

By-Lined Article

"The Termination Provision in Fidelity Insurance Policies: Practitioners Discuss a Split in Authority"

By Max Stern March 5, 2012

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The *Capital Bank & Trust* decision enforcing a fidelity bond's termination provision reflects the majority rule that there is no fidelity coverage for loss from an employee's acts when the employer knows in advance of the loss of past dishonesty on the part of that employee. Its holding is more sound than that of *Waupaca Northwoods*, which found the provision ambiguous in a crime policy with respect to knowledge of pre-policy inception dishonesty and thus unenforceable to bar coverage for acts by a known dishonest employee. The difference between these two case holdings illustrates the difference between applying a provision as written, on the one hand, and straining to find ambiguity in order to create coverage, on the other hand. The judge who authored the *Waupaca Northwoods* decision makes clear his sympathy for an employer who purchased a company that seemed to have two bad apples, one of whom knew of the other's prior termination for knowingly misusing the predecessor company's resources when he rehired the other as a plant manager for the new company. However, while sympathy for an employer (as opposed to an insurer) is not too surprising to insurance coverage practitioners, sympathy does not make for soundly decided precedent.

The guiding principle in insurance interpretation is whether there are two reasonable ways to read the provision, in context. In the context of fidelity insurance products, the majority rule makes clear that going forward neither employer policyholders nor insurers reasonably expect coverage for acts of employees once that employee's past dishonesty is known to the employer. The termination provisions state that coverage for that employee "terminates" upon such knowledge. The *Capital Bank & Trust* decision enforces the provision as written, straightforwardly concluding that where an employer

had pre-inception knowledge of an employee's falsifying signatures for loan documents, coverage as to that employee "terminated immediately upon inception." The *Waupaca Northwoods* decision, on the other hand, concluded that the word "terminates" reasonably can be read as requiring some period of coverage before being terminated. The problem with this holding is that such a reading is not reasonable in context; it is not supported by the words or by reasonable expectations. The words do not say that coverage has to be in force for some period of time before being terminated, and there is nothing inherently unintelligible or unexpected about coverage terminating at inception for an employee known to be dishonest. By straining to create ambiguity where none exists, the *Waupaca Northwoods* decision departs from sound precedent regarding the enforcement of the termination provision in fidelity insurance policies and bonds.

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