LIMITS OF LIABILITY: ATTEMPTS TO GO BEYOND THE OUTER LIMITS

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I. Introduction

In a typical claim situation, a claim handler determines the amount of loss that the insured has claimed, deducts those items that do not appear to be covered by the policy, applies any applicable deductible, and pays the loss that is within the limit of liability.[1] In a typical claim, there are no other carriers who perhaps should be contributing to any payment. However, the typical claim is not always the case, particularly when the loss arose from embezzlement or fraud occurring over more than one policy period and multiple insurers are involved.

A fidelity loss is often comprised of a series of related acts that occur over a number of years. While it is uncommon for an insured to sustain a loss from a particular peril, such as fire, more than once or twice in a number of years, dishonest employees tend to engage in a pattern of behavior that can result in many separate instances of loss over the length of their employment. By its very nature, therefore, a fidelity loss can raise issues concerning the limit of liability that are not present in other insurance claims.

An insured may have concurrent coverages, that is, two policies that both provide the same or similar coverage for the same loss or prior or subsequent policies that have been issued by the same carrier or by other carriers, all of which might provide coverage. When there is concurrent coverage, disputes can arise between an insured and its insurers; between two carriers who both have issued primary coverage for the same risk; between primary and excess carriers; and between carriers who have concurrent coverage. Because a fidelity loss can occur over a number of years or involve more than one employee or more than one scheme, an insured may seek to recover more than one limit of liability.

Carriers have crafted their products to account for the peculiar nature of fidelity losses. The fidelity bond forms traditionally have contained one of two different coverage triggers, depending upon the form used: Discovery or Loss Sustained. The Financial Institution Bonds, such as the Standard Form 24 Financial Institution Bond, most often are written on a discovery basis, i.e., the Financial Institution Bond provides coverage for loss sustained at any time, but discovered by the insured during the bond period. The

[1] Patrick J. O'Connor, Jr. and D.M. Studler, *Limits of Liability: A Multi-Faceted Perspective* (Surety Claims Institute June 25-26, Hershey, Pennsylvania 1999). *See also* D.T. HAWKINS, GUIDING PRINCIPLES: CASUALTY—FIDELITY—FIRE—INLAND MARINE, FIRST-PARTY PROPERTY LOSSES AND CLAIMS (1963).

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Standard Commercial Crime Policy,[2] often known as CR 1000 and CR 0001, provides coverage for loss sustained during the policy period and discovered within one year after the coverage terminates.

More recently, a hybrid form has been developed. In 2000, the Insurance Services Office[3] developed a new crime form, the ISO Form CR 0021Commercial Crime Coverage Form (Loss Sustained Form) for use in a package policy.[4] This form also provides coverage for loss sustained during the policy period and discovered no later than one year from the date of termination or cancellation. The extended discovery period, however, terminates immediately upon the effective date of any other insurance obtained by an insured, which replaced in whole or in part the insurance provided by the current policy, whether or not such other insurance provides coverage for loss sustained prior to its effective date.[5] This newer form also contains other modifications, which are aimed at protecting the policy's limit of liability, as will be discussed below.

Each of the three policies, the standard Commercial Crime Policy, ISO Commercial Crime Coverage Form CR 0021, and the revised Surety Association of America Financial Institution Bond[6] Standard Form No. 24, approach differently the discovery and timing issues that are unique to fidelity losses. The facts of the particular claim at issue and the nature of coverage acquired can greatly affect the allocation of loss among the insured and one or more insurers.

This article will analyze the pertinent provisions of the standard commercial fidelity policies and Financial Institution Bond, explore the ramifications of different policy and bond language, discuss the various time-related factors that can influence allocation outcomes, and review relevant case law on the subject. In order to make this article as useful a loss allocation guide as possible, a number of illustrations have been prepared that visually represent some of the issues discussed in this article.

Before addressing limit of liability issues, it is necessary to review the provisions of each of the bonds or policies that provide coverage for employee dishonesty and pertinent case law.

II. Types of Policy/Bond

A. THE COMMERCIAL CRIME POLICY – LOSS SUSTAINED CR 1000 AND CR 0001

The Commercial Crime Policy is written on a loss-sustained basis. The Declarations Page of the policy sets forth the limit of liability, the deductible, and the effective dates of coverage. The policy generally runs for a specific length of time, which most often is one year.

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[2] Hereinafter CCP.
[3] Hereinafter ISO.
[4] Linda G. Robinson, *The New ISO Commercial Crime Program Hits the Streets*, IRMI Insights (Sept. 2000), *available at* www.irmi.com.
[5] Section E.1.f. COMMERCIAL CRIME COVERAGE FORM (Loss Sustained Form) CR 00 21 07 02 (ISO Properties, Inc., 2001).
[6] Hereinafter FIB.

The primary policy 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 and provides that the policy only responds to "loss that is sustained through acts committed or events occurring during the Policy Period." Courts in general have interpreted the language to mean exactly what it says: the insured's losses must occur during the policy period.[7]

The language, however, does not address the relationship between the loss and the acts or events resulting in such loss. It is quite clear that this language mandates the acts or events must occur during the policy period. It is possible, however, for dishonest acts to be committed at one point in time, with the losses to be sustained as a result of those acts at a different point in time. This policy language, therefore, may be read to allow recovery for losses sustained outside the policy period due to acts committed or events occurring during the policy period.

2. Relevant Declarations

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. A common declaration in the CCP is a representation with regard to the cancellation of prior insurance:

> CANCELLATION OF PRIOR INSURANCE: By acceptance of this Policy you give us notice canceling prior policy or bond Nos. __________________________.

The cancellation to be effective at the time this Policy becomes effective.

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 canceled on the declarations.

3. Discovery Period of Loss

This provision is unique to the CCP, except in the rare occasions in which a FIB is written on a loss sustained basis. 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." This provision is critical because of the nature of a fidelity loss. As mentioned above, many employee thefts or embezzlements occur over a long period of time. The

[7] *See, e.g.,* DEAN P. FELTON & KEITH G. SEARS, FIDELITY BONDS 31 (1992).

discovery period grants the insured an additional twelve months within which to discover the loss. Therefore, 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. Thus, although coverage is not triggered by discovery of loss, the CCP does have a discovery component that is crucial to coverage.

4. Prior Insurance

This provision, which addresses most losses that occur over more than one policy period, provides 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.

This provision is commonly known as the superceded suretyship provision. The following elements of this provision should be noted:

(1) It applies to loss sustained during the period of any prior insurance;

(2) The loss would be recoverable under the prior policy, except that the time for discovery has elapsed;

(3) The current insurance would afford coverage had the acts occurred during its term;

(4) The current insurance became effective at the end of the prior insurance, with no gap in coverage;

(5) The limits of insurance under the current policy are not increased by this provision; and

(6) The insured is limited to the lesser of the amount recoverable under the current insurance (as of its effective date) or the prior insurance.

Traders State Bank v. Continental Insurance Co.[8] discusses the application of the superceded surety provision to a situation involving loss sustained during the policy period of a bond issued by another carrier. While the bond at issue was a Financial Institution Bond, it was written on a "loss sustained" basis with a superseded suretyship or retroactive extension of coverage clause (i.e., prior insurance provision) similar to that found in the CCP. The prior surety had paid the limit of liability under its bond as a result of losses the insured incurred due to a check-kiting scheme, which was perpetrated with the collusion of an employee. After the second bond was issued to the insured, the insured discovered that the same employee had also engaged in another dishonest scheme. The loss sustained with regard to this second scheme occurred during the period of the first bond. The second surety asserted that its bond did not provide coverage because the insured's losses would not have been recoverable under the first bond because its limits had been exhausted due to the check-kiting scheme. The court agreed and stated as follows:

> 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.[9]

Thus, because the prior carrier had paid all that was due the insured under its bond, the insured could not recover any additional sums for this policy year from its current carrier.

A similar holding is found in *Brigham Young University v. Lumbermens Mutual Casualty Co*.[10] There, an employee of the insured committed fraudulent or dishonest acts

[8] 448 F.2d 280 (10th Cir. 1971).
[9] *Id*. at 284.
[10] 965 F.2d 830 (10th Cir. 1992).

that resulted in the loss more than 300 works of art over a ten-year period. The missing art had a combined appraised value of $864,350. Lumbermens had provided coverage only for the last year during which the loss occurred. Three other companies provided coverage during the other years in which the loss occurred, with varying limits of liability and deductibles. The loss during Lumbermens period was valued at $9,250. Lumbermens applied the superceded suretyship provision of its policy and determined that it owed $137,488. The insured, on the other hand, claimed that Lumbermens was liable up to the face amount of its policy for all the loss, regardless of the date on which the loss occurred, with no allocation for the coverage that was provided by the prior carriers. The court opined on this issue as follows:

> The [prior insurance language] must govern. It provides that Lumbermens will cover certain losses sustained during prior policy periods that are discovered during Lumbermens' policy period. General Agreement C limits Lumbermens' obligation under prior bonds to the "amount which would have been recoverable under such prior bond or policy had such prior bond or policy continued in force until the discovery of such loss, if the latter amount be smaller;" that is, "smaller" than the face amount of the current policy. This limits the recovery to the amount shown in the chart above [below] as computed by Lumbermens.[11]

(See Table 1.)

[11] *Id.* at 834.

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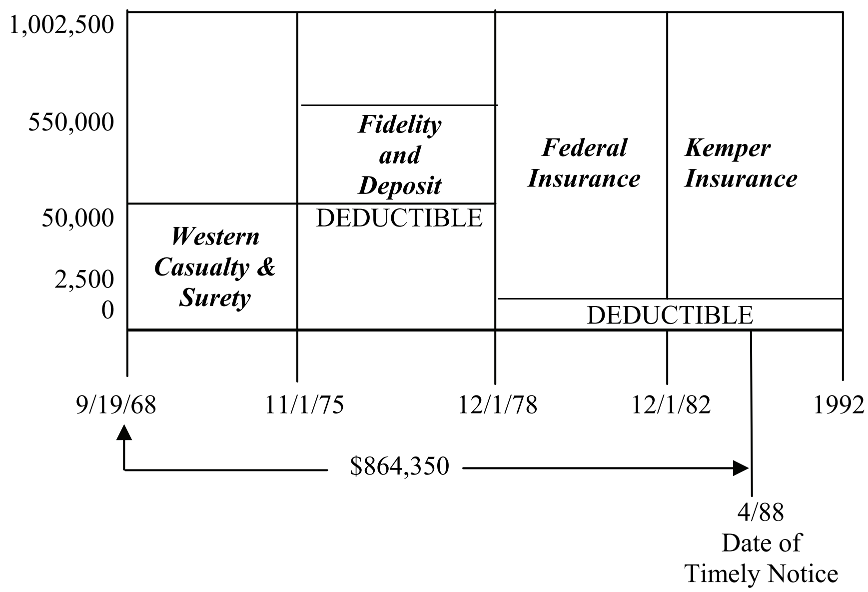
BRIGHAM YOUNG UNIVERSITY V. LUMBERMENS MUTUAL CASUALTY CO.



