losses arising from the acceptance of counterfeit currency;
- “Computer Systems Fraud” coverage: for losses arising from fraudulent entry of data or alteration of data causing the payment, transfer or delivery of property or funds; and
- “Fraudulent Mortgage” coverage: for losses on loans resulting from the acceptance of mortgages, deeds, “like instruments” or assignments that are defective because of trickery, fraud or false pretenses.

### **Nine Tips For Recovering For Fraud Losses**

1. Give Notice of a Loss Immediately.
2. Begin An Investigation.
3. Identify Potentially Applicable Insurance Policies.
4. Timely Submit the Proof of Loss.
5. Cooperate with the Insurance Company.
6. Stay on the Offensive.
7. Take the Direct Approach to Insurance Company Defenses.
8. Let Reason Be Your Guide.
9. Do Not Take No for An Answer.

### **Conclusion**

Perhaps the only thing worse than being the victim of theft from an employee’s dishonest acts is simply ignoring the insurance coverage for which you have paid significant premiums to cover these types of business losses. Paying for insurance coverage that is never pursued is no better than letting your employees loot your company with impunity. A successful business cannot permit either to occur. A company may not be able to prevent the actions of all dishonest employees, but it can decide to unravel the mystery of insurance coverage for such

acts by pursuing a claim with integrity, intelligence, knowledge and determination. ■

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