Coverage

Carrier	Limits	Deductible	Loss Amount by Period	Policy Period
Western Casualty	$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	$1,000,000	$2,500	17,200	12/1/78-12/1/82
Lumbermens Mutual	$1,000,000	$2,500	9,250	12/1/82-1992
			$864,350	

Solution

Step 1 – Establish limits of liability

	Western	Fidelity	Federal	Lumbermens
Insurance	$50,000	$500,000	$1,000,000	$1,000,000
Loss	721,862	116,038	17,200	9,250
Claim (after Deductible)	50,000	66,038	17,200	9,250

Step 2 – Claim under each policy period

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

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

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

TABLE 1

5. Prior Insurance Issued by Current Insurer

Condition 9 of the CCP pertains to renewals. 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 applies when an insured renews its policy with the same company or purchases coverage from an affiliate of the carrier issuing the prior coverage.[12] It addresses the situation that could occur when prior expired policies issued by the same (or affiliated) company can still respond to the loss as the discovery period is still open.[13] In the event 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.[14] (See Table 2.)

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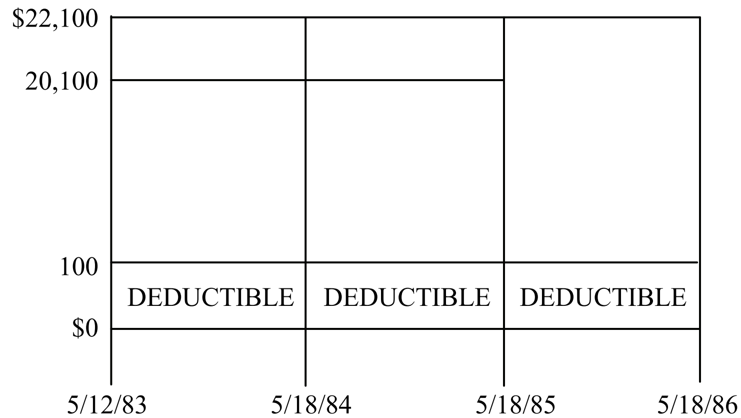
[12] *See, e.g.,* White Tire Distributors, Inc. v. Pennsylvania Nat'l Mut. Cas. Ins. Co., 367 S.E.2d 518, 519 (Va. 1988) (provision did not apply where prior carrier sought to avoid coverage on grounds that later carrier paid its limits).

[13] FELTON & SEARS, *supra* note 7, at 31.

[14] Columbia Hosp. v. United States Fid. & Guar. Co., 188 F.2d 654 (D.C. Cir. 1951); 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., 425 A.2d 803 (Pa. Super. Ct. 1991).

KAVANEY REALTOR & DEVELOPER V. THE TRAVELERS INSURANCE CO.[15]



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 that Travelers' contract was "continuous and noncumulative" and that Travelers' liability could not exceed $22,000, based upon Condition 9.

TABLE 2

Language similar to this provision has been found to be clear and unambiguous. In *State v. Hanover Insurance Co.,*[16] 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 caseworkers. 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."[17]

[15] 501 N.W.2d 335 (N.D. 1993).
[16] 431 S.W.2d 141 (Mo. 1968).
[17] *Id*. at 143 (quoting White Dairy Co. v. St. Paul Fire & Marine Ins. Co., 222 F. Supp. 1014, 1016 (N.D. Ala. 1963). *See also* Diamond Transp. Sys., Inc. v. Travelers Indem. Co., 817 F. Supp. 710, 712 (N.D. Ill.

6. Cumulative Liability

In recent years, General Condition 10 of the 1990 CCP has become perhaps the most contested provision in the Commercial Crime Policy. It provides as follows:

> "Regardless of the number of years this insurance remains in force or the number of premiums paid, no Limit of Insurance cumulates from year to year or period to period."

This provision is intended to emphasize that only one limit of insurance is available for one loss, regardless of the number of years coverage is in place or the number of premiums paid by the insured. It also is intended to prevent the stacking of policy limits in situations where a loss spans more than one policy period.

Surprisingly, courts have had difficulties with this or similar provisions, especially when read in conjunction with the terms set forth in the Declarations Page of the policy and the prior insurance provisions. A number of decisions within the past few years have found ambiguities in the Commercial Crime Policy and held that the insureds were entitled to more than one policy limit. One of the first such decisions was rendered by the California Court of Appeals in *A.B.S. Clothing Collection, Inc. v. Home Insurance Co.*[18] In this case, Home issued a commercial crime policy to ABS Clothing. The initial policy year ran from April 4, 1989 to April 4, 1990. The policy was renewed on April 4, 1990, and again on April 4, 1991. The policy had a $100,000 Limit of Liability. ABS Clothing paid an annual premium. In May 1991, ABS filed a claim for loss due to the dishonesty of two employees who stole approximately $1.4 million over a four-year period from ABS' checking account. Home acknowledged coverage for the loss and paid ABS $100,000. ABS claimed that Home was liable for up to its $100,000 limit for each policy period during which the loss occurred. The court held that Home issued a separate and distinct policy for each policy year.

> Home issued a separate policy document each year. Each policy was effective for a specified "policy period." The second policy stated it was a "renewal" of the first; the third stated it was a "renewal" of the second. Each policy contained a $100,000 "limit of insurance" as to crime coverage. Each policy contained a pledge from Home that "[i]n return for the payment of the premium, and subject to all the terms of *this policy,* we agree with you to provide the insurance as stated in *this policy.*" (Italics added.) Each policy also provided: "The Policy Period is shown in the Declarations.... *[W]e will pay only for loss* that you sustain through acts committed or events *occurring during the Policy Period.*" (Italics added.) The issuance of separate policy documents, each of which refers to terms, conditions and losses under that particular policy, is strong evidence the original policy and the subsequent renewal policies were intended to be

1993) ("[P]laintiff seeks to circumvent the $250,000 policy limit and recover its entire $750,000 loss. . . . [T]he court holds as a matter of law that the restrictive language of General Condition 9 precludes plaintiff from recovering anything beyond the $250,000 already paid by Travelers.").

[18] 41 Cal. Rptr. 2d 166 (Cal. Ct. App. 1995).

separate and distinct contracts.[19]

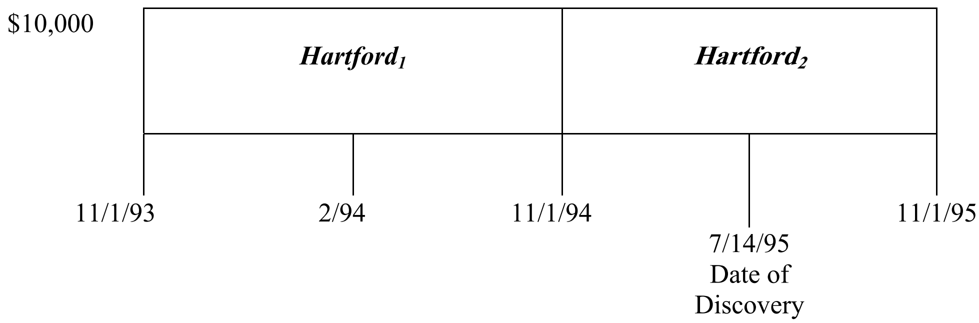
The court did not address the number of policy limits for which Home was responsible. *Karen Kane, Inc. v. Reliance Insurance Co.,*[20] however, affirmed the finding in *ABS Clothing* and further refined the application of the policy provisions to a loss that occurs over the course of several bond periods. In this case, Reliance issued three commercial crime policies to Karen Kane, Inc. for the respective policy periods: December 1993 to December 1994; December 1994 to December 1995; and December 1995 to December 1996. An employee embezzled funds from Karen Kane, Inc., starting in 1992 and continuing until May 1996. Karen Kane, Inc. submitted three Proofs of Loss to Reliance: one for $239,879.15 for the 1995 to 1996 policy year, at least $250,000 for the 1994 to 1995 policy year, and one for $434,978.07 for the 1993 to 1994 policy year. Reliance took the position that the employee's dishonesty constituted one occurrence, with only one limit of liability available. Once again, however, the court found that the policy issued for each year constituted a separate policy, with a separate limit of liability and that the term "occurrence," as used in the policy, was ambiguous. The court, however, also held that the one-year period for discovery of a loss after termination of a policy limited Karen Kane, Inc.'s recovery to two policy limits, as opposed to the three policy limits that it was seeking.

> The language of the one-year discovery rule is quite plain and would appear to apply in straightforward fashion. Kane's argument that the provision is "inconsistent" with other policy provisions, essentially because it limits the coverage provided for by those provisions, lacks merit. The district court correctly recognized that insurance companies are free to place limits upon the coverage of the policies they issue.[21]

Other recent decisions have reached similar conclusions about the accumulation of limits of liability over more than one policy period.[22] Interestingly, most courts have limited recovery to just two limits of liability, although their reasoning for this limitation is different. The court in *Harrington v. American Economy Insurance Co.*[23] relied on the suit limitations period in the bond.[24] In only one of the recent decisions, *Shemitz Lighting, Inc. v. Hartford Fire Insurance Co.*,[25] did the court accept the insured's argument that each individual incidence of employee dishonesty, even though it involved the same employee, constitutes an occurrence and allowed the limits of liability for each policy year to be stacked. (See Table 3.)

[19] Id. at 173.
[20] 202 F.3d 1180 (9th Cir. 2000).
[21] *Id.* at 1188.
[22] Harrington v. American Econ. Ins. Co., Civ. No. 03-712-MO, 2003 WL 23190177 (D. Or. Nov. 20, 2003); Robben & Sons Heating, Inc. v. Mid-Century Ins. Co., 74 P.3d 1141 (Or. Ct. App. 2003); Shared-Interest Mgmt., Inc. v. CNA Fin. Ins. Group, 725 N.Y.S.2d 469 (N.Y. App. Div. 2001); Shemitz Lighting, Inc. v. Hartford Fire Ins. Co., No. CV960052970, 2000 WL 1781840 (Conn. Super. Ct. Nov. 9, 2000).
[23] Civ. No. 03-712-MO, 2003 WL 23190177 (D. Or. Nov. 20, 2003).
[24] *Id.* at *4-5.
[25] No. 0CV960052970, 2000 WL 1781840 (Conn. Super. Ct. Nov. 9, 2000).

SHEMITZ LIGHTING, INC. V. HARTFORD FIRE INSURANCE CO.



	Limits	Claim	Court Found
Hartford$_1$	$10,000	$10,000	$10,000 per each act of embezzlement, up to $10,000 per occurrence
Hartford$_2$	$10,000	10,000	
Total		$20,000	

TABLE 3

In the *Shemitz* situation, each occurrence amount is below the limit and more than the deductible. This is favorable for the policyholder. However, when each occurrence amount is less than the deductible, using the *Shemitz l*ogic, with each occurrence for an amount less than the deductible, the insured would not recover.

Despite the apparent deluge of decisions finding insurers responsible for more than one limit of liability, one court recently reached the opposite conclusion. In *Sherman & Hemstreet, Inc. v. Cincinnati Insurance Co.*,[26] the insured argued it was entitled to a limit of liability for each policy year during which the embezzlement occurred. The two policies in question were written for a three-year period. The court observed as follows:

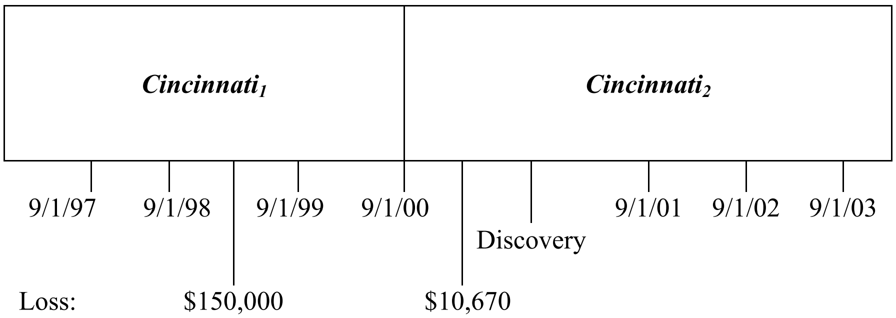
> Sherman argues that it paid an annual premium and it should not be denied annual coverage. In essence, Sherman argues, it received nothing in exchange for its payment of annual premiums. However, we note that where the policy intended for insurance limits to apply on an annual basis, it said so explicitly. For example, the policy's provisions for general commercial liability coverage state that the insurance limits for that particular coverage apply "separately to each consecutive annual period and to any remaining period of less than twelve months." Additionally, the policy's provisions for real estate agent error coverage state that if that particular coverage is in effect for more than one year, the insurance limits apply "separately to each consecutive annual period, and to any remaining period of less than twelve months."
>
> In contrast to these forms of coverage, though, the policy states that for employee dishonesty coverage, Cincinnati will pay no more than $50,000 per occurrence. Obviously, if the parties had intended for the

[26] 594 S.E.2d 648 (Ga. 2003).

> $50,000 limit to apply separately to each year the policy was in place, they would have expressly provided for it, as they did with regard to coverage for general commercial liability and real estate agent errors.[27]

(See Table 4.)

SHERMAN & HEMSTREET, INC. V. CINCINNATI INSURANCE. CO.



	Limits	Claimed Losses	Per Court
Cincinnati$_1$	$50,000	$150,000	
Cincinnati$_2$ (renewal)	$50,000	10,670	
Claim		$160,670	$50,000

TABLE 4

The court recognized that neither a multiple-year policy nor a renewal of policy allows multiple limits. In this case, the court reached the proper conclusion because the policy and the renewal of the policy were each issued on a three-year basis. The conclusion may have been different had the policy been issued with different policy numbers.

The cases tend to focus on the question of whether the policies are one continuous contract or a series of separate independent contracts.[28] 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.[29] In theory, at least, insurers should not need to prevail on this argument in order to avoid stacking. The language of General Conditions 8 and 9 should

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[27] *Id.* at 652.

[28] *See Karen Kane*, 202 F.3d at 1484.

[29] 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 evidenced by the provisions of the policy or bond that the renewal shall constitute once continuous contract. *See, e.g.,* City of Miami Springs v. Travelers Indem. Co., 365 So. 2d 1030, 1032 (Fla. Dist. Ct. App. 1978); Great American Indem. Co. v. State, 229 S.W.2d 850, 853 (Tex. Ct. App. 1950); Krey Packing Co. v. Employers' Liab. Assur. Corp., 127 S.W.2d 780 (Mo. Ct. App. 1939); Massachusetts Bonding & Ins. Co. v. Board of Co. Comm'rs, 69 P.2d 555, 556 (Colo. 1937). Decisions that have found one continuous contract include the following: USF&G v. Barbara, 70 F.2d 220 (6th Cir. 1934); Columbia Hosp. v. USF&G, 188 F.2d 654 (D.C. Cir. 1951); Kavaney Realtor & Developer, Inc. v. Travelers Ins. Co., 501 N.W.2d 335 (N.D. 1993); Santa Fe General Office Credit Union v. Gilbert, 299 N.E.2d 65 (Ill. App. Ct. 1973).

be sufficient. Section 8 clearly states that the insured is entitled to the lesser amount recoverable under the current insurance of the prior insurance. Section 9 gives the insured the greater of the amount recoverable under this insurance or the prior insurance. Despite the apparent clarity of the language, the majority of courts now seem to be finding in favor of the insured, at least to the point of allowing recovery of an additional limit of liability.[30]

Ironically, even the prior insurance provisions have also given some courts trouble when dealing with accumulation of limits of liability. For example, in *Cincinnati Insurance Co. v. Hopkins Sporting Goods, Inc.*,[31] 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.[32]

(See Table 5.)

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[30] It is interesting to note that an insured would receive the benefit of two policy limits if the prior carrier's year period for discovery had not yet expired at the time a loss is discovered. The courts seem to be applying the same reason for finding more than one limit of liability when the prior policy is issued by the same carrier.

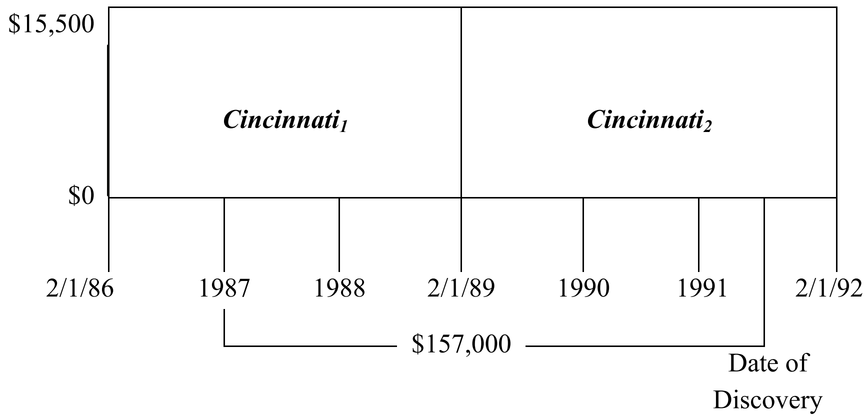
[31] 522 N.W.2d 837 (Iowa 1994).

[32] *Id*. at 839. *See also* White Dairy Co. v. St. Paul Fire & Marine Ins. Co., 222 F. Supp. 1014 (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 have 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.

222 F. Supp. at 1018.

CINCINNATI INSURANCE CO. V. HOPKINS SPORTING GOODS, INC.



Coverage

Carrier	Limits	Deductible	Policy Period
Cincinnati$_1$	$15,000	$0	2/1/86-2/1/89
Cincinnati$_2$	$15,000	$0	2/1/89-2/1/92

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 the 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 x 5 years) in total.

TABLE 5

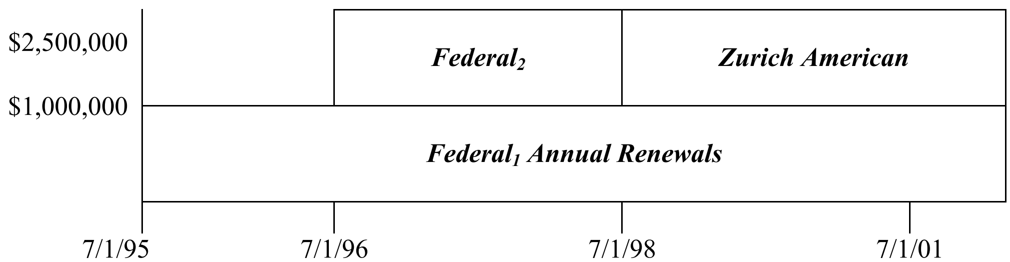
Similarly, the California Court of Appeals in *ABS Clothing* found the prior insurance clause difficult to interpret:

> Assuming, however, this "prior loss" is susceptible to the interpretation given 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 cannot be clearly and unambiguously established by this "prior loss" provision of the contract.[33]

[33] ABS Clothing Collection, Inc. v. Home Ins. Co., 41 Cal. Rptr. 2d 166, 173 (Cal. Ct. App. 1995) (citation omitted). 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

A recent decision involving prior insurance issued by another carrier addressed the situation when an excess carrier also issued a policy. In *The Times Picayune Publishing Corp. v. Zurich American Insurance Co.,*[34] Federal Insurance Company had issued a crime policy to plaintiff from 1990 to July 1, 2001. Federal also issued excess crime insurance policies for two one-year periods beginning July 1, 1996 and July 1, 1997. Zurich had issued an excess policy for the three-year period July 1, 1998 to July 1, 2001. The excess policies provided $1.5 million of coverage, payable only after the $1 million underlying limits had been paid. The plaintiff sustained loss of $2.3 million between 1995 and 2001. The loss during any given policy year was no more than $562,000. (See Table 6.)

THE TIMES PICAYUNE PUBLISHING CORP. et al.
V. ZURICH AMERICAN INSURANCE CO.



	Primary		Excess			
	Carrier	Limits	Carrier	Limit	Deductible	Loss
7/1/95-7/1/96	Federal 1	$1,000,000				$536,428
7/1/96-7/1/97	Federal 1	$1,000,000	Federal 1	$1,500,000	$1,000,000	268,871
7/1/97-7/1/98	Federal 1	$1,000,000	Federal 2	$1,500,000	$1,000,000	234,707
7/1/98-7/1/99	Federal 1	$1,000,000	Zurich	$1,500,000	$1,000,000	330,647
7/1/99-7/1/00	Federal 1	$1,000,000	Zurich	$1,500,000	$1,000,000	562,859
7/1/00-7/1/01	Federal 1	$1,000,000	Zurich	$1,500,000	$1,000,000	272,367
Total						$2,205,879

TABLE 6

Federal paid its $1 million limit of liability, without allocating any portion of the loss to any policy period. Zurich agreed to pay under its excess policy for the loss sustained after the effective date of its policy but refused to pay any losses sustained before the effective date of its policy. The court observed as follows:

> Zurich argues that its excess policy covers losses incurred before its inception date only if its policy would have covered those losses had it been in effect at the time of the losses, *i.e.*, only if the losses exceeded $1,000,000 during the earlier policy period so that the excess policy then in effect would have been triggered. Zurich contends that it is not liable for any of The Times-Picayune's losses sustained before July 1, 1998

limit of liability, see William J. Hacker, *Limit of Liability*, *in* COMMERCIAL CRIME POLICY 14-1 (Gilbert J. Schroeder ed., 1996).

[34] No. Civ.A. 02-3263, 2004 WL 169823 (E.D. La. Jan. 26, 2004).

> because The Times-Picayune's losses did not exceed $1,000,000 during the prior one-year policy period (or even during the prior two years when the two Federal excess policies were in effect).[35]

The court found in favor of Zurich, stating that the insurance policy was unambiguous:

> Thus, I find that Zurich's policy would not have "been in effect at the time the acts that caused the loss occurred," as required by the Prior Loss clause, because its obligation extended only to the two prior policy periods during which The Times-Picayune had carried excess coverage and the losses sustained during those two periods did not exceed the $1,000,000 limit of the primary policy.[36]

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. In theory, 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.**[37]** Furthermore, the language in the declarations page, to the effect that prior insurance is canceled, reinforces this conclusion.**[38]** Unfortunately, it does not appear the majority of courts deciding this issue view it in this manner.

7. Other Insurance

The CCP contains an "other insurance" clause, which provides 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

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[35] 2004 WL 169823, at *3.
[36] *Id.* at *8.
[37] *See, e.g.,* Hanson Ins. Co. v. Treasure Coast Travel, 660 So. 2d 1136 (Fla. Dist. Ct. App. 1995) (non-cumulative provision alone sufficient to restrict coverage to one of the policies but, when coupled with the prior insurance provision, only one policy is in play).
[38] 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. 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 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. *See* Hacker, *supra* note 33, at 14-3.

shown in the DECLARATIONS.

This provision can also be the subject of much interpretation and dispute when two carriers have issued policies that cover the same loss. It is not unusual for both policies covering a situation to have a provision stating that the policy is excess over other insurance that might also provide coverage. It is then necessary to resolve these conflicting provisions. Courts generally have held that if both policies contain an excess insurance provision, the excess insurance provisions cancel out each other and both coverages are treated as primary.[39]

In *Federal Insurance Co. v. Atlantic National Insurance Co*.,[40] the court reasoned as follows:

> In the present case, both policies cover the same occurrence and both contain "excess" clauses. If we were to take the language literally and give effect to each of these "other insurance" clauses, we would be required to concluded [sic] 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 out 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.[41]

Once it is determined that both coverages are primary, how the loss should be allocated between the two carriers becomes an issue. Most courts seem to have held that the loss should be allocated on a pro rata basis, based upon "policy limit rules."[42] Thus, if carrier A issued a $10,000 bond and Carrier B issued a $90,000 bond, Carrier A would pay 10% and Carrier B would pay 90% of the loss.

The other method of allocation is when policies are based on *Guiding Principles*.[43] *Guiding Principles* essentially provide insurers share common deductibles and limits of liability equally, so that, in the situation described above, Carrier A and Carrier B would share the first $20,000 of loss equally and Carrier B would then pay 100% of the loss up to its $90,000 limit of liability. Coverage shall be on the basis of the Limit of Liability Rule, except that the policy or policies affording separate coverage shall respond first to that loss it alone covers and the remainder of its limit of liability shall contribute to the common loss on the basis of the Limit of Liability Rule.

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[39] *See* Continental Ins. Co. v. Morgan, Olmstead, Kennedy & Gardner, Inc., 148 Cal. Rptr. 57 (Cal. Ct. App. 1978); Federal Ins. Co. v. Atlantic Nat'l Ins. Co., 250 N.E.2d 193 (N.Y. 1969); *see also* Douglas R. Richmond, *Issues and Problems in "Other Insurance," Multiple Insurance, and Self-Insurance*, 22 PEPP. L. REV. 1373 (1995); Marcy Louise Kahn, *The "Other Insurance" Clause*, 19 FORUM 591 (1984).
[40] 250 N.E.2d 193 (N.Y. 1969).
[41] *Id.* at 194-95.
[42] Continental Ins. Co. v. Morgan, Olmstead, Kenney & Gardner, Inc., p. 2, 83 Cal. App. 3d 593 (1978).
[43] HAWKINS, *supra* note 1, at GP-6.

If Carrier A's $100,000 bond had a $5,000 deductible and Carrier B's $100,000 bond had a $10,000 deductible, Carrier A would be responsible for 100% of the loss in excess of its deductible of $5,000 up to the deductible of Carrier B of $10,000. The balance of the loss would be shared equally by the carriers, up to their respective limits of liability.

B. HYBRID (LOSS SUSTAINED/DISCOVERY) CR 0021

The third type of policy providing coverage for employee dishonesty and fraud is the most recently developed policy. This hybrid, written on a Loss Sustained Form, is an attempt to counteract the holdings in *Karen Kane* and the other cases noted above. This policy's primary provisions relating to limits of liability and loss location are the following:

1. Coverage Trigger

Like the Commercial Crime Policy discussed above, the newer commercial crime form provides coverage for loss sustained through acts committed or events occurring during the policy period.[44]

2. Relevant Declarations

The provisions on the declarations page of this newer policy form are similar to those in the Commercial Crime Policy. It sets forth the policy period, the limits of liability and deductibles for the various coverages and the endorsements added to the policy. It also has the provision that states the acceptance of this policy cancels the prior bond or policy.

3. Discovery Period of Loss

The newer form, like the Commercial Crime Policy, provides that the insurer will pay for loss that is discovered no later than one year from the date or termination of the policy. Section E.1.f.(2) of the policy, however, constitutes a major departure from the prior policy. This section provides the following limitation on the one-year discovery period:

> However, this extended period to discover loss terminates immediately upon the effective date of any other insurance obtained by you replacing in whole or in part the insurance afforded hereunder, whether or not such other insurance provides coverage for loss sustained prior to its effective date.

Thus, if a commercial crime policy written on this form is replaced with another policy, an insured has no right of recovery under this newer commercial crime form. There are situations in which language will cause concern when used with package policy. For example, where the policy period #1 has employee theft coverage but the

[44] CR 00 21 07 02, Section E. 1. l.

package policy in period #2 has no employee theft or employee dishonesty coverage, is the second package policy considered "any other insurance obtained by you replacing in whole or in part the insurance afforded hereunder?" If so, neither the first or second package policy would address the loss. How courts will treat this situation remains to be seen.

4. Prior Insurance

The provisions in the CR 00 21 coverage form for loss covered under this insurance and prior insurance issued by the same insurer and loss sustained during prior insurance provisions are the same as the provisions in the Commercial Crime Policy, except that Section E.1.k., which addresses loss covered under this insurance and prior insurance issued by the same carrier, contains the non-cumulation language. The insurer will still reimburse the larger amount recoverable if the policy was replaced by a policy issued by the same insurer and the lesser of the amount recoverable under this insurance and the prior insurance. [45]

C. DISCOVERY FORM FINANCIAL INSTITUTION BOND

The Standard Form 24 Financial Institution Bond provides a typical example of a discovery bond.

1. Coverage Trigger

The Financial Institution Bond is written on a discovery basis of loss, so that coverage is provided for loss discovered during the bond period.[46] Section 3 of the Conditions and Limitations of the bond provides as follows:

> Section 3. This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.
>
> Discovery also occurs when the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

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[45] CR 00 21 07 02, secs. E.1.k. and E.1.m.

[46] 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. A FIB written on a loss sustained basis tends to function like a standard commercial crime policy. These bonds frequently 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 for a period of one year. Such bonds often contain a superseded suretyship provision that addresses losses that 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.

2. Policy Period

The term of the Financial Institution Bond is critically important. Item 2 of the declarations page declares the bond period. Most Financial Institution Bonds are written on a fixed-term basis for a period of one year. Occasionally, bonds are written for a three-year period and, in some cases, on a continuous basis.

3. Limits of Liability

The Financial Institution Bond is often written on an aggregate basis, so that only one limit of liability is available during a policy period, regardless of the number of claims or the amount of losses an insured may sustain. The aggregate provision, which is contained in Section 4 of the Financial Institution Bond Conditions and Limitations form, provides that the underwriter's liability for all losses discovered during the bond period shall not exceed the Aggregate Limit of Liability. It further provides that the Aggregate Limit of Liability is reduced by any payment under the bond. Section 4 also sets forth the parameters for a Single Loss. A Single Loss shall not exceed the Single Loss Limit of Liability set forth on the declarations page of the bond.[47] Single loss is also defined as follows:

> Single Loss means all covered loss, including court costs and attorneys' fees incurred by the Underwriter under General Agreement F, resulting from
>
> (a) any one act or series of related acts of burglary, robbery or attempt threat, in which no Employee is implicated, or
> (b) any one act or series of related unintentional or negligent acts or omissions on the part of any person (whether an Employee or not) resulting in damage to or destruction or misplacement or Property, or
> (c) all acts or omission other than those specified in (a) and (b) preceding, caused by any person (whether an Employee or not) or in which such person is implicated, or
> (d) any one casualty or event not specified in (a), (b) or (c) preceding.

Thus, if an employee, working alone or in collusion with others, commits a number of dishonest acts over a period of years, resulting in numerous losses, all such losses would be considered a single loss.

[47]The Single Loss Limit of Liability can be less than the Aggregate Limit of Liability.

The Single Loss definition contained in the Financial Institution Bond has not been the subject of much litigation. When it has been challenged, it has been found to be clear and unambiguous.[48]

4. Prior Insurance

Section 8 addresses situations in which the prior coverage was written on a loss sustained basis. Because the loss sustained coverage form usually has a discovery period extending into the period of coverage for 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.

Section 8 is similar to the prior insurance provisions found in the Commercial Crime Policy. Thus, if the current Financial Institution Bond, which is written on a discovery basis, replaces a bond written by the same insurer on a loss sustained basis, the total liability of the insurer under the current bond and the prior bonds shall not exceed the amount of the current bond or the amount of the prior bond, if the limit of liability under the prior bond is greater. In other words, the period of coverage prior to the current bond provides for recovery only if the insured sustained the loss during the term of the bond.

If the prior coverage was written by another carrier and the time to discover loss under the prior bond has not yet expired, the current discovery form bond becomes excess to the prior bond notwithstanding an “other insurance” provision contained in the prior policy or bond.

This provision does not affect many claims under the Financial Institution Bond and has not been the subject of litigation in situations involving the standard form Financial Institution Bonds, most likely because the Financial Institution Bond is only rarely written on a loss sustained basis.

5. Other Insurance

Section 9 is the “Other Insurance” clause. Like the “Other Insurance” provision in the Commercial Crime Policy and other insurance products, this section states that the current policy applies “only as excess over any other valid and collectable insurance or indemnity obtained by the insured . . . .” As discussed above, 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 is excess by virtue of an “other insurance” provision. There are no cases or secondary sources addressing this section. It is necessary to look to the other insurance provisions in other insurance polices.[49]

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[48] Citizens Bank of Newburg v. Kansas Bankers Sur. Co., 971 F. Supp. 1301 (E.D. Mo. 1997).
[49] ANNOTATED FINANCIAL INSTITUTION BOND 537 (Michael Keeley ed., 2d ed. 2004).

III. Types of Situation

After reviewing the policy provisions and the way the courts have interpreted them, it is necessary to review some of the situations that can arise, when dealing with multiple policies with different limits of liability and multiple policy years, in order to explore how these types of claims should be approached.

A. CONTIGUOUS POLICIES & CONTINUOUS POLICY PERIODS

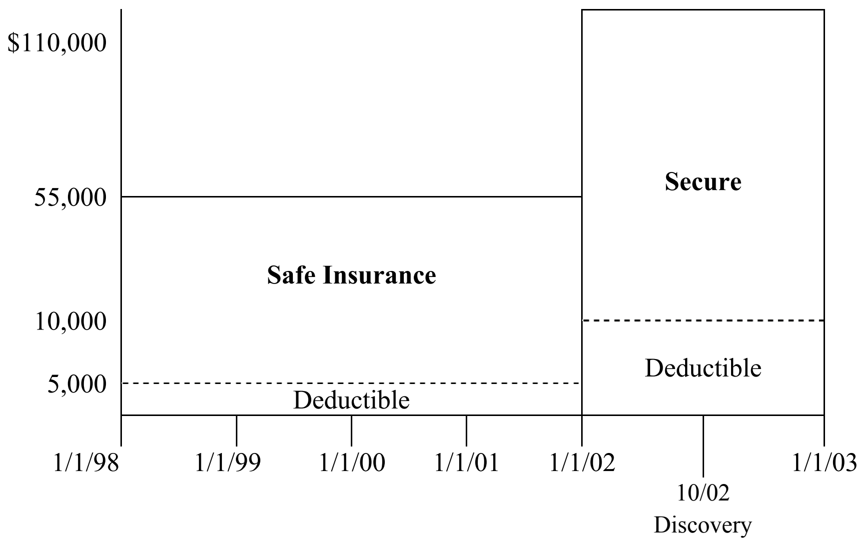
1. Loss Sustained Policy and Loss Sustained Policy

a. Multiple Carriers: As discussed above, the Commercial Crime Policy provides coverage for loss sustained during the policy period and discovered within one year after termination of the policy. Assume that XYZ Corporation obtained a Commercial Crime Policy from Safe Bond Company, effective January 1, 1998 to January 1, 1999, which was renewed annually until January 1, 2002. This Commercial Crime Policy had a $50,000 limit of liability, subject to a $5,000 deductible. Secure Bond Company wrote the Commercial Crime Policy for XYZ, effective January 1, 2002 to January 1, 2003, with a $100,000 limit of liability and $10,000 deductible. Jane Smith, XYZ's bookkeeper, had been embezzling funds from XYZ, beginning in 1998 until XYZ discovered her embezzlement in October 2002. Jane embezzled a total of $80,000 during this time, broken down as follows:

	Amount
1998	$10,000
1999	15,000
2000	20,000
2001	20,000
2002	15,000
Total	$80,000

Safe and Secure both issued their bonds on the Commercial Crime Policy form. Assuming the interpretations of contiguous and continuous coverage and applying superceded suretyship, the loss would be paid as shown in Table 7.

CONTINUOUS PRIOR POLICY COVERAGE INTERPRETATION



Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$50,000	$5,000	$10,000	$10,000	
1999	Safe	50,000	5,000	15,000	15,000	
2000	Safe	50,000	5,000	20,000	20,000	
2001	Safe	50,000	5,000	20,000	20,000	
2002	Secure	100,000	10,000	15,000		$15,000
			Total	$80,000	65,000	15,000
			Less: Deductible		5,000	10,000
			Loss		$60,000	$5,000
			Limits		$50,000	$100,000
			Payable		$50,000	$5,000

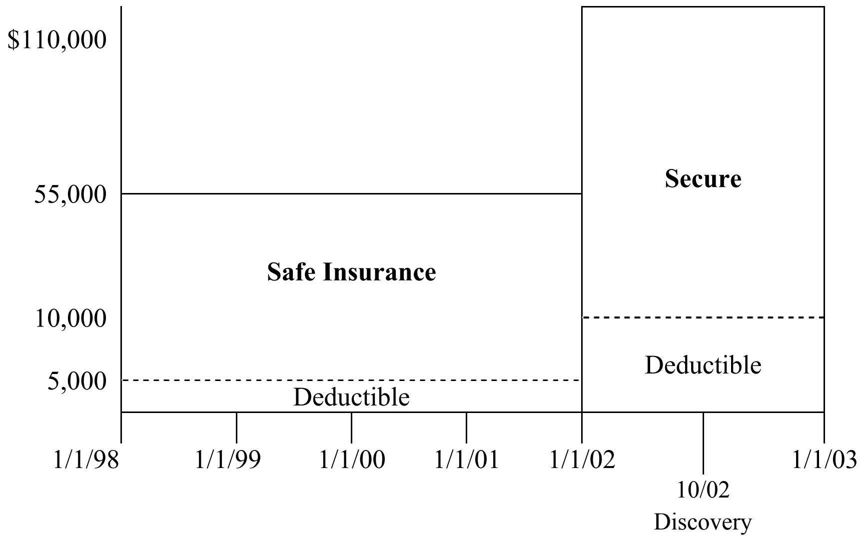
TABLE 7

Because the loss was discovered within one year of the termination of Safe's policy, Safe is responsible for the loss that occurred during 1998 ($10,000), 1999 ($15,000), 2000 ($20,000), and 2001 ($20,000). This loss totals $60,000, and Safe, therefore, will pay its $50,000 limit of liability of XYZ. Secure is only liable for the loss sustained during 2002 and, therefore, Secure will pay XYZ $5,000 ($15,000 less the $10,000 deductible.)

If the loss were discovered in October 2003 instead of October 2002 and Secure had issued a policy for the 2003 policy year, Safe would pay nothing because the twelve-month discovery period on the Safe policy had expired. Secure would pay $55,000 ($5,000 for the loss, after deductible, during the 2002 policy year and $50,000, what Safe's limit of liability would have been, had the time of discovery not expired).

*b. Same Carrier (*Karen Kane *Situation—Contiguous Interpretation):* Assume the same facts, except that Secure had issued the policies for all of the policy periods. This situation is analogous to that in the *Karen Kane* decision, which applied a contiguous interpretation to the policy language. If the reasoning in *Karen Kane* is applied to this claim, XYZ would recover $35,000 from Safe for the 2001 and 2002 loss and $5,000 from Secure for the 2002 loss. Discovery occurred more than one year after the termination of the earlier policy years, and XYZ, therefore, is not entitled to recover any of its loss for those years. (See Table 8.)

CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION

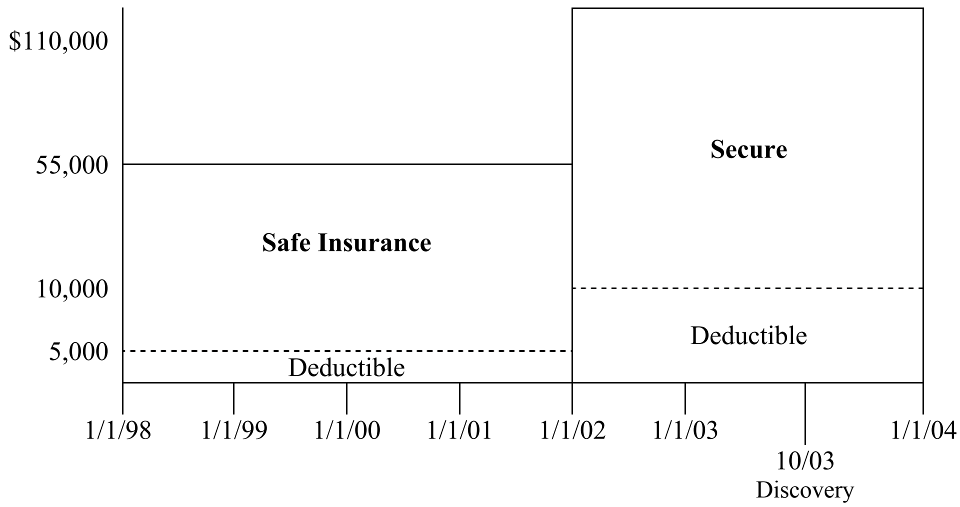


Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$50,000	$5,000	$10,000		
1999	Safe	50,000	5,000	15,000		
2000	Safe	50,000	5,000	20,000	$20,000	
2001	Safe	50,000	5,000	20,000	20,000	
2002	Secure	100,000	10,000	15,000		$15,000
				Total	40,000	15,000
				Less: Deductible	5,000	10,000
				Loss	$35,000	$5,000
				Limits	$50,000	$100,000
				Payable	$35,000	$5,000

TABLE 8

If the loss were discovered in October 2003 instead of October 2002, and we again apply the *Karen Kane* reasoning, with the contiguous interpretation, the amount of loss paid by the carrier is shown in Table 9.

**CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION
DISCOVERY ONE YEAR LATER**



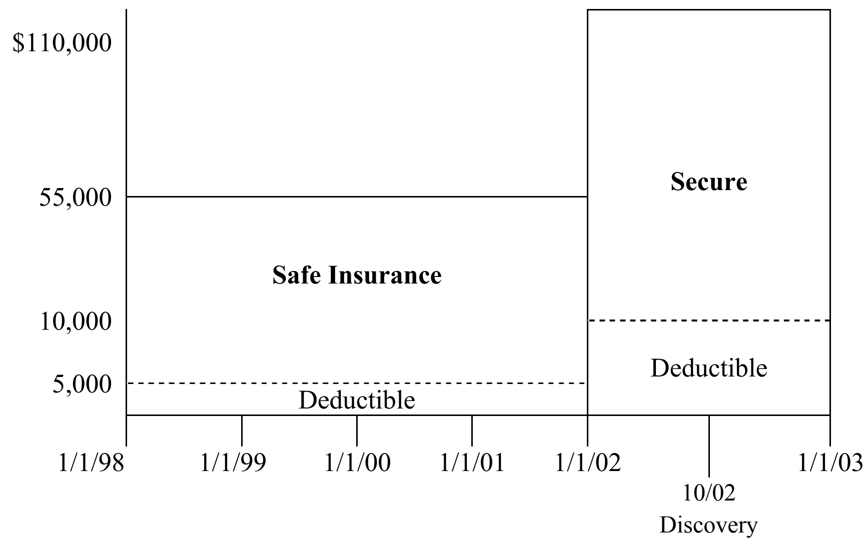
					Payable	
Year	Carrier	Limits	Deductible	Loss	Safe	Secure
1998	Safe	$50,000	$5,000	$10,000		
1999	Safe	50,000	5,000	15,000		
2000	Safe	50,000	5,000	20,000		
2001	Safe	50,000	5,000	20,000		$20,000
2002	Secure	100,000	10,000	15,000		15,000
				Total	$0	35,000
				Less: Deductible		10,000
				Payable		$25,000

TABLE 9

2. Loss Sustained Policy and Hybrid Policy

Assume the same facts as in A.1., except that Safe’s policy is written on the newer commercial crime policy form, which, as noted above, provides coverage for loss sustained during the policy period and discovered within one year for the termination of the policy period, with the discovery period terminating when the insured obtains a new policy. In this situation, under continuous interpretation, XYZ would recover $55,000 ($50,000 + $15,000 - $10,000 deductible) from Secure and $0 from Safe. Safe’s policy one-year discovery period terminated immediately when the Secure policy was purchased. (See Table 10.)

CONTINUOUS PRIOR POLICY COVERAGE INTERPRETATION – HYBRID POLICY

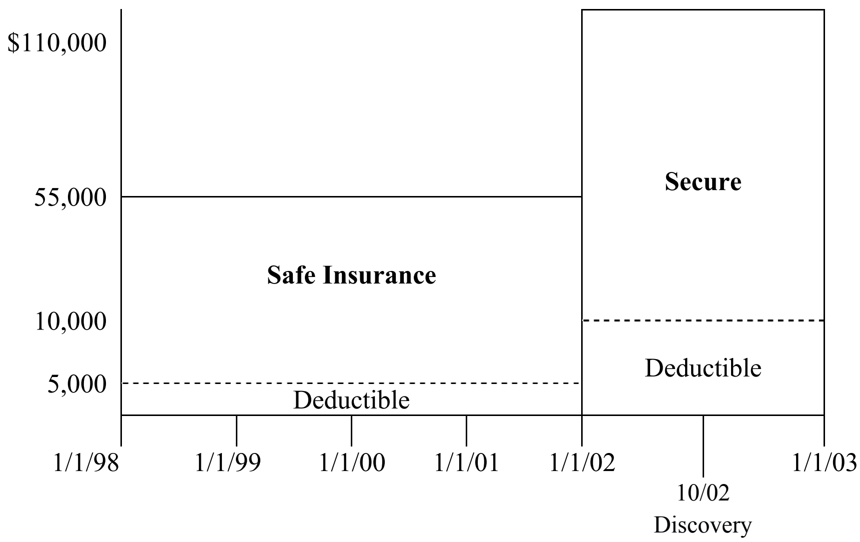


					Payable	
Year	Carrier	Limits	Deductible	Loss	Safe	Secure
1998	Safe	$50,000	$5,000	$10,000		
1999	Safe	50,000	5,000	15,000		$10,000
2000	Safe	50,000	5,000	20,000		20,000
2001	Safe	50,000	5,000	20,000		20,000
2002	Secure	100,000	10,000	15,000		15,000
				Total	$0	65,000
				Less: Deductible		10,000
				Payable		$55,000

TABLE 10

If, on the other hand, the contiguous interpretation is applied, XYZ would only be able to recover $25,000 from Secure ($35,000 less the $10,000 deductible) and nothing from Safe. (See Table 11.)

CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION – HYBRID POLICY



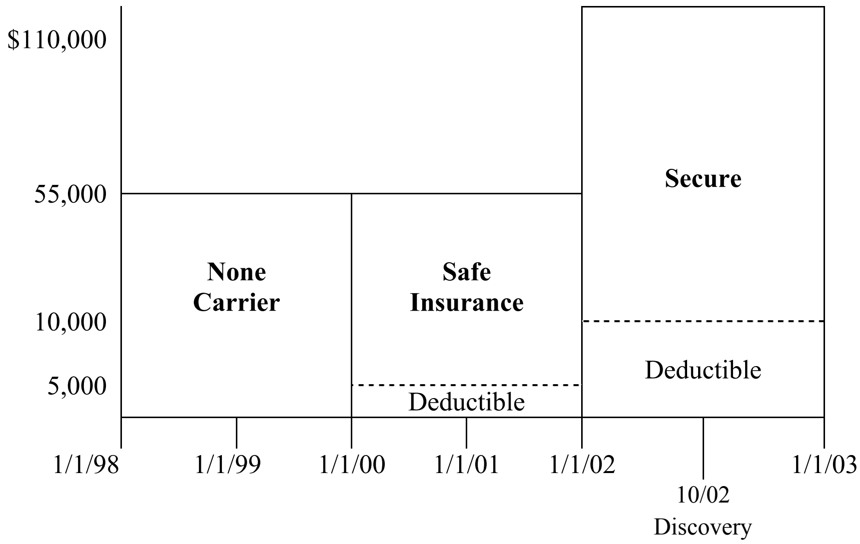
Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$50,000	$5,000	$10,000		
1999	Safe	50,000	5,000	15,000		
2000	Safe	50,000	5,000	20,000		
2001	Safe	50,000	5,000	20,000		$20,000
2002	Secure	100,000	10,000	15,000		15,000
				Total	$0	35,000
				Less: Deductible		10,000
				Payable		$25,000

TABLE 11

3. Loss Sustained Policy and Discovery Policy

Assume that XYZ Corporation is a mortgage company. Safe had issued a Commercial Crime Policy to XYZ for the 2000 and 2001 policy years. The 2002 policy issued by Secure was written on a Standard Form 15 Financial Institution Bond and, thus, was a discovery form bond. All of the other facts concerning the embezzlement remain the same. Secure is responsible solely for the losses sustained during 2002, 1998 and 1999. Safe and Secure are both liable for the 2001 losses. How the losses for this year would be allocated depends upon whether the carriers agree to prorate the exposure or follow *Guiding Principles.* (See Table 12.)

CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION – DISCOVERY POLICY



Year	Carrier	Limits	Deductible	Loss
1998	None	$0		$10,000
1999	None	0		15,000
2000	Safe	50,000	5,000	20,000
2001	Safe	50,000	5,000	20,000
2002	Secure	100,000	10,000	15,000
			Total	$80,000

Based Upon Common Law Exposure Apportionment

Carrier	Limit	Exposure	Prorated Loss	Less: Deductible	Payable
Safe	$50,000	33 ½%	$26,667	$5,000	$21,667
Secure	$100,000	66 2/3%	53,333	10,000	$43,333
Total					$65,000

Based Upon Guiding Principles

#1 – Establish Limits of Liability

	Safe	Secure
Insurance	$50,000	$100,000
Loss	$80,000	$80,000
Claim	$40,000	$80,000
Limit of Liability	$40,000	$80,000

#2 – Assess Loss Covered by Secure Only, Which Alone Covers 1998, 1999, and 2002, for $40,000 ($10,000 + $15,000 + $15,000), Less the $10,000 Deductible, for Loss of $30,000 with Remaining Liability of $45,000 ($80,000 - $30,000 - $5,000) Participates With Other Carrier

#3 – Contributions to Area of Common Coverage

	Liability Limit Remaining	Percentage	Pays	
Safe	$50,000	43.47%	$19,561	(43.47% x $45,000)
Secure	65,000	56.53%	25,439	(56.53% x $65,000)
Total	$15,000		$45,000	

#4 – Payable Under Each Policy

	Payable
Safe	$19,561
Secure	55,439
Total	$65,000

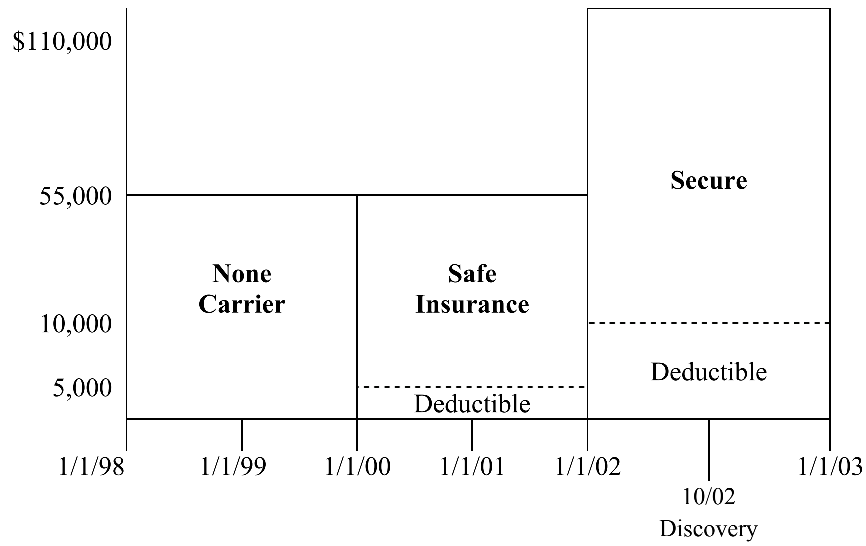
TABLE 12

Many individuals refer to the above as a "lapping" situation, or concurrent coverages, whereby more than a single policy addresses a portion of the loss period. While the *Guiding Principles* are more complex to apply, the results equipoise each individual's situation relative to losses, policy periods, limits, deductibles, and premiums collected.

4. Hybrid Policy and Discovery Policy

Assume the same facts as in 3. above, except that Safe's policy was issued on the newer commercial crime form in which the one-year discovery period terminates upon issuance of a new policy. Under these circumstances, Secure would reimburse XYZ $70,000 ($80,000 less the $10,000 deductible). (See Table 13.)

CONTIGUOUS PRIOR POLICY COVERAGE INTERPRETATION
COVERAGE TERMINATES UPON ISSUANCE OF A NEW POLICY



Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	None	$0	$0	$10,000		$10,000
1999	None	0	0	15,000		15,000
2000	Safe	50,000	5,000	20,000		20,000
2001	Safe	50,000	5,000	20,000		20,000
2002	Secure	100,000	10,000	15,000		15,000
				Total	$0	80,000
				Less:	Deductible	10,000
				Payable		$70,000

TABLE 13

Secure's Standard Form 15 Financial Institution Bond provides coverage for loss sustained anytime but discovered during Secure's bond period. Safe's liability for any of the loss terminated once Secure issued its bond.

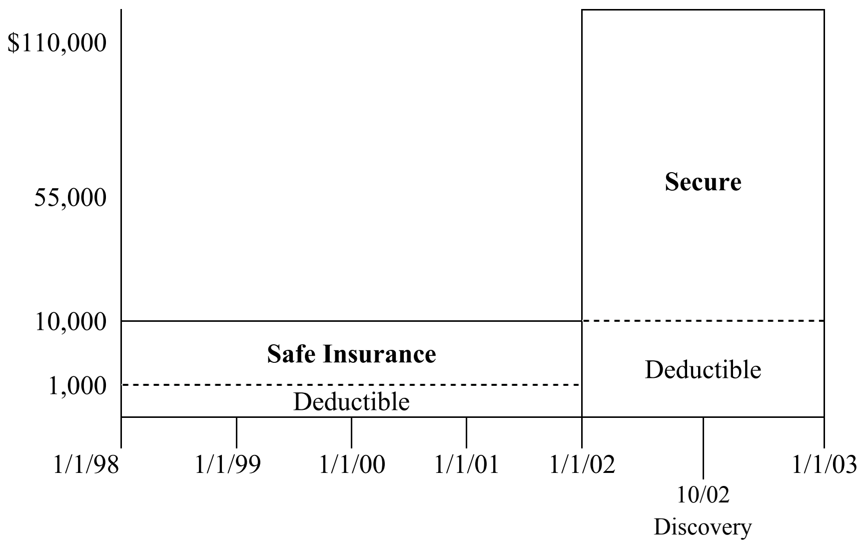
B. CONTIGUOUS POLICIES WITH DIFFERENT DEDUCTIBLE

The policies in the examples discussed above contained different limits of liability and different deductibles, but the deductible really was not an issue because of the loss and the policy limits involved. The following scenarios highlight situations in which there is a deductible.

1. Loss Sustained Policy and Loss Sustained Policy

Assume that Safe's limit of liability was $10,000 and the deductible, $1,000. Secure's 2002 policy still had a $100,000 limit of liability and $10,000 deductible. (See Table 14.)

LOSS SUSTAINED POLICY AND LOSS SUSTAINED POLICY



					Payable	
Year	Carrier	Limits	Deductible	Loss	Safe	Secure
1998	Safe	$10,000	$1,000	$10,000	$10,000	
1999	Safe	10,000	1,000	15,000	15,000	
2000	Safe	10,000	1,000	20,000	20,000	
2001	Safe	10,000	1,000	20,000	20,000	
2002	Secure	100,000	10,000	15,000		$15,000
				Total	65,000	15,000
				Less: Deductible	1,000	10,000
				Payable	$64,000	$5,000
				Limits	$64,000	$100,000

TABLE 14

If both policies provided loss sustained coverage, Safe would be liable for $10,000 for the loss sustained during the 2001 policy year and Secure would be liable for $5,000 ($15,000 less the $10,000 deductible) in 2002.

2. Loss Sustained Policy and Hybrid Policy

If Safe's policy was the standard loss sustained policy and Secure's was on the newer commercial crime form, Safe would still pay $10,000 and Secure, $5,000. If, on the other hand, Safe had issued its bond on the newer commercial crime form, Safe would pay nothing, but Secure would pay $5,000 ($15,000 less the $10,000 deductible in 2002 and what XYZ could have recovered from Safe, of $10,000, but the period of discovery had expired).

3. Loss Sustained Policy and Discovery Policy

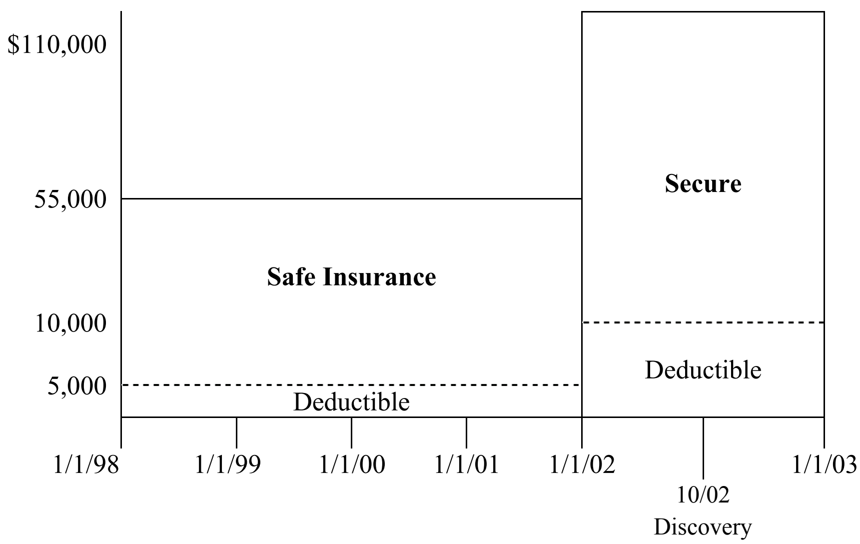
If Safe had issued a Commercial Crime Policy and Secure, a Financial Institution Bond, XYZ would recover $10,000, the result would be the same as discussed in A.3. above. Secure is responsible solely for the losses sustained during 2002, 1998 and 1999.

Safe and Secure are both liable for the 2001 losses. How the losses for this year would be allocated depends upon whether the carriers agree to prorate the exposure or follow *Guiding Principles*.

4. Hybrid Policy and Discovery Policy

If Safe had issued the newer edition of the Commercial Crime Policy and Secure had issued a Financial Institution Bond, Safe would pay nothing because its policy had been replaced and Secure would pay $70,000 ($80,000 less the $10,000 deductible). (See Table 15.)

HYBRID POLICY AND DISCOVERY POLICY



Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$50,000	$5,000	$10,000		$10,000
1999	Safe	50,000	5,000	15,000		15,000
2000	Safe	50,000	5,000	20,000		20,000
2001	Safe	50,000	5,000	20,000		20,000
2002	Secure	100,000	10,000	15,000		15,000
				Total		80,000
				Less: Deductible		10,000
				Loss		$70,000

TABLE 15

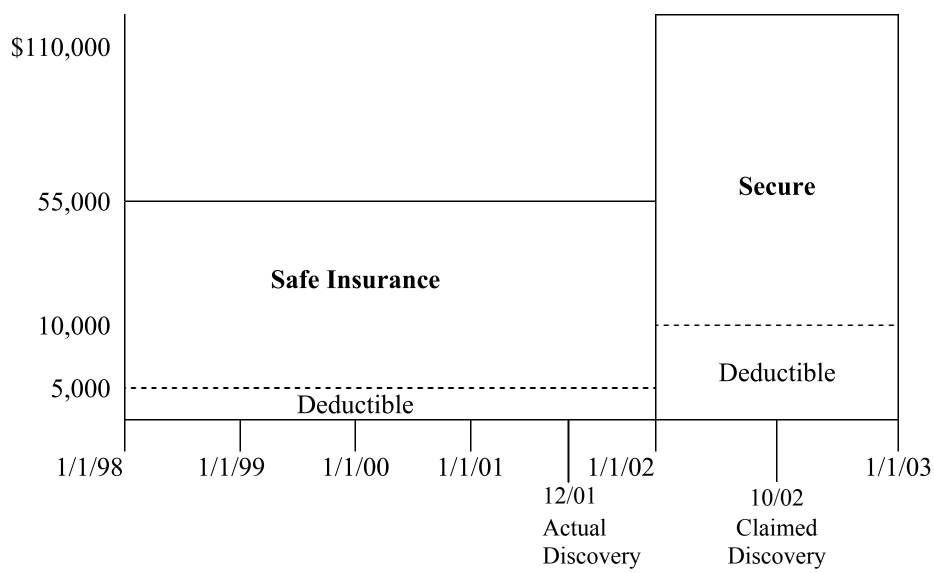
C. CONTIGUOUS POLICIES – MULTIPLE DISCOVERY DATES OR ACTUAL DISCOVERY DATE UNCERTAIN

A less common situation, but one that can arise, would involve an uncertain discovery date. For example, XYZ discovered the embezzlement loss at just about the time Secure issued its policy to XYZ or the insured claims that discovery occurred on one date and the carrier determines that discovery occurred earlier. This situation can be an interesting challenge to a claim handler.

1. Loss Sustained Policy and Loss Sustained Policy

Assume the same facts as in A.1. above, except that XYZ claims that discovery occurred in October 2002 and Secure's investigation has determined the loss and embezzlement were actually discovered in December 2001. (See Table 16.)

LOSS SUSTAINED POLICY AND LOSS SUSTAINED POLICY



Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$50,000	$5,000	$10,000		
1999	Safe	50,000	5,000	15,000		
2000	Safe	50,000	5,000	20,000	$20,000	
2001	Safe	50,000	5,000	20,000	20,000	
2002	Secure	100,000	10,000	15,000		$0
				Total	40,000	$0
				Less: Deductible	5,000	
				Payable	$35,000	

TABLE 16

Under these circumstances, Secure has taken the position that it is responsible for nothing under its bond because discovery occurred before the effective date of coverage. Safe, however, is acknowledging coverage for $20,000 for the 2000 policy year and is willing to pay XYZ $35,000 ($40,000 less the $5,000 deductible). Safe claims that, as in the *Karen Kane* contiguous doctrine, it is responsible for no more.

2. Loss Sustained Policy and Hybrid Policy

Assume the same facts as in B.1., except that Safe's policy was on the loss sustained form and Secure's was on the newer commercial crime form. Secure once again denied XYZ's claim and Safe tendered $35,000 ($40,000 less the $5,000 deductible). If, on the other hand, Safe's policy had been issued on the newer form, as well, Safe would likely argue that discovery occurred after the termination of the bond and that it, therefore, owes nothing.

3. Loss Sustained Policy and Discovery Policy

Assume the facts as in A.3. above, except that the discovery date is either October 2002 or December 2001 and Secure's bond was issued on the Financial Institution Bond form. If discovery occurred in October 2002, Secure is solely responsible for the losses sustained during 2002, 1998 and 1999. Safe and Secure are both liable for the 2001 losses. How the losses for this year would be allocated depends upon whether the carriers agree to prorate the exposure or follow *Guiding Principles*.

If discovery occurred in December 2001, Secure would owe nothing, and Safe would owe the 2000 and 2001 loss less the deductible.

4. Hybrid Policy and Discovery Policy

Assume the same facts as in C.3., except that Safe's policy was written on the newer commercial crime policy form and Secure's was on the Financial Institution Bond form. Here, Secure would be liable to XYZ for the full amount of the loss, less its $10,000 deductible.

D. CONGRUENT (CONCURRENT) POLICIES

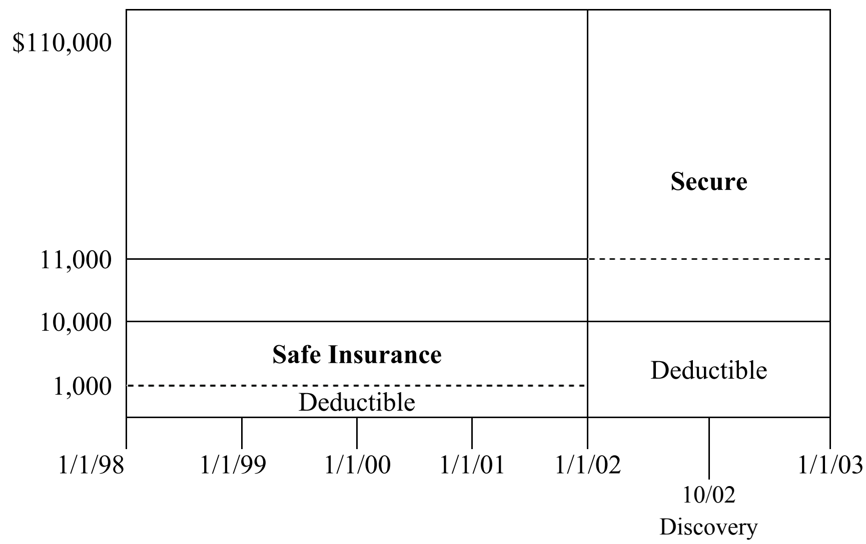
Congruent policies involve two or more policies that address a portion of the loss period or a portion of the loss. In other words, the lap of policies can be vertical, horizontal, or both.

1. Both Policies Are Primary

Assume that XYZ has sustained the same $80,000 embezzlement loss. XYZ has a Safe Business Owners Policy, which includes $10,000 in coverage for employee dishonesty, subject to a $1,000 deductible. The policy was issued on an annual basis. Secure has also issued a Standard Form Financial Institution Bond to XYZ, also on an annual basis, with a $100,000 Aggregate Limit of Liability and a $10,000 deductible. Whether both policies are primary, or both contain excess insurance language, the outcome would be the same. This concurrent situation is a horizontal lap of coverages. The difference lies in how the carriers would agree to allocate the loss. If Safe and Secure both agreed to prorate the loss based upon Common Law Exposure, the loss would be allocated as in Table 17.

LIMITS OF LIABILITY:
ATTEMPTS TO GO BEYOND THE OUTER LIMITS

BOTH POLICIES ARE PRIMARY



Year	Carrier	Limits	Deductible	Loss
1998	Safe	$10,000	$1,000	$10,000
1999	Safe	10,000	1,000	15,000
2000	Safe	10,000	1,000	20,000
2001	Safe	10,000	1,000	20,000
1998-2002	Secure	100,000	10,000	15,000

Based Upon Common Law Exposure Apportionment

Carrier	Limit	Exposure	Loss	Payable	Less: Deductible	Payable
Safe	$10,000	9.10%	$80,000	$7,280	$1,000	$6,280
Secure	$100,000	90.90%	80,000	72,720	10,000	62,720
	$110,000			80,000		
Total						$69,000

Based Upon Guiding Principles

#1 – Establish Limits of Liability

	Safe	Secure
Insurance	$10,000	$100,000
Loss	$80,000	$80,000
Claim	$10,000	$80,000
Limit of Liability	$10,000	$80,000

#2 – Assess Loss Covered by Safe Alone of $80,000 ($9,000 - $1,000 Deductible).
Maximum Liability for Safe is $1,000 ($10,000 - $9,000).
Assess Loss Covered by Secure Alone of $60,000 ($80,000 - $11,000 Deductible - $9,000 by Safe).

#3 – Contributions to Area of Common Coverage

	Liability Limit Remaining	Percentage	Common Loss	Covered Payable
Safe	$2,000	5.00%	$1,000	$50
Secure	40,000	95.00%	1,000	950
Total	$42,000			

#4 – Payable Under Each Policy

	Payable
Safe	$8,050
Secure	60.950
Total	$69,000

TABLE 17

If, however, both Safe and Secure followed the *Guiding Principles*, Safe would pay $50,000 and Secure would pay $45,000.

2. Specific Coverage v. General Coverage

In general, the more specific coverage is primary to the more general coverage, so that if Safe's policy, for example, were a scheduled crime policy providing coverage specifically for Jane Smith, it would respond before Secure's more general policy.

E. RAMIFICATIONS OF "GAPS" IN COVERAGES OF POLICY

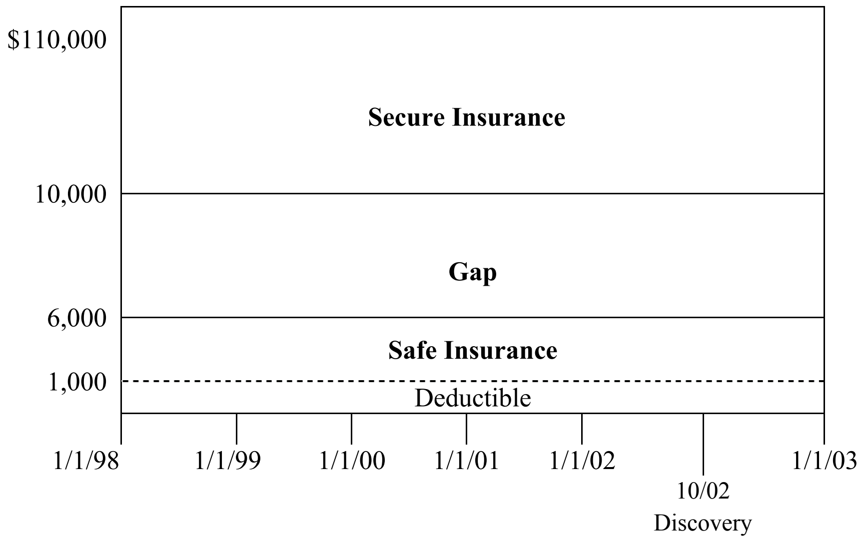
A "gap" occurs when no policy covers a portion of the loss period or a portion of loss. When gaps occur, they can take a horizontal or vertical effect, or both.

1. Both Policies Are Primary

Assume XYZ has sustained the same $80,000 embezzlement loss. XYZ has a Safe Business Owners Policy that includes a $5,000 limit and $1,000 deductible for employee dishonesty. The policy is issued on an annual basis. Secure has also issued a Standard Form Financial Institution Bond to XYZ, also on an annual basis, with aggregate limit of liability and $10,000 deductible. Both policies are primary. (See Table 18.)

LIMITS OF LIABILITY:
ATTEMPTS TO GO BEYOND THE OUTER LIMITS

BOTH POLICIES ARE PRIMARY – GAP IN COVERAGES OR POLICY



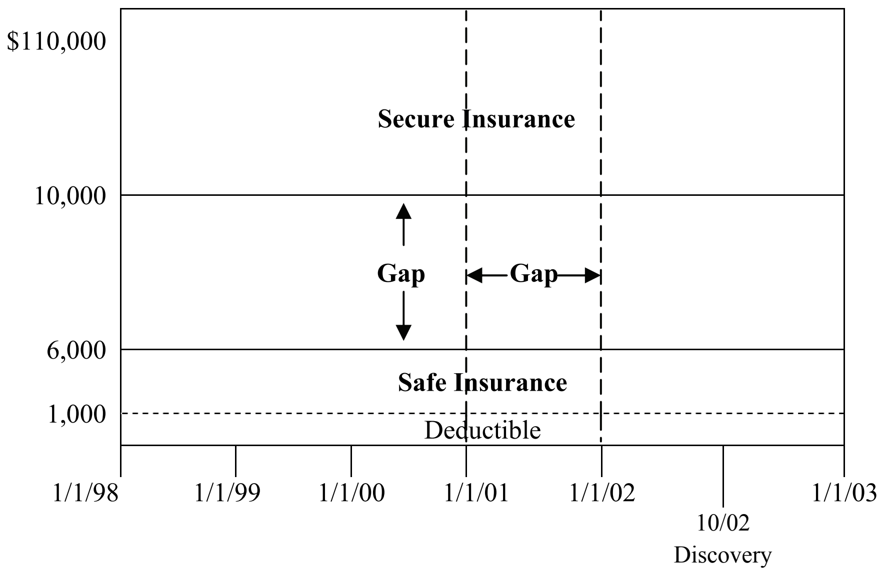
					Payable	
Year	Carrier	Limits	Deductible	Loss	Safe	Secure
1998	Safe	$5,000	$1,000	$10,000	$10,000	$10,000
1999	Safe	5,000	1,000	15,000	15,000	15,000
2000	Safe	5,000	1,000	20,000	20,000	20,000
2001	Safe	5,000	1,000	20,000	20,000	20,000
2002	Safe	5,000	1,000	20,000	15,000	14,000
1998-2002	Secure	100,000	10,000	15,000		
				Total	80,000	80,000
				Less: Deductible	1,000	10,000
				Loss	$79,000	$70,000
				Limits	$5,000	

TABLE 18

2. Both Policies Are Primary, But They Are Not Contiguous (Vertical Gap) Policies

Table 19 assumes a gap in coverage:

BOTH POLICIES ARE PRIMARY, BUT THEY ARE NOT CONTIGUOUS (VERTICAL GAP) POLICIES



Year	Carrier	Limits	Deductible	Loss	Payable Safe	Payable Secure
1998	Safe	$5,000	$1,000	$10,000	$0	$10,000
1999	Safe	5,000	1,000	15,000	0	15,000
2000	Safe	5,000	1,000	20,000	0	20,000
2001	Safe	None		20,000	0	20,000
2002	Safe	5,000	1,000		15,000	
1998-2002	Secure	100,000	10,000	15,000	0	15,000
				Total	15,000	80,000
				Less: Deductible	1,000	10,000
				Loss	$14,000	$70,000
				Limits	$5,000	

TABLE 19

3. Other "Gap" Issues

Depending upon discovery tails, the portion of losses addressed will be dependent upon type and language of the policy. However, following the *Guiding Principles* will lead to the appropriate answer.

F. ALLOCATION

When two or more carriers are involved in the same loss, as Safe and Secure have been with regard to XYZ's loss, then they generally should reach some type of sharing arrangement, with regard to claims expenses, but especially with regard to recovery. The allocation will be whatever Safe and Secure agree upon, but usually should be on a pro rata basis of some type. If it appears that XYZ is going to sue both carriers, the carriers may want to enter into some type of joint defense agreement, depending upon the circumstances.

IV. Conclusion

As can be seen, when two or more policies might provide coverage for a loss, the policy provision and the facts of a given claim can result in a situation where neither carrier nor insured obtains the result it intended or desired. When dealing with different coverage triggers, limits of liability and deductibles, it is necessary to review the specific policy language and the decisions interpreting the policies in order to handle a claim under a fidelity bond fairly and objectively.